

Russia's Fiscal Veto on CIS Integration

Henry Hale

October 1997

PONARS Policy Memo 15

Fletcher School of Law and Diplomacy, Tufts University

When the words "Russia" and "Near Abroad" emerge in the same sentence, they usually conjure up visions of imperialism and political subversion. In this brief, I argue that Russia has not, in fact, invested much effort into "reintegrating" the former Soviet space. Instead, powerful, market-oriented political forces have consistently led Russia to torpedo nearly every good chance it has had to reunify some of the newly independent states (NIS). For this and other reasons, Russian politicians across the spectrum are increasingly calling for Russia to focus not on state-driven integration in the CIS, but instead on a market-driven process which has been called "natural integration." By implication, if the international community wants to guard against Russian revanchism, it should not only increase development aid to Russia's neighbors, but should actively promote reforms within Russia which create strong interests in macroeconomic stability and fiscal discipline.

The Logic of Economic Anti-Imperialism

Russian politicians disagree mightily over how the former Soviet states should reintegrate, but a basic logic has driven Russia to pursue an essentially consistent policy despite important changes in government personnel. This logic has two main parts. First, when Gorbachev initially decreed that Soviet republics hold their own elections back in 1990, Russia's leaders were suddenly forced to respond to the narrow interests of their own republic's population. Thus even relatively conservative Russian politicians found electoral profit in calling for the economic sovereignty of Russia, a concept which meant sharply curtailing Russian subsidies (largely in the form of underpriced energy supplies) to the other Soviet republics. Still today, Russian voters are happy to talk about "integration" so long as they do not have to pay for it, and Boris Yeltsin has proven to be well aware of this fact.

Second, the imperatives of radical marketization powerfully reinforce this integrative frugality. One of the fundamental preconditions for successful economic reform, as well as for a successful economic policy generally, is to achieve macroeconomic stabilization, cutting inflation down to negligible levels. Yeltsin's first post-independence reformist team, led by Prime Minister Yegor Gaidar, sought a tight grip on monetary and credit emissions. After some initial wavering, his second team has also proven its anti-inflationary credentials. This ideology of tight budgets, and more importantly the fear of inflation, has become embedded in key economic ministries which Yeltsin and his supporters staffed as they gained more and more independence in the early 1990s.

This fiscal conservatism has profound implications for any Russian efforts to reintegrate the former Soviet space: they had better not involve heavy Russian expenditures, for funding will not be forthcoming. This is critically important, since most of the other willing NIS seek precisely some form of subsidy when they call for CIS integration. In this way, the Russian government officials most directly in charge of finance and economics have come to play a crucial behind-the-scenes role in stifling efforts to reunify the "near abroad."

To demonstrate the impact of this informal "veto power," I will briefly examine two cases where fiscal pressure forced Russia to renege on plans which otherwise seemed very likely to "reintegrate" parts of the former Soviet Union in substantial ways: the Ruble Zone of a New Type in late 1993, and the Russian-Belorussian Union Treaty in 1997. I will then describe how more coercive efforts to achieve integration have been relatively few and fruitless, and why these trends have been strengthening. Next, I will outline Russia's emerging new policy of "natural integration." I will then conclude by analyzing the implications for US policy.

Two Examples

I. The Ruble Zone of a New Type

In the early Fall of 1993, Russia was on the verge of reestablishing nearly complete economic control of five former Soviet republics which wished to continue using the Russian ruble as their primary currency. After a long and complicated series of negotiations, Belarus, Kazakstan, Uzbekistan, Tajikistan and Armenia had signed an agreement with Russia designed to create the "Ruble Zone of a New Type." In return for the right to use the Russian ruble, these countries actually agreed to unify their monetary systems with that of Russia. This entailed not only abiding by Russia's credit, emissions and banking policies, but also its overall economic, budget, trade and customs policies. These five republics each subsequently signed bilateral agreements with Russia which laid out their individual responsibilities. If Russia were eager to restore its formal dominance, this was a golden opportunity. Politically, the time also seemed right since the radical marketeer Gaidar had just months earlier been replaced as Prime Minister by Viktor Chernomyrdin, a man representing the powerful energy lobby which is generally thought to favor reestablishment of Russian hegemony in the region.

Yet the Ruble Zone of a New Type failed, and Russia was the one to pull the plug. The most basic problem was that after the Soviet collapse, the Ruble Zone had become an important hidden source of Russian subsidies to the other republics. According to one estimate circulating within the Russian government at the time, Russian cash transfers to Kazakstan, Uzbekistan and Turkmenistan amounted to 45-70 percent of their total national GDP, or almost the entire salary funds of these republics. Indeed, most republic claims for cash supplies were for the payment of wages.

The Ruble Zone of a New Type was, in fact, an effort to cut off these subsidies by forcing republics to put up collateral for cash supplies, which were treated as loans. But even this tightening of control could not guarantee that these republics would control their budget deficits, which would essentially amount to money created by Russia. In addition, reformers (urged on by Western technical advisors) worried that Russian enterprises would continue to provide goods to

other republics even if the latter could not pay, counting on their lobbying strength to gain reimbursement if necessary. Again, this would amount to money created by Russia. Such sources of subsidy and macroeconomic destabilization were dangerous precisely because they were very difficult to control. As a result, by early November 1993, Russia made it clear that there would be no Ruble Zone of a New Type, despite the widely heralded agreements and the loudly trumpeted progress toward "Economic Union" in the CIS. Faced with this "fiscal veto," the embittered republics were forced to launch their own tenuous currencies.

II. The Russian-Belorussian Union.

After the formal collapse of the Ruble Zone, Russia and Belarus began a long series of negotiations which culminated in the Russian-Belorussian Union Treaty, signed in April 1997 by Presidents Yeltsin and Lukashenko. The two sides had reached an agreement on Monetary Union three years earlier, in April 1994, but once again the effort was repeatedly delayed by Russian government officials responsible for macroeconomic stability (led by Gaidar, who made a brief governmental comeback as Economics Minister, and his successor Aleksandr Shokhin). By Fall 1994, Shokhin and his allies convinced Yeltsin that no monetary union was possible without some sort of political unification, and even then, not until Belarus brought its rate of inflation down to that of Russia. Indeed, opinion polls showed that most Russian citizens were unwilling to bear significant costs for the sake of either political or economic integration with their neighbors.

In the heat of a tough race for reelection in 1996, Yeltsin sought to outflank his hard-line opponents by reviving efforts to reintegrate the former Soviet space. This initially produced an agreement to create a "Russian-Belorussian Community." This agreement renewed the call for the eventual "unification" of monetary and economic systems, but left unspecified how this would take place. Would Russia agree to let Belarus have any say in what these policies should be? The non-answer appeared to imply not.

After Yeltsin won reelection and regained his health, he ceremoniously signed the Russian-Belorussian Union Treaty of April 1997. Here again, however, fiscally conservative forces in the Russian government managed to gut the agreement of all practical content, a fact which pro-union enthusiasts bitterly protested. On the eve of the signing, the Russians forced Lukashenko to pare down the detailed, 17-page document he wanted to a bare-bones 3-page draft, which was then signed. Subsequent satisfied remarks from the mouth of Boris Nemtsov, one of two first-deputy prime ministers in charge of economics, strongly suggested that he and his team had again invoked a fiscal veto on CIS integration, removing clauses which might commit Russia to unwanted expenditure and which might surrender control over the marketization process. The new document is "much more thought-out than before," declared Nemtsov. Yeltsin himself made clear that it was in part financial issues which had been left out, and explicitly noted that the treaty did not now involve monetary union. While Prime Minister Chernomyrdin was reported to have favored the union, he does not appear to have fought very hard to save it. The predictable result has been that virtually nothing has happened since the signing, and even symbolic achievements are in peril as a dispute over arrested journalists has escalated to the top levels of both governments.

The Failure of Russian Bully Tactics

Key elements in Russia's government and society have strong incentives to veto any costly Russian ventures in the "near abroad," although other governmental forces may initiate such ventures. Indeed, especially in 1993 and 1994, Russia had undertaken several significant "coercive" efforts to restore hegemony in its neighboring regions. Yet what is striking is not that Russia has made such attempts, but that they have been half-hearted, under-supported and not very successful.

Many observers have shown that Russia has manipulated ethnic conflicts in the newly independent states in an attempt to force them to integrate with Russia and grant it concessions, especially military ones. Assuming that the charges of intentional intervention are true (and this is not always clear), such policies have not been very productive. Moldova produced the most palpable success, obtaining de facto independence for the Slav-populated Transdnistria region and forcing Moldova to abandon notions of "reunification" with Romania. The Nagorno-Karabakh conflict, too, did remove the most virulent anti-Russian regime from power in Azerbaijan and prompt it to join the CIS. But current Azeri President Geidar Aliev has ensured that his CIS membership is not much more than symbolic. If anything, it improves his own access to the Moscow power structures in which he was once a dominant figure. Moreover, he has refused to allow Russia to base its troops in his country, and has kept Moscow in tow by only judiciously cutting Russian in on development of its oil fields.

Russia has had more success in manipulating the Abkhazian conflict, forcing Georgia to host Russian military bases while simultaneously endangering one of the more promising Caspian oil pipeline routes which might circumvent Russia's own line. Beyond this, however, Shevardnadze has refused to be a Russian pawn and has actively sought to orient his small state to Western commercial and strategic interests. He has also been involved in efforts to establish a Central Asian-Caucasian-Ukrainian bloc which threatens to cut Russia out of much of the economic activity expected when the Caspian oil boom gets underway. Indeed, suspicions of negative Russian influence in local conflicts have won Russia few friends in the region.

In mid-1993, Russia also began to apply heavy diplomatic pressure on certain former Soviet republics to grant their Russian populations greater status. This bullying, however, served primarily to alienate these republics, and only Turkmenistan granted its tiny Russian population the right to dual citizenship with Russia, although Kazakhstan did elevate the formal status of the Russian language, a small symbolic Russian victory.

Pressuring Ukraine, showing it that it is hostage to Russian energy supplies, has proven a still greater failure. Even President Leonid Kuchma, hailed as the "pro-Russian president" upon his election in 1994, has continued to push Ukrainian independence and to reject all meaningful efforts toward even economic reintegration.

Why This Trend Is Strengthening

Four recent sets of events have been strengthening the anti-imperialist forces within Russia, making the fiscal veto much less necessary to employ in the first place. First, continued marketization has been creating an ever more powerful (if still narrow) set of commercial interests which see macroeconomic stability as the key to their future material prospects. This new big business sector has proven its political might by getting Yeltsin reelected in 1996, and will be a force to contend with for any future Russian government. Second, the failure of coercive measures to achieve substantial integration, and their frequent result in the opposite effect, has weakened the credibility of arguments that bullying is the proper tactic. Third, Russia's debacle in Chechnya has disabused all but the most rabid hardliners that brute force is a viable option. Fourth, the failure of good-faith diplomatic efforts to build CIS institutions (resulting in part from Russia's own fiscal veto) has caused even conservative politicians to doubt that substantial reintegration will occur any time in the near future.

The New Trend to "Natural Integration"

These trends have prompted Russians of nearly all political stripes to downplay direct state efforts to reintegrate the former republics, and instead to encourage a market-driven process of "natural" integration. The basic logic is that Russia's economy is currently one of the strongest and is certainly the largest in the CIS, and as it grows, other republics will naturally gravitate toward it, since they will want to share in its prosperity. Russia has also experienced the most rapid accumulation of private capital in the CIS, giving Russian financial-industrial groups a major opportunity to invest in other CIS markets, linking them more closely to Russia. Thus when Yeltsin called leading bankers together and ordered them to stop feuding over the spoils of Russian privatization in September 1997, he also urged them actively to invest in the "near abroad" so as to promote the integration process. Critically, this policy actually promises success because almost all CIS states are quite receptive to the creation of joint ventures with Russia, since they are less politically charged and offer tangible results. Pressure is now growing in Russia to promote this process by reducing barriers to joint commercial enterprise with the former Soviet states. Largely for this reason, Russia has moved actively to settle outstanding political issues with its neighbors, such as its dispute with Ukraine over possession of the Black Sea Fleet.

Implications for US Policy

The Russian government, therefore, has powerful incentive to veto any costly effort to integrate the CIS states, and these incentives are growing. This has important implications for US policy toward the newly independent states.

- It suggests that Russia is unlikely in the near future to actively rebuild an empire in its "near abroad," even in the wake of NATO expansion. This does not exclude Russian military alliances with CIS states like Belarus, but it does suggest that they will be simply

"alliances," with all of their weaknesses, rather than a newly-created larger, more powerful and unified state on NATO's borders.

- US policies that encourage fiscal discipline in Russia will also discourage Russian efforts to dominate its neighbors. This is because these neighbors, if they are to accept integration now, are likely to demand effective subsidies as the price. This is particularly the case for resource-rich, but relatively underdeveloped Central Asia.
- Policies promoting the development of a market economy will help create socioeconomic groups which will back macroeconomic stabilization in the political arena. This in turn will discourage Russian revanchism.
- The US should encourage natural integration among the former Soviet states by continuing to push for free intra-CIS trade. A Russian policy oriented to natural integration will promote the kind of market-driven, mutually productive economic cooperation which has driven the European project over the past decades. It will promote more stable economic growth in the former Soviet space, since it aims to eliminate the random and constantly shifting barriers to trade which have characterized CIS economic relations in the past. Signs that natural integration is successful will also help disarm hard-liners who say that coercive measures are necessary to restore Russia's economy and to protect its interests in its neighbor states.
- The US would do well to remove as many barriers to the import of NIS goods as possible, since giving the non-Russian states access to alternative markets will ensure that they do not become more dependent on Russia than their proximity to it already demands.