



IN THE BACKYARD OF EUROPE:
STATE CAPITALISM AND INTER-STATE INTEGRATION IN
RUSSIA AND BELARUS

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Abstract

As visitors to Belarus observe, thirteen years after the fall of the USSR, the country is a theme park of Communism: Lenin's statues stand intact, three central streets in Minsk bear the names of Marx, Engels and Lenin, and newly-weds traditionally lay flowers at World War II monuments. With so many heavy imprints of Sovietism in its image, it has become a custom in academic and policy analyses to ascribe Belarus' poor reform progress to the lack of organised national self-identification and to the reluctance to break off from the command past decisively, eloquently exploited by the political regime of Alexander Lukashenko, often named as 'the last dictator of Europe.' As this paper attempts to argue however, such categorising of the politico-economic change in the post-Soviet Belarus is misleading. Although the path-dependency on the command administration indeed remains significant in contemporary Belarus', the Belarussian state has managed to capitalise on this legacy. Two factors have been central to the resilience of the economy and a certain progress in the Belarussian transformation: the role of the state in organising and sustaining the economy; and the involvement of neighbouring Russia in shaping Belarus' nascent capitalist model. This paper discusses these issues, attempting to outline some tentative scenarios of the possible future co-existence of Belarus with the EU-25.

Keywords: Belarussian transformation process

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Introduction: command economy then and now

There are two major contrasting views on contemporary Belarus. As seen from the West, Belarus future is undermined by the legacy of its Soviet past: Russia's overwhelming dominance over social, political and economic terrain prevent the new Belarussian nation from reconciling its own trajectory of development in the new Europe; while the political line of the incumbent President Lukashenko does not allow the country to fully open up to the progressive, modernising influence of the West. Thus the so-called Westernisers (Belarussian nationalists chief among them) nurture memories that cast Belarus as a country apart from Russia almost from antiquity, and advocate a thoroughly European origin of their country. Others however, (the majority) in the elite and many in the officialdom rely on symbols that evolved throughout two centuries or so when Belarus and Russia lived side by side in a common home, first in the Russian empire and then in the USSR (Ioffe 2003: 1266). While the history of sovereign Belarus has been largely forgotten or forcefully erased for two centuries of Russia's dominance, the readily embraced russification of Belarus' politics, economy and society has produced profound and far-reaching effects.

Of the fifteen members of the former Soviet Union, Belarus was the only republic that had no revolutionary ambitions for independence from Russia. While, for example, the Baltic states and the neighbouring Ukraine had to fight Moscow to re-gain their independence, Belarus sovereignty was a gift quite unexpectedly presented to the country at the Belovezh meeting of 1991. More than a decade on, the national idea of sovereign Belarus remains feeble: nostalgia for the Soviet past has been more appealing to ordinary Belarussians than an uncertain future of their young independent country. At the state level, governmental efforts to build up the national identity, although increasingly prominent in the past few years, either remain shaky, or unconvincingly transform into governmental efforts to construct a system of state ideology in the context of a closely administered command-type political economy.

In a small open economy like that of Belarus, the importance of path-dependency on centralised administrative system should not be discounted. During the Soviet period, the lack of natural resources and the geopolitical position pre-determined Belarus' role as

a scientific outpost for the rest of the USSR. The republic was renowned for its high-quality research institutions and specialists. Also, particularly in the late Soviet years, most of the enterprises underwent significant modernisation, were re-equipped and oriented towards the production of competitive consumer goods. The stable socio-political and economic climate attracted labour from other Soviet republics. Politically, due to Belarus' position within the USSR and its close yet subordinate ties with the top echelons of the ruling CPSU, there has always been a patriarchal aspect to the centre-periphery relationship between Minsk and Moscow. From the Communist system, the nomenklatura and technocrats inherited not only their connections and power, but also their methods of rule. Contrary to the founding principles of the transition paradigm, these methods appeared perfectly compatible with the free market economy. Rather than destroying the old politico-economic structures, Communist elites have played a decisive role in transforming them into a new economy (Burbach et al. 1997: 137).

In building an *apparatus market*, the authorities in post-Soviet Belarus, rather than promoting the development of national industrial, financial or banking systems, were by and large reflecting the interests of Russian capital. As a result of the 1990s reforms, and particularly since the coming to power of A. Lukashenko in 1994, Belarus is governed by what the World Bank (2002) calls a 'non-competitive political regime'. Typically in such systems, leaders from the Soviet era tend to pursue economic stability while securing their dominance over the post-Soviet political system. They feared the opening to global market forces and the rise of oligarchs in partially reformed economies. Instead, they preferred to preserve key elements of the previous command system, to maintain the state's predominant role and to avoid many painful adjustment costs associated with reform. By adopting a strong interventionist bias, leaders like Lukashenko ensure their positions remain powerful. Trade unions, business associations, and other civil society groups that might represent broader social interests are either circumscribed or tied to the state. The depth of the economic reform is thus highly dependent on the political leader's preferences.

Thus on the one hand, it can be argued that in approaching the dilemma of 'shock therapy versus gradualism,' Belarus has opted for the latter. The indecisiveness of the ruling parties of the early 1990s to embark on radical structural changes was reinforced later by a strong presidential line to preserve the social stability and avoid the painful costs of radical privatisation and liberalisation. On the other hand however, political choices of the ruling elites in 1991-1995 were more *ad hoc* rather than planned thoroughly in advance. Up until now, it is large interventionist state spending that has been sustaining the economy, rather than a conscious gradualist design restructuring measures (Popov).

To what extent has such an approach to reform worked for Belarus? Against the background of other central and eastern European states (CEE), it seems that it has. Across CEE, the introduction of shock therapy reforms was followed by a decade-long recession that rivals that of the Great Depression of the 1930s in the West (Kolodko 2001). Eastern Europe is the also only part of the world where poverty levels actually have risen during the 1990s. In the economic and financial spheres, as Gowan (1995, 1996) documents, CEE's previous position between Soviet dominance and dependence on foreign capital is being replaced by an even greater degree of penetration of global megacorporations, many of which raise dependence on foreign finance, narrow the

channels for domestic economic regulation, widens the opportunities for capital speculations and depresses domestic producers.

Against this background, Belarus' careful approach to restructuring has protected the domestic producer from the potentially negative effects of a liberalised economy and foreign competition. In 1996, after a five-year decline, Belarus registered a 2.8% growth of GDP. That year was the start of the Belarusian 'economic miracle.' During 1996-2000, GDP grew by 35%, industrial production by 65% (Table 1). But along with the annual GDP growth of around 6.3%, prices were increasing by 116% per year. No other transition country has registered such high growth rates with high inflation (Chubrik 2001). In the following years, according to official records, impressive growth record has continued. In 2003, Belarus' GDP increased by 6.8%, while in the first half of 2004 it grew by a startling 10.3%.

Table 1. Macroeconomic Reform progress, 1990-2000

Country	Real GDP in 2000 (1990= 100) %	Average inflation (CPI), 1991-2000 %	EBRD transition rating, 1999	Government revenue to GDP, 1999 %
<i>CSB average</i>	<i>106</i>	<i>41</i>	<i>3.1</i>	<i>39</i>
Czech Rep	99	13	3.5	41
Hungary	109	20	3.7	42
Lithuania	68	88	3.2	32
Poland	147	26	3.5	43
Romania	83	102	2.8	32
<i>CIS average</i>	<i>62</i>	<i>185</i>	<i>2.3</i>	<i>24</i>
Belarus	89	344	1.6	42
Georgia	30	257	2.9	16
Kazakhstan	65	163	2.7	19
Russia	66	163	2.5	34
Ukraine	43	244	2.5	35
Uzbekistan	97	182	2.0	32

Source: World Bank 2002.

Table 2. Belarus in the world: economic and social indicators

2004 rank	Country	Annual growth GDP % 1992-2002	CPI change, 1990-2002	Electricity consumption per capita, 2001, kwt/hr	GDP per electricit y unit, 2001	CO2 emissions per capita, 2001, tons
1	Norway	3	2.2	29290	5.5	11.1
2	Sweden	2	1.8	17355	4	5.3
32	Czech r.	1.4	6.7	6368	3.2	11.6
36	Estonia	2.3	16.7	5777	2.8	11.7
37	Poland	4.2	21	3595	3.9	7.8
41	Lithuania	-0.3	22.7	3095	3.7	3.4
50	Latvia	0.2	21.7	2617	4.1	2.5
57	Russia	-2.4	75.2	6081	1.6	9.9
62	Belarus	0.2	258	3340	1.9	5.9
70	Ukraine	-6	116.7	3465	1.4	6.9
78	Kazakhstan	-0.7	45.6	3964	1.7	8.1
94	China	8.6	6.7	1139	4.2	2.2
113	Moldova	-6.9	18.5	1572	1.7	1.5

Source: UN Human *Development Report*, 2004.

The EBRD admits that gradualism has allowed Belarus to retain a large share of production capacity, to avoid a massive and drastic fall in output and social conditions. A balanced approach to market integration has also allowed Belarus to retain the structure of domestic industries, mainly oriented towards production of finished goods. Shock therapy measures would have destroyed this cushion, especially given that unlike Russia, Belarus does not have the luxury of abundant natural resources it could exploit.

Moreover, although the Belarussian economy is relatively closed in relation to the European market, and although the import ratio is much lower than that of its neighbours - Poland, Lithuania and Ukraine - the Belarussian economy is quite open: exports account for more than 50% of the GDP. Export connections with Russia allow Belarus to capitalise on the 'economies of scale' effect. It ensures cost reduction and thus facilitates Belarus' activity on western markets. Belaz, for example, is currently the world's third-ranked producer of super-heavy trucks (after Caterpillar and Komatsu). The minimum acceptable profit margin requires Belaz to produce no less than 400 heavy trucks a year. Maintaining production capacity above this level is possible only due to purchases by the Russians. As a result, Belaz is now establishing its presence in Latin America (Ioffe 2004: 94).

On the other hand however, during the past three years, the stability cushion provided by the 1990s gradualism, appears to have been exhausting itself. Notwithstanding the reported high growth figures, the EBRD ranks Belarus 25th out of the 26 transition economies in the overall progress in economic reform, considering its poor performance in the areas of macroeconomic stabilisation and structural reform. UN *Human Development Report*, has just downgraded Belarus' ranking from the 53rd place in 2003 to 62nd in 2004 (Table 2).

According to UN calculations, in 2004 the PPP-weighted GDP per capita in Belarus dropped by 27.6% from its 2002 level, from \$7620 to \$5520. As the Report suggests, the socially-oriented model of the Belarussian economy does not stand the task of comparison with other 'transition' countries. The Baltic states and Poland spend far more on their health care systems than Belarus; the pension of an average Polish pensioner is higher than the wage of an average Belarussian worker. Technologically, Belarussian economy seems backward too: Belarus produces only half the Poland's amount of GDP per consumed energy unit, and 2.2 times less than China.

Structurally, the uneven effects of protectionism and state regulation have split the economy into two parts. On the one side, there is a small group of 200-250 enterprises and 300-400 companies, which are the main contributors to the budget. These firms thrive due to a wide range of special clauses: their tax burden is 10-15% less than elsewhere in the system; they reap the benefits of protectionism and exploit the price and demand factor of the undeveloped Belarussian small business system. Importantly, they work closely with large Russian structures and await the moment when these links can be legalised into formalised ownership rights. On the other side, there are 6500-7000 of small state and private firms. These companies do not have access to budget subsidies and benefits; their debts are not being written off and they cannot buy gas and electricity at below market prices; they are largely forbidden from attracting private investors and fire workers. These are the 'hard workers' of the Belarussian economy – they are of little interest to Russian or western investors, they spoil the official statistics and jeopardise the viability of the Belarussian economic model (Romanchyk 2004).

Belarussian economic model: a subsidised miracle of transition

Much of the secret to the decade of Belarus' economic and social stability lies in the role that Russia plays in configuring Belarussian politics and economy. There are at least three major elements in Russia's support for the Belarus. First, Belarus' trade with Russia (Belarussian exports in particular) expanded impressively following the activation of the Customs Union Agreement in August 1998. While trade flows between CIS members have shrunk since the collapse of the USSR, trade between Russia and Belarus has been growing steadily: Belarus accounts for 50% of Russia's trade with the CIS. Belarus also surpassed Ukraine as Russia's second largest trading partner after the EU. Second, Russian and Belarussian economists have estimated Russian direct and indirect subsidies in the region of \$1-2 bn annually. Subsidies to Belarus have included the cancellation of debts; low-interest rate credits to purchase Russian products; favourable barter deals; added customs revenue from foreign trade diversion due to the uneven customs legislation; and financial support for the Belarussian rouble, which began to be disbursed in 2001.

Third and most crucially, the low prices for Russian gas represent the most significant form of subsidy to Belarus from Moscow. The steady (and cheap) supply of Russian oil, gas and energy has been the major reason for Belarus' economic resilience. Using these key components to keep the economy subsidised and the infrastructure running, not infrequently, Belarus...delays paying for them. (As of 1 April 2004, the total 'gas' indebtedness of Belarus to Russia was around \$130 million.) The accumulated payment arrears are later settled through barter transactions that also maintained demand

for Belarussian exports – another important form of indirect subsidy from Russia. European price for gas is \$100 per 1000 cubic meters. Belarus pays (Russian internal price) around \$28-30; while Ukraine (competitor in transit) pays \$50-60. Gas accounts for 80-85% of energy resources in Belarus. The transit of Russian gas through Belarus is steadily growing: it increased by 35% compared to 1995. At the moment Beltransgas is able to transport up to 80bn cubic meters of fuel per year, and, unlike in the Ukraine, the transit schedule has never been broken here.

The availability of cheap and often *de facto* free energy inputs produced a paradoxical result. Despite its poor reform progress, Belarus is still considered to be one of the most successful examples of post-Soviet development. Belarus' record on living standards, employment and retirement, internal and external security has been much more impressive than that of the corrupt, crisis-stricken and war-torn Russia . Indeed, in 2002 *Transparency International* ranked Belarus at number 36, tied with Lithuania and less corrupt than Poland (ranked 45), not to mention Russia (71) and Ukraine (85). The World Bank/IMF index of the quality of government regulation is also higher in Belarus than in all other CIS states (Ioffe 2004: 101).

Moreover, as the World Bank (2002: 47) itself observes, when compared with the partial and poorly implemented reforms in many CIS states, Belarus' inaction did allow her to avoid some key mistakes in the early stages of transition. While continued state ownership did little to promote competitiveness or strategic decision-making at the enterprise level, it did deter the large-scale asset stripping and tax evasion that has damaged growth in the early stages of transition in most of the CIS countries. The capacity of the Belarussian state to maintain high levels of tax collection highlights the importance of these taxes in smoothing the initial output decline. The stability of fiscal revenues has boosted the scope for supporting declining sectors and social expenditures. Though it may be tempting to explain this fiscal performance as a product of the authoritarian state, a similar political regime has not guaranteed similar outcomes in Turkmenistan or Uzbekistan.

Overall therefore, the decade of state-led transition has not been easy for Belarus. The reluctance of the government to proceed with structural reforms and the pervasive state control over economic and social affairs does slow down the development of small and medium entrepreneurship that would be crucial for a small open economy. The inadequacies of the Lukashenko rule, although bleak when compared with the dictatorships of Central Asia and human rights abuses in other FSU states, do set enormous hurdles to a balanced development of the post-communist civil society and the economy. Yet Belarussian state capitalism has managed to preserve and capitalise on the much-needed socio-economic stability that had been sacrificed in many other former soviet states that opted for the shock therapy recipe. In the words of Moscow-based Mikhail Deljagin, exploiting the transit factor, Lukashenko has managed to retain some crucial domestic industries: some complicated production complexes and even agriculture have so far been more stable in Belarus than they are in Russia. At the same time, while the economic growth and the resilience of the Belarussian socio-economic system is not fictitious, it is largely explained by tight state protectionism and is critically dependant on the permissive attitude of the resource-rich Russia to her western neighbour. In this regard, one issue is are critical for the future of the Belarussian

political economy: whether Russia will be willing to continue to support Belarus economic model and the political regime?

Russia: building dependant capitalism in Belarus?

The Russia-Belarusian Union

In December 1999, nine years to the day after the Soviet Union was dismembered in the Belovezh woods, the then Russian president Yeltsin and the Belarus leader Lukashenko signed a Treaty that established a 'Union State' between Russia and Belarus. To this day, most of the clauses of the Treaty, as well as its actual constitutional status, remain evasive and unclear. Furthermore, its viability and progress in integration have been clearly affected by changes in the Russian political arena. In the time of the Yeltsin reign in Russia, speculation was rife about the intentions of the Belarussian leader to use the Union as a vehicle to the Moscow political stage – either to the Russian presidency or to the post of the Union leader. However with Putin's rise to power, such speculations, if they ever had any grounds, have largely faded away: Putin remains a strong political figure, enjoying unprecedented popularity and support from the Russian public.

With all the unresolved political status of the Union, it has long been clear that the major drive for Belarus to participate in the integration process is economics. More precisely, energy: Belarus is heavily dependent on the Russian economy. Russia supplies Belarus with 100% of its oil and gas, 80% of its energy resources, 80% of coal and 86% of crude metals. Russia is also the main market for Belarussian exports. Recent rises in world raw material prices only intensified the dependence of the Belarussian economy on Russian imports.

Yet unsurprisingly, economic integration between the two economies has been extremely uneven. Since 1999 and particularly since receiving Moscow's financial stabilisation credit in 2001, Belarus has been pushed into implementing a policy towards monetary convergence with Russia: lowering inflation, fixing the exchange rate, liberalising the foreign exchange market. In 2000, indeed, the government started to liberalise the foreign exchange market, and introduced a unified exchange rate for the Belarussian rouble. Despite these efforts, the necessary economic synchronisation between the two economies is unattainable. Belarussian economy is only 3% of Russia's. Inflation is persistently higher in Belarus than in Russia. The share of auctioned firms in Belarus is around 30%; in Russia – it is 70%. In Belarus rigid state controls, torturous bureaucratic procedures, licensing on the conduct of business slow down the development of small and medium entrepreneurship, the total size of which is no more than 10%. In January- June 2004, the share of foreign investment in Belarus shrank by 21.1% from its 2003 level and reached 1.1% (Belorysskaja Gazeta, 2 August 2004). In addition, since 1 January 1998, Belarussian joint stock companies have been operating under the rule of a 'golden share' – 51% of the stock – which gives the state the ultimate voice in taking executive decisions.

Currency Union

Macroeconomic and policy discrepancies between Russia and Belarus have also put on hold the most (economically) significant project of the Russian-Belarusian union: the common currency. According to initial plans, from January 2005, the Russian rouble was to become the single currency for the inter-state Union, and Belarus was supposed to adopt the Russian rouble as a legal tender. After some objections from Belarus, Moscow and Minsk finally agreed that the emission centre for the currency would be located in Moscow. These plans and perhaps more notably, the reforms necessary for a successful currency unification, provoke increasing objections from Belarus on the path to their realisation. Belarus wants a warranty of monetary autonomy, both before and after the introduction of the Russian rouble. It also wants Russia's assistance in the economic and social spheres. Russia, in turn, believes that these conditions will not only undermine the process of currency unification, but will also jeopardise financial and economic policies of both parties.

In the most recent negotiations in late 2003 and in summer 2004, Russia used gas as a major lever in pushing Belarus to agree on the single currency plan. In late August 2003 Gazprom refused to continue supplying gas to Belarus at domestic prices; Belarus in turn, threatened to raise transit rates for Russian gas. After some discussions, Russia was willing to lower its rates for Belarus, but on two conditions. First, the privatisation of the Belarusian gas transit system (Beltransgas). Second, to leave the transit through Belarus relatively cheap.

In the area of privatisation, the major problem is the participation of Russian capital. Belarus insists on controlling the largest share, while also asking for approximately \$5 bn of Russian investment. Russia, instead, is offering only one third of this sum – around

\$600 million. This is not the first time Russia is using its economic power as a lever in its relations with the CIS countries. Armenia and Kirgystan gave up whole industries to Russia, thus paying off some of their debts to Russia. Turkmenistan and Uzbekistan are obliged to supply their gas to Russia, while Georgia surrendered the control of its energy sector to RAO UES. Oil companies in the Baltic states are also on the Russian shopping lists. So Belarus, isolated from the rest of the world, is an easy target.

Belarus needs approximately \$2bn of investment per year. Big Russian business has been eager to buy into Belarus' oil, gas, chemical, food, telecommunications and service industries. So far, major privatisation deals with the Russians have fallen through due to Belarus' insistence on stringent conditions, which require the investor to maintain employment levels and social benefits for the workforce in order to gain majority control following a probationary period of up to five years.

Yet the Russian interest in the ownership of the Belarusian economy, undeterred by the 'golden share' rule, is already significant and growing. Indeed, the early 2000s have shown that notwithstanding periodic outbursts of official Moscow in relation to Lukashenko, big Russian capital continues to favour a monopolised, state-controlled economic model in formally independent Belarus. Formal political sovereignty has not

prevented large Russian financial-industrial groups from dictating their preferences to Belarus. One of the most vivid examples of this is the experience of the Ford car factory erected near Minsk in 1995-96. Despite the tangible benefits of the direct foreign investment and new employment opportunities to the economy, in 1997 Minsk was forced to shut the venture down. The pressure came from Russia, which was concerned that Ford-Belarus products would undermine the competitiveness of Russian-made cars.

Since Putin came into the Kremlin, the open economic dictate from Moscow to Minsk has become much less prominent and has assumed a form of a market pressure, rather than a direct policy command. (For example in January 2004 Gazprom simply cut off the supply of gas to Belarus for three days, pushing Minsk into open confrontation with Moscow). Yet most analysts foresee that the Russian expansion into the Belarussian economy will only intensify in the future and particularly closer to 2006, when Lukashenko would need the political and economic support for his third term in power. Some of the most successful Belarussian enterprises, predominantly in the food, telecom and textile sectors, are already controlled by Russians. In the oil business too, there are signs of all-too-keen Russian investment. According to the journal 'Russia's oil', *Lukoil*, the Russia oil giant, intends to process oil in Belarus in order to supply oil products to its retail chains in Central and Eastern Europe. *Lukoil's* participation in the sell-off of Belarussian oil refineries such as *Polimir*, *Khimvolokno*, *Naftan* and *Azot*, seems to be an attractive option for Belarus.

Overall, the largely mythical Russia-Belarus Union has not been a smooth project throughout. Since the summer of 2003, when the integration process met with serious difficulties, Gazprom has become increasingly reluctant to supply gas to Belarus at subsidised prices; in winter 2004 it cut off the supply of gas to the indebted Belarus for three days. In its turn, in negotiating the terms of gas payments, official Minsk likes to use Belarus' geopolitical position as a lever: it is estimated that by 2020, 50-67% of West European gas consumption will come from Russia through Belarus. To confirm that, in June 2004, a new commercial agreement on Beltransgas was finally signed by Russia and Belarus. According to the terms of the deal, Belarus will be paying \$300 million more for the gas, while Gazprom has only added \$45 million for its transit fee. After some manoeuvring around the Russian budget code, the Russian government decided to supply Belarus with a \$175 million of new money, in order to pay off some of the debt. This time, however, Russian money won't leave the territory of Russia and instead will be transferred from the Minfin to Gazprom accounts directly. As a result of new gas negotiations, Belarus will get 10.2 bn of cubic metres of gas, substantial foreign investment into Belarussian economy, increased oil supplies to 18 million tons, and a two-fold increase in tariffs for transporting oil across Belarus.

The opposition media in Minsk immediately interpreted the deal a 'political credit' to Lukashenko, or Moscow's de facto 'go ahead' for Lukashenko to change the constitution in order to stay in office for the third term. Indeed, the new supply of finance would conserve the Belarussian economic model, giving Minsk complete independence from the IMF, western financial assistance and political conditionality. Also, the conditions of the Russian credit imply that Belarus will retain its indigenous style of governance without a serious threat of running up a large debt burden; while relying on Russia in case external economic environment deteriorates. Yet according to Vladimir Dashkevich, a clearer indication of Moscow's 'go ahead' for the (un)constitutional

change in Belarus would be a start of a serious expansion of Russian capital into Belarussian economy - all the projects announced in 2003 but frozen so far (Volkov 2004). In any case, the new deal and its likely consequences seem to reinforce the fears of the Belarussian opposition: they insist that Belarus can only be truly independent if there is some counterweight to Russia's involvement in the form of western investment, first of all from the EU.

The EU and Belarus

Most popular explanations for the sluggishness of the economic reform and political change in Belarus focus on the inadequacies of the presidential rule. Yet as a recent series of publications by Ioffe (2003/4) suggests, Belarus is ailing not because of its president, but rather because of the lack of a genuine functional elite, equipped with political and economic knowledge, that can free the country 'from the psychological and structural shackles of the past.' Here, western attitude to the events in Belarus has been disparaging and counter-productive.

The EU policy towards Belarus has gone in three main stages:

- Early 1990s: the EU paid little attention to Belarus but did offer modest support and aid in interest of furthering political and economic reform. This achieved little in the chaotic conditions in time.
- 1996-2000 Following Lukashenko's unconstitutional extension of his power in 1996, a severe clampdown was imposed, amounting to a virtual breaking off of relations.
- 1999- policy has eased up slightly in the hope that dialogue might help promote some liberalisation. While this has put some financial assistance into the development of civil society, it has not led to wider political change.

The EU's cooperation with Belarus is in direct contrast to those with Belarus' southern neighbours, Ukraine and Moldova, whose leaderships have made some efforts to prioritise EU-oriented foreign policies, with the aim of joining as full EU member in some time in the future. Membership in the European institutions, such as the council of Europe, has been seen as the key to adapting to western European standards of democracy and to acceptance as a European state, as well as to opening doors to assistance from IFIs. As stated recently by the Commission,

“The EU relations with Belarus will continue to depend on progress towards democratisation and reform. The local elections in March 2003 will be given close attention in this context... Bilateral relations will be placed in the broader context of a need to intensify cooperation with the EU's new neighbours after the forthcoming enlargement.”

Since the 2000 change on the Moscow political stage references to Belarus' sovereignty, independence and national self-determination have become increasingly prominent in the Belarussian official political discourse. (In summer 2004, Lukashenko even mentioned that Belarus may consider joining the EU). Here, as one Polish observer notes, it is important to acknowledge that Lukashenko created a model of statehood that gives Belarussians a proxy of sovereignty in what is probably the only form possible at the current stage in the development of their national identity. For many months now, Lukashenko has been a very uncomfortable partner for the Kremlin in the talks on the new shape of the Union of Belarus and Russia, trying to secure maximum sovereignty for his own regime. While personal ambitions and egotism have certainly played a part here, Lukashenko is also motivated by political realism and concern for Belarussian statehood (Grajewski 2004).

The West in turn, has done little to support the forces opposing Russian domination in Belarus and even in Ukraine. The European Commission leaves open no place for cooperation with Belarus as long as the present government remains in power. Some believe this will encourage the Belarussians to push for radical changes, but others strongly disagree. Polls indicate that while many Belarussians favour closer economic relations with Moscow, they also increasingly want to retain their independence. Both Moscow and Minsk-based analysts say that the EU has never had a coherent and well-formulated policy towards Belarus and the latest move confirms the pattern. Despite its closed stance on Belarus, the EU has never presented any specific demands to Belarus except to formally urge Minsk to observe European norms. "As a result, Lukashenko is allowed to do whatever he wants, but should it 'according to the norms of decent European behaviour.' The Commission's toothless policies may be influenced by the fact that a pipeline supplying Europe with Russian gas travels through Belarus" (RFL, 13 May 2004).

Following the pattern of central European velvet revolutions, the West has maintained a rigid and alienating categorisation of Belarus' social forces: the current ruling regime vs. Belarussian nationalists (i.e., those radically opposed to it). As a result, foreign aid and attention has favoured almost exclusively the westernising nationalists, even though these self-proclaimed spokesmen for Belarus have had meagre following.¹ This narrow-mindedness is a strategic error on the part of western policymakers, whose reading of events in Belarus continues to hinge on cold war clichés and biased interpretations (Ioffe 2004: 110-113).

It is true that in the current Belarussian political landscape the middle, the socio-political layer between Russian 'empire -leaners' and nationalists is least vocal. But at the same time, this centre, mainly consisting of intelligentsia, is the largest, and potentially most decisive social force of change. These people do not take Lukashenko seriously, many despise him, yet their attitude to nationalist preaching is chilly at best. They speak Russian, listen to Russian music and watch Russian TV, yet they are not willing to sacrifice Belarussian sovereignty. As Ioffe maintains, these people may account for 50% of the potential electorate. Though heavily russified, Belarussian intelligentsia value Belarus' sovereignty much more than most of Lukashenko's

¹ As Ioffe documents, Stanislav Shushkevich, in a way Belarus' equivalent of Havel, never won a popular election. In 1994, at the helm of power, he received a meagre 9.9% of the vote.

supporters, and they would be less willing to sacrifice it. It is unsurprising, Ioffe notes, that these people reach out to Russia for help: the West has been unable and interested in discerning what may be the most promising political constituency in Belarus (Ioffe 2004: 114).

The new EU members like Poland and Lithuania, by EU standards, have far more amicable relations with Belarus through extensive trade and other contacts with Belarussian representatives. The unique position of these states means that they can play a pivotal role in future EU-Belarus relations. During its 2002 presidency of the Council of Europe, Lithuania prioritised the issue of relations with Belarus. Hoping to ease the tensions between the EU and Belarus, Poland and Lithuania have requested to act as mediators (Bjenstam et al. 2004). As Grajewski (2004) maintains, it is in Poland's interest for its eastern border not to become a line of new division in Central and Eastern Europe. But irrespective of how much effort Poland puts into developing good relations with the area of eastern European integration, the situation there will be determined by the course of events in Russia. This dependence is further reinforced by the position of the West towards the developments in the new EU's neighbours.

Like other 'grey areas' on the backyard of the new EU, Belarus is locked between the two power centres - Moscow and Brussels. So far, for the states like Belarus, these two anchors of foreign policy have been mutually exclusive. Belarus' strong (but in many ways forced) pro-Russian stance has been a key factor alienating it from the EU market and integration process. In this environment, Russia remains in a uniquely strong position to negotiate the terms of the economic union and political dynamics within Belarus. With the current economic boom in Russia, Putin's support can reinforce economic stability and even strengthen growth in Belarus.

A tentative scenario for the near future

Notwithstanding some recent outbursts of official Minsk addressed to some key political figures in Moscow; or the wide-scale campaign allegedly being planned by Minsk to discredit Russia in the eyes of the Belarussian public,² it is tempting to interpret the Russia-Belarus partnership as an example of Russia's strive to re-establish its dominant position in the former Soviet terrain. While at face value Putin's regime does not favour Lukashenko personally, the re-configuration within Russian internal political-economic structures, as well as the heightened domestic security priorities, imply that a closely manageable Belarus will be the preference of both Russian capital and security interests. Putin's current rapprochement with a far more problematic Ukraine proves that both geopolitically and economically, Russia regards the disposition of the new EU border states as a matter of high foreign policy priority. Economically, big Russian oligarchic

² Such theories, put forward by some of the opposition media, are mainly actor-centred and continue to support the view that Lukashenko needs Moscow's permission to stay in power for a third (at least) term, and/or succeed Putin in the Kremlin. Exploiting the personal animosity between Lukashenko and Putin, these observers suggest that the Belarussian president is about to launch a wide-ranging anti-Russian campaign in Belarus, in order to isolate the Belarussian voter from Russia's informational influence and to discredit Putin. See for instance, M. Podoljak, 2004, "Voina prezidenta", *Vremja*, 5-12 August, pp.8-9.

capital is keen to diversify their assets well beyond Russia's border, and Belarus is an appealing target in this post-Yeltsin search for ownership. In the security realm, being the most immediate buffer to the enlarged NATO camp, Belarus under Lukashenko is a guarantee of Russia's western border security, and major political forces in Moscow will most likely seek to preserve this status.

Although the actual implantation of the Russia-Belarus Union is likely to remain a mythical venture, Belarus' embrace of Moscow's political and economic influence in Belarus gives Russia many options in her economic and political ambitions for the 'little sister', yet also empowers her with a tool to influence the course of the politico-economic change. So far, the Kremlin has been reluctant to employ it, and considering the experience of Russia's recent involvement in the politics of its near neighbours, it seems unlikely that it would do so in the future. The recent months showed that Moscow's proactive back-up for the new leader of Georgia Saakashvili backfired with an aggressive anti-Russian stance of the new regime; having learned the lesson, the Kremlin now remains carefully dispassionate about the upcoming presidential elections in the Ukraine.

As a result, in 2005-2006, Belarus would probably represent an intriguing case of the first serious expansion of the Russian capitalist interest outside the Russian terrain. While the post-2006 scenarios of such an expansion can be offered only speculatively, it is clear that the Kremlin and near-Kremlin structures will not have any strong competition from the West in their search for Belarussian assets. The EU-25 in turn, preoccupied with accommodating the needs of the 10 new member states and preparing ready for a second wave of accession, is most likely to maintain its attitude of biased neglect to Belarus. Still, we can expect some EU-Belarus cooperation in the economic sphere to proceed ahead; the official Minsk can also be expected to become more flexible in its foreign policy vector. And although a dramatic turn in the Brussels-Minsk relations is still unlikely, individual, bilateral country-level projects, spiced between Belarus and the new EU member states like Poland and Lithuania, as well as some constructive dialogue on a meso-level are likely to mark Belarus-EU relations in the coming few years.

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