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## ***Russia in the Post-Soviet Space: Search for Rational Behavior and Prospects of Economic Integration***

### **Introduction**

The development of relations between the CIS nations has been recurrently declared a priority of the Russian foreign policy. However, in terms of consolidation of the post-Soviet economic and political space the outcome of more than a decade of the CIS functioning could hardly be considered successful.

After the dissolution of the political center of the former Soviet Union, the new independent states failed to keep alive the integrated economic complex created in the Soviet times. This turned to be a leading factor of degradation of the technologically most advanced industries and deep economic crisis that enveloped the whole area of the former Soviet Union.

In addition, given the perceived risk of the Russia's "empire ambitions" renaissance the new independent states strived for their sovereignty mostly through drifting away politically from their neighbor. Within this context both the process and outcome of transformation policy in Russia proved to be far from early expectations and as yet provide no ground to reckon it an example for the other post-Soviet nations.

Finally, one should admit indifference of the Russian public state bodies shown to the development of the CIS integration in the 1990s. This serves an evidence of at least their misunderstanding the role and significance of integration for the prospects of the national economy and political stability in this region crucially important to Russia.

In general, within the first decade followed the dissolution of the Soviet Union the Russian policy experienced self-contradiction and the shortage of consistency. This led to the implementation failure of the declared goals of the CIS nations' regional integration under the aegis of Russia. One could illustrate such a discrepancy between declarations and factual priorities using quantitative indicators of economic relations between Russia and the CIS nations. These show that the latter's share in the total external trade turnover of Russia currently amounts to less than 20% contrasted to 65% in 1990 while that share in the foreign investment flow makes up less than 1%.

### **Overview of Economic Development of CIS**

What is also the outcome of 13 years without USSR? To start with, I consider the economic development of the post-Soviet states in the last decade. Charts 1, 2 and 3 summarize the major macroeconomic indicators of the CIS countries (GDP, per capita GDP, population and GDP growth rates).

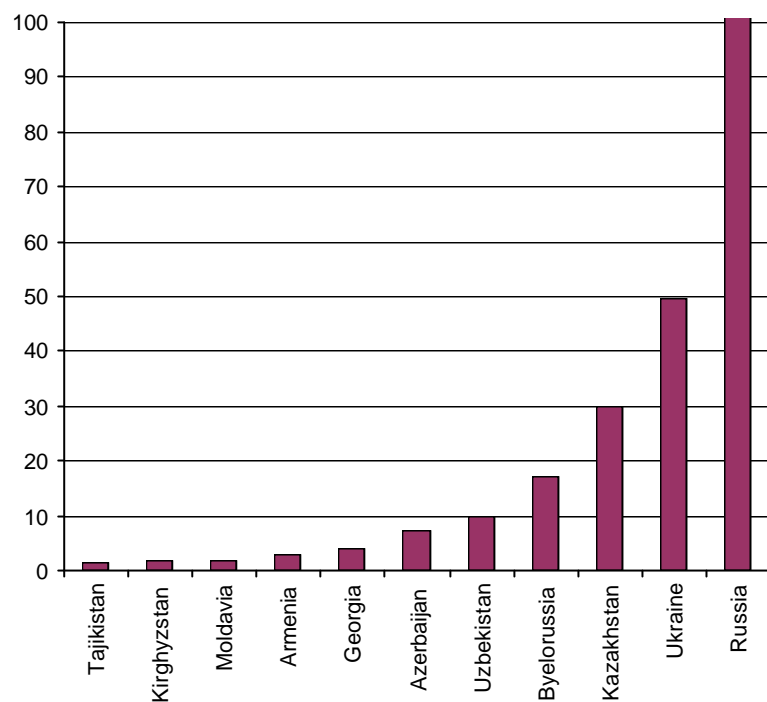


Chart 1: GDP, bln. USD, 2003<sup>1</sup>

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004

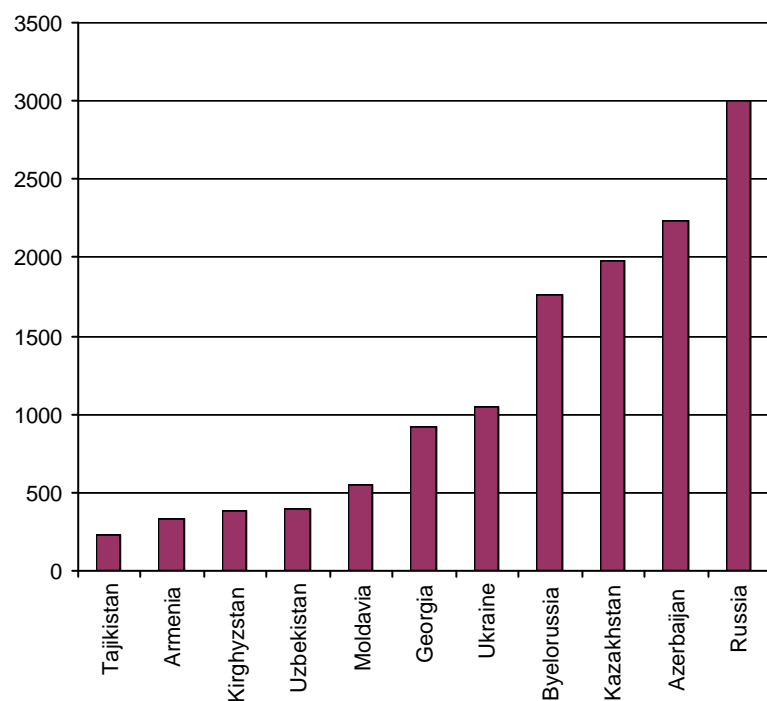


Chart 2: GDP per capita, USD

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004

<sup>1</sup> To make the chart clearer, column with the GDP of Russia (433 bln. USD) is only partly represented.

The changes in GDP are still highly correlated (see Chart 3). Despite disintegration trends, standard deviation of GDP as percent of the previous year is going down from 13,1 in 1992 to 2,6 in 2003 (the lowest level after the collapse of the USSR). It may be considered as an indicator of similar macroeconomic cycles in the region of the CIS.

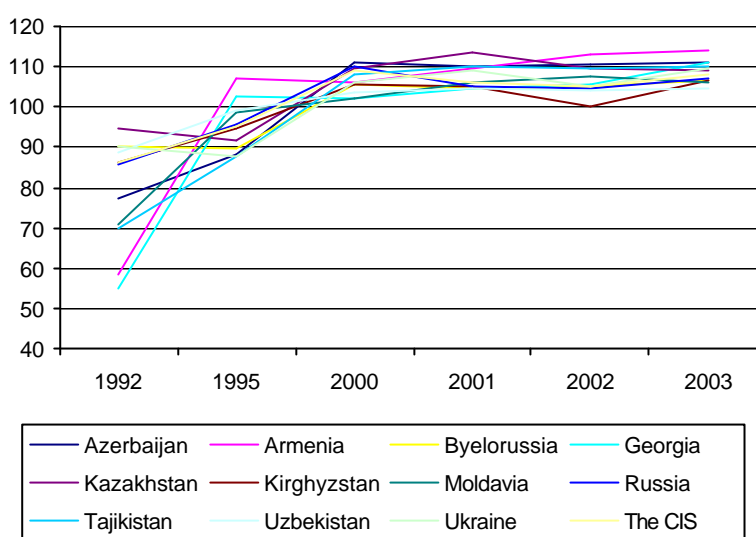


Chart 3: GDP as % of the previous year

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004

### Overview of Dynamics of Intra-Regional Trade and Investment Activity

In the meantime, if compared with the early 1990s, commercial relations between Russia and the post-Soviet countries diminished to a significant extent, reflecting the ongoing processes of disintegration. The volume of trade between Russia and the CIS countries was diminishing during the period from 1991 to 1999 with the exception of a small period of growth in 1995-1997. Overall there was a 7.3-fold decrease in 1999, as compared with 1991: in absolute figures the decrease was from \$138.1 billion to \$19 billion. And although there was significant growth in 2003, i.e., up to \$34.1 billion, there is no real reason to conclude that a fundamental change of the trend toward reduction is under way. The share of CIS trade in the volume of the foreign trade of the Russian Federation decreased from 54.6% in 1991 to 17.8% in 2003 and 18.3% in January – September 2004.

Among the CIS countries, Belarus, Ukraine, Kazakhstan, and Moldova are most tightly associated with Russia by foreign trade, while trade relations with Turkmenistan, Uzbekistan, and Georgia are far less intense. In addition, the balance of payments and budgetary revenues of Belarus, Moldova, Ukraine, and Baltic countries strongly depend on the volume of Russian transit through their territories. The countries of the Southern Transcaucasian region, Ukraine, Moldova, and Belarus receive significant foreign currency remittances from their nationals who have jobs in Russia. For Armenia, Georgia, and Azerbaijan, the sums of such remittances significantly exceed receipts from the export of goods (see Chart 4).

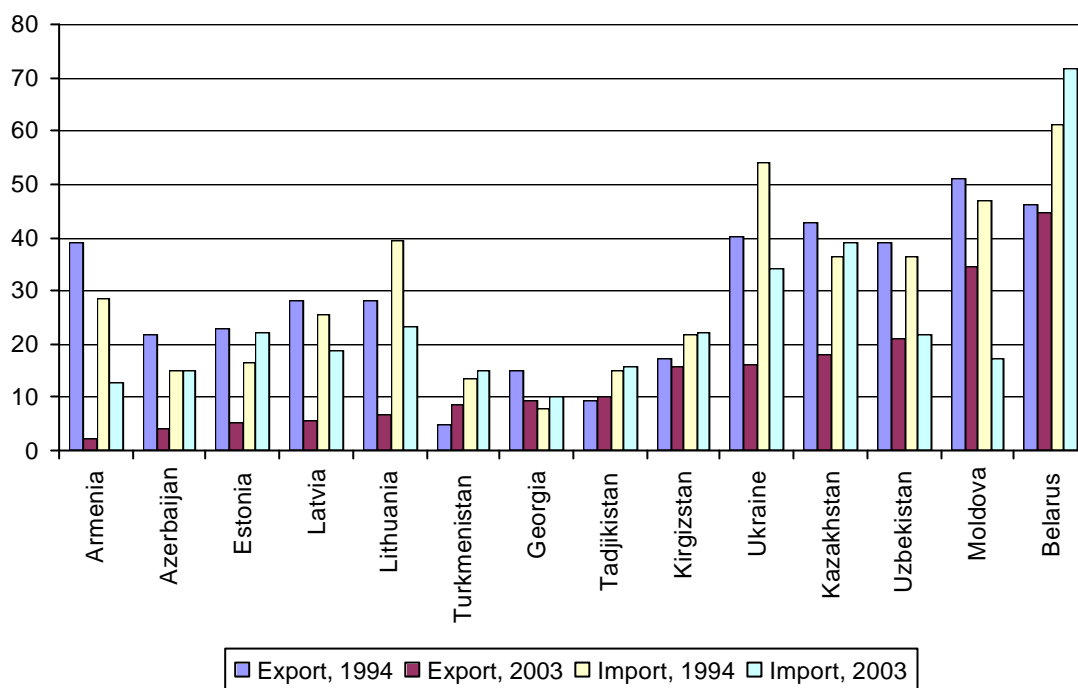


Chart 4: Russia's Share in The Foreign Trade of Post-Soviet Countries in 1994 and 2003, %

Source: Direction of Trade Statistics, Quarterly, June 2004. IMF

After significant drop of intra-regional trade in the early 90s, trade relations between CIS states are still underdeveloped. Average export of a CIS country is 8% lower, than 1991, but export to the CIS makes out only  $\frac{1}{4}$  of the pre-disintegration state. Export to other countries increased by more than 150%. The import structure demonstrates similar tendencies: despite the decrease of general import by more than 40% import from other countries increased by 17% and import from the CIS decreased by  $\frac{2}{3}$ . Since 1995, the decrease of intra-regional trade cooperation was also of great importance.

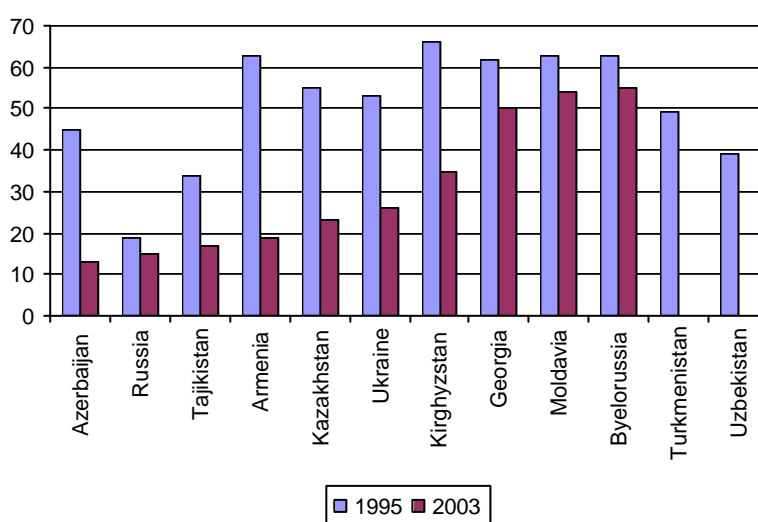


Chart 5: Share of CIS in export, %<sup>2</sup>

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004

<sup>2</sup> No data for Uzbekistan and Turkmenistan are available.

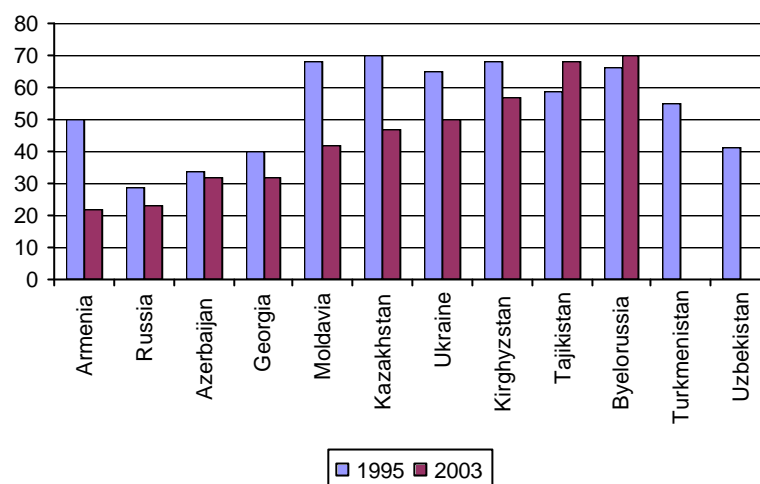


Chart 6: Share of CIS in import, %

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004

Share of CIS in export is still larger than 50% by Byelorussia, Moldavia and Georgia. Share of CIS in import exceeds 50% by Byelorussia, Tajikistan, Kirghyzstan and Ukraine. It is of great importance, that Russia's share of CIS in foreign trade is one of the lowest under the post-Soviet countries, because economic potential and geographic position of Russia makes it a natural leader of any post-Soviet integration.

However, since 1999 the share of intra-regional trade stabilized at 19-20% (export) and 39-40% (import). As in the same period the absolute volume of foreign trade of CIS countries increased, the trade within CIS also was growing. Preliminary data for 2004, which are partly available now, also show positive shifts in trade relations: e.g. Russian export to the Ukraine increased in H1 2004 by 41% (compared with H1 2003); import increased by 38%. The share of intra-regional of Byelorussia increased in Q2 2004 by 2 pp., of the Ukraine 0,9 pp. and of Russia by 1,7 pp.<sup>3</sup> After the 9 month of 2004 the export of post-Soviet countries in the CIS increased by 41%, and import by 39%.

Another positive trend is increasing investment activity of largest (mostly Russian) transnational corporations in the post-Soviet space. According to the World Investment Report 2004, there are 4 CIS countries among top 6 destinations for Russian FDI outflow. We believe, that this figure may be even to low, because investments are partly transferred via offshore centers or unregistered or even half-legal. That is why statistics can fail to disclose the whole FDI outflow.

<sup>3</sup> The "region" is defined not as the whole CIS, but as EES countries (Russia, Kazakhstan, Byelorussia, Ukraine).

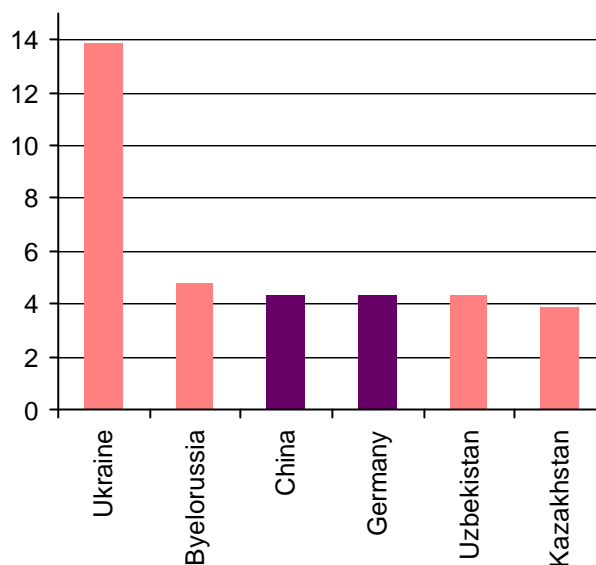


Chart 7: The top 6 destinations for FDI projects from Russia, 2000-2003 (in % of total FDI)

Source: World Investment Report 2004: The Shift Towards Services. UNCTAD, N.Y., 2004, p. 74

### Overview of Top-Down Integration Projects

Despite these positive trends arising bottom up, top down formal integration by creating numerous trade blocks and unions is still inefficient. An important problem for post-Soviet space is a de facto competition of integration blocks, when new integration projects launched are based on incomplete old agreements.

The economic integration within the formal framework of CIS is now considered to be practically impossible because of great divergence of institutional systems of post-Soviet countries. CIS is rather used to refer to a region including 12 post-Soviet republics than to describe an existing integration block. Even *Nazarbaev*, president of Kazakhstan and strong supporter of the CIS, proposed last summer to reduce economic functions of the Commonwealth and to concentrate its activity on security issues. In 2003 (completely without any reaction of the public) the agreement on economic union within the CIS exceeded. The only country still supporting the CIS as the main integration structure has been Ukraine up till now (however, after the establishment of the UES it concentrated its attempts to create a free trade area with no further obligations in the post-Soviet state within the framework of the new organization; the policy of the present-day Ukrainian government in respect of the CIS is still unclear).

The major integration projects in the post-Soviet space are now

- Eurasian Economic Community (EAEC), including Russia, Byelorussia, Kazakhstan, Kirghyzstan and Tajikistan;
- United Economic Space (UES) of Russia, Byelorussia, Kazakhstan and Ukraine,
- Organization of Central-Asian Cooperation (OCAC) of Russia, Kazakhstan, Kirghyzstan, Uzbekistan and Tajikistan, as well as
- Union State of Russia and Byelorussia.

These four groups have different origins, but very similar structure and similar purposes, as well as similar weaknesses. Principal objectives of these groups are mostly the same, as

they all are planning to create a custom union and a free trade area, expecting a deeper integration following (e.g. the Union State and partly the EAEC discussed the possibility of introduction of a join currency). However, even the free trade areas created by these groups are limited due to numerous exceptions.

Another integration project (and the only which does not include Russia) is the GUUAM, which includes Georgia, Ukraine, Uzbekistan, Azerbaijan and Moldavia. The origins of the GUUAM are connected with the TRASECA project and a new pipeline system from the Caspian Sea to the Western markets via Georgia and Turkey. The integration plans of the GUUAM are still unclear.

### **Different Approaches to Post-Soviet Integration**

The studies of post-Soviet integration developed several approaches to the strategy of integration and prospects of the CIS. To sum up, I consider four groups of theories (with practical political applications) (for a detailed discussion see *Grinberg, 2004*).

Originally two approaches dominated the discussion: the first one considered the disintegration of post-Soviet space and collapse of the USSR as an accidental event, and described post-Soviet states as lacking vital capacity. The reintegration of the post-Soviet space was also considered to be natural. The opposite point of view considered the Soviet economic ties as accidental and artificial and main source of inefficient redistribution. Dissolution of old economic connections was also a mean to improve economic performance of all post-Soviet states. In fact both approaches failed to explain the processes in the post-Soviet space. On the one hand, the dissolution of the old economic ties contributed to economic and social crisis in all post-Soviet countries. The “social integration” based on common traditions, social institutions and Russian as a “lingua franca” had a sufficient vital capacity (*Sterzhneva, 1999*). On the other hand, post-Soviet states demonstrated their ability to exist as independent nations.

That is why a new approach, which may be called an “approach of formal integration”, replaced the old ones in the discussion. Post-Soviet integration was compared with that of the European Union (for detailed critical assessment of this approach see *Shishkov, 1992, Shishkov, 1994, Shurubovich, 2000*). This approach can be considered as an example of institutional isomorphism – the central category of social constructivism institutionalism. First, the European integration (with powerful supranational bodies and different stages of integration from the free trade area to the economic and monetary union) seemed to be the natural way of creating an integrated economic area. Second, the European experience formed the main mental constructions used by expert community. Third, European approach was used as an example for “effective” economic integration, which could be adopted in the post-Soviet space.

However, the formal integration approach (which is still dominating the scientific and expert community) turned to be “paper integration”. The CIS structure includes more than 70 supranational bodies with insignificant authorities. A paradoxical situation appeared, when state signed agreements, which they even did not expect to follow. Old not realized agreements were replaced by new agreements. The number of official agreements exceeded 1000 with less than 10% being effective. *Yevstigneev (1997)* introduced a term “pseudomorphism” to describe post-Soviet integration, when the real meaning of official constructions has been quite different to that in the European integration. For example, a custom union was used by inefficient quasi-monopolies to strengthen their economic power. The problem of “formal integration approach” has also been that it ignored political processes in post-Soviet space including divergence of political systems.

Searching for an exit from the theoretical and political deadlock, a new paradigm was introduced. The post-Soviet integration was associated with expansion of large (mostly

Russian) corporations, which have been considered to be an “ordering power” (in terms of the ordoliberal theory) creating a new economic unity of post-Soviet space as functional region. The governmental activity was considered to be useless and surplus. This approach also simplifies economic processes in transformation states, because it ignores the problem of monopolization, concentration of economic power and “demand for bad institutions” (see e.g. *Libman, 2004*). But it is important to recognize, that in an spontaneous economic order activity of economic entities is of critical importance for regional integration.

### Role of Russia in the Post-Soviet Space

What is the reason for this fragile development of formal integration in the post-Soviet space? Indeed, one could believe this situation both a natural result of formation of the state sovereignty and logical aftermath of shock transition from the planned-and-distribution policy model to the market economic system in the new independent states. However, this changes nothing in the evaluation of the situation in real terms. The common economic space, which existed at the territory of the former Soviet Union, is largely destroyed.

Nevertheless Russia continues to play the key role in the system of relations between post-Soviet countries. Its GDP accounted for 76,6% of the total GDP of all CIS countries in 2003; the share in population was 51,2%, in territory 77,2% and in external trade turnover 65%. It is worth noticing, that the GDP share is significantly higher, than the share in population. It represents a higher per capita GDP in Russia (see Chart 2). De facto, with respect to many parameters, it continues to play the same functions, which it performed during the existence of the Soviet Union. Russia is the main supplier of energy resources to post-Soviet countries (with mineral resources being the main article of intra-regional trade in the CIS, see Chart 8), an important transit country for export and import, a large consumer of products manufactured in these countries, and an attractive source of jobs sought by people from the newly independent states. In contrast to the time before disintegration of the Soviet Union, Russia now acts as a large-scale consumer of transit services in several new states, providing them in return with a significant sustainable income.

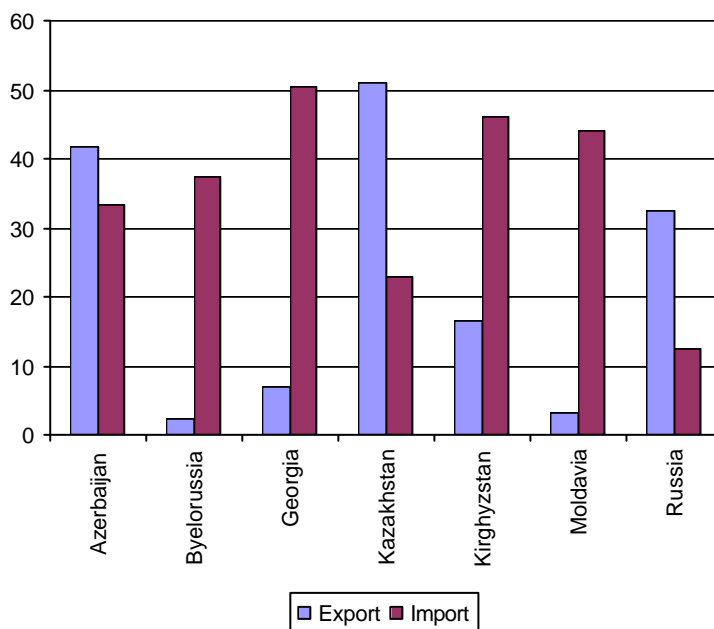


Chart 8: Share of mineral resources in export from the CIS and import in the CIS of selected post-Soviet countries, 2003, %

Source: Foreign Trade of the CIS Countries in 2002-2003. Statistical Review. Moscow, 2004



Considering the commodity structure of the intra-regional trade, it is important to notice, that oil & gas are the main import position for all countries excluding Russia. The export structure is more diversified with machines (Byelorussia), food & agricultural products (Georgia, Kazakhstan, Moldavia) and textile (Kirghyzstan) being the main article. Only for Russia and Azerbaijan oil & gas dominate the export in CIS countries<sup>4</sup>. This structure is partly very similar to that existing in the USSR but partly represents the primitivization of post-Soviet economies, which have passed a “tragic transit in the Middle Ages”.

### The Case of August Crisis 1998

The real significance of Russia for the economies of the post-Soviet countries was apparent after the Russian financial crisis in August 1998. The analysis of growth rates demonstrates an existence of certain transmission effects. Chart 9 compares changes in growth rates 1998 to 1997 and 1999 to 1998. In 1998 Russia and Moldova were the only two countries with decreasing growth rates. All other CIS countries demonstrated accelerating growth. But already in 1999 numerous post-Soviet republics (including countries with higher dependency upon Russia, like Byelorussia, Armenia and Azerbaijan) also reduced their growth rates. It is possible to conclude, that there has been a kind of lag in the transmission mechanism.

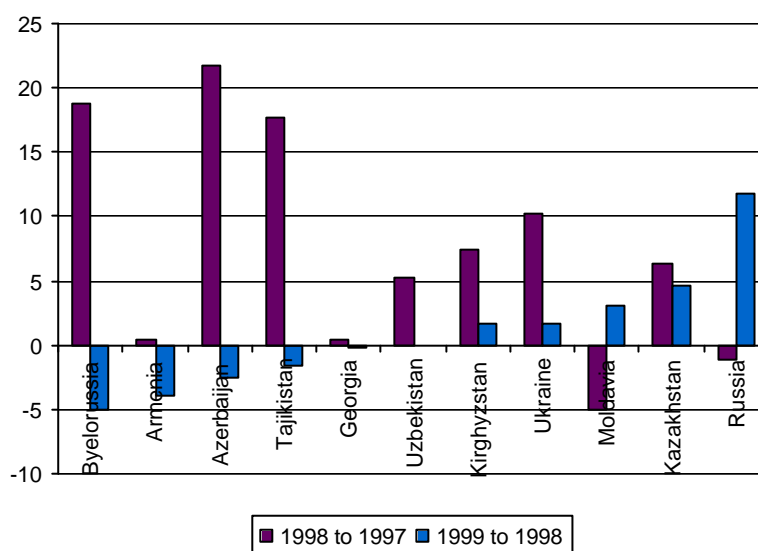


Chart 9: Changes in growth rates, percent points

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004

The crisis affected former Soviet republics in several ways. However, the overall effects and the intensity of the impact were different, depending on the level of that country's development, the nature and extent of its reforms, and the level of its economic relations with Russia. First of all, the crisis increased inflationary expectations and diminished confidence in the national currencies in all CIS countries. As a result, there was a drastic increase in the demand for freely convertible currency. The deterioration of the business situation in Russia also made a negative impact on the wages of many legal and illegal migration workers, and this diminished the flow of foreign currency to the CIS countries. In addition, the Russian crisis led to a decrease of foreign currency reserves in all the CIS countries without exception, since the foreign currency reserves were used to stabilize national currencies.

The "Russian factor" also had a perceptible effect on the volume of foreign trade. The four-fold devaluation of the Russian ruble hampered access to Russian markets of goods

<sup>4</sup> There is no information about the export structure for Armenia, Ukraine, Turkmenistan and Tajikistan.

produced in the CIS countries and facilitated the penetration of Russian exporters into the markets of these countries. This drastically reduced the production of goods for the Russian market in the CIS countries and significantly diminished the taxable base. As a result, the budget situation became more difficult. Decreasing budgetary revenues diminished opportunities for external debt servicing and additional borrowing on external financial markets.

All CIS countries have undertaken efforts to neutralize the effects of the Russian crisis. These efforts were determined by conditions, in which these countries found themselves, and opportunities, which they had. However, their response to the critical situation had some common features:

- Stricter controls of credit and finances, as well as of the banking system (increases in bank reserves, restrictions of foreign currency operations);
- Rescheduling of domestic debt servicing;
- A radical rather than moderate devaluation of national currencies;
- Increase of foreign debts owed to Russia (for energy), international financial institutions, and banks of "third countries";
- Search for alternative markets;
- Expansion of barter operations in foreign trade.

In several countries, the deterioration of the financial situation accelerated market reforms. These countries include Azerbaijan, Armenia, and Georgia. In contrast, in some other countries, management of the economy became more centralized; these countries include Belarus, Kazakhstan, and Uzbekistan. Belarus introduced export restrictions for domestically produced goods in an attempt to neutralize changes in price ratios, while Kazakhstan introduced import dues for goods imported from neighboring countries. Entrepreneurs from Baltic countries increased their efforts to create businesses on Russian territory and expand direct links with the administrative regions of Russia.

In general, the Russian crisis stimulated disintegration processes in the post-Soviet space. It was the trigger for crises in each of the CIS countries. It should be pointed out that the CIS countries in general are very crisis-sensitive (we call it "crisis potential"), which is a consequence of the numerous weaknesses of their national economies. A major structural flaw is their dependence on the export of only one or two types of goods, or dependence on markets of only one or two countries.

The consequences of the Russian crisis had negative impacts on the economy of the new states up to the middle of 1999. Thereafter, these negative effects became less significant, and the accelerating growth of the Russian economy began to positively affect the economies of the CIS countries.

### **Russian Policy in the Post-Soviet Space**

The Russian factor takes on a different form on the political arena. During the first years after the disintegration of the Soviet Union, Russia proclaimed all post-Soviet space to be the area of its vital interests and tried to dominate the policies of the CIS countries. The transformation of the CIS into a military-political union (with Russia playing the leading role), which would be recognized by international law, was thought to be an ideal scenario of CIS development. However, this policy led to tensions with almost all post-Soviet states, which were trying to conduct a balanced multi-factorial policy in order to neutralize Russian claims to leadership.

Russian policy toward the new independent states began to change in 1999. By that time, new threats from Islamic fundamentalism to the post-Soviet states became apparent. All coun-

tries of the Southern Caucasus and Central Asia began to experience more and more serious problems in relations with their neighbors. Under these conditions, the stabilizing role of Russia in these regions increased sharply. In this connection, it is quite logical that members of the Treaty of Tashkent on collective security have the closest military-political relations with Russia. Relations between Russia and countries of this group, the political and economic components of their cooperation are either similar (Belarus, Kazakhstan) or the political component exceeds economic significance (Armenia, Kirgizstan, Tajikistan). External threats represent an important factor, which brings these countries closer to Russia.

In relations with other countries, the economic component is more important than political factors. But there are big differences even here. Azerbaijan and Uzbekistan have a close co-operation with Russia. Azerbaijan needs Russian support in its border dispute with Turkmenistan, in its intricate relations with Iran, and in its search for an acceptable solution of the conflict with Armenia. Uzbekistan needs Russia's military and political support in the struggle with Islamic radicals, though Uzbekistan sees itself as a leader in Central Asia.

Representatives of the Ukrainian political elite were always actively playing the Russian trump card during presidential election and elections to the Ukrainian Parliament. This process was extremely polarized. Candidates supporting large-scale and broad cooperation with Russia were always popular among the electorate. However, after election the candidates conducted rather restrained policy towards Russia, looking predominantly to the West. This took place before presidential elections in Ukraine in November - December 2004. And despite unexpectedly exotic character of current runoff I shall take on myself risk to assert that henceforth the Ukrainian leadership will carry out actually all the same policy of equal distance from the West and the East by preserving pro-Western rhetoric.

Moldova, experiencing huge economic and political difficulties and strongly dependent on the supply of Russian fuel and the sale of its traditional exports on the Russian market, to considerable degree has been following pro-Western policy even after the victory of the communist at the presidential elections in 2001. But it is unlikely that Moldova will be capable of solving the Transdniester problem without Russian support.

Turkmenistan continues to pursue its own, independent foreign policy, distancing itself from Russia and the other CIS countries. On the economic front, however, greater cooperation with Russia in gas production is in the pipeline.

Georgia, which pursued, in my view, the most hostile policy with respect to Russia of all the post-Soviet countries, is now trying to establish a dialog with Russia.

Generally, over the last three years, we have seen a trend toward the increase of Russia's political influence in the post-Soviet countries. Thus, the political factor starts to be on a par with Russia's economic influence. The question is where this growing influence leads. Does this phenomenon stimulate the consolidation or on the contrary the fragmentation of this space?

### **Prospects for Future Regional Cooperation and Integration**

Reintegration, understood as the restoration of broken ties, has mainly become populist rhetoric, because conditions for full-scale integration on a market basis within the CIS have not yet matured. It is worthwhile to point out that proposal of new integration initiatives in the second half of the 1990s, which had become an almost annual event, and expectations of an "integration breakthrough" in fact only discredited the idea of reintegration. They were generating illusions, disappointments, and recrimination.

The disintegration of the Soviet Union and the hasty liberalization of the economies of the newly independent states highlighted the reality of the economic position of these countries: instead of desirable transition to the first world (this was a common intention by the end

of “perestroika”) they are moving to the third one. This fact was overlooked, when reintegration plans were developed. The declared goals and mechanisms proposed for cooperation were simply inadequate in terms of the conditions in these countries. At the present time, concepts like their "collective isolation" from the rest of the world are not even considered; it goes without saying that there are no initiatives on the development of a common position with respect to third countries.

In contrast, there is a distinct tendency of each of these countries to become independently incorporated into the process of economic globalization (some of the post-Soviet countries are already members of the WTO, while others are taking steps in order to become members). These countries also want to participate in European integration, diversify their foreign economic relations, cut down their trade on unreliable markets and increase the number of partners willing to invest and participate in the structural transformations of their economies.

Another process taking place in these countries is the erosion of those cultural and mental features of their populations, which were a basis of their previous unity. Despite all the differences between them, citizens of countries belonging to the European Union increasingly view themselves as Europeans. This definition is based on a common foundation consisting of cultural, ideological, moral, and ethical standards. However, nothing of this sort appears to exist in the CIS. "Homo soveticus, a new historic phenomenon", with all its good and bad properties is leaving the scene, and no new post-Soviet identity along the lines of a "Homo post-soveticus" is on the horizon. Of course, this makes the future of real multilateral cooperation rather uncertain.

Nevertheless, there is still deep economic interdependence between the CIS countries and it would be a mistake to ignore this interdependence. According to the available estimates, nearly 100 segments of Russian economy depend on relations with their partners in the CIS countries. This situation is common in the military-industrial complex, mechanical engineering, light and chemical industries, and several others.

Other CIS countries (besides Russia) also have a high degree of economic interdependence. Thus, a significant part of Georgian and Ukrainian demand for natural gas is satisfied by shipments from Turkmenistan. Shipments from Uzbekistan and Kazakhstan are vitally important for the economies of Tajikistan and Kirgizstan. The economy of Moldova has close ties not only to the Russian economy but also to the economy of Ukraine. The economic interdependence of the CIS countries as well as the growing awareness in many of them that reorientation to the West (where, with few exceptions — raw materials — there is no demand for their goods) may result in further structural degradation of their economies and the loss of high-tech industries and are those objective factors acting towards greater economic integration of the CIS countries. This process is also supported by certain remaining cultural, spiritual or personal (family) ties between the former Soviet republics. Another very important factor is that practically all adults in the CIS countries know the Russian language, which was the "language of communication between nations" in the Soviet Union. But one should not forget that we have to do with a disappearing reality.

The further development in the post-Soviet space will be determined in the foreseeable future by many factors acting in opposite directions. The expansion of the European Union to the East will have an important effect on the reintegration of CIS countries within the next few years. The effect may be two-fold. On the one hand, the expected rapid social and economic progress of new European Union members will serve to increase the gravitation of the CIS countries towards the European Union. On the other hand, the increased barrier on the borders with the European Union will prompt the CIS countries to look for ways of improving relations within the CIS.

All possible scenarios of the future development of the post-Soviet space will, of course, be dependent on the balance of forces within the member countries. One scenario of further evolution includes the breakdown of the post-Soviet space in its present form and the emergence of a new combination of transient political and economic alliances between countries and parts of countries. The other possibility is the formation of a significant stable alliance of countries around Russia.

In all scenarios, the central figure in the conflict of interests is Russia with 60—65% of the total CIS economy, 85% of the economy of the EAEC, and 95% of the economy of the Russia-Belarus Union. Further events in the post-Soviet space will largely be dependent on whether it will be capable of bridging the gap separating it from the leading countries of the world and transforming itself into a growing and prosperous part of the world economy. It should be added that Russian territory, a major part of the post-Soviet space, was in the 90-s the arena for serious and acute disputes and conflicts. At the turn of the 21st century, there was a real threat of the disruption of Russian economic space and Russia badly needed the reversal of these centrifugal tendencies and the consolidation of Federal authority. It would not be an overstatement to say that the economic and political weakness of Russia, which could not play the role of the consolidating center in the post-Soviet space, became in the last decade of the 20-century a very impotent factor for the economic disintegration of the postsoviet space.

The restoration of the "power vertical" in Russia, continuation of the remarkable economic growth during 2000-2004 as well as improvement of Russia's financial standing led to significant changes in the spirit of its relations with other CIS countries. In this context, Russia today is facing a difficult choice. Which of the reintegration processes must be given greatest priority? Should emphasis be put on the Union between Russia and Byelorussia, on the EAEC, on the implementation of a new idea called "United Economic Space"(Russia, Ukraine, Kazakhstan, Byelorussia) or the CIS as a whole? Russia simply cannot move in all directions at once, while preparing for membership in the WTO and developing its cooperation with the European Union and the Asia-Pacific Economic Cooperation (APEC), including China. Any progress along each of these directions of integration mentioned above requires significant intellectual efforts and financial resources.

Generally speaking, the balance of domestic and foreign economic and political factors will determine the position of Russia with respect to the four mentioned alliances. They include Russia's financial position, which is determined by export revenues and expenditures necessary for servicing external debt, credibility of the threat from Islamic radicalism, attitudes of the European Union and the United States to Russian policy in the region, conditions for accession to the WTO, and characteristics of macroeconomic policy, such as continuing liberalization "at any price" or increasing reasonable governmental activity.

I am sure that in the presence of any combination of political and economic factors, a fully functional integration of all CIS - states is unlikely within the next 10—12 years and, probably, in a more long-term perspective as well. The same seems to be true in terms of "union" of Russia and Byelorussia. Anyway the single state consisting of two republics hardly has a realistic perspective, at least in the short run because of a reluctance of today's leadership of Byelorussia to put up with significant losses of its sovereignty. It means, that **economic integration** (in the sense of developing of supra-national bodies and transferring power to them) as the main objective is to be replaced by a more modest approach of **economic cooperation**. One more factor, which excludes the possibility of creating powerful supranational structures, is the position of Russia, which is not enough powerful to act as a regional hegemon supporting a stabile international economic and political order (as the theory of hegemonic stability assumes), but is too powerful to dominate any supranational body, which is in that way turned to the periphery of Russian politics with former Russian

politicians “banished” after the end of their carrier in the structures of the CIS, Russian-Byelorussian Union or EAEC.

As the economic and political strength of Russia increases, the configuration of certain regional groups may change. These changes may involve participation in already existing alliances or the formation of new alliances. It is quite likely that the CIS will once again become more active. However, this would require very specific and realistic economic and political motivation. From the economic and political point of view, Uzbekistan appears as the most appropriate candidate for membership in the EAEC, while candidates for membership in the Russia-Byelorussian Union may include Ukraine, Moldova, and possibly Armenia.

Concerning prospects of a realization of the Agreement on formation of Unified Economic Space (UES-4), it is necessary to stress the exclusive importance of a probable dynamics of, so to say, the Ukrainian factor. In effect, the project of UES can be considered as attempt to involve the second country of CIS in terms of economic potential into processes of economic consolidation of the post-Soviet space. If this project will be successful, in fact we will be witnessing the enlargement of the Eurasian Economic Community though Ukraine, apparently, will not agree to full membership in it. If it happens, chances for formation of any supranational bodies in this space (EEC+1), are reduced, but the enlarged zone of free trade may become a working mechanism. Ukraine, as it is known, for a long time has been insisting on such mode of multilateral economic cooperation within the framework of the CIS. And Russia has made this year essential concessions, having agreed on collection of VAT in mutual trade in accordance with international rules. The formation of a zone of free trade consisting of EEC+1 provides for Ukraine unique opportunities for gaining additional economic and political benefits given that it becomes a very important part in the planned all-European economic space. However, the recent “Orange Revolution” in the Ukraine makes its participation in a deeper economic integration on the post-Soviet space questionable.

In one way or another, if Russia attempts to reintegrate post-Soviet space, it will have to solve overwhelming problems, unprecedented in their magnitude and complexity. As a first step, it will have to change its approach to organizing such a process and find a new model of cooperation, more appropriate to current conditions.

The mode used to organize such interaction between the countries during the first years of the CIS was traditional for economies with central planning. But the top-down command approach to integration was not applicable even for transition economies. It will be even more inappropriate for market economic systems and unacceptable politically for the newly independent states. Decisions taken in the context of the CIS were not linked with the interests of specific economic entities and, therefore, often were left "dangling in mid-air". Perhaps, the accent on governmental regulation of cooperation was to some extent justified during the first years of the CIS, when economic relations between the former Soviet republics were abruptly severed and the new market-oriented economic entities had not yet become fully functional. At the present time, however, when the center of gravity in mutual economic relations has moved to the level of economic entities, this approach seems to have seen its better day.

The new model probably has to function on the micro-economic level, recognizing the decisive role of individual businesses in the development of economic ties within the CIS. As demonstrated above, these microeconomic ties become of greater importance for post-Soviet space. As a monthly bulletin of the Alfa Bank states, many Russian countries consider the CIS as a “second Russia” with still existing sources of extensive economic growth. The dominance of micro-level is may be the essence of economic **cooperation** in a market economy.

The importance of B2B relations does not mean, however, that the development of mutual economic relations should be entirely left to the control of entrepreneurs, eliminating the roles played by the economic policies of the countries, as well as the institutional and legal aspects of cooperation. Successful development of cooperation requires consistent, purposeful, and mutually complementary actions both "bottom-up", i.e., from economic agents, and "top-down", i.e., from governmental agencies and emerging institutions. The role of governmental regulation in this process should undergo a profound change as compared with the recent past. Under the new conditions, governments should influence the development of economic ties between the CIS countries, mainly by creating the necessary conditions for successful relations between economic entities and for the formation of transnational economic institutions (financial-industrial groups, trusts, corporations, joint ventures).

Conditions leading to greater economic cooperation should include, among other things, the removal of barriers to the development of mutual trade and other forms of cooperation, the creation of an effective system of settlements, coordinated market reforms, harmonization of the economic legislation of partner countries, harmonization of tax and financial systems, as well as control of foreign economic activity. The goal should be to create within the framework of the CIS an effective mechanism for the enforcement of obligations of the partner countries and their economic agents.

Productive cooperation requires meticulous comparison of the profits and losses resulting from the implementation of various initiatives. Implementation of this principle requires clearly formulated priorities by the partner countries and proper attention to the available means for achieving set priorities. Governmental support of businesses cooperating with partners from the CIS countries in priority industries may be important. Such support at early stages would lead to significant financial expenditures, but the advantages resulting from cooperation in the long run could be significantly greater. From our point of view, among the high-priority tasks are the revitalization of promising commercial relations, restoration of cooperation between technologically related businesses, and the start of mutual investments, even if in a limited scope. We must remember that real economic integration in Western Europe began with the signing of the European Coal and Steel Community Treaty in 1951.

An important avenue for more active cooperation would be joint implementation by interested countries of promising projects mainly in the area of transportation, energy production, and communications. However, it would be inadmissible to use such projects (particularly projects with participation of third countries) for leverage or exercising pressure on partners within the CIS or for infringement of their interests.

Since member-countries of the Russia-Byelorussian Union, the EAEC, the GUUAM, and the OCAC are at the same time CIS members, it is necessary to try to coordinate the activity of these alliances and to depoliticize them as far as possible. The existing competition of regional integration projects does not contribute to its success. This will contribute to mutual openness and help to abolish elements of unhealthy competition. It should be remembered that subregional alliances pursue different interests and reflect differences of the potential of the participating countries; these groups have different goals and operate on the basis of different mechanisms.

Because of big differences that exist between the post-Soviet states, their limited financial resources and the poverty of their populations, there should be no strictly fixed rules on the unification of macroeconomic indicators (taxes, custom duties, interest rates, etc.). It is necessary to seek the forms and mechanisms of economic integration, which would be effective even in the presence of significant differences in the national economic systems.

Perhaps, it would be appropriate to create "industry-specific" common markets within the CIS in those areas where common interests justify this approach (common markets for

agricultural products, for metalwork, or perhaps, for labor, etc.). Those CIS institutions that deal with specific industries could play a constructive role in the creation of such markets. Cooperation is particularly important in the communication industry.

The emerging tendencies to cooperate at the transborder regional level should be supported as well. Such cooperation already exists between several regions of Russia and transborder regions of Ukraine, Belarus, and Kazakhstan, and brings significant benefits to the participating countries. It should be added here that high transportation costs increase the significance of transborder cooperation between the CIS countries.

It is important to secure public support for the process of rapprochement, to exert pressure on power structures, so that they would take steps to facilitate contacts between individuals and different groups of population, having common personal, cultural, economic, national, and other interests.

Russia's behavior is of primary importance for further development of the CIS. In order to play a positive integrating role in the alliances, Russia must develop a balanced and consistent course in its relations with partner countries. It is very important to properly identify those economic interests of these countries, which are relevant to cooperation with Russia, and to support them by all available means.

It is important to make a transition from declarations about the priority of Russia's relations with the post-Soviet countries to practical steps. It should be particularly stressed that Russian priority interests with respect to the CIS should not be interpreted as a sign that the CIS will have a dominant position in the system of foreign economic relations of Russia. The goal is to reverse the current trend and to maximally use the potential of interactions between Russia and its nearest neighbors, who share a common historic fate and are carrying similar burdens under new conditions.

Recognition by Russia that its relations with the CIS countries have priority and the fact that, objectively speaking, Russia is the economically strongest CIS country, obligate Russia to make certain material and financial efforts: Russia should play the role of donor for its economically less developed partners. In this connection, taking into account Russia's current limited opportunities, it is important to clearly define the acceptable degree of such "donor" activities and to designate the specific directions of such aid to its partners; the main criterion for such a system is whether in the long term it will bring economic or geopolitical advantages.

The real preconditions for the transformation of the now amorphous CIS into a viable regional bloc will appear only when pleasing dreams of integration are replaced by concrete goals, arising from a concrete collective interest. If Russia initiates a comprehensive programme of restructuring the post-Soviet economy on the basis of the carefully chosen priorities and the wide spreading of modern technologies, this interest will spring up without any coercion. I would designate it as a collective interest in the organization and development of competitive transnational corporations, able to be subjects, not objects of globalization, within the framework of the CIS.

No matter, which specific scenario will be developed in the future, we should recognize that the relationships between the post-Soviet states should not be based on coercion, as was the case in the Comecon, which served essentially as an economic superstructure for the military-political union. All the CIS countries, including Russia, will inevitably continue their sometimes very torturous search for the balance of mutual interests on an equitable basis, but this is the only way.

### **Post-Soviet and European Integration**

It is important to recognize, that the post-Soviet integration will never become a



geopolitical or geo-economic alternative to the European Union. In contrast, the success of reintegration within the CIS will depend on how this developing process in the post-Soviet space may be harmonized with European integration and whether CIS integration may become an organic (although modest in economic terms) part of European integration.

It also means, that the relations between the EU and the post-Soviet countries become an important factor of economic development of post-Soviet states, as well as of the post-Soviet integration. Charts 10 and 11 show, that the trade with the EU plays an important role for the majority of the CIS countries.

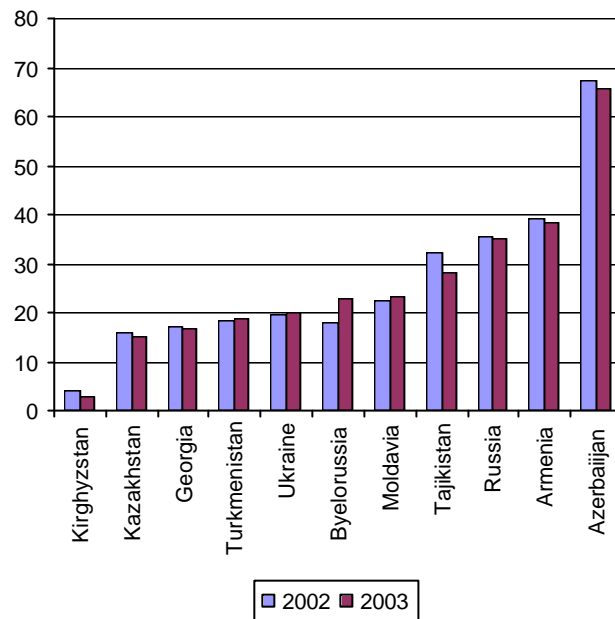


Chart 10: Trade with the European Union, % of total export

Source: Foreign Trade of the CIS Countries in 2002-2003. Moscow, 2004, p.44-45

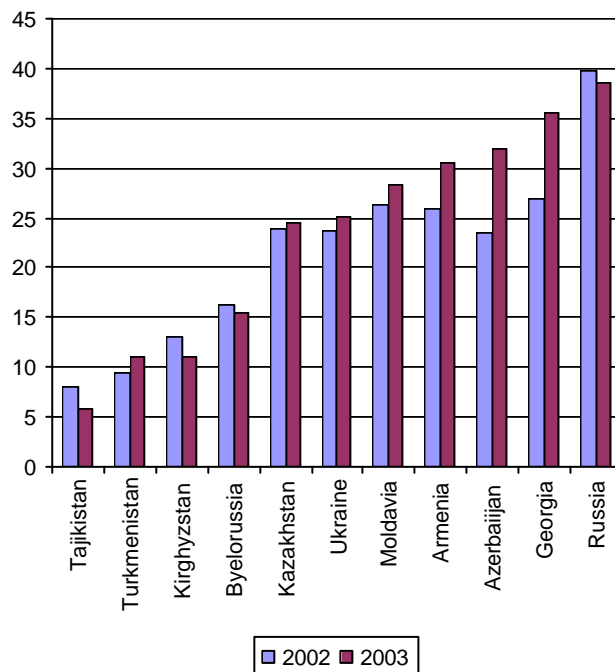


Chart 11: Trade with the European Union, % of total import

Source: Foreign Trade of the CIS Countries in 2002-2003. Moscow, 2004, p.46-47

Some post-Soviet countries (first of all, Ukraine) have already declared their plans to start accession negotiations with the European Union. Even the official name of the main Ukrainian governmental body responsible for economic issues is Ministry of economy and European integration. The ability of the EU to initiate new enlargement rounds is limited because of internal institutional and political problems. That is why I believe, that an intermediary solution is to be found to ensure a favorable environment for the economic relations between the CIS countries and the EU. The successful experience of CEFTA and of the Vyshegrad group can also be used to prove the importance of regional integration for development of relations with the EU.

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Table 1  
**Russia's Share in The Foreign Trade of Post-Soviet Countries in 1994 and 2003, %**

Country	Export		Import	
	1994	2003	1994	2003
Azerbaijan	21.9	4.0	15.2	15.0
Armenia	38.9	2.4	28.4	12.8
Belarus	46.1	44.8	61.1	71.8
Georgia	15.1	9.3	7.7	10.3
Kazakhstan	42.8	18.2	36.3	39.2
Kirgizstan	17.4	15.8	21.8	22.3
Moldova	51.1	34.7	46.9	17.2
Tadjikistan	9.3	10.0	15.2	15.8
Turkmenistan	4.7	8.6	13.6	14.9
Uzbekistan	38.9	21.0	36.4	21.7
Ukraine	40.3	16.2	54.1	34.0
Latvia	28.0	5.6	25.7	18.8
Lithuania	28.2	6.9	39.3	23.2
Estonia	23.0	5.2	16.6	22.1

Source: Direction of Trade Statistics, Quarterly, June 2004. IMF

Table 2

**The Share of the CIS and Other Countries in the Total Foreign Trade Turnover, %**

	1995			2003		
	Total	CIS Countries	Other Countries	Total	CIS Countries	Other Countries
<b>Export</b>						
<b>Azerbaijan</b>	100	45	55	100	13	87
<b>Armenia</b>	100	63	37	100	19	81
<b>Byelorussia</b>	100	63	37	100	55	45
<b>Georgia</b>	100	62	38	100	50	50
<b>Kazakhstan</b>	100	55	45	100	23	77
<b>Kirghyzstan</b>	100	66	34	100	35	65
<b>Moldavia</b>	100	63	37	100	54	46
<b>Russia</b>	100	19	81	100	15	85
<b>Tajikistan</b>	100	34	66	100	17	73
<b>Turkmenistan</b>	100	49	51	100	...	...
<b>Uzbekistan</b>	100	39	61	100	...	...
<b>Ukraine</b>	100	53	47	100	26	74
<b>Import</b>						
<b>Azerbaijan</b>	100	34	66	100	32	68
<b>Armenia</b>	100	50	50	100	22	78
<b>Byelorussia</b>	100	66	34	100	70	30
<b>Georgia</b>	100	40	60	100	32	68
<b>Kazakhstan</b>	100	70	30	100	47	53
<b>Kirghyzstan</b>	100	68	32	100	57	43
<b>Moldavia</b>	100	68	32	100	42	58
<b>Russia</b>	100	29	71	100	23	77
<b>Tajikistan</b>	100	59	41	100	68	32
<b>Turkmenistan</b>	100	55	45	100	...	...
<b>Uzbekistan</b>	100	41	59	100	...	...
<b>Ukraine</b>	100	65	35	100	50	50

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004, p.84

**Table 3. Major Macroeconomic Indicators for the CIS Economy (1991=100)**

	<b>1992</b>	<b>1995</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>GDP</b>	86	63	68	73	77	82
<b>Industrial production</b>	82	52	61	65	68	74
<b>Agricultural production</b>	93	73	69	74	76	75
<b>Capital investment</b>	61	36	34	38	40	47
<b>Goods transport (without pipeline transportation)</b>	74	31	24	25	26	28
<b>Retail trade turnover</b>	86	71	80	89	98	107

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004, p.13

**Table 4. Indices of the Physical Volume of GDP (at Constant Prices)**

	<b>1992</b>	<b>1995</b>	<b>2000</b>	<b>2001</b>	<b>2002</b>	<b>2003</b>
<b>As percentage of 1991</b>						
<b>Azerbaijan</b>	77.4	42.2	59.3	65.1	72.0	80.1
<b>Armenia</b>	58.2	59.8	76.8	84.2	95.3	108.2
<b>Byelorussia</b>	90.4	66.1	89.7	94.0	98.7	105.4
<b>Georgia</b>	55.1	35.8	47.5	49.7	52.5	58.4
<b>Kazakhstan</b>	94.7	69.0	78.0	88.5	97.2	106.2
<b>Kirghyzstan</b>	86.1	55.0	72.2	76.1	76.1	81.2
<b>Moldavia</b>	71.0	48.0	42.0	45.0	48.0	51.0
<b>Russia</b>	85.5	65.4	70.8	74.4	77.9	83.6
<b>Tajikistan</b>	70.0	41.0	41.0	45.0	49.0	54.0
<b>Turkmenistan</b>	...	...	...	...	...	...
<b>Uzbekistan</b>	88.9	81.6	98.8	103.2	107.5	112.3
<b>Ukraine</b>	90.1	52.3	47.4	51.7	54.4	59.5
<b>The CIS</b>	86	63	68	73	77	82
<b>As percentage of the previous year</b>						
<b>Azerbaijan</b>	77.4	88.2	111.1	109.9	110.6	111.2
<b>Armenia</b>	58.2	106.9	105.9	109.6	113.2	113.9
<b>Byelorussia</b>	90.4	89.6	105.8	104.7	105.0	106.8
<b>Georgia</b>	55.1	102.6	101.9	104.8	105.5	111.1
<b>Kazakhstan</b>	94.7	91.8	109.8	113.5	109.8	109.2
<b>Kirghyzstan</b>	86.1	94.6	105.4	105.3	100.0	106.7
<b>Moldavia</b>	71.0	98.6	102.1	106.1	107.8	106.3
<b>Russia</b>	85.5	95.9	110.0	105.1	104.7	107.3
<b>Tajikistan</b>	70.0	87.6	108.3	110.2	109.5	110.2
<b>Turkmenistan</b>	...	...	...	...	...	...
<b>Uzbekistan</b>	88.9	99.1	103.8	104.5	104.2	104.4
<b>Ukraine</b>	90.1	87.8	105.9	109.2	105.2	109.4
<b>The CIS</b>	86	95	109	106	105	108

Source: The Commonwealth of Independent States in 2003. Statistical Review. Moscow, 2004, p.19