

Work in Progress

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WHY BELARUS WOULD NOT BE CAPABLE OF REPEATING THE SOUTH KOREAN PATH AND FALL INTO A DEVELOPMENTAL TRAP?

BISS' CONTRIBUTION TO THE SEQUENCE OF DEMOCRATIZATION/MARKETIZATION REFORMS DEBATE.

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A note from the author

This working paper paves the way to one of the BISS new strategic areas of research: modernization and institutional change. From September 2012 BISS will open up the discussion of the topics, strategic to the country's developments: institutional upgrades, developmental traps, sequence of reforming, perspectives of modernization without Westernization, the influence of global rules on domestic institution-building (i.e. market-making, social development), etc.

This working paper is a first draft and may be complemented or revised; it contains only tentative conclusions. As a think-tank BISS is very much interested in your feedback on what we do, for we believe that only inclusive processes, feedback, and debates are truly valuable.

Executive summary

By now it is becoming clear that the Belarusian authorities continue postponing politically risky economic reforms and see their consolidated, and repressively -capable state apparatus¹ as a comparative advantage in managing the economic institutional change once it starts. This process unfolds as Russia is constantly increasing its pressure on Belarus concerning broad-scale economic reforms. Furthermore, it is becoming clearer that the reform process is unlikely to be opened to the broad public: accountable reforms go against the rational corporate interests of Belarusian and Russian political and economic elites.

All these contain two interconnected systemic risks. Firstly, the depoliticized and non-transparent economic reforms conducted in a low-accountability regime are likely to lead Belarus into a serious developmental trap, in which state-capture by vested interests (Hellman, 1996) (certain forms of oligarchization and cronyism), and external economic dependence will be most likely. Secondly, the non-transparent reforms will have long-term 'path-dependent' effects and the new capitalistic order of Belarus will be dominated by an asymmetrical distribution of property rights, severe economic distortions, and a predominance of 'bad institutions'. Are there ways to avoid the trap?

This working paper contributes to the old chicken/egg debate revived by the Liberal Club in June 2012 (market-making or democracy building first?). It is based on the critical overview of the relevant scholarly work in political economy and economic sociology literature and builds upon the experience of some Latin American, East-Asian and East and Central European countries.

It argues that the Belarusian elites should take the developmental risks of the economic reforms conducted by an illiberal state seriously, and sacrifice parts of their short-term rents of non-transparent reforms for the sake of the country's long-term developmental perspectives. It suggests the authorities to meaningfully open the process of economic reform to the public, and argues that this is paradoxically in the best interests of Lukashenka (not necessarily of his elites).

The question this paper addresses are neither abstract, nor naïve. Regardless of the particular incentives to reform (be them the loss of Russia's rents and the exogenous shocks or domestic political

¹ Here 'a strong/capable state' is used not in the normal Western definition as a liberal state with the rule of law, but as a state capable of executing the will of the autocratic incumbent.

pressures reinforced by the West) and regardless of the names of the incumbents and their corporate particularistic interests, Belarus ought to build upon the experience of the neighboring countries and avoid lasting developmental traps. An inclusive politicization of economic reforms could be the only means for stable development of political and economic institutions.

The paper is structured as follows: a) it starts by spelling out the Central and Eastern European determinants of 'relative success' in what the co-habitation of capitalism and democracy is concerned, b) it continues with the discussion of developmental traps and successful cases of autocratic modernization, c) it tailors the discussion to the contexts of Belarus and d) it provides possible tentative developmental pathways on which Belarus could embark, and highlights systemic risks and benefits.

1. The right recipe for the co-evolution of capitalism and democracy?

The 'happy family' of Eastern and Central European countries experienced a co-evolution of political and economic institutions after their independence, and reached some sort of stable coexistence of democracy and capitalism, which signified their accession to the EU. Here, democracy building went hand in hand with market making: the reformers successfully used the 'honeymoon period' after the collapse of the communist governments, capitalized on the social demand for Europeanization (back to Europe = back to normality), enjoyed societal patience to overcome the 'valley of tears,' and the politics of political compromise and confrontation only reinforced the quality of the state institutions required for efficient markets. By no means does this paper argue that their transition is fully over and the 'end of history' or the promised land is near, yet, CEE countries show rather stable institutional equilibria when it comes to the political and economic domains.

Belonging to the unhappy family of the post-Soviet countries where transition was derailed almost right after it started, Belarus rather experienced a co-decomposition of political and economic institutions instead of their co-evolution.

A right question to ask at this stage would be 'why' such a divergence took place. As a detailed comparative analysis of the pathways of Belarus and CEE will be the focus of the next paper of this series (which will be released on August 24 and devoted to the anniversary of the country's independence), suffice it to argue for now that it would be incorrect to reduce the explanations of Belarusian pathway to the 'deus ex machina' Lukashenka as well as to attribute CEE's success to the mere overwhelming role of the EU enlargement.

In what the theoretical explanations are concerned, the compatibility of co-habitation of democracy and capitalism in Central and Eastern Europe was well explained by Hellman (1998); Stark and Bruszt (1998) and Bruszt (2006) by the general scope condition — a presence of polity with extended accountability: reformers were held accountable before various societal groups which forced them to find compromises and experiment with economic institutions, which in turn shielded the decision making from the concentrated interest of rent-seeking groups. Absent is such an accountable process/polity, the decision-making on the reforms will likely be hijacked by the strong and organized economic and political groups who will be interested in having privileged access to property-rights, so that a few possessing the asymmetries of power and information will benefit at the cost of the many. This situation has been often labeled as a 'developmental trap' — an institutional equilibrium, in which the rules of the game for all serve narrow particularistic interests of those who had the most leverage over rule-making. Thus, those, interested in institutional change have no resources to do so, while those possessing resources are interested in the bad institutional status-quo.

When it comes to Belarus, the constant flow of external economic rents from Russia allowed the domestic political elites to choose the unreformed status-quo as an alternative to the risky and dangerous path of economic reforms. This variable still blocks the country's reformist path: Belarus is very likely to remain intact until Russian geopolitical ambitions could be easily cashed in, shared with state-dependent constituencies — shareholders of the status-quo and be used to support the repressive state apparatus. Yet, what is likely to happen when the status-quo deteriorates? Before we approach this question and dwell on the infrastructure of the political choices that the Belarusian incumbent has to make, let us first review the theoretical accounts on the market/democracy first debate and analyze some outlier cases which successfully contradicted those theoretical prescriptions.

2. Autocratic modernization is unique, while developmental traps are common?

The 'egg or chicken' (political or economic reform first?) question recently revived in the Belarusian public sphere by the Liberal Club needs to be well contextualized and positioned. Before we zoom in on it, there are at least three layers on which it unfolded in the scholarly and policy-making debates that are touched upon.

The first, and the most recent layer of the democracy/capitalism question is the so-called 'catch-up development' or autocratic modernization debate, which referred to the modes of market-making and welfare-enhancing reforms by autocratic governments (i.e. South Korea, Singapore, Hong-Kong, etc.) We will come back to the illustration of this case by the end of this paragraph.

Secondly, this 'egg/chicken' discussion is the continuation of the 1970-80s 'dinosaur' debate between the proponents of the modernization theory and the transitologists. For the former, democracy could be compatible with capitalism only in those societies, which reached a certain level of maturity translated to the 'right' distribution of preferences and values. Missing is such a society, when the reforms start, the broad social groups would use their newly acquired political and civic rights and throw the reformers out of the government immediately after the first waves of transitional hardships have landed. For the 'transitologists', the co-habitation of capitalism and democracy was not a matter of preconditions, but an outcome of political confrontation and compromise, which could sometimes enable the two to co-exist.

Thirdly, there was a more up-to-date policy-oriented capitalism vs. democracy debate around Eastern and Central Europe's transformation which gained its momentum in the early 1990s. This layer of argumentation is mostly relevant to our discussion and is the focus of this paper. Within this debate, there were two alternative policy approaches: one argued for shock-therapy, another advocated gradual transition.

The proponents of shock-therapy saw the potential losers from the reforms (i.e. unemployed, pensioners, etc.) as the most likely obstacle for implementing reforms and suggested to a) insulate the reformers from popular pressure, b) make the reforms as speedy as possible to prevent the losers from political mobilization and c) make a 'pact with the devil'—to form pro-reformist coalitions by granting the new active market actors with extraordinary property rights as a reward. In reality, that often meant bribing and giving systemic rents to those who could help the reformers overcome the counter-pressures from the side of the status-quo groups. This was believed to make reforms irreversible (for a detailed discussion see Schleifer and Treisman (1998)).

Contrary to them, gradualists believed that reformers should try pleasing broad constituencies by the right sequence of popular and unpopular measures which were ought to make the reforms increasingly popular with each step and thus irreversible ex post and ex ante.

The reality has proven to be totally different to what the policy makers have predicted. Speed, sequence, timing and pacing of the reforms proved to be rather irrelevant in comparison to one major factor: political context in which the reforms took place. In those countries where governments were deaf to social pressures and excused from public accountability, weak institutions, asymmetrical property rights and state capture were the usual outcome. To be more precise, during the periods of extraordinary politics, certain competing groups were powerful enough to mount particular self-benefiting asymmetries into the rules of the game which are being in flux thus 'privatizing/hijacking the state' (McFaul, 1998); or — capturing the state (Hellman, 1998). When the decision-making powers were vested within the executive branch, those incumbents were usually an easy

prey for strong market-actors willing to provide illicit cash transfers in exchange for being granted extraordinary economic rights (i.e. monopoly rights, privileged access to markets, etc.) The making of oligarchic regimes (i.e. Russia, Romania, Ukraine, Georgia, etc.) were thus the major obstacle for reforms in these countries: firstly, because the new winners were interested in stalling the partial reforms (liberalization without publicly accountable regulation), secondly, because the selected few could seek rents on the cost of the many by writing the general rules of the game. Contrary to this, state capture was less of a problem in the regimes of high political accountability with dispersed economic decision-making, i.e. in those where civil society groups (trade unions, NGOs, business associations) could control the implementation of reforms.

One could perhaps make a normative, but very abstract conclusion from here that Belarus should follow the normal track of democratization first and the market-reforms after if it will want to arrive at a combination of democracy and capitalism. Yet, what if we prioritize economic growth over harmonious political and economic co-development and take Belarus' leadership discourse of a 'unique Belarus' way' seriously? In other words, can a market-economy successfully develop under autocratic rule?

The answer to this question would be positive. Thus, clearly, the transformation experience that is relevant for Belarus is not limited to the Central and Eastern Europe and there are certain outlier examples of successful economic development under a strictly autocratic government. The most outspoken is the case of South Korea and it deserves a few words in this article.

General Park Chung-hee, who became the country's president in 1961 after the mass revolts, inherited a demolished economic structure. One of the first steps of General Park was the imprisonment of the country's wealthiest businessmen who were later on released in exchange for providing parts of their capital or company shares to the state. After the nationalization of 100% of banks in 1961, General Park received significant leverage on businessmen who in turn were united in the Federation of Korean Industry upon their release from prison. This created a system of 'chaebols' — business-state conglomerates usually run by an oligarchic family and growing because of the diversification of assets strategy. Chaebols were politically well connected, could execute state directives and helped intermediate between domestic and foreign capital. Similar patterns of business organization in a 'hierarchical capitalism' mode emulated Japanese 'zaibatsu' and could also be seen as key actors in Latin American forms of capitalism: (Chile, Colombia, Mexico, Brazil and Argentina). Korean chaebols (i.e. Samsung, LG, Daewoo, etc.) significantly affected the country's modernization and the imports of the western technologies. All in all, the success of the South Korean model was the result of the right system of checks-and-balances between the political and economic elites.

Firstly, the former saw chaebol's as the state's developmental partners who would also be capable of providing cash to the government when needed. In return, chaebol's could have stable and grounded expectations that they would not suffer from politically motivated expropriation of private assets. That would significantly harm the development of entire economic sectors.

Secondly, Korean political leadership could prioritize the goals of the the country's development over their own corporate interests, and General Park could successfully curb the appetites of his cronies and thus prevented the resources from being siphoned-off the economy.

Thirdly, Korean leadership possessed the necessary resources needed for grand investment projects, and successfully used external aid for development.

3. Is autocratic modernization relevant for Belarus?

Let us now contextualize the previous debate and tailor it to the particular context of Belarus.

As it was mentioned, there is little doubt that Belarus' leadership will try to retain the status-quo for as long as possible: engage in the Eurasian integrational project hoping to be able to cash-in certain of its advantages and seek rents out of the loopholes of the imperfect integrational institutions. The status-quo may be kept intact as long as Vladimir Putin will maintain that the benefits of the Eurasian integration outweigh the losses to Russia's budget from bailing-out Belarus. However, it is likely that Russia will increase the conditionality on Belarus by increasing its pressure on Lukashenka to honor his formal and informal obligations (compliance with the Eurasian rules, marketization and privatization). Whether when Russia's rents would become too costly for Lukashenka politically (i.e. trading more sovereignty for rents), or because of some other form of internal or external shocks/pressures, Belarus will inevitably move from a socialist-mixed economy to a certain form of capitalism. In the context in which the Belarusian elites and the Belarusian society are more concerned with successful economic development rather than with democratization of the country, thus there is little doubt that economic reforms will be conducted without meaningful political reforms. All in all, given that the inevitability of economic reform is unquestionable in the mid-term perspective, Belarusian leadership has a few realistic pathways to choose from the menu.

a) Autocratic modernization of Belarus?

One is to attempt the meaningful autocratic modernization of the country, which we could provisionally label South-Koreanization of Belarus. There are a few important preconditions and comparative advantages for this choice.

Firstly, regardless of the myths popular within the opposition, nowadays, Belarus is still a country with low state capture where cronies (it is incorrect to argue that there are oligarchs in Belarus²) have comparatively low impact on the formation of the general rules of the game. Lukashenka's regime has been based on directing the flows of externally obtained rents in favor of winning broad constituencies (partially, that constituted the 'social contract'), therefore, Belarus' President has always been rationally interested in curbing the appetite of his cronies, and preventing the authentic oligarchy from coming about, given that the concentrated rent-seeking groups could siphon off the resources intended to purchase social loyalty and public consent.

Secondly, a full autocratic advantage is out there: a vertically subordinated and well-controlled state-apparatus with the big scope of control over the economy is in place; the political opposition is on verge of extinction; the repressive apparatus can tame significant protests in the short-run; big-businesses are rather loyal than not and the parliament is reduced to a rubber stamp.

What could yet truly be needed for autocratic modernization (in case Lukashenka decides to go in this direction seriously) is the re-consolidation of a system of hierarchical capitalism, in which the system of well-managed cronies would be mounted. Practically, it means to allow further concentration of capital in the hands of the loyal private businessmen via privatization and preferential access to property rights, in exchange for them serving two purposes. Firstly, to support the social model by sharing parts of their rents with society and bear the insolvent enterprises with high concentration of labor on their shoulders. Secondly, to help resist the pressure from the side of Russian capital and assist in the country's development.

² One of the next papers of this series will be devoted especially to this issue.

Yet, there are a few important obstacles to Belarus' autocratic modernization (that would prevent Belarus from structurally emulating the South Korean path):

- There is a clear shortage of available liquidity in Belarus needed for grand investment programs (especially since cheaper European and US credits are temporarily unavailable), thus Lukashenka if he wants to repeat 'tigers jump' would have to withdraw resources from the paternalistic state programs which will in turn further affect the 'social contract' and dramatically decrease his popular support.
- Although Russia significantly improved when it comes to venture capital, high-tech products and innovative businesses, it is still far behind the Western countries, which could be the main credible modernization partners for Belarus. In this, Belarus is in a vicious circle: attracting Western capital/technology is hardly possible without political liberalization and certain forms of westernization, which in turn would demise the perspectives of autocratic modernization.
- There is a clear lack of up-to-date human capital in decision-making and know-how in both: attracting external credits/investments and directing them to potentially profitable strategic sectors. None of the numerous governmental programs on enhancing FDI inflow is implemented, and there is a very clear outflow of investors from Belarus. In other words, the government tries to solve the problem of low FDI by providing the potential investors with exaggerated, almost ridiculous and nearly offshore preferential conditions, while failing to defend national economic interests and create real value for the economy.
- Within the growing integrational pressures, Russia's political and economic elites have their own particularistic interests which may contradict Belarus' own developmental plans and strategies. The full ownership/control over Belarusian enterprises is what is really desired, while minority shareholder's equity partnerships with certain new Belarusian business groups (in case Belarusian 'chaebol's' start forming) or debt financing is way less attractive. To be more precise, Russian businesses are interested in authentic privatization of the Belarusian enterprises, but not in the M&As once those enterprises are sold to domestic business-groups.
- Finally, it is a big question, whether Lukashenka would be capable of keeping the appetite of rent-seeking groups interested in asymmetric property rights under control, as the influence of his cronies will inevitably grow as the Belarusian economy liberalizes. Furthermore, local groups could form coalitions with Russian financial-industrial groups interested in privatizing Belarus and move against their patron. This factor creates a big risk not only to the development of Belarusian society, but also to the survival of the incumbents in power.
- To conclude with the autocratic modernization scenario for Belarus: the question is not so much whether it will be successful, the real question is when this process will be derailed once started. Most probably, the attempts to turn Belarus into an autocratic modernizer, a la South Korea will end up in a situation of a very harsh state-capture (where the captors will be not only domestic market actors, but Russian state-business groups), Lukashenka will likely lose his power (it does not necessarily mean his political office) and Belarus will be faced with a long path-dependent pattern of further institutional decay.

b) Normal path for Belarus (a la Burma?)

A second path (which for now seems improbable and perhaps could be better labeled as the 'wishful thinking' of BISS) denotes a normal scenario of the reforms and might partially resemble the Burmese pattern, where democratic reforms preceded the economic ones once the country's leadership realized that the risks of dependence from the regional

hegemony — China — are too big, and so were the Chinese aspirations to acquire natural resources in Northern Burma.

The perfect turning point for this scenario in Belarus could have been December 19th, 2010, when Lukashenka could still secure his external legitimacy, advance in the Western direction and opt for partial political reforms in order to increase the flow of external Western aid. Nowadays it may be too late for that: the EU is obviously tired of dealing with Belarus, the West is largely disinterested in trying to convince l'Enfant T'errible to change, and there is an obvious dominance of pro-Russian moods within the governing elites, Belarusian society and a big track-record of commitments that Belarus has to honor within the integrational projects on which it embarked.

Yet, what could be still done is the damage control. Thus, it is paradoxically in the best interests of Lukashenka to extend the accountability of the government (even in the sphere of economic-decision making) and put in place a meaningful institution of public oversight in the course of the reforms. In doing this, the Belarusian authorities would clearly have to sacrifice parts of their rents, yet Lukashenka personally could gain the following:

- sharing the responsibility over the potential hardships of the reforms with non-state actors;
- obtaining a tool for minimizing Russia's privatization pressures (it is significantly easier to explain a 'no' to the requests by referring to actors exogenous to direct state control);
- demonstrating some improvements to international financial organizations which would in turn help improve the business-climate;
- minimizing the risks of 'non-sanctioned' rent-seeking which the government is not able to control;
- avoiding the developmental trap of partial reforms/state-capture when the reforms start.

Tentative concluding remarks.

Foreseeing possible stark criticism, this paper is not concerned with the incumbent's survival strategy, but argues that Belarus should avoid the developmental traps which came about in most of the transitional countries in which the economic reforms started in a low-accountability political regime. The uniqueness of the situation of Belarus is that it could learn from the post-socialist experience and have a more harmonious transformation once the political and economic institutions in Belarus get locked-out. Furthermore, Lukashenka has a unique turning momentum in which his rational interests correspond to the ones of society: public support for reforms is rock-solid (more than 70% according to IISEPS recent polling results), EU pressure to improve the status-quo is growing, so does Russian pressure (privatization, common ruble zone, etc.) while the cronyism path is dangerous, as Mubarak's Egypt demonstrates. Bringing more inclusiveness and transparency in the reform project is thus the priority for all the actors.

Last but not least, Lukashenka's strategic choice (in case it is not too late for such a choice) is whether he will lose part of his power (not necessarily his office) because of commitment to the Eurasian integrational project and the country's institutions will change because of the transnationalization pressures of an actor which certainly has bigger bargaining power (Russia). Or he will deliberately sacrifice a part of his power and influence to a partially controlled liberalization and marketization of the country. The latter leaves him more chances to maneuver while the first one does not. Furthermore, the latter leaves more hope for the Belarusian society to have a normal development, while the first does not.

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