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ON BELARUS



**ŠTEFAN FÜLE** EU-Belarus  
— relations conditioned on  
respect for values and based  
on contacts with people



**VLADIMIR MAKEI** Belarus  
and Finland — forging for a  
brighter future



# BALTIC RIM ECONOMIES

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Editor-in-Chief | Kari Liuhto  
(responsible for writer invitations)

Technical Editor | Saara Majuri

University of Turku  
Turku School of Economics  
Pan-European Institute  
Rehtorinpellonkatu 3  
FI-20500 TURKU, Finland  
Tel. +358 2 333 9567

[www.utu.fi/pei](http://www.utu.fi/pei)



## EXPERT ARTICLES

<b>ŠTEFAN FÜLE</b>	<b>4</b>
EU-Belarus – relations conditioned on respect for values and based on contacts with people	
<b>VLADIMIR MAKEI</b>	<b>5</b>
Belarus and Finland – forging a brighter future	
<b>FILIP KACZMAREK</b>	<b>6</b>
EU-Belarus relations	
<b>EVGENI KIRILOV</b>	<b>7</b>
The EU's Eastern Partnership and Belarus	
<b>QIMIAO FAN</b>	<b>8</b>
Belarus needs bold and comprehensive reforms to achieve sustainable growth	
<b>MAIRA MORA</b>	<b>9</b>
EU-Belarus – necessary partnership	
<b>FRANCIS DELAËY</b>	<b>10</b>
Unleashing Belarus' potential	
<b>ALEXANDER OSTROVSKY</b>	<b>11</b>
Eurasian integration – benefits for European businesses	

<b>SERGEY V. ABLAMEYKO</b>	<b>12</b>
Belarusian-Finnish cooperation in education and science – case of BSU	
<b>JUHA HÄMÄLÄINEN &amp; JUUSO VIITIKKO</b>	<b>13</b>
Belarus – developing economy	
<b>ANTTI O.K. NIEMINEN</b>	<b>14</b>
Kiilto Oy – first steps in the adhesives business in Belarus	
<b>TOPI PAANANEN &amp; ANDREI NAUMOVICH</b>	<b>15</b>
Peikko Group and Belarus	
<b>PAVEL LASCHENKO</b>	<b>16</b>
Business environment in Belarus today	
<b>HALINA SHMARLOUSKAYA</b>	<b>17</b>
External economic potential of the Republic of Belarus – economic outlook	
<b>IRINA YEREMEYEVA</b>	<b>19</b>
EU-Belarus relations – threats and political opportunities	
<b>SIERŻ NAŹRODSKI &amp; ULADZIMIR VALETKA</b>	<b>21</b>
Securities market in Belarus – still undisclosed potential	

<b>ALEKSEI BYKOV &amp; ANNA ZEZULKINA</b>	<b>22</b>
Measuring risks of regional development – case of Belarus	
<b>ELENA A. DOSTANKO</b>	<b>23</b>
Belarusian-Finnish relations	
<b>HANNA SMITH</b>	<b>24</b>
Eurasian integration as a defining factor in Belarusian foreign policy	
<b>ULADZIMIR ROUDA</b>	<b>25</b>
The crisis of the Belarusian economic model	
<b>DZMITRY KRUK</b>	<b>26</b>
Belarus – a chance to convert past mistakes into new advantages	
<b>GALINA GAVRILKO</b>	<b>27</b>
Integration on the territory of the former Soviet Union – a search for an optimum model	
<b>KARI LIUHTO</b>	<b>28</b>
How the Finnish firms view the Belarus business environment?	

ŠTEFAN FÜLE

# EU-Belarus – relations conditioned on respect for values and based on contacts with people

Expert article • 1454

**B**elarus is an important neighbour of the European Union and its people are important to us. So is a vision of a modern European future for them. The EU is offering Belarus closer cooperation to advance towards this goal in the framework of our bilateral relations under the umbrella of the Eastern Partnership. This offer is however conditioned by commitment to European values. Overall, the development of EU-Belarus bilateral relations depends on how the Belarusian authorities progress towards respect for the principles of democracy, the rule of law and human rights. The EU remains willing to assist Belarus to meet its obligations in this regard. Our policy towards our neighbours is not only about contacts and engagement with authorities. It is also about reaching out to the people, engaging with civil society and citizens. In the case of Belarus, this is expressed in a number of initiatives and projects, including the European Dialogue for Modernisation with Belarusian society. A recent positive development with direct impact on people is the launching of negotiations on visa facilitation and readmission agreements this January. After two years of waiting, the Belarusian authorities finally announced last November, at the Eastern Partnership summit in Vilnius, their readiness to engage in these negotiations. There have also been some positive signs in Belarus' cooperation with the international community on some specific issues, namely in the discussion on moratorium for the death penalty (Belarus remains the only country in Europe that still applies capital punishment) and on higher education. But the expected results have not yet been achieved.

## European concerns

At the same time, against the background of the EU's serious concerns about the lack of progress on the human rights situation in Belarus, the Member States maintain restrictive measures against those responsible for serious violations of human rights, the repression of civil society and democratic opposition, or whose activities otherwise seriously undermine democracy or the rule of law in Belarus, and those who are benefiting from or supporting the regime.

The general repressive policies continued in 2013 through the intimidation of representatives of civil society, petty harassment, dismissing people from their jobs, not allowing certain citizens to travel abroad and fining activists or sentencing them from short to medium periods in jail. On numerous occasions the EU expressed its grave concern about the lack of respect for human rights, the rule of law and democratic principles in Belarus.

## Critical engagement

Due to the fact that there are political prisoners and insufficient respect for democratic values and fundamental rights in Belarus, the EU's policy towards Minsk is one of critical engagement. This includes political support for civil society and the opposition, human rights organisations, as well as for political prisoners and their relatives. It also means co-operation through the multilateral track of the Eastern Partnership and

technical dialogues on specific topics of common interest. The multi-lateral track of the Eastern Partnership has been extensively used to engage Belarus in closer cooperation with the EU. Belarus actively participated in the four thematic areas (democracy, good governance and stability, economic integration and convergence with EU policies, energy security, contacts between people) and also in most meetings and activities in the framework of the Eastern Partnership (such as Ministerial meetings or Informal sectoral dialogues).

## European assistance

EU assistance to Belarus has remained limited to supporting the needs of the population and democratisation. Given the complex political situation in the country, the bilateral allocations funded under the European Neighbourhood and Partnership Instrument (ENPI) aimed at supporting cooperation in sectors of mutual interest and those benefiting most directly the citizens (regional development, environment, energy efficiency, green economy, food safety, border management etc.), putting emphasis on civil society participation and at the same time maintaining contacts at technical level with the Belarusian administration, in particular at local level.

EU assistance is also being given to civil society, victims of repression, students and NGOs. We support communities, vulnerable groups and human rights defenders. Significant support is also given to students through different options such as the Open Europe scholarship scheme which allows Belarusian students to study at European Universities, the languages course scheme for young Belarusians and the EU funded European Humanities University.

## Potential of 2014

Belarus will be in world's spotlight this May when the World Ice Hockey Championship takes place in Minsk. Such events are usually a window for the country – a window to the outside world and also a window for the outside world to see the country: not only its stadiums but also how it treats its people and what respect it shows for human rights and modern European values. This presents an opportunity to work on improvements in areas where we have voiced our concerns so that we can realise the full potential of EU-Belarus relations. ■



**ŠTEFAN FÜLE**  
EU Commissioner for  
Enlargement and European  
Neighbourhood Policy

VLADIMIR MAKEI

# Belarus and Finland – forging a brighter future

Expert article • 1455

Over the recent years, Belarus and Finland have advanced their political dialogue and bolstered trade and economic cooperation.

Contacts at the ministerial level, establishment and subsequent expansion of reciprocal diplomatic presence have increased economic ties between the two countries. Today Belarus hosts 25 enterprises with Finnish investment with the authorized capital of \$20.98 million and 5 representative offices of Finnish companies. Still, the existing potential has yet to be unleashed.

Sharing border with the European Union and being an active member of new powerful economic formations, such as the Customs Union and the Single Economic Space of Belarus, Russia and Kazakhstan, Belarus has practically become a "gateway" for foreign businesses. With the access to Belarus's 10 million strong domestic market, foreign investors can now explore new opportunities within an ample Single Economic Space of the three states of 170 million people, with equal conditions for economic entities, free movement of goods, services, labor and capital.

Among the conditions created within the Single Economic Space to foster trade and investment are abolition of internal customs and transport control; duty-free import of technological equipment for investment projects; gradual harmonization of technical regulations, application of common sanitary and phytosanitary measures, etc.

Northern European states are rightly considered to be the source and engine of innovation on the continent and throughout the world. Despite the challenges facing international financial and economic systems, this region demonstrates positive growth rates.

Successful innovative development of Northern European countries has spurred the interest of Belarus seeking to expand bilateral relations, especially in trade and economy. Particular attention has been paid to Finland, the only country in the region that currently hosts a fully functioning Belarusian diplomatic mission.

Finnish authorities have consistently demonstrated their commitment to enhanced expert dialogue with their Belarusian counterparts and deeper involvement in the search for mutually beneficial ways to improve the EU-Belarus relations. Such an approach garners support from Finnish companies and their growing interest in the Belarusian market.

Trade could be another example of a developing pragmatic cooperation for the benefit of the people. Belarus-Finland trade has been on the rise since 2010. In 2012, bilateral turnover in goods has grown by 48.6 percent from 2011 to reach \$297.3 million, an all-time high. The same year, trade in services totaled \$17.6 million.

A stronger Belarus-Finland trade and economic interaction has contributed greatly to the implementation of bilateral projects. Special importance is attached to enhanced cooperation on mutually beneficial areas, such as energy, energy efficiency and biotechnology, forestry, biofuel, engineering, innovation, R&D.

Just one success story of Belarus-Finland cooperation is the acquisition by OLVI of a majority stake in Belarusian brewery LIDSKOE PIVO. Today LIDSKOE PIVO works at full capacity, holds a significant market share of beer (15%), kvass (67%) and juice (32%) in Belarus and exports its beverages to the Baltic States and Russia. In 2012, LIDSKOE PIVO was the most profitable OLVI's subsidiary compared with its production lines in Latvia, Lithuania and Finland.

OLVI and other Finnish companies METSO-MW POWER, KESKO, INGMAN GROUP, TIETO, SCIENCESOFT operating in Belarus have brought about new opportunities and joint initiatives.

Traditional biennial forums attended by entrepreneurs from the two countries provide a good venue for establishing new direct contacts and enhancing the already existing beneficial links, for further promoting Belarus-Finland trade and economic relationship and for improving the whole atmosphere of bilateral cooperation.

The Fourth Finnish-Belarusian Economic Forum scheduled for April 8, 2014 in the ancient capital of Suomi – the city of Turku can become a significant inflection point for broader bilateral cooperation. The Forum could create a favorable environment for an active dialogue that might eventually evolve into concrete activities such as meetings,

thematic workshops, exhibitions and other forms of business interaction. The Forum will hopefully trigger intensified cooperation in hi-tech spheres and creation of new joint ventures and production lines.

The potential of Belarus-Finland relationship is still underutilized. There are good prospects and grounds for improved bilateral cooperation in the future. The opportunities are there, and they are not to be missed. ■

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**VLADIMIR MAKEI**  
Minister of Foreign Affairs  
The Republic of Belarus

FILIP KACZMAREK

# EU-Belarus relations

Expert article • 1456

For the last few years EU-Belarus relations have been considered as difficult and are mainly based on technical dialogues and discussions. This complex situation is influenced by many factors, namely failure to conduct free and fair elections, to establish the rule of law and to introduce democratic reforms. All previous successive elections held in Belarus under the authoritarian rule of President Aleksander Lukashenko have failed, according to international observers, to meet basic international standards for democratic elections. Moreover, the last presidential elections in 2010 were marked by large-scale frauds and a violent crackdown on the opposition, civil society and the media, and as a result represented a negative turning point in the relations between Brussels and Minsk. Consequently, the European Union introduced a tailor-made policy towards Belarus, which it defines as "critical engagement", based on restrictive measures against the Belarusian regime, and on the strengthened engagement with civil society and the political opposition. This policy of critical engagement has been maintained further after the 2012 parliamentary elections which, again were found by the OSCE/ODIHR election observation mission to have violated basic democratic standards. Accordingly, the Council of the EU decided to extend restrictive measures for another 12 months, which includes travel bans and freezing assets for selected business entities. Furthermore, the Euronest Parliamentary Assembly was unable to recognise the Belarusian Parliament as a legitimate representative of its people.

Belarusian authorities have avoided all forms of an open dialogue. After repeated refusals by the authorities in Belarus to provide entrance visas to Members of the European Parliament, the EP delegation has been unable to travel to Belarus in recent years. The latest visit of the delegation to Belarus took place in November 2002. The most recent attempt to organise such a visit was initiated in June and in October 2013 and even after a positive first reaction from the Belarusian side, the visits were refused due to, what was called, the lack of an agreement regarding technicalities. However, the delegation maintains an active and regular dialogue with the representatives of Belarusian democratic opposition, and civil society organisations.

The EU has been repeatedly expressing concerns about the lack of respect for human rights and fundamental freedoms in Belarus. Belarus remains the only country in Europe that still uses the death penalty and refuses to impose a moratorium. Politically motivated persecutions of civil society and opposition organisations in Belarus are one of the main obstacles in a way to normalise its relations with the EU. In fact, The European Unions' policy, in this matter, is completely clear. The EU will unfreeze the relations, restart political dialogue with Minsk and gradually lift sanctions only when all political prisoners are unconditionally realised and pardoned. The recent European Parliament report on the EU policy towards Belarus by Justas Paleckis adopted on the 12th of September 2013, acknowledges this problem and calls on the Belarusian authorities for further actions in regard to an improvement in the situation of human rights. According

to the report, Minsk should 'lift all obstacles and restrictions to the exercise of freedom of associations, expression, movement, peaceful assembly and thought for pro-democracy opposition groups and civil society organizations, not to exclude those sentenced to death in 2013 and impose a moratorium on the death penalty with a view to its complete abolition'.<sup>1</sup>

Due to this political situation, Belarus has excluded itself from the EU's main regional framework which is covered by the European Neighborhood Policy and the chosen policy of self-isolation. Despite being a member of the Eastern Partnership since 2009, Belarus only participates in its multilateral track. To date, Minsk has not expressed any will to strengthen cooperation and an open dialogue with the EU, even though many opportunities have been offered. One of them is the European Dialogue on Modernisation with the Belarusian Society which was launched in March 2012 by the Commissioner for Enlargement and Neighbourhood Policy, Stefan Füle. This dialogue aims at exchanging views with representatives of the Belarusian civil society and political opposition on the necessary reforms for the modernisation of the country and on how relations with the EU should develop, including priorities for possible EU financial support. Four working groups are set to address the political dialogue, justice and home affairs, economic and social reforms, and trade and regulatory issues.

The EU is ready to discuss the reform programs set up in line with the aspirations of the Belarusian society. Therefore, the EU is waiting for the Belarusian government's response to whether or not it will accept the invitation to participate in the initiative. To this point, the Belarusian regime has proposed to alter the format of the Dialogue on Modernisation toward an interstate "Partnership for Modernisation". However, the change in Belarus will only be possible with the full participation of the civil society and the democratic opposition in national decision-making. One is sure that the Belarusian authorities' absence from this dialogue and fragmented opposition has thus far limited the initiative from reaching its full impact.

One of the incentives for Minsk to initiate a dialogue on democratic modernisation of Belarus might be opening negotiation on visa facilitation and a reduction of their costs for citizens. This measure, according to the aforementioned report, will not only be profitable for Belarusians, but also, may "facilitate and intensify people-to-people interaction and help to prevent the further isolation of Belarusian citizens". Nevertheless, much work is still to be done to improve the situation in Belarus and to enhance relations between the EU and Belarus. This success depends on the willingness of Aleksander Lukashenko to allow democratic changes in his country. We will be able to observe whether any changes will be applied during this year's local elections, as well as, in the Presidential elections scheduled for next year. ■



FILIP KACZMAREK

Chairman  
EP Delegation for Relations  
with Belarus  
European Parliament

<sup>1</sup> EU policy towards Belarus (A7-0261/2013 - Rapporteur: Justas Vincas Paleckis), <http://www.europarl.europa.eu/sides/getDoc.do?type=TA&reference=P7-TA-2013-0382&language=EN&ring=A7-2013-0261>



EVGENI KIRILOV

# The EU's Eastern Partnership and Belarus

Expert article • 1457

The relationship of the EU with Belarus falls within the framework of the European Neighbourhood Policy, which covers neighbours of the Union in the South and the East. The Eastern Partnership component of this policy is the one within which the relations and cooperation between the EU and the country are shaped, the other countries covered by this programme being Armenia, Azerbaijan, Georgia, Moldova and Ukraine. Belarus is part of the Eastern Partnership since its launch in 2009. The country is second in terms of territory and population among the 6 Eastern Partnership countries, and shares more than 1 000 km of common border with the European Union. The relationship between the EU and Belarus has a large potential for deepening in numerous areas such as trans-border and economic cooperation. Developments in recent months still need to be interpreted and should show concrete signals of continuity and sustainability, before allowing us to give a positive assessment.

The Eastern Partnership policy has several dimensions, which deal with: democracy, good governance and stability; economic integration and convergence with EU standards; energy security; mobility and contacts between people. As a contribution to the this policy, and with a move responding to the desire to engage more, politically, with the Eastern Partners, the European Parliament proposed to its homologues and subsequently established together with them the – EURONEST Parliamentary Assembly. As the European Parliament does not recognize the legitimacy of the Belarusian Parliament, Belarusian MPs are, for the time being, not taking part in the Assembly's activities. Moreover, the Assembly has established a working group on Belarus to serve as a platform where Members discuss developments within the country, or between the country and the EU, together with representatives of the Belarusian civil society, the opposition and other organisations.

The cooperation of the EU with Belarus, as with all other Partners, needs to reflect the fundamental democratic values which are the roots of the Union, among which the respect of civil liberties and the protection of human rights should be mentioned. In this context, the potential engagement of Belarus in a political dialogue with the EU should go hand in hand with the release of jailed human rights defenders and political activists. According to NGO reports, the number of politically motivated arrests has been decreasing in the period 2011-2012, but, at the same time, some further restrictive legislative measures have been taken in Belarus. Improvements in the legislative environment are, and will be, pivotal for the EU side before any further political or trade cooperation. This implies that the ball is in Belarus' court as far as progress in bilateral relations is concerned, and it is up to Minsk to decide if they prefer them to be in progress or stagnation.

Within the Eastern Partnership, there are three main types of documents being discussed and negotiated with the partner countries. These are the visa-facilitation agreements, the readmission agreements for those persons residing without authorisation and the association agreements. At the Eastern Partnership Summit in Vilnius on 28-29 November 2013, Belarus announced its decision to accept the EU proposal to start visa facilitation and readmission talks. The

Belarusian Deputy Foreign Minister visited Brussels at the end of January 2014 in this context. This is a historic opportunity for both the Belarusian and the EU citizens, because the agreements would pave the way for easing citizens' mobility to a great extent. These visa facilitation agreements are targeted at various groups of citizens: young people, scientists, participants in cultural or study exchanges, members of families of Belarusian nationals residing in the EU, etc. The fact that Belarus has shown a new impetus for intensifying the bilateral relations with the EU should undoubtedly be considered as a positive element. The European Parliament firmly believes that smooth mobility of people is one of the pillars of EU cooperation with its neighbours but also an essential element to build up mutual trust and economic prosperity. We also believe that it is the ordinary citizens of our partner countries who are often deprived from access to the EU, if such agreements are not in power, and this is why we have been very supportive of starting and implementing visa facilitation agreements with all our neighbours. We most warmly look at this development and believe it will be a starting point for deepening cooperation on all levels.

The enhancement of the EU-Belarus contacts would strengthen relations and increase mutual trust both on political level and in the people-to-people contacts. The full use of the Eastern Partnership instrument will bring stability and prosperity on the European continent and will contribute strengthening the sense of shared future and responsibility. ■



EVGENI KIRILOV

Co-President  
Euronest Parliamentary AssemblyMember  
European Parliament since 2007  
from the Group of the Progressive  
Alliance of Socialists and DemocratsMember  
EP Committees on Foreign Affairs,  
Security and Defence, Regional  
DevelopmentMember  
EP Delegations for relations with  
the countries from the South  
Caucasus and with the Former  
Yugoslav Republic of MacedoniaHonourable Member  
Parliamentary Assembly of the  
Council of Europe

QIMIAO FAN

# Belarus needs bold and comprehensive reforms to achieve sustainable growth

Expert article • 1458

**B**elarus faces unique challenges, but also opportunities to accelerate and deepen structural reforms to spur sustained growth. The economy did well until the 2008 global economic crisis unfolded. Between 2000 and 2008, Belarus grew at an impressive annual rate of around 8 percent. This high growth helped reduce poverty rapidly from 47 percent in 2000 to less than 5 percent in 2008. During that period, Belarus benefited from strong economic growth in its main trading partners, high global commodity prices, and access to underpriced energy imports from Russia.

The situation deteriorated sharply with the onset of the 2008/2009 economic crisis and has since shown only modest signs of recovery. Macroeconomic imbalances emerged, including a large and unsustainable current account deficit, rising external and public debt, and persistent inflationary and exchange rate pressures. In 2011, these imbalances spiraled out of control and resulted in a severe balance of payment crisis. While tighter macroeconomic policies by the authorities restored tentative stability during 2012 and 2013, macroeconomic risks remain substantial.

The macroeconomic difficulties of the past years are an expression of deeper structural challenges in the economy. Three developments stand out in this regard. First, Belarus has become more dependent on energy trade: minerals (including crude oil and natural gas at below world prices from Russia) accounted for 38 percent of total imports while mineral exports, mainly refined oil products, accounted for 36 percent of total exports in 2012. While energy trade has helped economic growth, it has also exposed Belarus to risks associated with volatility in commodity prices and outcome of the annual negotiation of import prices with Russia. Second, productivity growth in non-energy sectors has been stagnating. This is especially true for the large state-owned sector which accounts for more than half of Belarus' GDP and two thirds of employment. Detailed analysis carried out by the World Bank has shown that state-owned enterprises not only have lower productivity, but their productivity also increased at a slower pace than comparable private sector enterprises. Third, Belarus has suffered from a loss in competitiveness. Rapid growth in real wages has routinely outpaced growth in labor productivity, creating cost pressures and undermining competitiveness. These internal cost pressures were compounded by high inflation and appreciation of the real exchange rate.

Reigniting sustainable growth in Belarus will require bold and comprehensive reforms. First and foremost, sound macroeconomic management continues to be critical. The global outlook remains weak, especially for emerging markets. Recent global market jitters triggered by prospective tightening of monetary policy in the US are likely to raise the cost of and constrain access to external liquidity for emerging markets, including Belarus. Given its challenging external

position, Belarus' macroeconomic policies should aim to prevent further deterioration of its balance of payments. Exchange rate flexibility and tight fiscal and monetary policies, including containment of credit growth, are all essential to avoid a renewed bout of macroeconomic instability. Second, comprehensive structural reforms are needed to revive and sustain productivity-led growth. Remaining price distortions should be eliminated. Reduction of enterprise subsidies, restructuring and ultimately privatization would strengthen market incentives and competition and help allocate resources more efficiently in the economy. Closer integration into the global economy, including membership in the World Trade Organization and diversification of exports, especially of non-energy exports, would also make Belarusian economy more resilient to economic shocks. Finally, further improvement in the investment climate and better protection of private property rights would facilitate development of a more dynamic private sector. The Belarusian authorities are moving in this direction. The joint action plan by the Government and National Bank of Belarus adopted in October 2013 contains important reform measures, including monetary and credit policies, privatization, price deregulation, utility tariff reform and establishment of a competition framework.

These reforms are not easy, but necessary for Belarus to secure future growth and prosperity. While reforms can be gradual, they need to be comprehensive. Ultimately, they would need to reorient the role of the State from heavy direct intervention in the economy to that of creating an enabling environment for private sector-led growth. Belarus has many of the ingredients to develop into a dynamic high income economy: an excellent location in the center of Europe, a skilled and disciplined workforce and good infrastructure. Whether or not Belarus will reach its potential will depend on its ability to move forward on structural reforms. ■



QIMIAO FAN

Country Director for Belarus,  
Moldova and Ukraine  
The World Bank



MAIRA MORA

# EU-Belarus – necessary partnership

Expert article • 1459

**E**conomic cooperation between Belarus and the EU has rich history and even greater potential. Regardless, I believe, transient political tensions, trade and investment cooperation has been steadily growing over past decades. The EU has always been pragmatic while building economic links with its Eastern neighbours, inevitably involving Belarus as key partner due to the country's geographic position, historical belonging to the European family and promising anticipations of full-fledged association. Belarus is European and has always been European. One look at the map is enough to understand why our cooperation is indeed needful.

Economic cooperation, which is generated and promoted much less by politicians, but by mutual interests of simple people and companies, is advancing despite frictions in the parallel political universe. Evidences to it are some impressive statistics. For instance, Belarus is world leader by number of Schengen visas per capita. This is, besides other, a striking indicator of our close economic and cultural ties.

Turning to some more traditional indicators, it is important to emphasize that the EU is one of the biggest investors in the Belarusian economy ensuring at periods up to half of all investment in the country. The EU is as well stable second largest trade partner of Belarus, challenging the 1st place with the Russian Federation. Main positions of the EU export are machines and equipment, being an important source of modernisation of the Belarusian economy. Traditionally Belarus exports mostly primary goods (mineral, chemical, base metal products), but the share of ICT services, logistics, engineering is growing.

At the same time it would be realistic to highlight challenges. Just as performance of Belarusian companies is often affected by developments on the EU market, including through consequences of financial crisis, Belarusian economy could largely benefit from the EU experience in transiting to market economy, privatisation and liberalisation policies.

Knowing that, it would be legitimate to ask, what is the EU precisely doing to support market economy transition and intensify economic relations with Belarus? Besides traditional trade and investment promotion, a lot of efforts are concentrated to deliver EU technical expertise and advice where it is needed through cooperation programmes.

EU development aid in Belarus combines various assistance programmes from which Belarusian people and companies benefit. Strategically, support to private sector development and market economy has always been our priority in the country. To this end the EU advances numerous aid programmes on different levels – from

promotion of green economy to culture, which becomes increasingly important for the economy.

We support private sector development through Eastern Partnership regional programmes designed to bridge SMEs in the EU and in the Eastern neighbouring countries. Together with our partners from EBRD we provide technical assistance and consultancy to most active local enterprises helping them to adapt to demands of the free market economy. All these measures are complemented by promotion of public-private partnership initiatives. In this sense, knowing that the share of private sector in Belarus being limited to about 30% of country's GDP, it is increasingly important for the EU to promote the role of SMEs in the economy as main growth driver.

The EU also works a lot on the regulatory level, financing large quality support programmes. This should allow facilitating EU market access for Belarusian producers by adjusting local regulatory, technical and administrative requirements to the EU standards.

Regional and local economic development remains as well on top of the EU cooperation agenda for Belarus. We believe that local actors

must be involved to promote and achieve good governance, sustainable development and inclusive growth. In Belarus the EU promotes these principles through the programme "Support to regional and local development in Belarus" (RELOAD).

The idea behind these at first glance isolated facts and figures is simple. Belarus is a European nation. In this sense, cooperation between the EU and Belarus is indispensable. Its people, its economy and policies are integral part of the European landscape. While progress is needed on the political level, it is obvious that continuous intensification of contacts among people and companies already leads to significant mutual gains. Moreover, constant widening of economic relations and people-to-people contacts, that are expected to progress even more with the visa facilitation measures currently being discussed, is perfect vehicle for advancing inherent universal values of democracy. Inevitable further development of economic relations will bring us even closer, creating the basis for deeper integration. Taking into account rather modest actual level of exchanges, one can only imagine the potential. ■

Belarus is European and  
has always been European.  
One look at the map is  
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our cooperation is indeed  
needful.

MAIRA MORA

Ambassador  
Head of Delegation  
Delegation of the European  
Union to Belarus

FRANCIS DELAEY

# Unleashing Belarus' potential

Expert article • 1460

With street names like Lenin and Karl Max, it is easy to portray Belarus as the last soviet bulwark. Few outsiders realize that the country has in fact a small but thriving private sector. Minsk is home to swanky restaurants that would not look out of place in London or New York. Belarusian IT companies and manufacturers successfully compete across the globe, underscoring the tremendous potential of the country and its people.

The economy is, nevertheless, dominated by the state which accounts for 70% of GDP and employs two thirds of the labor force. Cheap energy from Russia, a favorable external environment and strong domestic demand (bolstered by an expansionary fiscal and monetary policy), enabled Belarus to accomplish impressive feats over the past decade: annual growth averaged 7.1%, absolute poverty declined from 30 to 4.6% and its ranking on the Human Development Index tops that of other CIS countries.

The self-induced balance of payment crisis of 2011 exposed the limits of this state-dominated model and its dependence on Russia. Wage increases and monetary loosening in the run-up to the 2010 presidential elections led to a rapid widening of the current account balance and a loss of central bank reserves. In May 2011, the central bank devalued the Belarusian ruble by 56% against the dollar. Simultaneously, the authorities introduced price, export and currency controls which disproportionately affected the private sector. Low levels of international reserves prevented the central bank from supporting the new exchange rate. In October 2011 the authorities conducted a further devaluation to unify the multiple exchange rates that had emerged. Inflation peaked at almost 110% year-on-year.

Support from Russia and the Russia-led EurAsEc Anti-Crisis Fund enabled the authorities to stabilize the economy towards the end of 2011. The devaluation briefly boosted exports in 2012 but the price advantage quickly eroded. External imbalances reemerged in 2013. The slowdown in Russia and the drop in potash prices following the break-up of the Belaruskali-Uralkali cartel caused a sharp decline in exports. Wage increases and directed lending fueled imports and inflation. By the end of the year central bank reserves had dropped to US\$6.6 billion, less than 2 months of imports. These developments combined with approximately US\$3.2 billion in external debt repayments in 2014 paint a precarious picture.

Russia has offered a US\$2 billion intergovernmental bail-out loan at a fixed interest rate of 4%. The central bank received the first tranche of US\$440 million on January 4, 2014. The extradition of Vladislav Baumgartner, the head of Uralkali who was detained in Minsk in August 2013, paves the way for a possible resurrection of the potash cartel. The authorities are also in discussions with Rosneft to increase its stake in Mozyr Oil Refinery, one of Belarus' most profitable companies. Likewise they are considering selling a stake in MZKT, the manufacturer of the long-wheelbase chassis used for

the transportation of Russian intercontinental ballistic missiles. These measures will provide some temporary respite at the price of ever growing dependence on Russia.

Belarus' reoccurring macroeconomic imbalances are caused by its state-driven model and exacerbated by the political business cycle. Despite the government's modernization agenda, productivity growth is stagnating in the state-owned sector. To maintain popular support especially in the run-up to important elections, the authorities try to stimulate the economy and raise domestic living standards by increasing real wages. This erodes the country's competitiveness, hampers exports while fuelling imports and puts pressure on the exchange rate. Reluctance to allow a gradual depreciation increases the risk of a brusque devaluation in the longer term. The recent 20% devaluation in Kazakhstan may create a domino effect in Russia and Belarus with which it forms a customs union.

To break this vicious circle, the authorities need to transform the economy. Presidential Directive No. 4 outlined an ambitious reform program to support private sector development. Following an initial wave of reforms in 2010 that led to an improvement in the World Bank's Doing Business rating, momentum was lost during the 2011 crisis. The authorities now need to resume and deepen structural reforms to reduce the role of the state in the economy. Among others they need to commercialize and privatize state enterprises, pursue WTO accession and streamline the legal and regulatory environment to support private sector development. These measures would unleash Belarus' undeniable potential and allow its hidden champions to emerge. ■

The views expressed in this article are those of the author and do not necessarily reflect views or policy of the EBRD.

FRANCIS DELAEY

Head  
Minsk Resident Office  
EBRD

ALEXANDER OSTROVSKY

# Eurasian integration – benefits for European businesses

Expert article • 1461

**T**he Customs Union and the Common Economic Space between Russia, Belarus and Kazakhstan represent two elements of probably the most ambitious regional project launched on the post-Soviet area since 1991.

Eurasian Development Bank (EDB) analysts have assessed that the Eurasian integration has certain economic prospects, and according to their estimates the macroeconomic impact of the integration within the framework of the Common Economic Space (CES) is likely to ensure an annual increase of Russia's GDP by USD 75 billion, Belarus - USD 14 billion and Kazakhstan – USD 13 billion (in 2010 prices) by 2030. Indeed, the economic impact will depend on whether all kinds of risks (economic, political, force majeure, etc.) are successfully minimized.

The Eurasian economic integration has reached a qualitatively new level over the past three years. The Custom Union has become operational since January 1, 2010. In 2011, the entire package of 17 basic CES treaties was ratified by the member states, and on January 1, 2012 the treaties came into force. The Eurasian Economic Commission—a supranational body that is in charge of all integration processes—started functioning as of February 1, 2012. Currently, the preparation of a systematic international treaty, targeting the creation of the Eurasian Economic Union by January 1, 2015, is underway.

Belarus agreed to the creation of the Union within the framework of the Customs Union and then the Common Economic Space for it considers the integration as an important factor of its dynamic socio-economic development. And its participation yields results: abolition of export duties on oil and import customs duties, natural gas prices linked to Russia's domestic price level, uniform customs tariff, unified customs regulation and customs procedures, unified trade regime with third countries, coordinated technical regulation policy, cancellation of internal border control, arrangement of conditions for growth in trade between the three countries.

The CES provides common economic infrastructure and regulation procedures, coordinated tax, monetary and customs policies, free movement of goods, capital, services and labour force, thereby inducing the volume of the member states' mutual trade turnover and the flow of transit traffic.

The three member states will conduct the coordinated macroeconomic policy based on unified principles and rules of competition, and shall apply common approaches to industry and agriculture support as well as to the public procurement.

From European producers' point of view, the CES is a huge consumer market. The success of the integration project aroused interest of such countries as Vietnam, New Zealand in the establishment of a free trade regime with the Customs Union. India, Israel and members of the European Free Trade Association also expressed their interest in assessing the potential merits of closer cooperation with the CES.

As an integration unit, the CES is open for the participation of other states and supranational formations that share the goals of the association and are ready to undertake the required commitments.

Finally, what are the benefits for European businesses? Belarus is becoming more investment-attractive and increasing its selling points in terms of trade prospects.

The additional opportunities that open up to external parties and concerned businesses include:

1. The freedom of movement of both domestic goods and goods of third countries due to:
  - abolition of customs duties and unification of customs procedures;
  - uniform rules for technical regulation, veterinary and phytosanitary measures application (i.e. businesses and manufacturers do not have to "adjust" specifically to the requirements of each particular market);
  - reduction of all forms of internal border control (except for passport control at the Russian-Kazakh border).
2. Unified customs tariff and non-tariff regulation in trade with third countries protects the interests of domestic producers including JSVs and other forms of foreign capital enterprises.
3. Technological equipment, primary commodities and materials imported for investment projects shall be exempt from import duties (as long as such commodities and materials are not produced by the CU member states).
4. Goods imported from third countries as a contribution to the equity capital are subject to tariff exemption.
5. The CES is purported to create a level playing field for economic entities operating on the territories of the three countries to foster fair competition within the framework of the common market.

It is worth noting that external investors will be provided an unimpeded access to the common market of goods and services of the three member states accounting for approximately 170 mln consumers. The non-discrimination principle is enshrined in the CES legal framework. This applies especially to meeting the needs of the member states in primary commodities, including fuel and energy resources, in particular, its free (unobstructed) transportation.

All in all, why Belarus? The point is that the shortest transportation routes from Europe to the Asia-Pacific region transit across the country; the infrastructure of the Belarusian-Polish border area hosts significant overload and storage facilities ensuring the optimal supply patterns, while the expansion of the logistics network is underway. ■

ALEXANDER OSTROVSKY  
Ambassador of Belarus to Finland

SERGEY V. ABLAMEYKO

# Belarusian-Finnish cooperation in education and science – case of BSU

Expert article • 1462

**B**elarusian State University belongs to a highly internationalized university community and traditionally puts a great attention to cooperation with foreign partners both at inter-university level and within international projects framework. A special attention is paid toward Nordic countries and in particular Finland due to the fact that in both Belarus and Finland higher education plays a significant role in society and the national innovation systems. In common with other countries with highly developed higher education sector, both countries develop enhancement-oriented quality assurance systems. With all that said one should believe that both BSU and Finnish universities would benefit either from bilateral cooperation or joint educational and research projects.

Much has been already done in this direction. As of the end of 2013 one can see results achieved as well as new fields to discover, new opportunities to unleash and new mechanisms of further cooperation to develop.

For today the major part of links between two countries has been established within EU Programmes and joint projects implemented within their framework.

Ample opportunities for exchange visits to University of Turku and Oulu University for BSU students, academics and staff are opened within three joint projects launched in 2011-2012 within Erasmus Mundus Action 2 Programme. Several successful joint researches were conducted within these projects.

Overall data on student exchanges with Finland demonstrates interest shown by BSU students for visiting Finnish HEIs. A good example of high interest BSU has toward studies in Finland is recent statistics of BMU-MID and MID projects grant completions: University of Turku is the most wanted university in the consortia.

Another major cooperation framework is the EU Tempus Programme. Currently the SUCSID project "Inter-universities Start-Up Centers for Students' Innovations Development and Promotion" is implemented opening up an opportunity for cooperation with Tampere University of Technology and, above all, sharing experience with its advice and support service for the entrepreneurship and innovations "Talli", as well as with Finnish network of association supporting start-up businesses "New Enterprise Agencies".

A promising cooperation mechanism with Finland is provided by the Finnish Centre for International Mobility CIMO. Thus, BASERCAN project (Baltic Sea Region Caucasus Network) which is coordinated by Aleksanteri Institute of the University of Helsinki enables a dozen of BSU staff members and students to pursue study visits to Helsinki.

As of October 2013 BSU has become a member of the Baltic Sea Region University Network (BSRUN). However BSU had already had some joint events within the network, as for example the international conference "University – Business Cooperation" held at BSU in October 2011.

Scientific and research activities are also given great attention in cooperation between two countries. One of the major tools for such cooperation is the EU's Seventh Framework Programme for Research. Several research visits to Finnish research institutions were conducted by Belarusian specialists and researchers, as well as a number of joint scientific projects were launched. Among them are the EU FP7 CACOMEL project and the EU FP7 NET4SOCIETY project connecting the University of Eastern Finland and BSU.

Belarus and Finland are also working together in the sphere of nuclear safety. In 2011 a number of specialists and young chemists had been trained in Finland at the Radiation and Nuclear Safety Authority bringing new links with Posiva Research Company, Energy Company Teollisuuden Voima Oyj.

BSU students and academic staff also participate in various international conferences, seminars and other activities hosted by Finnish HEIs during 2011-2013. Our young researchers and academics visited Jyväskylä University, Research Park of Turku, Aleksanteri Institute, Finnish Institute of International Relations, Institute of Russia and Eastern Europe, Department of Eastern Europe and Central Asia in the Ministry of Foreign Affairs, Åbo Akademi University and many others.

Such a long list of Finnish HEIs having links with BSU can be seen as one more proof of interest shown by both countries toward joint work and cooperation. Staying in the global world the education systems of both Belarus and Finland face similar challenges, develop close and interconnected fields of research and work in the same direction toward enhancing the quality of education. In this light, sharing best practices, enriching experience through joint work and enhancing student, academic and staff mobility between BSU and Finnish HEIs with no doubt contribute to development of both sides. ■



SERGEY V. ABLAMEYKO

Rector  
Belarusian State University

Doctor of Science

Academician  
National Academy of Science  
Belarus



JUHA HÄMÄLÄINEN &amp; JUUSO VIITIKKO

# Belarus – developing economy

Expert article • 1463

**D**uring 2001-08 Belarus experienced strong economic growth. GDP grew on average by 8.3 percent annually – higher growth than Europe or Central Asia experienced. Global economic crisis of 2008-09 hit Belarus through decrease in export demand (mostly in the CIS region and especially in Russia) dropping growth to 0.2 percent. Rapid but short-lived economic recovery in 2010 was fuelled by expansionary fiscal and monetary policy leading to high inflation. Belarusian rubel (BYR) lost nearly 70 percent of its value relative to US Dollar. In 2011 inflation of the currency was 109 percent. Tightening fiscal and monetary policy through 2012 lowered inflation and improvement in trade deficit eased pressure on current account. By continuing tight fiscal and monetary policy in 2013, Belarus has managed to restore macroeconomic stability.

## Energy efficiency an economic and political instrument

New favorable trade agreement with Russia in 2012 was an important instrument to improve energy trade balance and to boost Belarus's economy. Still over 90 percent of electricity is generated from natural gas of which most is imported from Russia making energy a powerful tool in politics for Russia. Energy efficiency is a major part of Belarus's 2020 plan including most of the renewable energy sources: wind power, biogas, solar energy, and hydropower. Most interesting projects are around hydropower and biogas. Belarus has a vast network of rivers in which small hydropower plants can be applied. The country also has large mock and forest resources, and a large agricultural industry from which biogas generation could benefit from. Also waste management is relative undeveloped and has open possibilities for more modern solutions.

## The customs union and free economic zones

Customs union between Belarus, Kazakhstan, and Russia (established in 2010 and activated in 2011) is seen to have a positive influence on the country's economic growth. According to logistics companies operating in the region, the customs union has been successful and transportations between the countries "is like operating inside one single country". Queues in the border stations are short, unlike occasionally on the border between Finland and Russia. The customs union with Belarus's quality metal workshop sector offers an interesting alternative for Finnish manufacturers in their Russian business. Further economic growth is also hoped to be gained through tax incentives. Free economic zones (FEZ), located in cities of Minsk, Gomel, Vitebsk, Grodno, Brest and Mogilev, aim to offer favorable conditions for business through preferential taxation. FEZ residents' tax incentives include 50 percent discount on VAT on import substitution goods, no real estate tax, no tax on purchasing vehicles and exempt from profit tax the first five years after which a 50 percent discount is applied. Other benefits include customs duty exemptions on listed raw materials. Addition to FEZs Belarus

## World class in information technology

Similar tax incentives, offered in FEZs, have proved to be successful in the IT sector. Today Belarus is seen as one of the most important IT-outsourcing countries in the world. Hi-Tech Park (HTP) continues to offer tax incentives for its member companies. The resident companies are exempt from all corporate taxes and customs duties. Unlike FEZs, HTP is a virtual park. As FEZs member companies have to locate within defined geographic area, HTP member companies can enjoy it's the legal conditions within whole territory of Belarus. A member status can be applied if a company deals with engineering and software development. Belarus's competitiveness in IT is not only based in tax incentives but also on skilful IT developers. Belarusian programmers have a chance to get trained at the training centers of IBM, Lotus, Microsoft, and other large IT companies. The country also has a large presence of small and midsize software companies that actively do business across country borders. Roughly 95 percent of all IT services are sold to companies outside Belarus, including Finland. Well-developed software industry is seen in the country as strong basis for hardware development. Belarusian government is currently hoping to attract interest of foreign companies and investors to the sector.

## Trade and economic relations to Finland

A mutual knowledge about business projects has been the reason for growing trade. Finnish export to Belarus was approximately EUR 110 million in 2012.

For many years Belarus has climbed up in rank in World Bank's "Doing Business" report. It currently holds position 58 out of 185 countries. The country has been noted among leading countries in IT-outsourcing and high technology services. ■



JUHA HÄMÄLÄINEN

Chairman  
Finnish Belarusian Chamber of  
Commerce  
Finland



JUUSO VIITIKKO

Director  
Finnish Belarusian Chamber of  
Commerce  
Finland



ANTTI O.K. NIEMINEN

# Kiilto Oy – first steps in the adhesives business in Belarus

Expert article • 1464

**K**iilto Oy has been active in the adhesive business in Belarus for almost five years. The idea of establishing a subsidiary in Belarus was originally conceived by the then sales manager of Kiilto-Klei Russia. He was born and grown in Belarus and wanted to move back from Moscow to his homeland. After carrying out a small market research, he succeeded in convincing the management of Kiilto Oy to establish a subsidiary in Minsk, the capital of Belarus. IOOO Kiilto-Klei was established on 25th of April, 2009.

From the outset, IOOO Kiilto-Klei has served industrial customers and construction companies in Belarus. Industrial companies include wood working manufacturers producing products such as furniture, parquet floors, windows and doors. Additionally, important customers are found within sandwich element manufacturers producing high quality components for the transportation industry. Business in the construction sector is limited mainly to the parquet floor assemblers.

Seen the business from here, some interesting observations can be made. In many industries in Belarus, the most modern Western technology does not exist yet. However, there are companies who have invested in modern machinery, but it is typical that the new production lines do not run effectively. In many cases the new equipment have been placed in the existing, old buildings and hence, production lay outs are ineffective. There is a great interest in the latest technology and I believe that the current problems will be solved in the near future, when companies start to make real profit.

In Belarus big companies are typically state owned companies, but there are small size private owned enterprises, too. For a foreign, unknown company it is easier to start the business with a local small-size company. Top directors from the buyer and seller would meet and open the doors to the customer's production and purchasing departments. In general, without their effort, it is hard for a new sales manager to enter into the business with the client. Big companies are often huge and the business is done mainly by agents, who know the customers and actually control the business. Without the help of these agents it is extremely difficult to start any kind of co-operation with big customers.

There are also major cultural differences in the Finnish and Belarusian way of doing business. For example, business corruption is common in Belarus. It is very similar to the corruption that can be found in Russia and other CIS countries. The tradition of corruption is so deep-rooted that it is hard to weed out in the near future. Western companies try to avoid corruption and often use local agents to conduct the business with a final customer.

Finding professional sales directors and managers can also be difficult. Typically, the most important incentive is bonus salary and it does not always motivate to build long lasting customer relations, but rather short term benefits. A high turnover of sale managers is a

burden, especially when selling products that require a good knowledge of production, materials and products' technical features. Commitment to the company that pays regular monthly salary is low.

Directors and top managers in Belarus often lack good, Western style management skills. This is also a cultural aspect and it is not always seen as a big problem within local organizations. Softer management style is often appreciated in talks, but in practice, harsher attitude is still needed and expected. Support from the directors or top managers to individual sales managers is non-existent or of low value. Company's financial records are typically not open to everyone, so, result based bonus systems are not used or at least, they are not recommended by the local directors.

Yes, there are clear differences in the way of making business in Finland and in Belarus. But this applies to business relations between any two countries, for example, between Finland and Sweden as well as between Belarus and Russia. Differences exist and it is a fact. The real art of making business is to overcome the difficulties between cultures and practices, and build a business relationship that satisfies both parties.

Personally, I warmly encourage Finnish companies to start business in Belarus.

Minsk is an extremely beautiful and safe city with many magnificent buildings. It is in many ways a far more modern city than any city in Finland and after the world championships in ice hockey, hopefully, more open, too. The countryside in Belarus is also beautiful and it resembles Finnish countryside with vast areas of forests and fields. Roads are good and traffic is smooth, which is totally different compared to the roads and traffic in Russia. People that I have met in Belarus are very friendly and they like to work with western companies, although English language is not that common. However, I believe it will change in the near future, when the new generation enters the business life. ■

Personally, I warmly encourage Finnish companies to start business in Belarus.



ANTTI O.K. NIEMINEN

Ph.D., Adjunct Professor  
Managing Director  
Kiilto Oy  
Finland

TOPI PAANANEN &amp; ANDREI NAUMOVICH

# Peikko Group and Belarus

Expert article • 1465

**P**eikko Group Corporation is a leading global supplier of concrete connections and composite structures. Peikko's innovative solutions make the customers' building process faster, easier and more reliable. Peikko has subsidiaries in 30 countries in Asia-Pacific, Europe, the Middle East, and North America, with manufacturing operations in 9 countries. Peikko is a family-owned and run company with over 1000 professionals and a net sales amounting to 125 M€ in 2013.

Peikko started to get interested in the Belarus market back in 2009. At that time there was already some in-direct sales to the market through Peikko's Lithuanian customers. Generally Peikko understood that the building programs initiated by the Belarus government will eventually lead to the modernization of country's Soviet style precasting industry. Based on the discussions with modern precast machinery manufacturers, Peikko understood that major investments will take place in a matter of years.

With regard to project flows from Lithuania, Belarus had declared that it allowed the use of Eurocodes when developing investment projects, not only the Soviet SNIP norms. This allowed Peikko's Lithuanian customers to develop projects in Belarus, also helped by the fact that the projects had exemption from customs payments and VAT. Therefore, it was technically already OK to use Peikko's products in these projects, and thus create a good reference base for the future business of Peikko.

After recovering from the recession, Peikko decided to establish an own sales team in Belarus in summer 2010. A legal entity Peikko BelRus FLLC was established in December 2010, with a local Managing Director recruited for the company at the same time. As always for Peikko, it takes time to train the personnel, visit customers and build such a trust among them that business can start. Belarus was not any exception to the rule, and the first orders were received only after 8 months of operation, in August 2011. The year 2011 faced also some difficulties from the total market performance point of view, e.g. the fact that the currency devalued more than 300% did not help the concept of importing products from outside Belarus. The products used on the Belarus market are mainly manufactured in Peikko's factories in Slovakia and Lithuania.

During the first operating year the market was investigated by hundreds of visits to structural designers, developers and precast factories. It was understood that there were no existing norms or design codes for Peikko's products, and therefore Peikko created official documents together with the government project institute NIPTIS, with the intention to guide the use of Peikko's products. There were almost 50 small seminars organized throughout the country where the NIPTIS recommendations were presented.

Relatively soon Peikko selected two product focus areas in Belarus: products related to industrial concrete flooring applications and products related to cast-in-situ punching reinforcement solutions. For the latter product area Peikko decided to also use Belarusian rebar material for manufacturing and selling Punching Shear Reinforcement (PSB) studs in Belarus. Both product areas were sold to private developers and constructors; companies which were eager to use new, efficient and proven solutions.

This above focus was relatively different compared to Peikko's normal focus in other countries. However, it was quite soon understood that the government owned precast element factories were lacking motivation for innovation, despite recent investments in some new machinery.

Peikko Belrus FLLC team was only one single person during 2011 and H1/2012. This time was more or less a time when Peikko was establishing itself on the market and finding its strategy for the future. Once the right path was found, a sales assistant/bookkeeper was hired in autumn 2012 and soon after a Sales Manager was recruited. With the decision to go into manufacturing in summer 2013, a Chief Engineer was recruited after undergoing an extensive training program at Peikko's Slovakian factory. During January-February 2014 several workers will be recruited to start the manufacturing activities.

Peikko's Belarus office is situated in Minsk. The new manufacturing operations will be located in rented premises 70 kilometers from Minsk in a small city of Stowbcy. Peikko intends to use the President Degree #6, which gives special tax and customer clearance conditions for new production companies in small city areas.

Peikko usually develops its business by step-by-step principle and this is also the case with the Belorussian operations. The manufacturing will start in January 2014 in small-scale with limited personnel and machinery only. However, Peikko's objective is to grow the business to some 5-8 M€ annual level in 2014-2016. The manufacturing operations are essential for Belorussian clients, but also products will be delivered also to Russia and Kazakhstan due to favorable customs union conditions. In Peikko's view the Belorussian cost structure will also remain favorable for the foreseeable future.

All in all, Peikko is in its starting phase in Belarus. Nevertheless, Peikko is very confident of the Belorussian market and Peikko's capabilities to grow its own operations. ■

**TOPI PAANANEN**

CEO

Peikko Group Corporation  
Finland**ANDREI NAUMOVICH**Managing Director  
Peikko BelRus FLLC  
Belarus

PAVEL LASCHENKO

# Business environment in Belarus today

Expert article • 1466

**B**elarus is not the most well-known country in the world. Many people even think that Belarus is a part of Russia and not a separate sovereign state. However, those keen on science and history know that Belarus is the Radzivil princes' ancestral land and the native land of Zhores Alferov, Nobel Prize Winner in physics. Art connoisseurs certainly know such great artist as Mark Shagal, who also comes from Belarus. It should be recalled that BelAZ, the world's largest mining dump truck with a capacity of 450 tons, is assembled in Belarus. Moreover, most of the sport lovers definitely know the name of Darya Domracheva, three-time Olympic champion of Sochi.

The location of Belarus in the heart of the European continent has predetermined its being a transport and logistic hub. Belarus is an active proponent of various types of economic integration in the post-Soviet area: it joined the Customs Union with Russia and Kazakhstan in July of 2010, and later, in January 2012, it became a member of the Common Economic Space; soon (in 2015), it will join the Eurasian Economic Union. At the same time, relations with Europe are quite strained due to a number of reasons which in many cases are related to the "political issue" in Belarus and hence are not always clear and transparent either for a man in the street or for a businessman. To a certain extent, this gave rise to a situation when most of the direct foreign investments, M&A deals, as well as participation in privatization stem from Russia.

The facts show that Belarus has achieved the following at the macro-economic level:

- Political and social stability in the country in the last 20 years
- A fairly predictable economic policy pursued by both the Government and the National Bank
- All the six Belarusian regions' gradual, sustainable and uniform economic and infrastructural development
- One of the lowest unemployment rates in Europe and the CIS (less than 1%)
- A large labor market with a supply of a well-educated, relatively inexpensive and qualified workforce relating to production
- Ongoing reforms designed to alleviate the tax burden (personal income tax of 12% and profits tax of 18% for legal entities are one of the lowest in the world) and facilitate tax administration.

The weak points of doing business in Belarus are not always evident, but they are well-known to foreign companies which are already in business in Belarus.

According to the survey of foreign companies operating in Belarus, which was conducted by the Foreign Investment Advisory Council under the Council of Ministers of Belarus, there are three main factors which restrain direct foreign investments: (1) the language barrier due to the poor knowledge of foreign languages by the workforce, including mid-level managers; (2) acute shortage of senior executives with a "market-oriented" mentality and knowledge of finance and economic principles; (3) unpredictability of changes in legislation.

The small share of the private sector (less than 30% of the GDP), mainly the share of small and medium-sized enterprises, reveals another weakness of the investment climate in Belarus, i.e., the rather low level of the "entrepreneurial spirit" and the private initiatives in the business environment. One can also mention lack of autonomy in decision-making by most Belarusian officials, who prefer to make decisions through collegial and authoritative bodies, as one of the constraining factors for investor attraction.

The objective weak points of the current business climate in Belarus include the poor progress in corporate governance in general and, consequently, the inefficiency and non-transparency of state enterprises and corporate groups, which account for 80% of Belarusian economy. Moreover, the state took no steps to introduce mass privatization in the last 20 years despite the efforts of the IMF and the World Bank. Privatization in Belarus doesn't have system-based character and every deal requires the President's approval. The absence of a certain privatization and investment attraction strategy affects the Government's and the National Bank's capability to make commitments and deliver the respective messages to the world business community, which in general substantially restrains the attraction of investments.

Nevertheless, new business opportunities for investors, such as the growth of public-private partnership, should be mentioned. Now the state encourages, in every possible way greenfield to come to small and medium-sized towns in the area of IT, agriculture, pharmaceuticals, alternative energy, and energy saving by providing individual customs and tax privileges.

The obvious threats that the Belarusian economy has faced in recent years include the gradual loss of the traditional markets in Russia due to Russia's accession to the WTO in 2012. The "potassium" scandal in 2013 and the limited oil supplies from Russia contributed significantly to the export shortfall and led to a negative external trade balance (\$1.724 billion by the end of 2013), forcing the Government to increase foreign borrowings. That can be countered only by greater labor productivity, the modernization of a number of industries, and the growth of the export potential. Obviously, the state sector of Belarus cannot do that alone. ■



PAVEL LASCHENKO

Country Managing Partner for Belarus  
Ernst & Young  
Belarus

HALINA SHMARLOUSKAYA

# External economic potential of the Republic of Belarus – economic outlook

Expert article • 1467

**T**he Republic of Belarus has a small open economy, which due to the limited resource and capacity of the domestic market depends on the development of foreign economic relations. It occupies 0.15% of the world territory (207.6 km<sup>2</sup>) and ranks the 6th place among the CIS (after Russia, Kazakhstan, Ukraine, Uzbekistan, Turkmenistan) and the 13th among the European countries.

Thereby, foreign policy, formed in the country, is aimed at creating of favorable conditions for the expansion of reproduction and international exchange, regulation of economic relations with other countries. It is implemented in the form of an export-oriented and import-substituting economic model, which involves:

- development of export potential and increase in the volume of export on the basis of export-oriented industries;
- selection of the industries with the greatest import-substituting potential;
- involvement in the investment processes that allows to improve the competitiveness of goods and services;
- participation in the integration groups.

The Republic of Belarus obtains necessary foreign trade potential, which is influenced by the following factors: favorable economic and geographical position; diversified industrial complex; industries manufacturing competitive products in the domestic and foreign markets; availability of major oil and gas pipelines, the development of industrial infrastructure, high quality of human capital, low labor costs; effective system of personnel training, the development of scientific and technical potential; vast land resources, favorable climatic conditions for fodder, flax, potato, large reserves of renewable forest resources, fresh water (surface and underground), potassium salt, clay, cement and other raw materials for the construction materials industry; cultural and historical values, the attractiveness of natural landscapes.

Industry is the basis of foreign economic potential of Belarus. Significant export potential is concentrated in the petrochemical and chemical, timber, woodworking and pulp and paper industry, construction materials, light industry, and agro industrial complex. In recent years it has strengthened due to the export of services. In the structure of exports of services predominate transport services (67%), travel, computer and information services, communication services, construction services. However, the existing structure of exports of services indicates the development of labor-intensive services: transport, mainly trucking, construction and communications.

The development of foreign trade plays a key role in the country.

In 2013 the volume of foreign trade in goods was \$ 79.6 bn., export amounted to \$ 36.8 bn., and import reached \$42.8 bn. The world export share of the Republic of Belarus is 0.18 %.

The export products of Belarus are diversified and number more than 1000 items. Among the most significant exported goods it is possible to mark out the following: petroleum products, potash and nitrogen fertilizers, metal-rolls, tractors, trucks, agricultural equipment, buses, trolleybuses and trams, road-building equipment, technological and electrical equipment, refrigerators and freezers, micro-electronics and optical devices, chemical fibers and thread, yarns caprolactam, tires, wood and woodworks, furniture, clothes, shoes, dairy and meat products, and sugar.

The Government takes measures in order to diversify export geographically and structurally. Thus, along with the strengthening of the position of the Republic of Belarus in the CIS, Asia, America, Africa and Oceania country expands its Belarusian exports to new countries, which led to the development of new markets (Venezuela, Vietnam, India, South Korea, etc.); increases the volume and range of supplies and services in the developed markets of several countries; enlarges the list of goods, in the production of which Belarus has the greatest comparative advantage in the global market.

At the same time in the Republic of Belarus takes place a gradual transformation from a strategy of creating trade-intermediary networks to the formation of transnational product-investment model of economic relations, based on the activation of export of the Belarusian capital and aimed at expanding commodity distribution networks and deepening cooperative ties with foreign firms through the creation of branches of domestic enterprise, joint ventures (JVs), assembly plants, etc.

This creates opportunities for shift of national resources to manufacture of high-tech and science-consuming products; updating of international specialization of the country; creating of the prerequisites for securing of positions in the markets of these countries; penetration to new adjacent national and regional markets (Latin America – Venezuela, Brazil, Argentina, Bolivia and Cuba; in Asia-Pacific countries – China, India, Iran, Vietnam; in Africa – Nigeria in the west, Ethiopia in the east; the Gulf countries).

Diplomatic relations between the Republic of Belarus and the Republic of Finland were established in 1992. There is a development of such forms of cooperation as trade, investment cooperation in the fields of education, international cooperation, regional development programs by the Council of the Baltic Sea States.

Thus, Belarus is diversifying export. Over 60% of it is ferrous metal-rolls, furs, raw timber, ethylene polymers, outerwear, tex-

Industry  
is the basis of  
foreign economic  
potential  
of Belarus.

Expert article • 1467

tiles, cyclic hydrocarbons, trailers and semi-trailers, cement. However, the level of trade and economic cooperation between the Republic of Belarus and the Republic of Finland is not high enough.

The most promising directions of Belarusian-Finnish trade-economic and investment cooperation are following: advanced telecommunications technology, metallurgy, in particular, the polymeric coating metals; wood and paper industries. ■

**HALINA SHMARLOUSKAYA**

Doctor of Economics  
Professor of Economics

Dean  
School of International Economic Relations  
Belarus State Economic University  
Belarus

Pan-European Institute

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IRINA YEREMEYEVA

# EU-Belarus relations – threats and political opportunities

Expert article • 1468

**E**U-Belarus relations have suffered from stagnation for many years. The European Union has criticized Belarus for violations of electoral standards, human rights, for crackdowns, and some other issues. Because of this, the EU has been applying different kinds of restrictive measures toward Belarus.

The process of the ratification of the Partnership and Cooperation Agreement was suspended in 1997, and later, the EU banned access to its territory for all Belarusian senior state officials. Relations between Belarus and the EU started to improve in 2007 after Belarus had some issues dealing with Russia. From that moment on, the Belarusian government made a decision to broaden its relationship and develop economic cooperation with the EU. The European Commission, in turn, offered to Belarusian authorities to start the process of democratic transformation. One year later, Brussels suspended the visa sanctions previously imposed on Belarusian officials, and invited Belarus to join the Eastern Partnership. However, this cooperation didn't last long and didn't bring any significant results.

In 2010 there was a new phase of deterioration of bilateral cooperation when EU-Belarus relations were frozen in response to the political situation in the country: the violations of electoral standards in Belarus' presidential elections and the ensuing crackdown on civil society, political opposition and independent media. Moreover, it worsened in February 2012, when the EU expanded its sanctions against Belarus over its alleged human rights violations, after which Minsk ordered the Polish ambassador and EU envoy to leave the country. All EU member state ambassadors were temporarily withdrawn in response. The ties were further strained by an incident in July 2012 in which a Swedish light aircraft dropped hundreds of teddy bears bearing pro-democracy slogans over Belarus.

Currently, the European Union is committed to a policy of critical engagement towards Belarus, through:

- restrictive measures, targeted against those people who are responsible for the violations of electoral standards and human rights, as well as those who support the regime or drawing benefit from it
- sectoral dialogues and within the multilateral track of the Eastern Partnership initiative
- support to civil society and victims of repression
- an offer to start negotiations on visa facilitation and readmission agreements to the benefit of the public at large
- dialogues with Belarusian authorities on the reforms needed to modernize the country and on the potential for developing relations with the European Union (including possible European financial support).

This year, Belarus expressed a desire to improve its strained ties with the European Union. It's a good aspiration for Belarusian society to move towards the West and get mutual benefits from this cooperation. Indeed, the lack of legal, political and institutional links between the EU and Belarus limit interaction to issues of mutual interest (such as energy security or border control). Moreover, the EU countries are the greatest partners of the Belarus exports. At the same time, Belarus is an important transit corridor between the East and the West, providing about 30 percent of deliveries of Russian gas and almost 50 percent of deliveries of Russian oil to the EU countries. Belarus is an important transport artery through which automobile and tracks from more than 100 million tons of cargo annually follows. All this makes this cooperation very important, but there is a lot of work to do to make it fruitful.

For further bilateral relations' development, some steps need to be taken by both sides. The EU needs to involve Belarusian officials in all kinds of dialogues, summits, roundtables, and other activities more productively, and in this case, there are more chances in the future to implement the reform proposals elaborated within meeting's framework. Belarus has never become a full participant of the Eastern Partnership initiative and, as a result, feels discriminated against the EU. Belarus can't participate in the bilateral dimension of the Eastern

Partnership, since the policy covers Belarus only partially. Belarus was excluded from the interparliamentary cooperation (Euronest) because of the non-recognition of the Belarusian parliament, though e.g. Azerbaijani MPs participated in the Euronest regardless of electoral problems in their country. Belarus wasn't represented at the highest political level at the Eastern Partnership summits, contrary to other partner countries.

In addition, further efforts should be made in negotiating a Schengen visa facilitation agreement with Belarus. Academic exchange and scholarship programs should also be expanded. Both measures would have the clear goal of expanding the circle of Belarusians with a personal or business interest in enjoying closer ties with the EU.

The upcoming privatization process of state assets can be seen as an opportunity for the EU, especially for European businesses. Europe could offer its technical assistance to the Belarusian government. Technical or expert cooperation in areas of mutual interest has been a relatively consistent feature of cross-border/regional cooperation. Projects supporting the preservation of the environment and sustainable development in Belarus, already with some ongoing cooperation, would be an excellent way to foster cooperation and knowledge transfer. Similarly, projects focusing on energy efficiency and renewable sources – also with relevant examples underway – should also be fostered as a way to introduce European advanced technology, to

For further bilateral relations' development, some steps need to be taken by both sides.

limit Russia's leverage on the energy-dependent Belarus and, even as importantly, to generate business opportunities and quality jobs inside the European Union.

Belarus, in turn, needs to stop the harassment of civil society, the political opposition, and independent media for relationship improvement. The European Union's policy is absolutely clear. As soon as there are no political prisoners and they are acquitted (under Belarusian law, anyone who acts on behalf of an unregistered organization could face a two-year prison term), the European Union will be ready

to build up steady bilateral relations with Belarus and discuss the reform of the program and the support of the modernization of Belarus according to the Belarusian people's aspirations.

Belarus can still use the opportunity to get benefits from the European Union and give grounds to look at this country more positively. The Belarusian authorities just need to take the necessary steps and bring Belarus back to the heart of Europe, where it belongs. The more openness to political and economic reforms, the more engagement Belarusians will find from the European Union. ■

**IRINA YEREMEYEVA**

Dr., Associate Professor  
Belarusian State Economic University  
Belarus

SIERŻ NAŪRODSKI &amp; ULADZIMIR VALETKA

# Securities market in Belarus – still undisclosed potential

Expert article • 1469

In early 90s, banking systems of post-communist countries served as the only source of capital within each disturbed economy. Emerging stock exchanges were considered as powerful tool for capital accumulation during privatization and effective allocation of limited resources. To make it work, governments pursued remarkably different policies as a response to deep macroeconomic imbalances.

In Belarus, the stock exchange was registered in 1992. But in fact, it has gained meaningful development speed only in 2008, leaving sixteen previous years behind as symbol of uncertainty and lost opportunities.

As a result, by the end of 2012 total size of securities market in Belarus traded at stock exchange (consisting of stock market capitalization, issues of public debt securities, financial sector bonds, and corporate sector bonds) was only 17% of GDP, or 4 times less comparing to average of CEE/CIS countries.

The structure of securities market in Belarus has got diversified shape only in 2010, when both financial and corporate sector bonds outstanding increased from much below 1% of GDP to close to average regional values. In 2012 banking and corporate sector bonds outstanding were equal to 5.8% and 5.1% of GDP respectively.

The weakest parts of securities market of Belarus remain those of equity and public debt. Stock market capitalization in 2012 was 0.7% of GDP, while the same CEE/CIS average value was 28% of GDP. Even having been on its peak in 2010 (6.7% of GDP), stock market capitalization in Belarus was lower than in any of its neighbours'.

Public debt securities in Belarus until 2008 used to be the major part of securities market giving over 9/10th of its value. In 2012 it was as big as financial and corporate sector bonds markets (5,6% of GDP), but still few times less than regional average.

The size of securities market in Belarus is not competitive in the region and does not stimulate capital formation. Indicators of liquidity of Belarusian shares market are also not optimistic. The value of shares traded as percentage of GDP, in 2012 in Belarus was 0.3%, much lower than in Russia (36%) and Poland (14%), but comparable to Ukraine (0.7%) and Lithuania (0.4%). In terms of turnover ratio (value of stock traded as percentage of market capitalization), Belarus in 2012 ended up high with 21%, loosing to only Russia (88%), Hungary (55%), Poland (43%), and Czech Republic (27%). But that achievement is rather questionable as being possible mainly due to decrease of stock market capitalization in 2012.

Given the described parameters of Belarusian securities market, its role in investment allocation could hardly be significant. Indeed, excessive reliance on internal funds in Belarus is a sign of potentially inefficient financial intermediation. According to World Bank's Enterprise Survey 2013, proportion of investments financed internally is 78% in Belarus compared to 61% in Eastern Europe & Central Asia (EECA). The difference in share of investments financed by equity or stock sales is even more striking: 1.1% in Belarus compared to 8.7% in EECA.

The decennial trend of decreasing return from high investment in Belarus (on average 32% of GDP during last 10 years) signals for existing systemic imbalances induced among others by the underdevelopment of securities market. The inversed incremental capital output ratio (calculated by dividing the rate of GDP growth by the investment-to-GDP ratio) dropped from 0.45% in 2004 to 0.2% on average for subsequent years.

Knowing that securities markets support efficient allocation of capital, why in Belarus its contribution to investment financing is so modest? There is a number of structural reasons. Domination of state-owned banks as a main source of investment creates channels of uncompetitive privileged access to capital for SOEs and consecutive high cost of capital for private firms. "On-the-paper" privatization changes only legal form of SOEs, without creating new ownership and stimulating corporate governance. Remained soft budget constraints allow delaying of restructuring. The situation when more investment is needed to produce an extra unit of output is likely to continue in Belarus without introducing market principles of public programs approving. In addition, the policy of excess employment and administrative wage targeting contributes to distortion in functional distribution of incomes: the share of labour incomes in GDP is growing despite shrinking of markets.

All in one, it generates a kind of institutional trap as diminished return to investment depresses investors' demand for strong financial institutions and creates incentives to capital drain. So the risk of slowing of economy's diversification and increasing of existing imbalances becomes higher.

Therefore, the securities market development in Belarus is a major precondition of sustainable economic growth and should be in the spotlight of comprehensive structural reforms aimed to improve resource allocation. ■



SIERŻ NAŪRODSKI

President  
CASE Belarus  
Belarus



ULADZIMIR VALETKA

CASE Fellow  
CASE Belarus  
Belarus

ALEKSEI BYKOV &amp; ANNA ZEZULKINA

# Measuring risks of regional development – case of Belarus

Expert article • 1470

**T**he purpose of research carrying out is revealing risk factors specifying the threats of decreasing in level of social and economic development of Belarusian regions. The period of retrospective data analysis covers 6 years – from 2006 to 2011. Belarusian economy has suffered two crises during this period including recession of 2009 caused by the world crisis, and also currency crisis in 2011 when the Belarusian rouble was devaluated in 2,5 times. Challenges which the Republic of Belarus has been recently faced with include the consequences of the world crisis, the increase of commodity prices, problems of trade balance deficit and external debt growth.

The prospective trends of Belarusian economy development lead to changes of the regional structure of economy, resulting in expansion of new businesses based on processing of local resources, rendering services of logistics and tourism in the regions. On the other hand, less competitive regional companies with high material and energy consumption, based on obsolete technologies, will leave the market. Future prosperity of particular Belarusian regions is also dependent on the world commodity prices because a number of the largest companies specializing in oil refining, chemical industry, metallurgy, and forming the most part of Belarusian exports, are located in regions.

As a rule, any strategy of regional development based on estimation of conditions of regional economy and such conditions are usually measured in static, relying on actual information. We hold to dynamic approach to regional economy estimations, taking into account future possible changes of social and economic indexes of the region economy, including future risks of regional growth such as: fluctuations of leading economic development indicators, surplus or deficit of labor resources in the region, insufficient level development of transport, power and social infrastructure.

By administrative structure, the Republic of Belarus includes the capital city of Minsk and 6 areas (oblasts) with 5 oblast centers, 7 towns of oblast submission and 118 administrative districts. According to the previously provided researches, the differences in social and economic development among administrative districts in one oblast are always considerably bigger, than the difference between any oblasts. Therefore we explored cities, towns and administrative districts as regions in our research. The sum of enterprises' net profits and population incomes per capita has been chosen as a general indicator specifying the level of social and economic development within every region.

At first we estimated the level of regional social and economic development for riskless conditions using actual data, and then we realized risk assessment. We measured risk using standard deviation of chosen general indicator of regional social and economic development computed for every region in every year. Next we subtracted three standard deviations from the average general indicator for every region and found levels of regional social and economic development in conditions of high risk. As a result we have got two ratings of 131 Belarusian regions: one for riskless conditions, another – for high risk conditions.

Administrative districts, where the largest enterprises of oil refining, chemical industry, metallurgy, motor vehicle industry are located,

occupied the top lines of rating composed for riskless conditions. The cities as well as administrative districts with highly developed agriculture and services occupy the top lines of rating composed for high risk conditions. Regions where only several large industrial enterprises, especially related to rough sector, are located occupied the bottom lines of rating composed for high risk conditions.

Our finding is the following. Regions with highly diversified economy and balanced development of various industries and services, large and small businesses, are more resistant to risks. Conversely, regions where one or two largest enterprises are located are characterized by extremely high risk, even if these enterprises are successful but based on material and energy resources extraction and refining.

The following measures counteracting risks of regional development are offered:

- to promote founding small and medium-sized businesses in regions with a high risk level;
- to ensure labor mobility between towns and small districts based on inter-regional public transport;
- to create regional clusters located on several nearby administrative districts round the largest enterprises.

As a possible background for cluster creation we consider such phenomenon as a complementary character of regions. If economic indicators of several administrative districts located side-by-side change eventually in an opposite phase then such districts are considered as complementary. On the contrary, if economic indicators of neighboring districts change eventually one-way, unidirectional then such regions are not complementary. We have revealed a group of potentially complementary regions located round the city of Novopolotsk, in the north of Belarus. These regions are match for future cluster that assists in minimizing potential risks of regional development. ■

**ALEKSEI BYKOV**

Dr. in Economics, Professor  
Belarus State Economic University  
Belarus

**ANNA ZEZULKINA**

Belarus State Economic University  
Belarus

ELENA A. DOSTANKO

# Belarusian-Finnish relations

Expert article • 1471

**D**iplomatic relations between the Republic of Belarus and the Republic of Finland were established on February 26, 1992. In May of the same year, President Mauno Henrik Koivisto visited Belarus. The opening ceremony of the Embassy of the Republic of Belarus in the Republic of Finland was held on February 22, 2012 to commemorate in the 20th anniversary of establishing diplomatic relations. Currently, the bilateral cooperation is legislated by seven international treaties and a number of ministerial documents. Political dialogue is maintained by regular exchange of reciprocal visits between ministries and agencies, parliaments, business communities of the two countries.

Belarus and Finland are dedicated to balanced cooperation in international organizations, the most significant results are achieved in collaboration on the environmental issues. There is also bilateral interest in expanding contacts on security issues, in particular on border security and border control.

Today bilateral cooperation is represented by a number of commercial initiatives established within the last decade. Finland-Belarus Society (2002), Finland-Belarus Trade Association (2009), Finnish-Belarusian Chamber of Commerce, Finnish-Belarusian Joint Committee on International Road communication were established. The representative of the Belarusian Chamber of Commerce and Industry in Finland was appointed (2012). Finland-Belarus Business Forums are conducted (the Fourth is forthcoming on April 8, 2014). Currently direct flights are open between Minsk and Helsinki.

The cooperation between Belarus and Finland has been developing since the Soviet era. In the 1960s-1980s, Finland was one of the key trade partners importing from the Belarusian SSR tractors, trucks, machinery, glassworks, diesel, petrol, flax and hemp fibers, wood for the production of coal, cotton textile, musical instruments, cutlery sets. The Belarusian SSR imported garments and fabric, technological equipment. Nowadays Belarus exports oil, salt, furs, iron and non-alloy steel products, the imports ranges from lead and lead products to flour, starch, corn, and cereals, knitted fabric, the wood pulp and dyes. In January-November 2013 the bilateral trade amounted to 216.0 million U.S. dollars (28th place among the trade partners of the Republic of Belarus, 84.4% over the same period in 2012), exports decreased by 11.7% and amounted to 98.9 million dollars. Imports from Finland amounted to 117.0 million (81.3%). The foreign trade balance was negative - \$ 18.1 million. In January-September 2013 Finland invested in Belarus \$ 9.2 million (almost 100% - direct investment).

On the territory of Belarus there are 25 companies with Finnish capital (compared to only 12 in 2008). Among successful examples of such cooperation are: three projects for the construction of mini-thermal power plants implemented by Finnish company «MW Power Oy» in Škloŭ, Zhlobin, Pruzany: company «Olvi» acquired a majority share of «Lidskoe pivo» (Lida Beer): the construction of shopping malls «OMA» by Finnish concern «Kesko»: modernization of Gomel ice cream factory by Finnish company «Ingman Ice Cream». A representative office of glassworks «Neman» was opened in Helsinki in 2013. Energy sector, industry, engineering, construction and construction materials, tourism as well as the scope of hi-tech and startup are prospective areas for further cooperation.

In Belarus we keep the memory of the outstanding Finnish artist, sculpture and architect Alexander Ahola-Valo (Finnish - Aleksanteri Ahola, 1900 -1997), who received his artistic education in Vitebsk at Yehuda Pen art school where Marc Chagall and Kazimir Malevich were his teachers. Alexander Ahola-Valo entered the history of Belarusian culture (so called Belarusian renaissance period, 1919-1930s) as a creator of pavilion «Stories of Suffering Humanity» in Minsk (1930-1941), the artistic designer of many famous classical works of Belarusian literature of 1921-1930 and the author of engraving «Dazhinki» (1928).

The cultural cooperation was developing since the Soviet era. A number of works by Belarusian authors were translated into Finnish, Belarusian movies were demonstrated in Finland. Today both countries continue to seek humanitarian and cultural cooperation. Agreements are signed between the National Academies of Sciences of Belarus and Finland (1995), as well as between 6 universities of Belarus with 7 universities of Finland; a number of Belarusian-Finnish research projects are implemented. Every year Belarusian students of Swedish, Finnish and Norwegian languages celebrate holiday Mid-sommar. «Olvi» foundation provides scholarships to talented Belarusian students. Partnership relations between the cities Baranovichi and Heinola are established (1978). Art industry demonstrates another successful example of cultural connections between two countries. In 2012, Finnish-Russian-Belarusian movie «Role» and «I will not return» (Russia, Finland, Estonia, Belarus) were filmed. In 2013 Finnish director Dome Karukoski visited Museum of History of Belarusian Cinema, Helsinki documentary film festival DocPoint was presented during annual Belarusian cinema festival «Listapad», Finnish band «The Rasmus» performed in Minsk. ■

ELENA A. DOSTANKO

Director

Center for International Studies

Belarusian State University

Belarus



HANNA SMITH

# Eurasian integration as a defining factor in Belarusian foreign policy

Expert article • 1472

The events in Ukraine and the winter Olympics in Sochi in Russia have occupied the news headlines in recent weeks. As usual Belarus has been left in the background. Many have noted, however, that the Belarusian president Lukashenka has played ice hockey with president Putin in Sochi prior to the Olympic games. That already shows, without deeper analysis, how important Russia is for Belarus. Russia is Belorussia's number one foreign policy priority.

From the Russia-Belarus relationship there emerge several paths that Belarus is following. The most important and noteworthy is the Eurasian integration process. There are several projects going on simultaneously. The Eurasian Customs Union (ECU) of Russia, Belarus and Kazakhstan has been working since 2010 and since 2012 the three countries have been a single economic space. The ECU has been widely portrayed as a Russian tool to reintegrate the post-Soviet countries. However from the Belarusian perspective the ECU project can also strengthen Belarusia's negotiating position vis a vis Russia. Russia is the "big brother" for Belarus. The two countries do have a complicated relationship but both seem to need each other. For Belarus a formal multilateral framework is a positive thing. It provides the country with more international weight and if Russia wants to get the benefits of multilateral cooperation, it has to now and then bend towards the basic principle of multilateralism – compromise.

The ECU was intended to be transformed into the Eurasian Union (EU) in 2015 along with new members such as Armenia and Kyrgyzstan. However the latest developments also relating to events in Ukraine suggest that first the ECU will become the Eurasian Economic Union (EEU), toning down the political aspects and emphasizing the economic. While the ECU process lacks a deeper political dimension the Union between Russia and Belarus covers for that. In December 2013 at the meeting of the Supreme State Council, with presidents Putin and Lukashenka present, 14 Union state documents were signed. The documents cover implementing a military technical cooperation program, enhancing cooperation against corruption, cooperation in ensuring international information security, a budget for 2014, joint events to celebrate the 70th anniversary of Victory in the Great Patriotic War in 2015 and a program of coordinated foreign policy efforts for 2014-2015. This was a significant event from the Belarusian point of view. Russia and Belarus have similar interests in Asia, Africa and South America. With a coordinated effort in foreign policy the global reach of both countries can increase. At the same time this provides both with room to play in cooperation with the EU and China. Russia and Belarus share similar views on China, namely that interest based cooperation is good but too close a dependency on China should be avoided.

The third important project in the Eurasian space is the Collective Security Treaty Organization (CSTO). This is first and foremost a security alliance and so the cooperation is military cooperation. The cooperation includes creation of the collective air force, special opera-

tions forces, and equipping the collective rapid deployment forces. The Belarusian role in aid for Tajikistan in protecting the Tajik-Afghan border is highly interesting, since this could even result in a Belarusian troop deployment. For Lukashenka to get real military action would boost his image on the domestic scene ahead of the presidential elections this year.

Often in Belarusian international politics there is a rapprochement with the EU and Europe. This seemed to be the case also this time. The Vilnius EaP summit at the end of 2013 opened up a possibility to form a negotiating agenda and talks about visa facilitation with the EU. Despite the positive signs, about 12-15% of the Belarusian population would like to move permanently to abroad given the chance, and most of those are well educated and the part of population with some wealth. This indicates that those people do not have much trust in their country's ability to change significantly. Real progress between Belarus and the EU requires some changes in Belarusian domestic politics. Furthermore if the Belarusian leadership continues to put first and foremost its foreign policy priority on the Eurasian integration processes, it will shadow bilateral progress between the EU and Belarus.

In the shadows of Russia supported by Eurasian integration it can be argued that Belarus punches a bit above its abilities and strength in the international arena, especially in Asia, Africa and South America. Belarusia's place should be in Europe, but the growing division between the EU members looking for cooperation based on norms, and the post-Soviet countries looking for areas of shared interests, will also make the Belarusian path towards the EU countries complicated. ■



**HANNA SMITH**  
Researcher  
Aleksanteri Institute  
University of Helsinki  
Finland

ULADZIMIR ROUDA

# The crisis of the Belarusian economic model

Expert article • 1473

**T**he essence of the *Belarusian economic model* – as referred to by the Belarusian economists employed in public institutions – lies in ensuring high rates of economic growth and maintaining a relatively high level of the labor force prosperity, with no major structural reforms of the economy – remnants of the state socialist era. The World Bank experts called it a *Belarusian paradox*.<sup>1</sup>

The pace of economic growth in Belarus has been impressive indeed, especially compared to that of the neighboring states, that chose to follow the path of radical market reforms and at the beginning of the process had to forget about the standard of living to ensure high competitiveness of their economies. The World Bank experts distinguish two stages of growth with different reasons behind them. During the first phase that lasted from 1996 to 2000, GDP grew by 77.4%, or by 6.6% annually<sup>2</sup>. At that time a special relationship between the Republic of Belarus and the Russian Federation played a crucial role. Belarus succeeded in maintaining a better industrial production capacity than its eastern neighbor. Customs border between the two countries was virtually abolished as a result of the so-called Treaty on the Union. Belarusian goods got significant price benefits in the Russian market. They were not of the best quality, but cost significantly less due to cheaper labor force in Belarus.

By the time Russian economic growth resumed after the 1998 default, the Belarusian industry had already taken a stable position in the Russian Federation. Economic growth in Belarus was also due to increasing the existing industrial capacities rather than creating new ones – thus, large investment was not required. Obtaining Russian economic preferences was followed by substantial Belarusian concessions in military and political spheres and even by Lukashenko's pledge to merge the two countries.

During the second stage of economic growth in Belarus in 2001–2009 some new factors contributed to maintaining positive economic dynamics. A radical improvement of the external economic situation played a crucial role in the economic growth<sup>3</sup>. The increase of the world oil prices has brought us direct benefits as a result of the expanded export of petroleum products to the EU, as well as indirect benefits – due to the acceleration of economic development in Russia and the increased demand on its market. Besides oil, prices rose for metal products and potash fertilizers, which make up the bulk of Belarusian export. The demand in the home market increased as a result of the state efforts in the payment sphere. One point was missing to make the economic growth permanent and stable: structural market reforms, including property privatization. Only these measures are able to ensure economic efficiency – without them, any head of state has to rely on market factors, which are present today and gone

tomorrow. Unfortunately, Alexander Lukashenko and his advisors have missed the right time to introduce such reforms in a favorable economic environment. This happened because economy became secondary to politics in Belarus. With president fearing to become unpopular and lose power, populism is not an extreme measure but a systemic phenomenon.

In 2009 the repercussions of the global financial crisis had an impact on the Belarusian economy. It consisted mainly in the reduction of cost and demand for certain Belarusian export commodities (petroleum products, ferrous metals, potash fertilizers, engineering products), dollar and euro fluctuations and the rise of prices for credit resources in the domestic market. In 2009 the national debt in Belarus doubled, having reached 7.9 billion dollars. With this measure the authorities tried to compensate for the negative trade balance and to provide the growth of GDP in 2010 – the year of the following presidential elections.

The unprecedented financial crisis came a year after the presidential election in 2011. It was provoked by the decision of the president to devalue the Belarusian ruble by 56%! This measure hit ordinary people, especially the most vulnerable groups of the population – retirees, for example (the most faithful Lukashenko's electorate). In 2011 the inflation rate in the country reached 209 % of that in 2010. The national currency rate fell by more than 2.5. In terms of the average salary Belarus was among the poorest countries in Europe.<sup>4</sup>

In 2012 the economic situation somewhat stabilized due to the influx of lending from Russia, after Lukashenko and Putin had signed an agreement on Belarus becoming part of the Customs Union with Russia and Kazakhstan, which in 2015 should become the Eurasian Economic Union – an economic, political and military alternative to the European Union. This agreement is extremely unprofitable for Belarus, as it breaks all the economic links with the EU – a much more powerful entity to the west of its borders.

However, all the actions of the Belarusian authorities do not guarantee that economic stagnation will come to a close. According to the 2013 results, there only was a minimum GDP growth – by 0.9%, while industrial production fell by 4.8%, exports of goods and services declined dramatically – by 16.9% and the rate of inflation remained high at 13.8%.<sup>5</sup>

The high imbalance of net exports is of particular concern as it can lead to yet another devaluation of the Belarusian ruble.

Thus, the *Belarusian economic model* has demonstrated its complete failure in the era of stagnation, which could drag on for years to come, if there is no change of the state power. ■

ULADZIMIR ROUDA

Ph.D. in Political Science

Professor

European Humanities University

Lithuania

<sup>1</sup> See: Economic Country Memorandum for Belarus. N.Y.: The World Bank, 2005, p. 25.

<sup>2</sup> Ibid.

<sup>3</sup> Belarusian GDP reached a record 10% of growth in 2005 and 2008. It didn't reach this figure in other years.

<sup>4</sup> Romanchuk R. Belarus: Economic Results 2011 <http://www.belaruspartisan.org/bp-forte/?news=118021>

<sup>5</sup> See: National Statistics Committee data of the National Bank of the Republic of Belarus, December 2013.

DZMITRY KRUK

# Belarus – a chance to convert past mistakes into new advantages

Expert article • 1474

**B**elarus is often treated as 'terra incognita' even among its neighbors. Indeed, the development path of the country is severely distinct from other CEE countries. In terms of long-term growth, majority of transition countries during the last decade fell back upon the growth of TFP (total factor productivity, i.e. technology and efficiency) being accompanied with reasonable growth of capital. Belarus, in turn, secured its growth almost entirely due to accumulation of capital, while productivity gains were extremely poor, especially in tradable sector. This path became possible due to high returns on capital given a number of benefits delivered by Russia (cheap gas and oil, preferential access to the Russian market). This easy path made Belarus one of the growth leaders in 2000-s in the CEE. However, this growth was accompanied by rapidly progressing external imbalances, as low productivity transformed into low competitiveness of tradable Belarusian goods.

By the end of the decade, enjoyment of easy solutions played a low-down trick with the country: it has mostly exhausted the potential of capital-based growth strategy, although the expectations and habits of high growth preserved. Furthermore, in late 2008 and 2009 Belarus found itself involved into global contagion, which contributed to poor output growth. That time the authorities actually ignored structural challenges and resorted to active expansionary policies. Hence, since 2010 a skewness towards short-term priorities explicitly visualized in government's policy. In other words, the government tried to struggle against structural problems by means of short-term tools. The repercussions followed in 2011: Belarus suffered large-scale currency crisis (the devaluation of national currency was roughly triple). The devaluation formed a 'grace-period' for Belarus, as the price competitiveness of its exports improved, which was a chance to recover a balance between long-term and short-term priorities. But previous mistakes of expansionary policy were repeated, and nowadays the country again finds itself facing a fragility of macroeconomic equilibrium with the background of lack of growth potential. However, today's situation is different from those in 2011 in some aspects.

First, the currency crisis has generated a huge wave of inflation expectations and radically reduced credibility to monetary policy (visualized in extremely high share of deposits nominated in foreign currency, which is fluctuating around 60%). Actually, monetary policy fell into a trap and its effectiveness is extremely low. A similar story is about fiscal policy, which has not much room for a maneuver.

Second, the currency crisis triggered long-lasting cyclical recession. The lack of room and low effectiveness of economic policy tools cannot provide enough stimuli to the economy to pass this stage till now.

Hence, at the first sight economic prospects for Belarus are really ugly: poor growth potential, cyclical recession, low effectiveness of economic policy, fragility of financial market, and progressing external imbalance. This perspective implies that macroeconomic adjustment is inevitable. External borrowing is the only solution that allows avoiding new macroeconomic adjustment until now. Recent trends at European emerging markets (capital outflows, weakening output growth and depreciations of exchange rates) sharpen the challenges.

Hence, most probably in near future the government will have to carry out such an adjustment. Otherwise, there are risks of automatic adjustment.

As strange as it might sound, from a broader perspective this new situation for Belarus presents a chance rather than a threat. Majority of CEE transition countries nowadays experience an impact of reduced growth potential (for them it is associated with the lack of capital) along with cyclical challenges. And in majority cases there is a trade-off between policies stimulating potential growth

and those stimulating demand. As for Belarus, it has accumulated a stock of capital that would allow recovering its growth potential if the country can advance its productivity. However, the latter may be provided rather rapidly through institutional adjustments basing on the experience of the other CEE countries. In other words, the untapped potential of the past may generate growth even in a depressed CEE environment. And there is one more piece of good news. Such kind of policies simultaneously will enhance demand, while standard economic policies currently cannot do so. Hence, for Belarus there is little if any contradiction between short-term and long-term priorities. Moreover, the government shows some signs of readiness to such reforms. So, there is a chance for an ugly duckling to mature into a beautiful swan. ■

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DZMITRY KRUK

Researcher  
Belarusian Economic Research and  
Outreach Centre  
Belarus

GALINA GAVRILKO

# Integration on the territory of the former Soviet Union – a search for an optimum model

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The integration processes development on the territory of the former Soviet Union reflects the universal tendencies caused by economy development interests and other spheres of human activities, as well as the next round of globalization of political and economic processes in the modern world. The realization of essential geopolitical and economic interests of the countries-participants depends on the efficiency of co-operation of the states which use the opportunities of such formations as the CIS, EurAsEC, UBR.

Taking it into account, the Noncommercial Fund 'Heritage of Eurasia' has conducted the research 'The Perception of Integration Processes on the Territory of the Former Soviet Union by Experts and Leaders of Public Opinion', the main purpose of which was the identification of divergences and a common ground in different countries elite's views about the integration.

The experts' opinion concerning the integration development rates were different. There are two possible scenarios. The first one (which is supported by the majority of experts) — the "European" scenario of integration — assumes a gradual merger which will take about 50 years. The second scenario — "Integration breakthrough" — represents a "shock" option of integration within 5–10 years, directed on prevention "removing other centers of integration to peripheries within which their development will be organized in another way".

The expert community noted the following problems of integration: The absence of a clear integration idea of the states on the territory of the former Soviet Union. This problem is considered primary and defining by some experts. The absence of an accurate concept reduces integration processes participants' motivation for coordinated joint actions, induces to take the advantage of its position. It was offered to formulate the idea of integration either together, or on the basis of creation of "integration institute" as the decision.

Between the countries-participants of integration processes there were considerable distinctions in the level and rates of development, the lack of conceptual models of an effective integration. Lack of reasonable approaches to this problem and the existence of a number of alternative options of policy concerning the regions which are different in the development level (to wait when they join themselves, to exclude from the integration; to create helping programs, etc.) are noted. Attempts of an organizational solution within the lack of conceptual understanding are noted.

Insufficient understanding of the state interests by the political elite, the absence of a substantial state-formed idea (in this case, probably, only Kazakhstan can be seen as an exception). As a result there are no super subjective regulators, the actions of the states leaders in many respects are guided by political conjecture considerations. It makes a negotiation process instable: management change in one of the countries leads to the resumption of negotiations from scratch.

Discrepancy between existing organizational forms and a stage of integration process development. One of the most important organizational problems of integration is the inadequacy of a real process, a lack of a systematic vision of the events, timely estimates and feedback. The bureaucratic structure isn't capable to react to occurring changes adequately alone. More flexible organizational forms capable quickly to adapt for a very dynamic situation are necessary. Experts emphasized various aspects of this problem, important for the efficiency of the integration process.

Inconsistency of the integration process with directions and levels. As experts specify, the plurality of organizational forms, a selfish lobbying, the lack of the effective mechanism of coordination of economic, political, social and resource factors complicate the integration process.

Insufficient organization of integration parties: business communities, expert community, institutes of civil society. Forces which can push the authorities to treat the integration process more seriously can be both business, and a civil society. However, they are still insufficiently organized. According to experts, associations of the businessmen representing their interests in interaction with the authorities (as exactly they, but not the authorities, are really interested in an effective integration) are necessary.

Concerning integration associations structure experts incline to the necessity to concentrate efforts on the creation of a real integration association of the states which are at a comparable level of economic development. Belarus, Kazakhstan, Russia and Ukraine belong to this group, there is a possibility of voluntary accession of other states. The experts note that it is reasonable for Russia to correct a way of realization of its integration aspirations, to treat more respectfully the status of the partner countries, to recognize really their equality as parties of the interstate right at distinctions in scales and economic potential.

According to the experts' opinion, the economic integration where the leading part is assigned to business community has to become the main direction of efforts of all parties of the integration process. ■

GALINA GAVRILKO

Assistant Professor, Ph.D.

Department of International Economic Relations  
Belarusian State University  
Belarus

KARI LIUHTO

# How the Finnish firms view the Belarus business environment?

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**C**lose to 7,000 companies with foreign capital have been registered in Belarus by the beginning of 2013. Around 30-40 of these foreign firms have been founded by Finnish companies. The Finnish firms have invested nearly \$ 100 million in Belarus, and with this sum Finland stands as the sixteenth most active foreign investor in the country, representing approximately 1 % of the Belarus inward FDI stock. In October 2013, I interviewed a director of 10 Finnish firms operating in Belarus and asked their views on the Belarus business environment. The PEST analysis is used to describe their opinions on the Belarus business milieu. The main results can be summarised as follows:

## Political (P)

- Centralised rule and the authoritarian political system have created stability, but the leadership change may create major instability.
- The regulatory environment is clear but changes can be rapid and unpredictable.
- The administration works properly, though more slowly than in the developed West.
- Some deficiencies could be found in privatisation and public tenders.
- Finnish firms were generally pleased with the ownership rights.
- Finnish firms have not experienced immaterial property right violations in Belarus.
- The strategic benefits of the Customs Union are obvious, but on the operational level the Customs Union still needs further improvement.
- Political dispute between Belarus and Russia/the EU can create additional problems for the Finnish firms as well.
- The US blacklist on some Belarusian state-owned enterprises has created indirect problems for some of the Finnish firms.

## Economic (E)

- The Baltic States and Russia have offered a springboard for entering Belarus.
- The growth opportunities in Belarus are good, though the purchasing power of the middle class has deteriorated after the 2011 financial crisis.
- Belarus is a rather normal business environment, i.e. no major peculiarities related to competition, taxation, payment system, transportation and the legal system could be found.
- It is easy to find office space but a problem emerges with industrial premises.
- The Belarusian banks are seldom used as a source of finance.
- Repatriation of profits to Finland is not a problem, but prepayments abroad are not working well.
- Mandatory sales of a part of export revenues is a Belarusian peculiarity for the time being.
- Exchange rate risk of the Belarusian currency is obvious, and hence the hidden dollarisation of the economy has already begun.
- Subcontracting and outsourcing develop fast.

## Sociocultural (S)

- Recruitment of personnel is generally not a problem.
- Technological skills of local staff are good but managerial and internationalisation skills need considerable upgrading.
- Staff turnover is higher in Belarus than in the West, but it has not been a specific problem for Finnish firms.
- Salary differences are notable between white collar and blue collar workers.
- Trade unions do not present a problem, on the contrary, trade unions hinder progress more in Finland.
- Finland has a good national image and its goods are regarded as high-quality and its firms as reliable partners.
- Crime and corruption are not a specific problem.

## Technological (T)

- Technology transfer from Finland to Belarus works as the core of the technological base of the Belarus subsidiary.
- ICT systems are frequently imported from Finland, though the Belarusian and Russian ICT systems are also in use in Finnish firms.
- Technological breakthrough innovations in Belarus are rare.
- Belarus does not have an image of a high-tech country, which has prevented some Finnish firms from building R&D activities in the country.
- Customs fees of imported technology are not a problem.
- R&D cooperation with a Belarusian company gives an additional competitive advantage to a Finnish firm.

I would like to end this article by quoting a Finnish director, who stated about the Belarus business environment as follows: "We have been positively surprised." All the results of this survey will be presented at the IV Finland-Belarus Business Forum at the Turku School of Economics on 8.4.2014 (<http://www.utu.fi/en/units/tse/units/PEI/events/Pages/Belarus-Business-Forum.aspx>). The forum is free of charge for all the participants. ■

KARI LIUHTO

Professor, Director  
Pan-European Institute  
Turku School of Economics  
University of Turku  
Finland





# BALTIC RIM ECONOMIES

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