

Belarusian Analytical Workroom

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Getting to the heart of the matter

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THE DEADLOCKS OF INTEGRATION IN THE EURASIAN ECONOMIC COMMUNITY

The Eastern Partnership: 'a bone of contention'

In his fight for Ukraine Putin is fulfilling two tasks.

1) He is preventing the weakening of Russia's defence capability. Given the political association with the EU, the deployment of NATO troops in Ukraine will soon follow, and the distance from the northern border of Ukraine to Moscow is less than 500 km; the same distance as that from Crimea and the eastern border of Ukraine to the division of silo-based missiles in the Saratov Province. Medium-range missiles cover such distances within just a few minutes. This time is insufficient to protect people from attack. That is why Russia sees the seizure of Crimea as a great strategic victory. It will seek to annex eastern provinces of Ukraine, too.

2) Putin has repeatedly claimed that Russia will either become great or cease to exist as a state. This is probably not far from the truth. To be in line with other states of paramount importance in the world, Russia needs first of all, to increase its economic potential. Hence, the idea is to create a single economic space (Eurasian Economic Community) around it on the territory of the CIS.

But without Ukraine, whose economic potential and level of technological development is streets ahead of that in Belarus, Kazakhstan and other CIS countries, the Eurasian Economic Community loses its significance for Russia.

Hence, such a desperate Russian struggle against the economic integration of Ukraine with the EU following the signing of the Association Agreement (AA) and the Deep and Comprehensive Free Trade Agreement (DCFTA) between Ukraine and the EU.

The battle for Ukraine: there will be no winners

The war in Ukraine has brought about a reduction in the foreign trade turnover with Russia and a reduction in the industrial output of Ukraine, additional expenses and a deterioration of the economic situation as a whole. Earlier estimates of the economic effectiveness of Ukraine's integration with the EU have turned out to be irrelevant. They did not take into account the substantial funds needed to wage war in the East of the country, stabilise the economic situation and restore the state. New geopolitical risks, which were not considered earlier in the estimates, have

emerged. New estimates of the effectiveness of the integration have been made by a group of independent Russian liberal economists who can hardly be suspected of sympathising with Putin or his policy, and they have carried out an assessment of the investments in the economy needed to solve the current problems in Ukraine¹.

Since 2005, underinvestment in the economy has led to an increase in the depreciation of fixed assets from 44% to 78%. With this deterioration, it is impossible to manufacture competitive products. In 2014-2018 it is crucial to invest at least \$ 190 bn in key assets. To cover the negative current account balance during the same period, another \$ 80 bn is needed and another \$ 55 bn - to manage the external debt.

Failing trade and economic relations with Russia and other countries of the Customs Union have led to a loss in export earnings. The share of exports to Russia constitutes 24% (2013) of total Ukrainian exports. Out of \$ 19.2 bn exports to Russia, Ukraine can redirect as little as \$ 2.9 bn to other countries. On the other hand, Russia's import from Ukraine could only be as little as \$ 1-2 bn. Thus, Ukraine may lose \$ 14-15 bn annually due to worsening trade relations with Russia.

Estimates of the income lost from the decrease in the number of labour migrants to Russia, Russia's withdrawal from pipeline transit via the territory of Ukraine, upholding high gas prices for Ukraine, reduced number of trips of Russian citizens to Ukraine, shortfall of Russian investments and the above-mentioned decrease in revenues from exports to Russia total \$ 33 bn a year (That's twice the value of the aid package offered by the IMF to Ukraine in 2014-2015). Let us recall that such a sum is needed by Ukraine in excess of the costs required to cover the deficit of the current account balance and term investments in the economy.

Thus, due to poor relations with Russia, Ukraine is going to lose \$ 33 bn a year in the course of the first two years and will then begin to adapt to the situation with the annual losses over the next two years being half that amount. Within four years, the shortfall in income due to the lower level of economic relations with Russia will amount to \$ 100 bn. Let us recall that another \$ 135 bn must be spent during this period to repay the deficit in the current account balance and service the external debt.

Money for Ukraine will have to come from the EU and not only the minimum amount referred to above. More resources than those in Greece will be needed for the modernisation of Ukraine's economy. Can the EU bear such costs at the moment? Especially when one considers that measures aimed at rescuing the southern European countries from default will deplete resources. But let us recall that should regular economic relations with Russia be restored, the necessary expenditures within the first 4 years will be reduced by \$ 100 bn.

1 See E.Vinokurov, S.Kulik, A.Spartak, I.Yurgenis *Tupik bor'by integratsiy v Evrope*. // Voprosy ekonomii No.8, 2014. M

The loss of Russia's income in the case of dreadful relations with Ukraine is insignificant (about \$ 5 bn a year). Another issue is much more important: should Ukraine enter the EU, first of all, the aim of creating the Eurasian Economic Community (to increase the economic power of Russia) will be practically unachievable. Geopolitical ambitions of Russia – to be on a par with the leading states in the world – are crumbling. At the same time, the plans to build a 'Greater Europe' are also collapsing.

Perhaps Putin is right: if Russia is not great, it really might not hold on to rich natural resources and fall apart. But let us not forget that Russia has accumulated an armoury of nuclear weapons and that nationalists and fascists, rather than liberal westernisers, will come to power.

It is clear that Russia is ready to go to great expense to continue its fight for Ukraine. It uses the truce reached to continue the extensive programme of rearmament (about \$ 800 bn) and a media war (for example, almost all video materials on the events in Ukraine currently available on YouTube in Russian are propaganda materials favouring Russia).

A compromise is possible

In the current situation, a proposal for a compromise, 'new platform of cooperation in Wider Europe' presented in the above-mentioned article by independent Russian scientists is of interest. A prerequisite for the new platform of cooperation between the EU and Ukraine, the EU and Eurasian Economic Community are the following conditions: 1) 'the renewed format of the Ukrainian state will be developed by the internal Ukrainian dialogue' and 2) 'this state will confirm its non-aligned status'. In this case, Ukraine establishes the DCFTA with the EU.

The existing CIS FTA¹⁵ is practically 'going deeper' into the DCFTA format with additional agreements on new areas of cooperation (free movement of capital, liberalisation of access to financial markets, competition norms and standards etc.). After the CIS FTA turns into the DCFTA, Ukraine can access it. In addition, Ukraine and the Eurasian Economic Commission signs the protocol on the removal of technical barriers to trade and the protocol on the electronic exchange of information on customs declarations. I. e. Ukraine does not join the Eurasian Economic Community. (Let us recall that Ukraine is a part of the CIS FTA even today). Ultimately, the FTA is supposed to be created. It includes the EU, Ukraine and the Eurasian Economic Community i.e. this means realisation of the plan to create 'the integration bridge' from Lisbon to Vladivostok. It is assumed that these agreements on the establishment of a broad integration project will be an integral part of the plan to restore the Ukrainian economy with the support of the EU, Eurasian Economic Community, United States and other donors.

Perhaps this plan will have to be adjusted in a year or two, since today the Eurasian Economic Community is beset with contradictions among its members.

The Eurasian Economic Community today: an ineffective and unstable organisation

Belarus is a weak link within the Eurasian Economic Community

Belarus and Kazakhstan have not supported Russia's sanctions against western countries (the ban on food imports from the EU and other countries). Therefore, they have the right to import primary products (meat, milk, fruit, vegetables) from any country, turn these primary products into goods of their own production through their processing, and supply them to Russia. Since Rosselkhoznadzor (the Federal Service for Veterinary and Phytosanitary Surveillance) controls the country of production of the goods, Belarus, for example, can buy Polish pork for consumption in Belarus and legally send its own pork produce to Russia.

A number of commercial companies in Belarus work within the framework of 'grey' schemes shipping foreign produce to Russia without any processing having been carried out. The Rosselkhoznadzor's checks carried out on August 27 and September 12 in Moscow (the Moscow and Tula Provinces) 'revealed sales of a wide range of fruits and vegetables imported from a number of EU countries including Spain, Greece and Poland'². It is also noted that products pass through the territory of Belarus. Rosselkhoznadzor tried to participate in checks of imported foodstuffs on the Belarusian border for 2 weeks. Still, it was not allowed to do so, in spite of its right to participate in joint checks. In general, the Ministry of Agriculture and Food of Belarus responded to the requests of Rosselkhoznadzor in a taunting manner: 'In the current situation, the ministry shall refrain from joint checks based on random sampling at the checkpoints of the external border of Belarus'.

In general, by imposing sanctions, Russia punished itself. This is another example of inadequate decision-making by the Russian leadership with negative consequences for the country: 'The war of sanctions and inadequate public administration promise a protracted crisis and shock scenario of change in the vector of development of Russia's decelerating economy'. This was announced by the member of the budgetary committee of the State Duma of Russia Sergei Petrov at the Reuters summit³.

On the one hand, Belarus has won by smuggling foreign goods as a result of sanctions, but it will also lose out due to the devaluation of the Russian rouble, on the other. Belarusian industrial goods will become more expensive in Russia and demand for them will drop.

The Belarusian authorities are not so afraid of the western sanctions as they are of the consequences of Russia joining the WTO when it comes to the economy of Belarus. Russia (and the Eurasian Economic Community) is reducing import

2 See http://naviny.by/rubrics/ecomomic/2014/09/24/ic_articles_113_186905/

3 See <http://charter97.org/ru/news/2014/9/27/117773/>

duties at the moment. In addition, the demand is diminishing both in Russia and on the world market. As a result, the volume of Belarusian exports has dropped: it decreased by 18% in the first half of 2014 compared to 2012 over the same period. The terms of foreign trade have deteriorated: average export prices in the first half of 2014 were 6% lower when compared to the first half of 2012, import prices – 1.8% lower. In 2015, the price of natural gas will increase from \$ 165 to \$ 195. At the same time, the prices of petroleum products are dropping on the world market. They accounted for 36.8% of Belarusian exports of goods in the first half of 2014. Competitiveness and the volume of sales on the global market of key production in the mechanical engineering sector is decreasing.

More than 100 exemptions for Belarus and Kazakhstan will exist within the common customs tariff of the Customs Union until the beginning of 2015, i.e. more than 100 major products of Belarusian export are under temporary tariff protection. Despite this protection, for example, Belarusian exports of trucks to Russia fell by 1.3 times in 2013, truck tractors by 1.5 times. Imports of trucks from non-CIS countries to Russia increased by 2.8 times in 2013. When the agreement on the establishment of the Eurasian Economic Community comes into force (01.01.2015), this protection will be removed. At the same time, the rates on imports of many goods of foreign manufacture to Russia will be cut from January 1, 2015.

Agricultural subsidies in Belarus are now several times higher than in Russia or Kazakhstan. At the same time, 61% of farms generate losses (excluding subsidies) according to the official data and if profitability has been estimated accurately (taking into account capital turnover time and the rate of inflation) then at least 90% of enterprises are unprofitable in practice. Belarus is obliged to reduce these subsidies every year. But how can you diminish them given such a number of unprofitable enterprises?

Generally, Belarus does not meet many of the conditions it should currently comply with under the agreement on the Common Economic Space (as of 01.01.2012). It protects the country against the influx of Russian capital and goods, does not carry out liberalisation of economy etc. It remains a semi-Soviet country where 70% of GDP is generated by the public sector. And the government sets growth targets and output volumes for enterprises (except small enterprises). Belarus does not even try to observe CES requirements to liberalise the economy and comply with parameters of the macroeconomic policy (for example, the inflation rate will reach about 120% in 2014).

Belarus has not yet defaulted thanks to Russian subsidies and loans. In Belarus, the gross foreign debt per capita is now about one and a half times higher than that in Ukraine. At the same time, the country consumes more GDP than it produces. It intercepts loans to pay back current debts and settle the negative current account balance. As a result, the gross external debt is growing.

Lukashenko does not hide the fact that, above all, he is interested in Eurasian Economic Community membership as a means of gaining access to Russian energy

resources at low prices and of increasing investor interest in Belarus (one can produce something here and supply the capacious Russian market).

Lukashenko pulls the Eurasian Economic Community back to socialist economy, openly supporting Zyuganov in his fight for presidency in Russia. When Chavez was still alive, Lukashenko's ideologists (Y. Shevtsov, S. Kizima) published an article in 'The Belarusian Thought' («Белорусская думка») journal, the agency of the presidential administration, stating that integration with countries with common ideologies is more important for Belarus than integration with neighbouring states. This is how they tried to justify integration with ALBA countries that were implementing Hugo Chavez's idea of forging a 'socialism of the 21st century'.

At the same time, the situation unfolds in such a way that Russia may squander its savings in one year and a half (see our article 'Russia's ambitions: are there enough resources?' («Амбиции России: хватит ли ресурсов?») in the previous issue of the Analytical Bulletin) thus, it may end up in a critical condition itself.

Kazakhstan is disappointed in the Eurasian Economic Community

In January 2014, Putin's academician adviser S. Glazyev presented his report 'Prospects for the Common Economic Space and Eurasian Union' («Перспективы Единого экономического пространства и Евразийского союза»). The new meaning of integration, Glazyev contends, is now not only about the unification of economies but also about 'the restoration, replenishment of a certain unity - that is, it is a new wholeness. And it requires new and unifying ideas.' Such a unifying idea is seen by Glazyev in the ideas of Eurasianism developed in the 1920s-1930s. 'Eurasians', Glazyev recalls, 'rejected the atheist, materialist and socialist doctrines of bolshevism'. 'Eurasians' advocated dealing with 'the nightmare of universal Europeanisation' and demanded the 'shake off of the European yoke'.

In 2012, Putin called himself a 'conservative' and started to defend Russia's traditional values. Such well-known Eurasians as Prokhanov and Dugin appealed to the electorate on behalf of Putin during his election campaign in 2012.

All this alarmed the government of Kazakhstan. Sultan Akimbekov, the director of the Kazakh Institute of World Politics published an article in the 'The Centre of Asia' («Центр Азии») (No. 21-24) journal in late 2012 where he rebukes Putin: '...when Moscow makes a call to everyone to unite around it and at the same time, confront the West alongside it, this cannot be an action plan... We are not ready to give up independent foreign policy and we do not need Russia's mediation in interactions with the outside world. It is unacceptable for Kazakhstan to advocate the notion of integration through the ghosts of dead empires.' In the very same article he says that the model of Russian statehood and the model of inefficient economy are not appealing for Kazakhstan.

Events in Ukraine, in whose affairs Russia has interfered, justifying its actions by the protection of the country's interests and the protection of the Russian-speaking population are in conflict with the views of Nazarbayev. It was he who suggested the idea of Eurasian integration when speaking in London at 'Chatham House' back in 1994. In his speech, he had already condemned the potential actions of Russia in Ukraine: 'I hope that the time has passed when a country could suddenly announce that its vital interests extended to the territory of another state. A return to such imperial thinking is absolutely futile'.

The disappointment of Kazakhs as regards the Eurasian integration project whereby Kazakhstan is the only state with a stable market economy (as evidenced by the indices of economic freedom in the member states) could lead to the growing attractiveness of the Chinese integration project 'the Silk Road Economic Belt'. This is also a 'Eurasian' project but this word has only geographical connotations for both China and Kazakhstan. In cases of economic cooperation China does not put forward political demands, which is important for Kazakhstan.

And yet another important advantage of the Chinese version of integration – China has outstripped Russia in the field of technology and it lavishly invests in partner countries (Belarus is not one of them).

Russia cannot become the locomotive of the Eurasian Economic Community

Russia is the locomotive of Eurasian integration, yet today it can offer its integration partners neither technologies nor investments. It has no attractive ideology either. On the contrary, a call for the fight against Western civilisation, expansion of Russian interests to the territory of neighbouring countries (Ukraine is an example) scares away the elites of neighbouring countries.

Yet even this is not the main problem of Russian society. Investments and technologies can be offered by the West. But again, these investments will turn, for the most part, into bribes and kickbacks, sedimenting in new mansions of officials in offshore zones. And Russia will not thrive, even with the support of the EU and the integration of its economic space with the EU. Over the last 300 years, several attempts to modernise Russia have been made in vain. The proposed integration project may end in much the same way.

Something Gaidar was so afraid of has happened in Russia – the 'Asian model' of society has been restored: the model which was a little shaken after the collapse of the USSR. The main characteristic of this model is unity of power and proprietorship. Quite a number of scientific works have been written on the subject of why technical progress and economic growth are not possible here⁴.

⁴ See, for example, the work of Dr. Varlamov *Tri zagadki 'Aziatskoy modeli'*, Petrozavodsk, 2010

Another characteristic of Russia is the lower level of reflexivity or rationalism of the Russian ruling elite. Decisions are often made intuitively, under the influence of emotions. A recent example of this was Putin's decision to ban the imports of foodstuffs from the EU and some other Western states to Russia. Should the West consistently comply with Putin's demands and not supply Russia with modern genetic material (seeds of cereals, sunflower, sugar beet), from next year, crop yields in Russia will decrease by approximately one third, and the milk yield as well as the weight gain of the cattle will decrease as a result. Besides, sanctions are off-target. Russia punishes most of all its own society and not foreign manufacturers. For example, fish prohibited for import to Russia has already been imported to Belarus in greater amounts than local businesses can process. It is clear that this fish will get to Russia, but mediators will earn money along the way and fish products will be more expensive for the Russian consumer.

Another example of how the basic mistake in designing Eurasian Economic Community institutions has made it incapable. The Eurasian Economic Commission (EEC) is allegedly a supranational body of the Eurasian Economic Community⁵. But EEC decisions as well as the decisions by the Eurasian Economic Community Court are nonbinding. A country may not execute the decisions of these bodies as it is impossible to apply any sanctions other than ultimately referring the case to the Supreme Economic Commission which consists of the heads of member states that make decisions by consensus, too.

For example, since January 2013, pricing in the Common Economic Space should be market pricing. But nothing has changed in Belarus. What is more, during the session of the Council of Ministers on March 1, 2013, Lukashenko demanded that his prime minister strengthened price regulation. Belarus violates the agreement on free pricing, yet the Eurasian Economic Commission (EEC) or the court of the Eurasian Economic Union cannot force sovereign Belarus to implement something its president does not want to.

The only imperfection of the institutional framework of the Common Economic Space (CES) is enough to bring about the failure of the entire project aimed at increasing the economic potential of Russia through the economic integration of the post-Soviet space.

Summary

Going back to the plan of integration of economic spaces of the EU, Ukraine and the Eurasian Economic Community, proposed by the group of Russian scientists (and discussed now in the think tanks of the West), let us note once again that the value of this proposal, in our view, lies in the prerequisite of the 'out-of-the-bloc' status of Ukraine. The states situated at the border of civilizations like Ukraine or Belarus are doomed to be outside the bloc since their population is not homogeneous in

⁵ In this text, the Eurasian Economic Community implies the Common Economic Space (CES) which formed in 2012 to replace the Customs Union, as well as the Eurasian Economic Union which will replace the CES in 2015.

terms of language, religion and values. The desire of one part of the population, for example, in Ukraine towards deep integration with the EU, has provoked antagonism both among nationalists⁶ and separatists. Though they are a minority, they are passionate and armed, and they can 'rock the boat' i.e. draw currently neutral citizens into a conflict.

At the same time, implementation of the said integration plan may not give positive results. Another technological modernization of Russia may well be futile as history has repeatedly shown in Russia. But this time, yet another setback against the backdrop of contemporary geopolitical conditions may lead to its disintegration and dangerous imbalance in the region with the nuclear power. Therefore, this plan should be supported by yet another plan of prior strengthening of the post-Soviet space by carrying out institutional reforms in Russia.

6 Andrey Tarasenko, leader of *Right Sektor*: 'In actual fact, joining Europe would mean the death of Ukraine. Europe will be the death of the state and Christianity. We want a Ukraine for Ukrainians and run by Ukrainians, not one that serves the interests of others'. <https://ru.wikipedia.org/wiki/%D0%95%D0%B2%D1%80%D0%BE%D0%BC%D0%B0%D0%B9%D0%B4%D0%B0%D0%BD>