

# ACCELERATED INTEGRATION IN THE UNION STATE OF RUSSIA AND BELARUS

## Risks and opportunities for foreign investors

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<b>Subjects and sectors</b>	Union State, economic integration, sanctions and counter-sanctions, localization
<b>Stakeholders</b>	Russia, Belarus

By the end of 2021, the supreme authorities of the Union State of Russia and Belarus may give their final approval to 28 programmes for integration of the two states. These programmes were initially approved by the Presidents of Russia and Belarus on 9 September this year; a day later, they were then approved by the heads of government at a meeting of the Council of Ministers of the Union State. A [resolution](#) of the European Parliament adopted on 6 October takes a negative view of these integration processes, interpreting them as a threat to Belarus' sovereignty. The EU also has concerns over the two states' military rapprochement.

Even though the programmes have not yet been publicized, their general contents are known, allowing conclusions to be drawn and assumptions made concerning the format of the integration processes, the prospects for creating a single regulatory and legislative space in certain areas (product labelling and tracing, for example), the likely effect these processes will have on integration within the Eurasian Economic Union (EAEU) and also the role they will play in the sanctions war between Russia and Belarus, on the one hand, and the West on the other.

Once the heads of state approve these programmes, relevant Ministries, Central Banks and other agencies will start implementing them. This work might affect both the legislation of Belarus (harmonization with the Russian legislation) and integration within the EAEU. Implementation of the integration measures is expected to take between one and four years.

In these bilateral integration relations, Russia prioritizes taxes and customs, traceability and labelling, and payment system integration. Belarus is mostly interested in integrating energy markets (particularly buying gas at Russian domestic prices), and unobstructed access to the Russian market for its industrial and agricultural commodities.

## EXECUTIVE SUMMARY

The 1999 Treaty on Establishing the Union State sets the integration framework but does not determine the depth of the two countries' integration, which could potentially follow one of the following scenarios:

1. In-depth integration with a political component;
2. Profound economic integration (without a political component);
3. Limited integration (in individual economic areas).

The format and scenarios for development of Russia-Belarus integration are determined by several factors, including the dynamics of the sanctions war between Minsk and the West, the extent of Russia's support for Belarus, the stance taken by other actors (in particular, China) in their dialog with Belarus, etc.

The dynamics of integration might impact significantly on foreign investors for the following reasons:

- › Close integration will accelerate the substitution of Western goods and technologies in Belarus. These processes will be similar to those observed in Russia, which has been under sanctions since 2014 and has been focusing heavily on import substitution and localization.
  - › In the case of Belarus, which does not have major resources for import substitution, this would likely signal substituting Russian, Chinese and other alternatives for Western goods, technologies and services.
- › The depth of integration and the extent of the financial and other types of assistance Russia provides to Belarus may affect the position taken by the US, the EU and other Western states concerning new sanctions to be imposed on both Belarus itself and on Russia. Such assistance could be seen as Moscow supporting the regime in Belarus, which the West views as illegitimate.
  - › New sanctions and counter-sanctions could, in turn, directly affect individual companies and entire economic sectors where foreign investors are prevalent.
- › In-depth integration of Russia and Belarus could serve as a prototype for integration in the EAEU, with the potential to significantly impact the regulatory framework throughout the Union.

## MEETING RESULTS

The general contents of all the 28 union programmes were published on 10 September as [“overarching areas of Union building”](#), included in a joint statement by both heads of government. The following provisions of the Union programmes are the most informative:

- › Labelling and traceability of commodities
  - › Unifying approaches to legal regulation and technical assistance in mandatory labelling of commodities.
  - › Synchronizing work on mutual recognition of means of identification.
  - › Synchronizing approaches to traceability mechanisms, integrating information systems for automating data exchange.
- › Tax and customs legislation
  - › Concluding international treaties on common indirect taxation principles and on deepening collaboration between customs bodies.

- › Introducing an integration system for indirect taxation in Russia and Belarus. Additionally, creating a joint advisory body: a Union State Committee on Taxation.
- › Gas
  - › Drawing up operating principles for a united gas market in the Union State. Implementation of these principles is tied to the “movement toward aligning the two states’ economic environment.”
  - › According to information at Kesarev’s disposal, creation of a united gas market is dependent on Belarus complying with the Union taxation and customs programmes.

Additionally, the joint statement notes agreements concerning “harmonization”, “alignment” or “coordinated approaches” in veterinary and phytosanitary control, in transportation and public procurement. Russian Prime Minister Mikhail Mishustin also stated that Belarus would be able to access Russian public procurement, support measures and subsidies, and would enjoy an expanded market for its industrial and agricultural products.

## POLITICAL AND HISTORICAL CONTEXT

The Treaty on Establishing the Union State was signed on 8 December 1999 by Belarus President Alexander Lukashenko and Russian President Boris Yeltsin. The Treaty in effect includes provisions on creating a single economic and monetary space, and includes a major political component (creating new supranational institutions, a common constitutional act, etc.). At the same time, for the last twenty years, the integration processes have been quite inert and so the Treaty has essentially lacked practical meaning.

The development of integration roadmaps was proposed in 2018 by Russia’s former President and former Prime Minister Dmitry Medvedev, with 31 then announced in January 2019. Subsequently, Russia-Belarus economic relations have been viewed precisely as a series of roadmaps; in early 2021, the process was rebranded and the 31 roadmaps were transformed into 28 Union programmes.

Belarus-Russia integration then received further impetus following the Belarus Presidential elections in August 2020 and the foreign and domestic political problems they generated. Mass protests in Belarus and the hardline response from government security forces caused the EU and the US to impose sanctions. As a result, authorities consequently lost the opportunity to walk the tightrope between the interests of Russia and the West, even though, before the elections, Minsk reproached Moscow for destabilizing the domestic political situation in Belarus.<sup>1</sup>

In February 2021, Belarus’ Minister for Foreign Affairs Vladimir Makey spearheaded a revision of trade policies, in particular, changes to the country’s export structure. Previously, exports were structured by thirds, with the EAEU, the EU, and other countries each accounting for a third of Belarus exports. Subsequently, exports are to be structured as “half-quarter-quarter” with the EAEU accounting for half of exports.

The division of exports into thirds was connected on the one hand with obstacles blocking access for Belarus industrial and agricultural products to the Russian market (discriminatory terms for obtaining industrial subsidies, regular prohibitions on supplies of agricultural products, and the import substitution policy Russia has been actively conducting since 2014), while on the other hand it allowed Belarus to minimize its dependence on the Russian market (in 2010–2020, Russia accounted for between 40% and 60% of Belarus’ trade turnover).

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<sup>1</sup> In July 2020, Belarusian authorities announced they had detained militants from a Russian private military company PMC Wagner. Immediately before the elections, Alexander Lukashenko said that “militants” from this unit had been purposefully brought to Belarus to destabilize the situation and organize a “color revolution.” These people were later handed over to Russia.

After the EU and the US imposed sanctions on Belarus, it could no longer diversify its exports by increasing the EU's share, so it had to revise its export structure goals. At the same time, sanctions also affected imports: instance, in June 2021 Rolls Royce refused to sell engines to BelAZ, the biggest Belarus manufacturer of large dump trucks. The Belarus Minister for Industry announced that the British-made engines would be replaced with alternatives from Russia and China.

Replacing Western commodities and parts with Chinese- and Russian-made analogues is becoming a sustainable trend.

## **FORWARD-LOOKING SCENARIOS**

The most likely integration path is a middle option between conservative (Russia and Belarus integrate within the EAEU vector) and advanced (in-depth economic integration including a single emissions centre, single customs service, etc. while simultaneously establishing supranational authorities' bodies) scenarios. In September 2021, both Putin and Lukashenko noted that establishing common political institutions had not been discussed as part of the Union programmes. Yet compared to the integration processes in the EAEU, integration in the Union State is moving along vigorously.

Russia's long-term goals in its integration with Belarus entail maximum integration of the Belarusian economy with Russia's (mostly through implementing Russia's legislative principles and approaches in Belarus), with a view to thwarting the "Ukrainian scenario" and preventing Belarus from re-orientating its foreign policy towards the West. Belarus' goals are more utilitarian as it concentrates on energy deliveries from Russia on preferential terms and on Belarus commodities gaining access to the Russian market while resisting political integration and preserving the country's sovereignty.

The political situation in Belarus is, however, unstable and, should there be a regime change, integration with Russia is likely to become less of a priority. On the other hand, Minsk had repeatedly stated it was prioritizing integration with Russia (including after the EU and the US imposed sanctions on Belarus following the 2010 Presidential elections) but, when an opportunity presented itself, Minsk developed economic and political relations with the West, which could include, for instance, American oil delivered to Belarusian oil refineries and working on deliveries of natural gas from suppliers other than Russia.

Owing to the worsening of Belarus' relations with the West and Russia's active involvement in handling the Belarus' domestic challenges, integration processes have become more dynamic, making it still possible for the integration processes to follow any of the scenarios described below:

1. In-depth integration with a political component;
2. Profound economic integration (without a political component);
3. Limited integration (in individual economic areas)

### **IN-DEPTH INTEGRATION INCLUDING A POLITICAL COMPONENT (estimated probability: 20%)**

This scenario involves the two countries' in-depth economic integration including a single currency, and also political integration involving establishment of supranational regulators and a common defense space.

Implementation of the in-depth scenario depends on how Belarus' relations develop with the EU and the US. The scenario will become more likely if the West maintains or even steps up its sanction pressure on Minsk.

Developments favouring this scenario include the continuing migration crisis on the EU-Belarus border and the EU working on the fifth package of anti-Belarus sanctions. It should be noted that in response to the steps taken by EU and US governments and companies, Belarusian authorities are adopting measures that significantly impact Western companies in Belarus, for example official sanctions imposed on Skoda Auto, Beiersdorf and Liqui Moly,<sup>2</sup> plus unofficial measures<sup>3</sup> including control and monitoring, tax inspections, etc.

Belarusian authorities focus principally on foreign companies that publicly proclaim their stance on the actions taken by the Belarusian authorities. This means that foreign companies on the one hand face pressure from the opposition, human rights organizations and NGOs demanding they cease or limit their activities in Belarus, while on the other, they face higher risks of Belarusian authorities imposing counter-sanctions on them for publicly refusing to collaborate.

Exacerbated relations with the West require Belarusian authorities to deepen their relations with Russia and seek new partners. At the same time, the process of Belarus developing trade and economic relations with such states as China, Iran, Pakistan also depends indirectly on Russia's stance. The elimination of or a reduction in import duties and creation of free trade areas comes within the EAEU's purview, where Russia's influence is significant; additionally, transport routes from Belarus to those states run through Russia.

A factor acting against this scenario is Moscow's caution when it comes to the overall sanctions policy. There have been precedents of the EU imposing sanctions on Russian individuals and companies for maintaining ties with the Belarusian authorities.<sup>4</sup> Generally, given the Western sanctions against Belarus, Moscow's attitude to the political aspects of integration has changed significantly, despite Minsk calling for a joint response within both the Union State and the EAEU. A joint response to the anti-Belarusian sanctions is currently of no interest to Russia but instead poses significant additional risks.

### **PROFOUND ECONOMIC INTEGRATION (estimated probability: 50%)**

As noted above, in its integration with Belarus, Russia is prioritizing taxation and customs, labelling and traceability. Integration in these areas is connected with Russia's desire to establish control over the movement of goods in the common customs territory. In our estimation, therefore, the issue of a loan of US\$640m to Belarus by the end of 2022 could be related to the abolition of the order granting Belarusian re-exporters tax benefits and essentially contributing to sanctioned goods being imported into Russia.

Belarus in turn is interested in integrating energy markets, gaining access to Russia's public procurement and reducing barriers to selling its industrial and agricultural products on the Russian market. The solution to these Belarusian problems within the EAEU is unclear, since neither the EEC nor the EAEU Court have the requisite powers to lift the protectionist measures adopted by the national governments of the EAEU states. This is confirmed by the Strategic Directions for Developing European Economic Integration until 2025 not containing provisions on expanding the powers of the EEC and the EAEU Court.

This scenario rules out any joint response to sanctions. At the same time, Russia's sanctions-related economic assistance to Belarus is being expanded through the extension of new loans and refinancing of old ones, plus

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<sup>2</sup> These companies refused to sponsor the Ice Hockey World Cup in Minsk. Subsequently, order No. 240 of 23 April 2021 of the Council of Ministers prohibited importation of these companies' products into Belarus.

<sup>3</sup> In September 2021, the State Control Committee and Gosstandart (the State Committee for Standardization of the Republic of Belarus) declared 15 detergents manufactured by German (HERR KLEE), Czech (Robeta) and Polish (Clovin) companies to be non-compliant with State standards. As a consequence, their importation into Belarus and sale in the country were prohibited.

<sup>4</sup> In June 2021, as part of its fourth sanctions package, the EU imposed sanctions on Russian businessman Mikhail Gutseriev who conducted energy business in Belarus (oil sales to Belarusian oil refineries) and sold potassium fertilizers (Gutseriev owns Slavkali, which is currently building the Nezhin mining and processing plant to manufacture potassium chloride). Russian companies are also likely to suspend deliveries of oil to Belarusian refineries hit by US sanctions.

the granting of industrial subsidies on a par with Russian manufacturers. Currently, the governments of the two states could be carrying out preliminary work on determining forms and amounts of economic assistance to Belarus.

### **LIMITED INTEGRATION (estimated probability: 30%)**

This scenario entails only gradual development of Russia-Belarus relations, with Minsk taking no significant steps forward to integrate with Russia. Implementing this scenario could help normalize relations with the West.

Short-term, this scenario appears out of the question owing to the escalated sanctions war between Belarus and the West. In particular, in September 2021, following the first stage of the Zapad-2021 joint strategic Belarus-Russia military exercises, Lukashenko stated that lifting of the sanctions was a condition for any dialogue with the West.

One of Minsk's potential instruments in implementing this scenario is to delay the measures stipulated in the Union programmes scheduled for late 2022 – early 2023 in areas of priority for Russia. It has already been noted that the timeframe for implementing the taxation and customs measures is connected with the terms on which loans are issued.

## **RISKS AND CONSEQUENCES FOR FOREIGN COMPANIES**

Accelerated integration of Russia and Belarus entails the following principal risks:

- › Increased economic and regulatory dependence on Russia:
  - › Integration within the Union State largely entails Belarusian legislation implementing Russia's approach; consequently, this integration carries the same risks for foreign companies working in Russia. These are primarily the trends toward substituting Russian and Chinese goods for Western commodities and toward localizing production.
  - › Refusal to import Belarusian goods and to deliver commodities to Belarus. The sanctions imposed by the EU and the US mean that foreign companies are refusing to buy Belarusian goods. For instance, Japan's Yokohama has cancelled deliveries of products manufactured at the Belarus Steel Works. Minsk Automotive Plant has encountered problems in selling electric buses to Ukraine.
  - › Many foreign companies are also refusing to cooperate with Belarusian enterprises, including as part of selling their commodities to Belarus. For instance, Beckers Group, pump manufacturer Danfoss, dump truck manufacturer Liebherr, and Rolls Royce have refused to cooperate with Belarusian equipment manufacturing enterprises. British American Tobacco has ceased collaborating with Neman, the Grodno tobacco factory.
  - › Minsk responded to foreign companies ceasing their activities in Belarus with statements by the Prime Minister and other officials that their products would be replaced with Chinese and Russian analogues. The West's increased sanction pressure will negatively affect the competitiveness of Belarusian enterprises on foreign markets.
- › The risk of counter-sanctions:
  - › Counter-sanctions could primarily affect manufacturers of everyday goods since import substitution in this area is the least problematic.
- › Re-orientating logistics routes for exporting Belarusian goods and a threat to the transit of European goods via Belarus and Russia:
  - › Increased dependence on Russia is also connected with transport and logistics routes being reorientated toward Russia, as evidenced by the re-orientation of commodity export trans-

shipment (primarily petrochemicals and potassium chloride) from ports in the Baltic states to Russian ports, and the approval of Union programmes in transportation policies. On the other hand, Lithuanian authorities are considering prohibiting the transport and trans-shipment of Belarusian potassium fertilizers.

- › At the same time, President Lukashenko has publicly announced the possibility of stopping the eastward transit of Western commodities, although no specific actions have yet followed this statement.
- › Risks for Russian business people and companies due to assistance to Belarusian authorities:
  - › Russia's involvement in Belarus may become an additional reason for imposing Western sanctions against Russia or individual Russian companies and businessmen (as was already in case with Mikhail Gutseriev).

## **EFFECT ON INTEGRATION PROCESSES IN THE EAEU**

Approval of the set of Union programmes is not the final step in Russia-Belarus bilateral integration. However, Moscow may use the project to accelerate further integration within the EAEU. Leading Belarus officials have repeatedly mentioned the connection between integration within the Union State and integration processes in the EAEU, even though it is Russia that has a greater interest in extending the Union State integration approach to the EAEU.

Implementing this approach within the EAEU involves spreading the risks present on the Russian market to the EAEU states. Clearly, import substitution and demands that manufacturing be localized carry the greatest risk. Currently, import substitution trends in Russia are strongest in information technologies, as seen in the legislative demands concerning pre-installed software.

## **RECOMMENDATIONS**

The following risk minimization recommendations may be given to companies working in Belarus and Russia:

- › To monitor trends in integration alliances:
  - › in the Union State, since Union programmes and other substantive documents are from the outset discussed, approved and coordinated at the supranational level.
  - › in the EAEU, since the experience of integration within the Union State and in some areas could be extended to the EAEU.
- › To monitor the changes in the Belarusian regulations in taxation and customs, labelling and traceability, and payment systems, since changes in these areas will soon affect companies working in Belarus.
- › To monitor the changes in the West's sanctions policies toward Belarus, and in Belarusian official and unofficial counter-sanctions, and:
  - › To monitor Belarus's attempts to bring the matter of a consolidated response to western sanctions to the level of the Union State and the EAEU;
- › To remain pointedly apolitical and not to interact publicly with the opposition, avoiding, as far as possible, open public interactions and refraining from responding to their requests.

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