

Impact of the integration processes in Europe on Belarusian regions

In general, the position of Belarus within the integration processes in Europe is quite peculiar. It is schematically shown in the figure below:

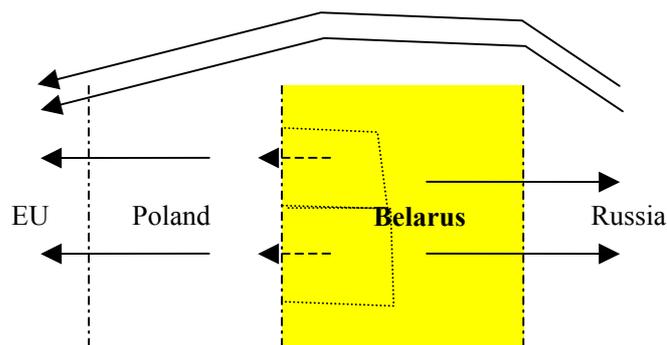


Figure 4. Belarus in European integration process

Belarus is affected by the two major integration processes: one is the enlargement of the EU, the other integration with the Russian Federation. Economic and political forces in Poland, the western neighbor of Belarus, are directed westwards, to the EU. The forces in Russia, the eastern neighbor, are also largely directed towards closer integration with Western Europe. Recent events and agreements (the Kaliningrad question, energy supplies, trade issues, etc.) show that Russian leadership has been very successful in building fruitful collaboration with the EU. Unlike its neighbors, Belarusian political and economic forces are directed eastwards. Only two western regions that culturally have more in common with Western Europe (Poland in particular) than with Russia have some forces that push the country towards the west. The position of Belarus therefore contradicts the on-going processes in Europe.

The impact of EU enlargement on the Belarusian regions

Trade and investment flows show that economic interdependence between the Belarusian regions and the candidate countries is quite weak. Therefore, the accession of Poland, Lithuania and Latvia to the European Union would hardly make a significant impact on the Belarusian economy in general, although, as Belarusian experts claim, some strategic markets for certain major Belarusian exports would probably be lost. Nitric and potash fertilizers that are now exported to Poland may be faced with the EU antidumping duties upon accession (Rudnikov, 2003). Belarusian trucks that are currently widely purchased by Latvian companies most probably would not meet EU standards and would have to leave this market as well (Bogdankevich, 2002).

The EU enlargement may significantly affect only the western regions, Grodno and Brest, because they have stronger ties with the candidates (Poland in particular). The impact of the EU enlargement in the western regions would be defined by the following factors:

1. Introduction of Schengen visas to enter Poland.
2. Development of border infrastructure; modernization of old border crossings and the building of new ones.
3. Activities related to the EU regional policy in north-east Poland; investments from the Structural Funds.
4. Development of trans-border co-operation in the “Bug” and “Neman” euroregions.
5. New neighborhood policy of the EU.

Introduction of Schengen visas

The introduction of Schengen visas to enter Poland is often said to be the first negative factor of EU enlargement. This measure would mainly affect the western Belarusian and the eastern Polish regions. As mentioned above, many Belarusians who live in the border regions have been involved in cross-border trade, and many small businesses in eastern Poland have been serving those

trade flows. During the last ten years, the cross-border trade became one of the significant sources of income for certain companies in Poland, and, to a much larger extent, in Belarus. Therefore, the planned introduction of visas aroused many fears among the population in border regions of the two countries.

Analysis of this issue shows that the impact of the new border-crossing procedures on the economies of the Polish and Belarusian regions is very difficult to estimate. Currently it is agreed that the single entry visas to Poland (and, accordingly, to Belarus) will cost **E10**, and the multiple entry visas valid for one year **E50**. It should be said that the Polish government suggested mutually issuing visas free of charge but the Belarusian government refused this (Romanchuk, 2003). In any case, the cost of a visa would not become a serious obstacle for Belarusians if they decide to travel to Poland. As for regular visitors such as private traders, **E50** a year would be insignificant among other expenses.

What is more important is the procedure of how the visas would be granted. If Poland applies the criteria used by the current Schengen states (official invitations, proof of financial self-sufficiency, and a bureaucratic routine at the embassies that cause long queues) cross-border mobility would decrease significantly and the cross-border trade would slow down. The inability of Polish authorities to establish an efficient visa procedure was probably the reason why the introduction of visas for Belarusians was postponed until October 2003. The declarations of EU officials and representatives of the Polish government underline that visas aim at ordering the border crossing and would not impede the movement of people. If these declarations match the reality, the introduction of visas would not make any significant impact on regional dynamics either in Poland or in Belarus.

Infrastructure development

A positive trend in border-crossing issues related to the EU enlargement is the development of border infrastructure, including the modernization of old border crossings and the building of new ones. The EU finds it very important to keep its external borders transparent and efficiently managed. Therefore the Union has been financing modernization of its future borders via pre-accession aid in Poland and the TACIS program in Belarus. New terminals and infrastructure are being built, which should at least decrease the queues at the border. Supposedly, the trade flows between the two countries would become more intense, although any estimation is very hard to make as other factors (e.g. trade regime and business climate) would be crucial. Only if the Belarusian government creates the conditions by which Belarusian territory would become an efficient transit corridor for goods delivered from the EU to Russia and back, would the developed border infrastructure become a significant factor in the development of the western regions.

The EU Structural Funds in North-East Poland

It may be anticipated that activities related to the EU regional policy in north-east Poland and, in particular, investments from the Structural Funds would have spillovers to Belarusian territory. The major aim of the EU regional policy is the intensification of economic activity in regions that lag behind. This is done by investments to infrastructure development, training and re-training programs as well as the development of small businesses. It is now very hard to estimate the potential effects of the EU regional policy in Poland, because detailed programs and financial plans are still being worked out. In the optimistic scenario, the efficient actions of the Polish authorities and the EU institutions would help to induce faster growth in the eastern Polish regions, and new businesses in search of better opportunities would invest in bordering Belarusian regions. Indeed, the labor force in Belarus is relatively cheap and well trained. In the western regions people speak Polish and the free economic zones that exist in the bordering regions may become very

attractive for investors. If this optimistic scenario would come to fruition in the years following 2004, the western Belarusian regions would receive a strong positive impulse caused by the EU enlargement.

Cross-border cooperation

Belarus participates in two euroregions, “Bug” (established in 1995) and “Neman” (established in 1997). Along with the two western Belarusian regions, Brest and Grodno, the euroregions encompass bordering parts of Poland, Lithuania and Ukraine. Belarusian partners have participated in a few common projects. For example, in the “Neman” euroregion these included: 1) creation and networking of the Belarusian office of the “Neman” euroregion in Grodno (common budget E196,928); 2) creation of a consulting service on small business development in Novogrudok, Belarus (common budget E239,600); 3) training program on cross-border transport management and logistics (common budget E175,200); 4) regional development and environment in the “Neman” euroregion (common budget E989,560)¹.

Officials from the Belarusian and Polish sides state that the “Bug” and “Neman” euroregions have had very low efficiency in reaching their declared aims, in particular, in development of transnational co-operation (Komornicki, 2002). One of the reasons for this is the opposing political trajectory of the Belarusian leadership. In the existing circumstances, collaboration with the western European countries is not a priority, and relations with the EU are more antagonistic than just cold. Secondly, decision-making in Belarus is very centralized so that regional and local governments are extremely limited in their actions. The majority of strategic decisions about intra-regional development have to be taken by the central government or require a long procedure of agreement with all kinds of central authorities. Such circumstances erode the

¹ Data obtained from the Office of the “Neman” Euroregion in Grodno.

initiative of the regional and local governments to carry out activities offered by the Polish and Lithuanian partners in the euroregions.

Nonetheless, the euroregions give the EU an opportunity to engage Belarusian regional elites in closer relations via cross-border cooperation initiatives. This becomes very important since the Partnership and Cooperation Agreement between Belarus and the EU was frozen in 1997. EU support of the cross-border initiatives would grow as both Poland and Lithuania would become eligible for INTERREG (Strand A in particular) and related programs (European Commission, 2003). Since 1994, Poland obtained E311.15 million for cross-border cooperation and after accession these funds would be increased (Sadowska-Snarska, 2002). Belarusian partners would probably not be eligible for INTERREG, but can be supported by TACIS Cross-Border Cooperation schemes.

There is a possibility that enhanced attention to the future neighbors of the EU would increase the amounts spent for cross-border co-operation as well as stimulating the Belarusians to take an active part in the projects. The major effects of collaboration within the euroregions could be:

- development of technical infrastructure, particularly in the cross-border area
- development of social infrastructure, cultural and educational exchange
- environmental safety and better spatial planning
- some growth of cross-border trade and investment
- growth of tourism

These potential effects would occur in western Belarusian regions, but the spillover to other regions would probably be minor.

One of the most important factors that would define the benefits and threats of the enlargement to neighboring states would be the future EU policy towards those neighbors. The European Commission proposed a framework for the so-called “New Neighbourhood Policy”, which outlines the future relations with the new neighbors of the EU. This document underlines the importance of EU involvement in building fruitful collaboration with all neighboring countries, and, in particular, Russia, the Ukraine, Moldova and Belarus (European Commission, 2003). As stated in the document, the Union is keen to support the development of a stable market economy, the rule of law, efficient administration, a clean environment, security, and other issues. Within this policy, the EU is able to go as far as offering full participation in the single market (free movement of goods, services, capital and labor) without membership (European Commission, 2003).

The Commission stipulates that for Russia, the Ukraine, Belarus and Moldova, community, EBRD and European Investment Bank (EIB) supported initiatives should be further developed. While the central role played by the EBRD should continue to be supported, the EU could also consider the progressive and targeted increase of EIB lending to Russia, and its extension to the Ukraine, Moldova and, eventually, Belarus. In the Commission’s opinion the EU should ensure the International Financial Institutions take adequate account of the importance of spending on education, health and social safety net provisions in their policies towards the neighboring countries. It is further emphasized that Eastern neighbors should benefit from more direct grant aid and budget support for tackling poverty, social and economic inequality and exclusion to achieve greater social cohesion (European Commission, 2003).

What is important is that the Commission will consider the possibility of creating a new Neighbourhood Instrument which builds on the positive experiences of promoting cross-border cooperation within the PHARE, TACIS and INTERREG programs. According to the Commission, this instrument will focus on trans-border issues, promoting regional and sub-regional cooperation

and sustainable development on the Eastern border.

The latter commitment would directly benefit the western Belarusian regions, and, in particular, the activities carried out within the two euroregions. As detailed financial plans have not yet been elaborated, it is very difficult to estimate the potential effects on the development of western regions. Most probably, the EU activities would help to induce growth in those areas, but a lot would depend on the internal economic and political situation in the country at the time when the programs would be realized.

In general, the assistance offered by the EU New Neighbourhood Policy is conditional on a country's progress. In other words, the EU would not pay if the country 'does not behave'. That can cause a problem for Belarus as the country's policies usually do not comply with EU expectations. The Commission admits that relations with Belarus would not be easy:

The EU faces a choice in Belarus: either to leave things to drift – a policy for which the people of Belarus may pay dear and one which prevents the EU from pursuing increased cooperation on issues of mutual interest - or to engage, and risk sending a signal of support for policies which do not conform to EU values (European Commission, 2003, p.15).

The impact of integration with the Russian Federation on Belarusian regions

The integration processes between Belarus and the Russian Federation started in 1995 when a customs union agreement signed by Belarus, Russia, Kazakhstan, Kyrgyzstan and Uzbekistan came into force. The customs union appeared to be a mere political declaration as every country continued to have an autonomous trade policy. This was justified when in 1998 Kyrgyzstan joined the WTO without any settlement with its partners in the customs union.

Since 1995, Belarusian leadership, unlike any other CIS country, pushed for closer integration with Russia. In 1996 the agreement on the Community of Belarus and Russia was signed; a year later, the Community was transformed into a Union of the two countries and, finally, in late 1999 the Presidents signed the agreement on the Union State of Belarus and Russia.

It has been admitted by Belarusian and Russian economists that all those actions were nothing but political declarations. The majority of the documents signed under the framework of the Union State did not contain any significant commitments. The integration rhetoric was a useful political and ideological instrument for both presidents Yeltsyn and Lukashenko. Yeltsyn wanted to keep an ally at the time when all the other former Soviet republics turned away from Russia. Lukashenko wanted cheap oil and gas, easy access to the Russian markets and, most significantly, access to the Russian political arena (Tarasevich and Lobatch, 2001).

A politically not economically based decision to eliminate borders with Russia became very harmful for the Belarusian economy in the long run. Apart from large volumes of “gray” trade that undermined the competitiveness of local production and official importers, the resulting trade diversion from more competitive markets froze the much-needed restructuring of the Belarusian state companies. Besides, this ‘single vector’ policy led to a situation where 56% of Belarusian foreign trade was done with Russia (100% of oil and gas imports), which made the Belarusian economy extremely sensitive to decisions taken by the Russian government (Tarasevich and Lobatch, 2001).

Under President Putin, Russian policy towards Belarus became much more pragmatic. Putin stopped all integration rhetoric by offering “the closest variant of integration” – incorporation of Belarus into the Russian Federation. Although Lukashenko held it back, economic and political dependence on Russia have been forcing Belarusian leadership to take decisions that serve exclusively Russian interests (Romanchuk, 2003).

In these circumstances Belarus is being forced to privatize the biggest and the most efficient state-owned enterprises in the chemical, petrochemical and fuel industries and to invite investors only from Russia. The chemical and petrochemical industry in Belarus represents an interest for the Russian investors. The equipment in those companies is not worn out compared to other Belarusian industries; the companies are profitable and have potential for growth. Only big Russian oil and gas companies (Gazprom, Lukoil, Itera, Surgutneftegaz, TNK) expressed an interest in buying those companies. According to Belarusian and Russian experts, it is now a good time to buy cheaply the best pieces of Belarusian state property (Grib, 2003). Belarus needs investments badly; it is unlikely that foreign companies would participate in tenders (the business climate in the country is ranked very low, and important foreign investors, such as Ford, Ikea, and MAN already left the country). Belarus is dependent on Russia and therefore Russian investors would have a priority in any case. Big Russian oil companies have direct access both to Kremlin and Lukashenko, therefore they are quite sure that their interests in Belarus would be protected. To date, Russian companies have not acquired any shares of Belarusian property as they found the conditions set by the Belarusian government to be not acceptable. Belarus has put itself in the situation where Russian companies basically dictate the conditions for privatization. Now potential investors wait until the Belarusian government suggests a better price for the property.

Big Russian companies choose certain factories for investment and the regional dimension has never been present in the decision-making. Small and medium businesses do not find Belarus attractive for investment; therefore, the regional factors for Russian investment in Belarus have not yet appeared.

The currency union, which is being created, again, on the conditions of the Russian Federation would de facto seal the incorporation of Belarus into the Russian Federation (Tereschenko, 2002). Substitution of the Belarusian ruble with the Russian currency would create

more threats than opportunities. Belarus would lose its own monetary policy that used to be much softer than that in Russia and would have to adjust to stricter rules. The Belarusian economy is not yet ready to refuse devaluation as one of the most popular monetary policies. Introduction of Russian ruble would probably create a shock that would drastically decrease the competitiveness of Belarusian products in Russian markets and lead to severe economic and social consequences (Bogdankevich, 2002).

Following the logic of international experience, eastern Belarusian regions should have gained a lot from the integration processes with the Russian Federation. In Poland, the western regions that were closer to the EU took the largest benefits out of the accession process. Contradicting the Polish experience, Belarusian statistics show that economies in the eastern Belarusian regions did not get any significant impulse for growth. The number of loss-making companies increased, investments from Russia have been very low, and migration of labor has not been intensified. Open Russian markets did not bring significant advantage to the eastern regions as the companies were not able to use the economies of scale and to earn money for reconstruction. The turnover with Russia in those regions has not been stable, exports during the last few years have decreased and prospects for the future are not optimistic at all as Russian products become more and more competitive even within Belarus.

The price/quality ratio for most Belarusian products becomes less and less attractive for Russian consumers. Modernized private companies in Russia start producing similar products at a better price. Chinese and Korean exports to Russia of electrical devices in particular, put extra competitive pressure on Belarusian goods sold in Russia. Belarusian products lose competitiveness at Russian markets because of growing inefficiency of the state-owned enterprises and the

inadequate economic policy of the government². Privatization was frozen in Belarus in the early 1990s, and the old industrial state-owned giants have seen very little modernization since then. The socially-minded policy of the government obliged owners to keep all the workers in the companies even though their duties were not needed any more. Loss-making production could not be closed; instead, the companies strived for the state subsidies. The unfair tax system redistributed profits from the companies that have been doing relatively well to those that were in continuous loss. The procedure of bankruptcy has never been initiated. Such a policy led to the situation where the companies could not save money to change obsolete equipment and introduce new, more efficient technologies. Foreign investors have been reluctant to participate in the state-owned businesses. In these circumstances, the costs of production have been rising continuously but quality has not improved since the mid-1990s. The economic policy of the government, the state regulation of prices in particular, created a situation when even Belarusian beer makers (all of them are still state owned) started to quickly lose markets to Russian and Ukrainian brands within Belarus (Romanchuk, 2003). In some towns that are located close to the Russian border, small traders import bread, which is less expensive and of much better quality than that baked at the state-owned factories in Belarus.

In general, it appears like the western Belarusian regions gained more out of the eastward integration process than the eastern regions. The number of loss-making companies in western Belarus has been much smaller, and exports to Russia during the last five years have been more stable (Statistical Yearbook (2)). Actually, the western Belarusian regions lost more than they gained from the relations between Belarus and Russia. An economic policy that was declared to serve the interests of Russia discouraged Polish and Lithuanian companies from investing in Grodno and Brest.

² Problems of Belarusian exports to Russia have been extensively discussed in *Belarusskaja Gazeta* (Belarusian Newspaper) and *Belarusskij Rynok* (Belarusian Market) from 1999 – 2003.

These two regions have much in common with the two countries due to cultural and historic reasons. Grodno and Brest were Polish territory before 1939; people there can speak Polish, most of them regularly visit Poland and used to visit Lithuania before the country introduced visas. Despite this, Polish and Lithuanian investors did not show any serious interest even in the free economic zones created over the border in Brest (1996) and Grodno (2001).

Closer integration with Russia and the freeze of the Partnership and Cooperation Agreement with the EU created trade diversion from Central and Western Europe to Russia. This had a harmful impact on western Belarusian regions, because it undermined their economic potential. Companies in Grodno and Brest were discouraged from keeping and extending their share in the more competitive, but very promising Polish and Lithuanian markets. Exports to Poland and Lithuania demand higher standards and give more stimulus for technological innovations. In the late 1990s Polish producers started to use western European technologies, and if trade flows between neighboring Polish and Belarusian regions were developing, those technologies would have spilled over to Belarusia. Russian technologies are not that advanced and therefore trade with Russia did not enrich Belarusian companies with innovations. The open borders with Russia created an artificial situation where the necessary macro- and microeconomic reforms in Belarus have been postponed (Zaiko, 2003). It can be said that “easy” exports to Russia largely absorbed the inevitable consequences of the unreformed state owned economy.

The eastward policy of Belarus and disregard for Poland as an important trading partner resulted in a rather protectionist trade regime on the Belarusian-Polish border. For example, the citizens of Belarus (if they are not registered entrepreneurs) can import no more than 50 kilos of “manufactured goods” and 10 kilos of foodstuffs duty free. Each excessive kilo is due €2 euro of customs duty. This means that a washing machine or a refrigerator becomes almost twice as expensive in Belarus. As an outcome, a significant share of Polish imports slid to a “gray” sector. It

is quite astonishing that the share of Poland in the total official trade of the Brest region in 2000-2001 was merely 6.2 % and that of Lithuania only 1.4%. For the Grodno region the share of trade with Poland and Lithuania during the same years was 9.2% and 6.7% respectively. For comparison, the share of Poland and Lithuania in total Belarusian foreign trade is respectively 3.2% and 2.3% (Table 7). These quantities are clearly too low for neighboring states.

The disadvantages of the western Belarusian regions also arise from another factor. The greater the dependence of Belarus on Russia, the more decision-making on internal Belarusian issues is done in Moscow. In these circumstances the EU-Belarus policy becomes largely a part of the EU-Russia policy, which may disregard the specific problems of Belarus and undermine the efficiency of the EU assistance. The potential inadequacies would mostly affect the western Belarusian regions because their relations with the enlarged EU, both cultural and economic, are the strongest in comparison to other Belarusian regions.

Closer integration with Russia would lead to a situation where exports of the eastern regions to the enlarged EU would drop almost to zero. In other words, the way the integration with Russia has been implemented facilitated the deterioration of the Belarusian economy. In Poland, on the contrary, enhanced integration with the EU induced additional impulses for economic growth.