

## Russian-Belarusian economic relations after 2014 - change or continuity?

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### Abstract

Russian economic policy towards Belarus is a result of structural ties, binding both countries. The performance of Belarusian economy and therefore the position of president A. Lukashenka, depends on Kremlin's support. This framework allows Russia to influence its partner. Exports blockades, negotiation on gas and oil prices etc. are frequently applied to reach Kremlin's goals. Russian interest in Belarus are both political and economical. Moscow is striving to keep Minsk in its sphere of influence, especially through inviting it to projects integrating the post-Soviet area, and economic tools are used to pursue that goal, as evidence provided demonstrate. At the same time Russia is realising economic interests. „Milk wars” are conducted in order to protect Russian companies. Pressure in oil sphere is used to assure proper income for companies that are connected to economic ruling elite of Russia. Increase of gas prices should be seen as an attempt to base relations in this sphere on rules closer to „market basis”.

Russia's invasion on Ukraine in 2014 was not an element that changed the relations between the two countries in the economic sphere. Therefore Russian-Belarus economic relation are from its very core doomed for constant conflicts and negotiations. Both sides are not ready to fully realise their commitments as written in the documents signed by them and constantly try to test the limits of the other side. However the economic crisis, that both countries experienced significantly limit their room of manoeuvre. Russia's troubles limits Kremlin's possibility to support its ally. At the same time Minsk's position in negotiation of economic issues is weakening. In the long run this issue may change the structure of bilateral economic relations.

### Disclaimer

*This publication expresses only the opinions of the author himself and cannot be considered the official position of the Ministry of Foreign Affairs of the Republic of Poland.*

### Introduction

The paper will explore Moscow's economic policy towards Minsk. It will try to answer two questions. First we will try to establish whenever there was a systemic change in bilateral economic relations after the Revolution of Dignity in Ukraine and subsequent Russia's invasion on its neighbour, initiated in 2014. Then we will try to confirm or reject the statement, that Russia is using the economic tools in its foreign policy to reach specific goals. These goals will be defined as: keeping the country within Moscow's sphere of influence and widening Russia's presence in the economy of a given country.

Both countries were parts of USSR's economy, what resulted in their trade and finance interconnectivity and in some cases - production complementarity. Another heritage of the Soviet past could be seen in similarities of their respective economic models. This inheritance created a structure, that urged both countries to cooperate.

Belarus is heavily dependent on Russia in economic affairs. Moscow is Minsk's main economic trade partner. Gazprom is providing Belarus with gas on preferential prices. Products of key Belarusian sectors are exported to Russia. Also Russian oil is refined in Belarusian

refineries and the product of refining is exported abroad - being important source of hard currency. Russia is also main investor and provides credits to maintain Minsk's liquidity. Given the instability of the Belorussian economic model, this support allows President Aliaksandr Lukashenka to stay in power.

It is frequently underlined, that when Vladimir Putin came to power in Russia, Kremlin started to decrease its economic support for Belarus<sup>1</sup>. This narrative suggest that Borys Yeltsin was more inclined to support the government in Minsk. However one could notice that Yeltsin was serving as a president for 8 years (1991-1999), while Putin is ruling Russia for more that 16 years (from becoming an elected president in 2000 until today<sup>2</sup>) and the decrease is still ongoing. Nevertheless it should be noted that the aid after 2000 became increasingly bound to certain conditions.

Minsk is important Moscow partner in projects concerning the integration of post-Soviet space. It is a member of all important political, security and economic bodies in the region i.a.: the Union State of Russia and Belarus, the Commonwealth of Independent States, the Common Security Treaty Organisation and the Eurasian Economic Union.

Post-2014 events changed the environment in which these bilateral relations are conducted. With the Revolution of Dignity in Ukraine, Moscow grew more suspicious towards Minsk, fearing that it will follow Kyiv's example and drift towards the EU. President A. Lukashenka found himself in new geopolitical circumstances with Russia, his traditional biggest ally, using openly military power in Europe agains another post-Soviet state.

Another important element of the situation after 2014 was the worsening economic situation in both countries. Russian economy is experiencing serious difficulties, arising from lack of internal reforms, overstretch of resources , low oil prices and western sanctions. Belarus experienced significant GDP fall, being a result of inherent disequilibrium of its economy, and also - long-term lack of reforms.

Some incidents in 2016/2017 suggest that economic relations between the partners experienced a serious slump. The gas and oil disputes, restrictions on agricultural exports or border blockages seem to be a telling evidence.

We will begin the analysis with the presentation of the economical models of Belarus and Russia. We will also draw attention to their current economic situations Then we will explore trade relations between the two countries. In the next section we will look at Russian investments in Belarus, together with Moscow's credit support. Finally we will describe bilateral relations in crucial energy sector - trade in gas and oil. Due to limited space examples presented here are by default selective. The goal of the paper is to provide the picture of bilateral relations rather than a complete history of Belarussian-Russian relations.

### Conditions of bilateral economic co-operation

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<sup>1</sup> Compare e.g. Andrew Wilson, *Belarus. The last dictatorship in Europe* (New Haven and London: Yale University Press, 2011), 244.

<sup>2</sup> Some authors sometime suggest that the period of D. Medvedev's Presidency should be analysed as a different moment in Russia's political history. This author is a supporter of the opinion that for the whole post-2000 cycle V. Putin was the power centre.

As pointed above, both countries, shares some elements of economic models. However Belarus and Russia underwent different developments during the post-communist quarter century.

Russia is characterised as oligarchic (or „crony”) capitalism, where economic power understood as control of ownership and income, is strictly connected with political one. Belarus can be described as patrimonial economy of disequilibrium - where the political leader is also the sole real owner of all assets in unstable environment.

According to G. Sharafutdinova there are three important elements, that lie in the core of crony capitalism system. First issue is the problem of rule of law. In economies of this type law creation is not rational, and it's execution is not stable. As a result therefore the administration in crony capitalism is not a predictable one<sup>3</sup>. It depends on current interests of the ruler and his clients.

Another problem is the question of property rights. Classical capitalism is based on the protection of the right of property, that can be violated only in certain situations, stipulated by law. In countries with crony capitalism present the right to own is not based on the rules of law but on privileges. Structure of this kind are ruled by system of personal exchanges, that allows profiting only to a limited group of people that provide political support to the central dissonant of the property<sup>4</sup>.

Third feature of crony capitalism is the deep connection between politics and economy. This relationship is double-sided. On one hand economical tools are used to pursue political goals of the state and its ruling elite. At the same time this means that political actions are subordinated to economical gains of the rulers<sup>5</sup>.

This model seems to adequately describe sources of current Russian economic policy. A group of political-economical leaders, that gathered around President V. Putin, dominating player, is concentrating on pursuing political and economical goals, that serves the interests of the group.<sup>6</sup>

The model has a direct impact on foreign economic policy of a state. It means that its actions are coherent (because are led by a single centre). The policy is both driven by political and economical goals. The hierarchy of objectives is defined by the small ruling group. Finally - to assure achieving this goals the policy is not transparent and based on informal rather than formal relations.

Patrimonial model of disequilibrium is based on two concepts. The patrimonial domination, as Max Weber describes it "is based not on the official's commitment to an impersonal purpose and not on obedience to abstract norms, but on a strictly personal authority".<sup>7</sup> Consequently

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<sup>3</sup> Gulnaz Sharafutdinova, *Political Consequences of Crony Capitalism inside Russia* (Notre Dame: University of Notre Dame Press 2011), 23-25.

<sup>4</sup> Ibid.

<sup>5</sup> Ibid.

<sup>6</sup> Compare e.g. Maria Domańska, „Crisis in Russia. The Degradation of the Model of Economic Governance”, *OSW Studies* 61, 2017.

<sup>7</sup> Max Weber, *Economy and society : an outline of interpretive sociology* (New York : Bedminster Press), 1006, 1064-1068.

the ruler in this model is the only decision-maker, as well as the only owner of assets.<sup>8</sup> Weber describes this model with regards to Russia of Peter the Great, however Richard Pipes in „Russia under the old regime” traces it back to the times of Ivan the Terrible<sup>9</sup>. Yuri Latov, economic historian, describes similar economic model in Middle Age Russia. In his narrative this type of control is called „power-ownership”<sup>10</sup>.

The other element of Belarusian economy is its chronic disequilibrium. The model of disequilibrium describe markets that are unable to reach point of stability after the shock by itself (by sole forces of the market). Models of those type i.a underline the role of planners and centrally prepared plans in economies modelled in that way for the emergence of disequilibrium and its liquidation.<sup>11</sup>

Both concepts underline the fact that the management of economic system is mainly based on President A. Lukashenka personal control. This also influence the way Minsk conducts foreign economic policy. It is mainly aimed at retaining position of Belorussian president, who is individually deciding on political and economical goals of the state. Domination of one decision centre allows for quick, short-term adjustments to the changing environment. Finally actions in foreign policy are also mostly conducted in not transparent and informal way.

Both countries experience economic troubles after 2014. Russia has been struggling with recession since 2015. The fall in GDP, industrial production, the decrease in real incomes and wages was a constant occurrence. Consumer spending (this accounts for 50% of GDP) and investments (which cover a further 20% of GDP) have decreased. In 2016 GDP growth was only 0,3%. The major fall in oil prices has had the strongest direct influence on the deterioration of the macroeconomic indicators leading to a reduction of revenues from oil exports and the depreciation of the Russian currency. This increased the costs of both imports and the servicing of foreign debt.<sup>12</sup>

In 2016 Belarus’s GDP fell by 2.6%. The main reason for the continued decrease of this indicator has been the poor situation of the Belarusian oil industry which accounts for 15% of industrial production. Some information suggest that the total debt of the largest production plants may exceed 6 billion USD. An amount higher than the current level of the Belarusian central bank’s foreign-exchange reserves<sup>13</sup>. Crisis in industrial sector is dangerous due to the fact that it is responsible for around 40% of GDP.

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<sup>8</sup> This concept is used here only for the purpose of analysing the economic part of Belarusian state. The discussion on differences between classic patrimonial and "neo" or "modern" patrimonial model, proposed by S. N. Eisenstadt will not be discussed here.

<sup>9</sup> Richard Pipes, *Rosja Carów*, (Warszawa: Magnum 2006), 40.

<sup>10</sup> Юрий Латов, „Власть-собственность в средневековой России“, *Экономический вестник Ростовского государственного университета* 2004 (2), p. 117.

<sup>11</sup> E.g. C. Davies, W. Charemza (ed.), *Models of Disequilibrium and Shortage in Centrally Planned Economies*, (London: Chapman and Hall 1989).

<sup>12</sup> Domańska, „Crisis in Russia”, 7, 9.

<sup>13</sup> Kamil Kłysiński, „Illusions of power and stark realities: The second year of the economic crisis in Belarus”, *OSW Commentary*, Mart 14, 2017.

Moscow's policy towards its western neighbour function within this structure. It is policy motivated by overlapping political motives and the profit-gaining goals of narrow elite, that is close to President Putin. At the same time the partner Kremlin faces can fully control it's own system, therefore it is hard to play on differences within the economic elite.

#### Trade relations

Russia is Belarus main trade partner. It is responsible for around 44% of Belarus export and 59% of its import (compare table 1). For Moscow Minsk bares significantly lesser meaning - 4,5% of Russian export and 5,7% of its import concerned its western neighbour.<sup>14</sup>

In 2016 Belarus exported to Russia goods worth 10,8 bln USD and imported - 15,3 bln USD<sup>15</sup>. Main export goods are diary products, vehicles and (especially in recent years) oil products. The main part of imports from Russia are: oil, gas, petroleum products, electricity, steel, steel pipes, parts for cars and tractors.

The Republic of Belarus depends on Russian supplies of energy raw materials, necessary for the functioning of its industry. Also - as will be explained later - cheap oil imports from Russia allows Minsk to earn foreign currency from oil products exports. An important element of trade cooperation is the import from the Russian Federation of parts used in Belorussian industrial plants (mainly electromechanical sector). Finally Russia is the market for goods manufactured in Belarusian factories. This considers heavy industry, that is a significant part of GDP and provides employment for significant part of the society. Considering the above conditions - the negative balance in trade in Russia's favour is of a structural nature.

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<sup>14</sup> "Внешняя торговля", *Федеральна служба государственной статистики*, [www.gks.ru/wps/wcm/connect/rosstat\\_main/rosstat/ru/statistics/trade/#](http://www.gks.ru/wps/wcm/connect/rosstat_main/rosstat/ru/statistics/trade/#) (accessed May 20, 2017).

<sup>15</sup> "Внешняя торговля", *Национальный статистический комитет Республики Беларусь*, [http://www.belstat.gov.by/ofitsialnaya-statistika/makroekonomika-i-okruzhayushchaya-sreda/vneshnyaya-torgovlya\\_2/](http://www.belstat.gov.by/ofitsialnaya-statistika/makroekonomika-i-okruzhayushchaya-sreda/vneshnyaya-torgovlya_2/) (accessed May 16, 2017).

**Table 1. Russian-Belarusian trade 2000-2016**

	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	2016
<b>Value of export mIn USD</b>	3 710	3 963	3 977	4 880	6 485	5 716	6 845	8 879	10 551	6 719	9 954	14 509	16 309	16 838	15 181	10 398	10 819
<b>Percentage of total Belarus export</b>	51%	53%	50%	49%	47%	36%	35%	37%	32%	32%	39%	35%	35%	45%	42%	39%	46%
<b>Value of import mIn USD</b>	5 605	5 438	5 922	7 602	11 219	10 118	13 099	17 205	23 507	16 726	18 081	24 930	27 551	22 905	22 190	17 143	15 295
<b>Percentage of total Belarus import</b>	65%	66%	65%	66%	68%	61%	59%	60%	60%	59%	52%	55%	59%	53%	55%	57%	55%

Source: National Statistical Committee of the Republic of Belarus

Since the beginning of 1990s both countries were gradually removing official obstacles in trade relations. In 1992 a free trade agreement was signed, envisaging however, that both signatories could limit the import from the other partner in „special situation”. This reservation was repeatedly used by both sides to justify introduction of trade blockades<sup>16</sup>. A joint customs union, created in 1995 together with Kazakhstan was a next step on the way to trade integration. In 2000 the State Union of Belarus and Russia was created. This unique in the CIS area organisation is based on presumption of deep political and economic coordination of i.a. industrial policies or trade in energy resources.

Belarus is also a member of wider projects of post-Soviet region economic integration, promoted by Russia. It joined in 2000 the Customs Union, formed with Kazakhstan, Kyrgyzstan, Russia and Tajikistan, was reformed into the Eurasian Economic Community. Three years later the Joint Economic Area was created, encompassing Belarus, Kazakhstan, Russia and Ukraine.

Further economic integration in the post-Soviet space continued in the triangle Belarus-Kazakhstan-Russia. In 2010 those three countries created the Customs Union. Then a Common Economic Space followed in 2011 and finally in 2014 - an Eurasian Economic Union was created.

Formally this framework should translate into unhindered economic exchange. However, as it was underlined before, both Minsk and Moscow prefer informal actions and do not usually feel to be bound by treaty obligations. Therefore both sides regularly use different instruments to block a trade from a partner country or subsidised its own export, on various stages of bilateral cooperation.

In the 1990s., Belarusian companies took advantage of the lack of control on common border to ship to Russia various goods from third countries, that otherwise would be subject to tariffs (e.g. alcohol, tobacco or sugar). Belarus would also use import quota or import licences to limit imports from Russia. Another important instrument was maintaining by Belorussian National Bank lower BYR rates.

Moscow, on its part, in this period was introducing changes in the tariffs without Minsk consent, (although it was envisaged e.g. by the rules of the State Union) influencing the interests of Belarusian exporters. Imposing duties on used cars, that was intended to protect Russia's automobile industry but significantly diminished inflows to Minsk's budget, was one of the examples of this practice<sup>17</sup>. At the same time Moscow was maintaining lower tariffs on goods that were competitive to Belarusian ones (e.g. food products, textiles) in order to satisfy growing demand for products of better quality on Russian market.

Approach to the legal issues of economic integration was also presented more recently with Minsk opposing the introduction of a common tariff code of EEU. President Lukashenka didn't sign the project, agreed in December 2016, claiming that the document is not properly

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<sup>16</sup> Adam Eberhardt, *Gra pozorów. Stosunki Rosyjsko-Białoruskie 1991-2008* (Warsaw, Polski Instytut Spraw Międzynarodowych, 2008), 86.

<sup>17</sup> Eberhardt, *Gra pozorów*, pp. 90-91, 95.

protecting Belarus' interests<sup>18</sup>. However after the energy dispute of 2016/17 was solved, and Moscow agreed to some concessions (see pages 15 and 22), Belarusian president agreed to approve the document.

The most widely publicised was the problem of Belorussian dairy products' exports to Russia. Due to governmental subsidies products from Belarus are price-competitive on Russian market. Dairy lobby in Russia periodically pressure its government to block Belarusian trade of those goods. This frequent blockades are nicknamed "milk" or "cheese wars".

Conflict of this kind took place e.g. in 2012. After Moscow's blockade Minsk was forced to agree to limit its export of products from discussed sphere. In addition, it was agreed that the Belarusian side will agree with the Russian authorities the level of prices for goods in this sphere.

The introduction of sanctions by the EU in 2014, after Moscow's aggression on Ukraine, created an environment for appearance of new intermediary schemes in trade. Belarusian companies used the opportunity to expand on Russian market by relabelling and reexporting products from the EU and Ukraine to Russia. Mainly this consider food products. This resulted i.a. in another „milk war” of 2016. Russian phytosanitary services restricted the access of Belarusian food products, justifying this decision with the detection of the presence of harmful substances in the food products. In addition to that Belarus was accused of providing incorrect documentation, and conducting dumping policies while exporting its products.<sup>19</sup> A new limitations were introduced in May 2017 - this time Rosselkhoznadzor explained the introduction of new restrictions by the fact that the analysis revealed forbidden substances in imported goods<sup>20</sup>.

Bilateral relations in the trade sphere support the argument that both sides prefer informal relations to respecting long-term legally binding agreements. The will to achieve short term-economic goals prevails over the need to abide of jointly agreed rules. At the same time Belarus is consequently joining all integration initiatives, proposed by Russia.

#### Russian investments and credits

Russia is also main investor in Belarus. Russian capital accounts for 60-70% foreign investments in Belarus (compare table 2). In January 1 2016 direct investments from Russia were worth 10,2 bln USD (57% of all investments)<sup>21</sup>. However it should be underlined that Russian investment engagement is relatively fresh and dates back to 2005. Increase in interest

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<sup>18</sup> "Лукашенко объяснил, почему не подписал Таможенный кодекс ЕАЭС", *БЕЛТА*, February 3 2017, [www.belta.by/president/view/lukashenko-objjasnil-pochemu-ne-podpisal-tamozhennyj-kodeks-caes-231443-2017](http://www.belta.by/president/view/lukashenko-objjasnil-pochemu-ne-podpisal-tamozhennyj-kodeks-caes-231443-2017) (accessed May 17, 2017).

<sup>19</sup> Kamil Kłysiński, „The risk of escalating tensions in Minsk-Moscow relations”, *OSW Analyses*, 04/02/2014.

<sup>20</sup> "У Белоруссии высыхает молоко", *Коммерсантъ*, May 19 2017.

<sup>21</sup> "Прямые иностранные инвестиции", *Национальный банк Республики Беларусь*, [www.nbrb.by/statistics/ForeignDirectInvestments](http://www.nbrb.by/statistics/ForeignDirectInvestments) (accessed May 16, 2017)



was an effect of direct Kremlin's stimulating policies. The significant growth of Russian FDI was observed in 2007, with purchase of 50% of Beltransgaz by Gazprom.

The oil sector is an important sphere of activity of Russian investors. Rosneft and Gazpromneft, are co-owners of 42% of the Mozyr refinery. Lukoil-Bielarussiya is an owner of an extensive network of gas stations. Alians group is present by BielRosAlians and Tatneft registered in RB its subsidiary Tatbelnieftieprodukt. Also a group of smaller companies with Russian capital operate in oil sector. They include e.g. Juninvest-M and Junis-oil,<sup>22</sup> that are considered to be an important link in the oil-import-export-petrochemical chain.

Russian investments in the banking sector include i.a. BPS-Sberbank, Belvneshekonombank, Belgazprombank, Vneshtorgbank Bank (Belarus); AKB Belrosbank and Alfa-Bank. Three of those banks (BPS-Sberbank, Belvneshekonombank and Belgazprombank) belongs to the group of „system banks”, controlling 87,9% of assets in the market (as of 1<sup>st</sup> half of 2016).<sup>23</sup> Apart

**Table 2. Russian FDI in Belarus 2011-2016**

	2011	2012	2013	2014	2015	2016
<b>Cumulative Russia FDI (mln USD)</b>	5 877,9	8 372,9	9 037,3	9 822,2	10 154,5	10 214,5
<b>Percentage of total FDI</b>	59%	64%	62%	59%	57%	54%

*Source: National Bank of the Republic of Belarus*

from Belrosbank and Alfa-Bank all those entities are controlled by the Russian government.

Sberbank investment is an telling example of Russian economic policy towards Belarus. It shows how often in their relations transactions (both political and economical) are interconnected. In 2009 a possible Russian investment in banking sector was discussed. In the second part of the year it became apparent that one of the largest Belorussian banks - BPS - will be probably privatised. At the end of December 2009, Belarus received a syndicated loan of approximately USD 201 million from four Russian banks - Sberbank, Vneshekonombank, Gazprombank and Alpha-Bank Securities (so institution having subsidiaries in Belarus). Sberbank was the agent of the loan. Few weeks after the resources were transferred to the Belarusian budget, A. Lukashenka approved the transaction of purchase of BPS by Sberbank.

The project of construction of nuclear power plant in Astravets is another issue high on the agenda. The debates on its realisation were ongoing at least since early 1990s. Finally, after negotiations between 2009-2011 an agreement was signed, according to which Russian

<sup>22</sup> Compare e.g. Kamil Kłysiński, "Wielki biznes na Białorusi. - geneza, uwarunkowania i perspektywy", *Komentarze OSW*, September 9 2013.

<sup>23</sup> Максим Равский, "Банки Беларуси во II полугодии 2016-го: активы и прибыль", *Белорусская деловая газета*, July 27 2016, [bdg.by/news/authors/banki-belarusi-vo-ii-polugodii-2016-go-aktivy-i-pribyl-0](http://bdg.by/news/authors/banki-belarusi-vo-ii-polugodii-2016-go-aktivy-i-pribyl-0) (accessed May 17, 2017).

company Atomstroyeksport will construct two nuclear blocks of general power 2400 MW. The construction works were initiated in 2012. The project will be financed from Vneshekonombank credit worth 10 bln USD.

Russian investors are also active in the field of telecommunications and high technology. AFK Sistiema owns 49% of cell company MTS. The Alfa-group's Zappieltelekom owns 49.9% of the shares in the chain of mobile telephony Evroset. In the sphere of construction e.g. the company Itera was active, especially in the project of the reconstruction of the port of Minsk-1.

On various stages of cooperation Kremlin was pressuring Belarusian authorities to allow Russian companies to participate in the privatisation process. As pointed above usually this was connected to the discussion on other economic issues - e.g. credits issues concerning gas or oil deliveries.

In 2011 Russia decided to structurize the negotiations on the above-mentioned issue. It was agreed that one of the circumstances of providing the credit for Belarus from Moscow controlled Eurasian Fund for Stabilisation and Development (see below) will be an obligation to privatise companies worth USD 7,5 bln. Vehicle production company MAZ, fertilisers producer Belaruskaliy and Belorussian refineries were usually mention with connection to this project. It was widely understood that only Russian companies will be allowed to participate. However during the course of the realisation of the agreement EFSD representatives dropped this condition in 2013.<sup>24</sup>

Russian credits are another important element of bilateral cooperation in financial sphere. Loans were granted both for current needs (e.g. covering gas liabilities) and for maintaining macroeconomic stability. Before 2011 Russia was providing credits mainly through bank loans. Sbiernbank was usually main agent providing this kind of support. Russia was also assisting in publications of Belarusian credit instruments on world markets.

The implementation of above-mentioned loan of USD 3 bln under the EFSD agreement was an another mean used by Russia to strengthen the position of eurasian integration bodies. The success of the credit programme from the fund, that was shaped on the model of IMF would present the eurasian integration organisations as able to provide economic stabilisation to the region. Therefore, despite the fact that Belarus didn't fulfil all requirements of the program in 2017 another USD 2 bin credit was awarded to Minsk, as a part of the agreement reached after the energy dispute 2016/2017. Thanks to both programs ESDF is currently the biggest Belarus' creditor.

However Russia remains second single biggest donor. Kremlin didn't completely resigned from bilateral credits. Again, as a part of accord after the conflict in 2016/2017, Moscow agreed to grant Minsk another credit worth USD 1 bln.

Cooperation in financial and investment sphere shows, how Moscow is using it's financial support to achieve political and economical goals. By providing financial resources Kremlin is

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<sup>24</sup> „Кредит ЕврАзЭС: от Беларуси больше не требуют приватизации”, *Telegraf.by*, March 13, 2013, [telegraf.by/2013/03/kredit-evrazes-ot-belarusi-bolshe-ne-trebuyut-privatizacii](http://telegraf.by/2013/03/kredit-evrazes-ot-belarusi-bolshe-ne-trebuyut-privatizacii) (accessed May 17, 2017).

assuring liquidity of Belarusian budget, therefore securing Lukashenko's position. Lukashenko - in turn - understands that his condition depends on this support, what is another argument for him to remain within Russian sphere of influence. At the same time Russia uses its financial pressure to broaden its presence in Belarusian economy.

#### Gas sector

Russia is the only exporter of natural gas to Belarus. It is a crucial energy resource: 84,4% of electric and heat energy in 2015 in Belarus was produced by gas-fuelled power plants.<sup>25</sup> Belarus imports around 20 mld m<sup>3</sup> of natural gas per year (30 mld m<sup>3</sup> in 2016)<sup>26</sup>. State-owned Russian company Gazprom was main deliverer of the resource. Even in the period 1998-2004, when Belarus was buying gas from other companies (i.a. Itera, Sibur, Transnafta), Gazprom remained the biggest single seller of gas to Belarus.

Russian-Belarusian relations in gas sphere since the beginning of Belarusian independence evolve around three problems. First is the matter of the price of the gas delivered. The second was a problem of gas transit through Belarusian territory. Third element was Gazprom participation in privatisation of Beltransgaz, the national gas operator.

The issue of gas payments is the most important of the three. Low gas prices are crucial for maintaining the image of „socially oriented” economy in Belarus, by keeping prices of energy for house holds on low level. They also help to maintain the production in industry sector, that is responsible for around 40% of GDP, and is an important employee in the country.

Since 1990s. both parties were in constant discussion on the level of gas prices. Moscow was aiming for rising prices of the raw material provided, while Minsk was trying to keep them as low as possible. The dispute, especially since the creation of the State Union usually evolved around idea pursued by Belarus, that since both countries are participating in joint economic integration project, gas prices should be on a level of internal Russian prices. On the other hand Russia was pushing for prices close to „European level”, however never explaining what does it mean in financial terms. Gas prices remained higher than prices on internal Russian market, but still - the lowest among all post-Soviet Gazprom’s clients, and significantly lower than prices for EU member states (compare chart 1).

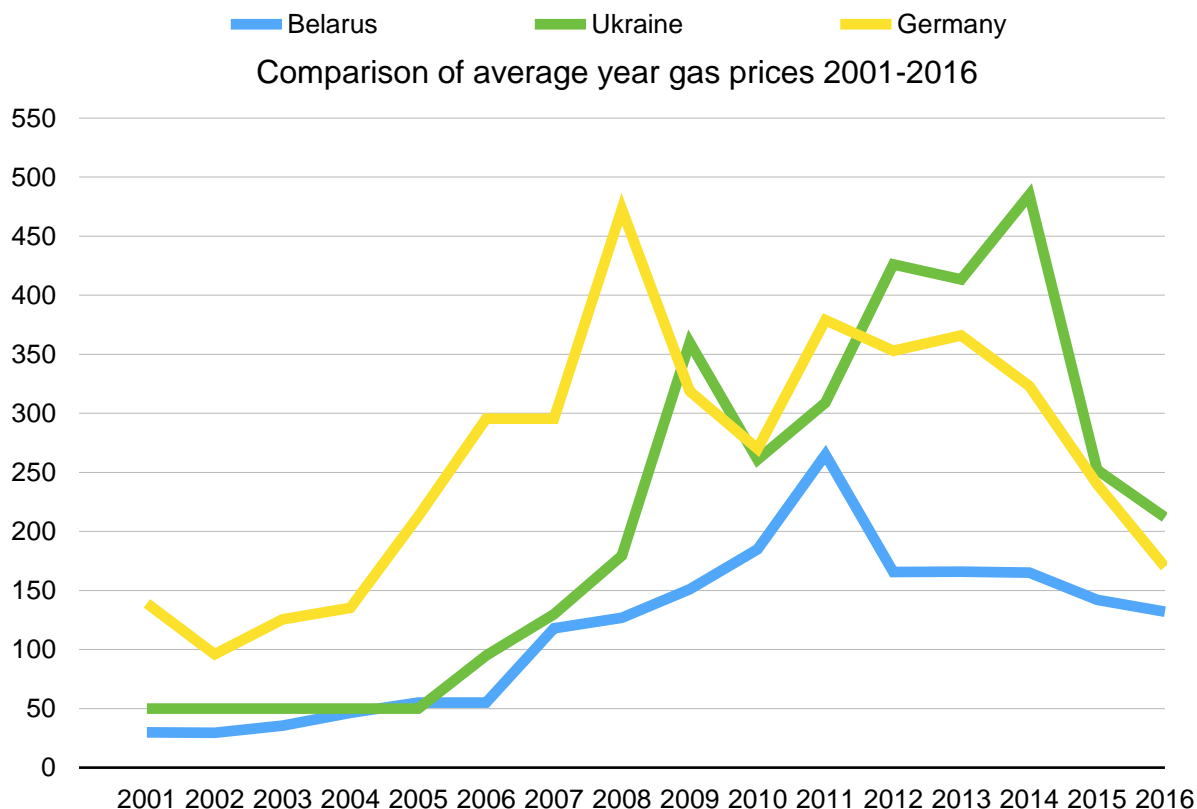
Source: M. M. Balmaceda, *High life in Minsk, 2014; Centre for Eastern Studies; press and media reports*

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<sup>25</sup> "Энергетика 2015", Инвестиционная компания "ЮНИТЕР", March 2015.

<sup>26</sup> "Внешняя торговля", *Национальный статистический комитет Республики Беларусь*, [http://www.belstat.gov.by/ofitsialnaya-statistika/makroekonomika-i-okruzhayushchaya-sreda/vneshnyaya-torgovlya\\_2/](http://www.belstat.gov.by/ofitsialnaya-statistika/makroekonomika-i-okruzhayushchaya-sreda/vneshnyaya-torgovlya_2/) (accessed May 16, 2017).

Up to 2007 gas prices for Belarus were set on yearly basis. Since 2007 Russia was trying to apply a structured approach, that would lead to gradual rise of the prices. Agreements signed after that date introduced the system of monthly price adjustments, according to the global oil



prices with additional „integration” coefficient, ensuring gradual, not rapid, rise of prices.

However Minsk would regularly delay payments for gas, or would pay the price that it considered to be preferential for Belarus. Problems with gas payments lead to Gazprom curbing deliveries in 1993, 2002, 2004 and 2010. Each of these disputes would finish with Moscow agreeing to some concessions - especially in terms of pricing - to the Belorussian side. Preferences are seen when compare the prices for Belarus and Ukraine (tab. 3). Only in 2005, when Gazprom removed its competitors from Belarussian market, the price for Belarus was higher than for its southern neighbour. Next year Belarus again was receiving gas on preferential prices. However one should notice that Kremlin was successful in gradual rising of gas prices.

Those concessions were usually made shortly before or after Minsk would agree to participate in Russia led integration bodies. After gas agreement of 1993 Minsk agreed to sign the Agreement of Friendship with Russia, to sell stakes in Mozyr refinery and lend free of charge military installations in Wilejka and Bardnovichi. Similarly after 1996 gas agreement Minsk

joined the Agreement on Association of Belarus and Russia<sup>27</sup>. Regulation of gas issues agreed upon in 2011 were followed by Minsk becoming the member of Common Economic Zone.

Belarus serves as a transit route for Russian gas export to Poland and Germany. The raw material is transported through the Yamal pipeline, built between 1994-2005. President A. Lukashenka was using the project as another tool in relations with Russia. Initially the pipeline was used by president A. Lukashenko to symbolise Belarus reliability as transit state for Russia's gas to Europe. This was especially useful in the context of deterioration of gas relations between Moscow and Kyiv in the 1990s. It also served the purpose of presenting to the Kremlin Belarus' readiness to be a reliable partner. But as the project was approaching its final stage, Minsk started to block its finalisation in order to use this project as a leverage in the discussion on gas prices.<sup>28</sup> This may be seen as partial success, since the price for gas in 2006 was the same as in 2005.

However with the signing of German-Russian agreement on construction of Nord Stream Belarus lost this leverage. For some time Minsk was raising the issue of the construction of the second line within the Yamal project, that was envisaged within the original agreement, however with Gazprom officially backing away from extending the Yamal project, and the beginning of discussion on the NS2 project - this argument was abandoned. It is worth to underline, that one of the reasons (apart from political agenda) for Gazprom's engagement in the Nord Stream project was the will to find transit alternative to route through Belarus and Ukraine.

Another issue that was connected to gas disputes, was the problem of purchasing stakes in Beltransgaz, the national gas operator, to Gazprom. The energy sector analyst M. M. Balmaceda calls this long lasting transaction - „selling the dream”<sup>29</sup>. Moscow made first attempt to invest in the company with the gas agreement in 1993. Although both sides agreed to carry out the transaction, Belarusian parliament voted against approving the agreement<sup>30</sup>.

The question was negotiated regularly since 1990s, until in 2006 it was agreed that Gazprom will purchase 50% in Beltransgaz. The transfer of stakes took place between 2007-2010 in four tranches. The handover of shares was closely harmonised in time with transfer of the money by Gazprom. However the Russian side was not satisfied with their control it executed over Beltransgaz and further pressured Belarus. The remaining half of the company was sold in one tranche in 2011. According to president A. Lukashenko the sell of the remaining 50% of Beltransgaz assured lower gas prices for Belarus.<sup>31</sup>

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<sup>27</sup> Margarita M. Balmaceda, *Living the High Life in Minsk. Russian Energy Rents, Domestic Populism and Belarus' Impending Crisis*, (Budapest New York: Central European University Press, 2014), 168-9.

<sup>28</sup> Balmaceda, *Living the High Life in Minsk*, 121.

<sup>29</sup> Margarita M. Balmaceda, *The politics of energy dependency. Ukraine, Belarus and Lithuania between domestic oligarchs and Russian Pressure* (Toronto, Buffalo, London: University of Toronto, 2013), p167.

<sup>30</sup> Eberhardt, *Gra pozorów*, 166. This event took place before A. Lukashenka became president, so it should be rather seen as an element of internal political fight in Belarus, than deliberate negotiating technique.

<sup>31</sup> Татьяна Полежай, "Лукашенко о продаже Белтрансагаза: "Что, я должен был молиться на эту ржавую трубу, которая в земле лежит?"" , *News.tut.by*, December 2 2011, <https://news.tut.by/economics/261858.html> (accessed May 17, 2017).

In December 2014 another agreement regulating gas relations for the period of 2015-2017 was signed. It was based on the price formula from the 2011 agreement - in 2016 it should be on level 142 USD (average).

However in 2016 another crisis erupted - Moscow claimed that Minsk owes Gazprom USD 726 mln (as of April 2017) due to payment for gas according to price between 80-107 USD.<sup>32</sup> Again - this was justified by Belarus by the fact that, since it is a member of EEU it should be charged for gas like internal clients in Russia.

Russia reacted by reducing oil deliveries, what forces Minsk to repay the debt at the end of April. A. Lukashenko agreed to sign the Common Tariff Code of the EEU. At the same time Moscow agreed to some concessions towards its partner in financial (see p. 15) and oil spheres (see p. 24).

Relation in gas sphere are another example of the dominance of informal relations over frameworks put down in agreements. Regularly both sides would change previously agreed conditions of gas trade. Due to the importance of gas deliveries for Belarusian economy the circumstances under which the resource is delivered is a good leverage to keep Minsk within Moscow's sphere of influence.

### Oil and oil products

Russia remains the dominating supplier of crude oil to Belarus, despite Minsk's repeated attempts to implement diversification projects (e.g. deliveries from Venezuela between 2010—2012). Moscow companies are delivering around 20-22 mln t of the raw material per year - 18,1 mln t in 2016<sup>33</sup> Russia also exports oil products that undergo productions in Belorussian refineries.

The importance of refinery sector for Belarusian, budget lies in the fact, that it's one of main sources of foreign currency. Around 70% of oil product manufactured in two Belorussian refineries: Mozyr and Naftan is exported abroad. Belarus exports oil products mainly to European ports (The United Kingdom, The Netherlands, Latvia). In recent years Ukraine became new important market of these products. Since 2012 significant part the products is exported to Russia.

Income from oil products exports was specifically useful for covering debts for gas. This additional revenue was called by analysts and journalists „the oil rent” - an income, coming from the difference between the prices of Russian oil and global prices of oil products. The highest income from this source Minsk received between 2004-2007<sup>34</sup>.

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<sup>32</sup> Kamil Kłysiński, Szymon Kardaś, „Russia and Belarus reach agreement on oil and gas”, *OSW Analyses*, October 12, 2016.

<sup>33</sup> National Statistical Committee of the Republic of Belarus.

<sup>34</sup> Compare, e.g. Николай Некрашевич, "Сколько заработала Беларусь в 'тучную нефтяную пятилетку', *Завтра твоей країны*, January 22 2009, [zautra.by/art.php?sn\\_nid=5610](http://zautra.by/art.php?sn_nid=5610) (accessed May 17, 2017).

It is also important to underline that Russia's companies had a substantial interest in working with Belarus in this sphere. Mozyr and Nafta are capable of deeper processing of oil, than more Russian refineries. This allowed Russian companies to produce oil products of higher value and export them abroad. Also Moscow is interested in channeling some of hi-octane petroleum export to Russian market, that for some time experienced a deficit of that products. The duties on export of oil products, introduced in 2007, were partially aimed at achieving this goal

Relations in oil sphere are more complicated than the situation in the gas sector. In contrast to the gas sphere, that is based on relations of two governmental entities, this market is characterised by a presence of group of companies of Russian, Belarusian and joint ownership. Companies are connected to political leadership of both countries<sup>35</sup>. Negotiations between both countries in this sphere, after the dissolution of USSR evolved around the issue of tariffs on oil and oil products and ownership of Belorussian refineries.

The issue of duties was a main element of negotiations in that sphere. The Belarusian side emphasised that the imposition of customs duties on goods exported from one country of the Customs Union to another country of this organization is contrary to the UC rules.

Initially Minsk was receiving oil on duty-free basis, and all or most of tariffs levied on oil products were transferred to Belarusian budget. This created the above-mentioned „oil rent”. However the Russian side slowly was trying to lower Belarus' excessive income from this sector.

In December 2006 Moscow introduced a tariff on oil export to Belarus (the agreement on United State of Belarus and Russia envisaged the unification of tariffs on oil and oil products). In response Minsk begun illegal siphoning of oil from Druzhba pipeline, what led to short term blockade of oil deliveries to Belarus by Russian Transneft. As a result an agreement was reached at the beginning of 2007, that led to the introduction of tariffs on oil exports to Belarus (with the exclusion of quota for Belarusian „internal use”) and the scheme of the division of tariffs on oil product exported from Belarus between budgets of both countries, that gradually increased Moscow's income from this source.<sup>36</sup>

In March 2010 Belarus filed a suit in CIS Economic Court against the duties on oil, claiming they are not in line with agreements between Minsk and Moscow. However the court rejected the lawsuit and suggested that the issue should be resolved on bilateral level. During the dispute Russian side underlined that the duties may be removed only when Common Economic Zone Belarus-Kazakhstan-Russia will be created. This promise was fulfilled. After ratification by the Belarusian parliament of the package of appropriate documents the export duty on oil was liquidated in December 2010. In exchange it was agreed that 100% of duty on oil products will be transferred to Russian budget.

The 2010/2011 negotiations also are a good example of the role of private companies in the dialogue in this sphere. For a short period in January 2011 Russian oil companies would not

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<sup>35</sup> Compare, e.g. Wilson, *Belarus*, 244-5

<sup>36</sup> Discussion concerning crude oil deliveries was connected to negotiations of the gas contract. Compare Balmaceda, Balmaceda, *Living the High Life in Minsk*, 132-4.

export crude oil, pressuring Minsk to ensure even division of access to refineries between Russian and Belorussian companies and reintroduction of subsidies for oil processing.

Interesting example of Belarusian-Russian cooperation in the oil sector was the so-called „solvent issue”. In 2012 series of reports appeared, that growing number of Belarusian companies were declaring goods as solvents or chemical diluents. The main recipients were Latvia and the Netherlands, who were main importers of Belarusian petroleum products. This lead to the conclusion that to escape duties on oil products’ Minsk is „disguising” them as solvents (this required a minor, easily reversible chemical operation<sup>37</sup>)

Probably the above described procedure was carried out with the approval of the highest decision-makers of both countries, who obtained "unofficial" income from the procedure. According to some opinions the customs services of the EU countries that imported the above-mentioned commodities also did not want to disclose it, because their countries earned profit as intermediaries<sup>38</sup>. However when the issue became too public, the Russian side pressured the western neighbour to abolish the scheme.

As explained above the Russia-Belorussian energy dispute of 2016/17 lead to temporary reduction of oil exports to Belarus. After reaching the agreement the deliveries were resumed. In addition to that the Russian side agreed to abolish the former obligation to delivering 1 mln t per year of Belarusian oil products to Russia.

Taking into the account the technological value of Belorussian refineries, Russia was pressuring for widening the presence of Russian capital in the companies. As pointed above - agreement on giving access to Mozyr refinery was part of agreements in the energy sphere at the beginning of 1990s. After this transaction Minsk resisted the pressure, however the idea of purchasing the shares in refineries returns each time the problem of Russian companies participation in the privatisation of Belarusian companies is discussed.

Oil sector is another market where preference for informal procedures in cooperation between Minsk and Moscow is visible. Evidence from this sphere (especially the "solvent affair) confirms that government of both countries are ready, to some extent, to protect businesses working in the grey area, due to closeness of oil companies to decision makers.

### Conclusions

Russian economic policy towards Belarus is a result of deep, structural ties, binding both countries. The performance of Belarusian economy and therefore, the position of president A. Lukashenka, depends on preferential conditions of the economic relations with Russia. Its functioning rely on deliveries of energy resources from Russia on preferential conditions. Main Belorussian export products are sold on the market of its eastern neighbour. Moscow is

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<sup>37</sup> Communication with energy expert, June 2012.

<sup>38</sup> Communication with diplomats in Minsk, June 2012.



providing financial support to assure Minsk's liquidity. Finally Russia's investments are present in crucial parts of Belorussian economy.

There are different assessment of the real value of Moscow's support for Minsk. These depends on the sphere the given analysis is focused on. For example IMF's calculations are based on analysis of the balance of payments. According to this approach in 2015 the support constituted 11% of the Belarus GDP. The report shows the decline of Russian backing. In 2013 it was worth 20% of GDP, in 2005 - 22% of GDP.<sup>39</sup> Basing on this evidence Russian economic news agency RBK calculated that the value of support equaled respectively: USD 6,7 bln, USD 6 bln, USD 14,4 bln.<sup>40</sup> Again it is worth to underline that despite this fall in the amount of aid and repeated suggestions by the Russian side that it will stop supporting its western neighbour (including famous V. Putin's statement from 2002 on the need to "separate apples from oranges")<sup>41</sup> Moscow is avoiding drastic decisions, that would significantly destabilise Belarussian economy.

This framework allows Russia to influence its partner. Exports blockades, negotiation on gas and oil prices etc. are frequently applied to reach Kremlin's goals. As explained earlier Russian interest in Belarus are both political and economical. Moscow is striving to keep Minsk in its sphere of influence, especially through inviting it to projects integrating the post-Soviet area, and economic tools are used to pursue that goal, as evidence provided demonstrate.

At the same time Russia is realising economic interests. „Milk wars” are conducted in order to protect Russian companies. Pressure in oil sphere is used to assure proper income for companies that are connected to economic ruling elite of Russia. Increase of gas prices should be seen as an attempt to base relations in this sphere on rules closer to „market basis”.

Preferential gas prices and financial support serve as means to expand Russian capital presence in Belarussian companies. At the same time the activity in investment sphere seems to serve both of these goals. On one hand it assures deeper control over Belarussian economy. On the other - Russia is pressuring to gain control over companies that could provide profit or strengthen its position on regional or global markets.

Belarus, on its part however, is not willing to bow to all Kremlin's postulates. President A. Lukashenko understand the importance of his country participation in Eurasian economic project for Russia. He is using every possibility to exploit this element to his own ends. That is - to maintain economic stability in the country and, as a consequence, to keep his position as a ruler.

Therefore Russian-Belarus economic relation are from its very core doomed for mutual distrust, constant conflicts and negotiations. Both sides are not ready to fully realise their

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<sup>39</sup> International Monetary Fund, "Staff Report for the 2016 Article IV Consultation", *IMF Country Report*, No. 16/298, September 2017, 28.

<sup>40</sup> Иван Ткачёв, Антон Фейнберг, "Скрытый счет на \$100 млрд: как Россия содержит белорусскую экономику", *РБК*, April 2, 2017, [www.rbc.ru/economics/02/04/2017/58e026879a79471d6c8aef30](http://www.rbc.ru/economics/02/04/2017/58e026879a79471d6c8aef30); 2/04/2017 (accessed May 15, 2017)

<sup>41</sup> Александра Самарина, Наталья Меликова, Иван Родин, "Отделение мух от котлет затягивается", *Независимая газета*, January 25, 2006, [www.ng.ru/politics/2006-01-25/1\\_otdelenie.html](http://www.ng.ru/politics/2006-01-25/1_otdelenie.html) (accessed May 17, 2017).

commitments as written in the documents signed by them and constantly try to test the limits of the other side.

This means that Russia's invasion on Ukraine in 2014 was not an element that changed the relations between the two countries in the economic sphere. As presented above conflict in integration processes, trade relations or energy issues are imminent part of those relations.

However the economic crisis, that both countries experienced significantly limit their room of manoeuvre. Russia's troubles limits Kremlin's possibility to support its ally. At the same time Minsk's position in negotiation of economic issues is weakening. In the long run this issue, rather than military conflict between Moscow and Kyiv may change the structure of bilateral economic relations.

Some general conclusions concerning Russia's policy towards countries of the CIS area may be draw from the above analysis. Moscow actions in the region are an effect of political motives. Economic reasons play an important role, but are of secondary concern.

Another important conclusion is the fact, that Kremlin while negotiating with its partners, is using tools from different fields to solve different issues - political leverages are used to gain investment preferences, energy subsidies - to achieve security goals etc. This translates to frequent usage of so-called „package solutions”.

Finally it should be suggested by the analysis provided can be - to some extent - use as basis for analysis of Russia's relations with Moldova and to lesser extent with Ukraine as well as cooperation between those countries. This is due to similar economic complementarity and approaches to economic relations.

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