

Illusions of power and stark realities: The second year of the economic crisis in Belarus

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In 2016 the basic macroeconomic indicators of the Belarusian economy clearly proved that the Belarusian government failed to reverse the negative trends which occurred in 2015. The gap in the foreign trade balance grew, industrial production dwindled, foreign debt increased and the low foreign-exchange reserves continued. GDP fell for the second consecutive year and so it can already be stated that a long-term economic recession is setting in.

The crisis has been caused by the failing, outdated model of the Belarusian economy. The country's difficult economic situation was also influenced by external factors such as a substantial fall in the amount of Russian oil supplied at preferential prices to Belarusian refineries and an economic downturn in the world's potassium-based fertilisers, which significantly reduced the profits from sales of Belarus's most profitable exports. The Belarusian government, probably due to pressure from the long-standing crisis, has increasingly been referring in its rhetoric to the chances of improving the situation due to the development of innovative sectors (e.g. IT) and to the expansion of the freedom of operation of small and medium-sized enterprises. However, this has not translated into real reforms, even those limited to selected economic sectors. President Alyaksandr Lukashenka still fears he will lose full control of the Belarusian economy and is trying to maintain heavy industry based on large-scale production plants and dependent on supplies of natural resources from Russia and access to the Russian market. The Belarusian government is thus blocking the development of an economy based on strong foundations of economic growth which would be independent of external factors. In autumn of 2016 there was an unprecedented escalation of tensions between Minsk and Moscow which has yet to ease off. In this context, it should be expected that the crisis will continue in 2017 and the risk of an economic recession in Belarus will increase.

The continuation of negative trends

According to official data, in 2016 Belarus's GDP fell by 2.6%. Although the fall was less severe than in 2015, when it fell by 1.3 percentage points, the value of GDP when calculated in US dollars dropped in the previous year by US\$ 8.1 billion and stood at US\$ 47.2 billion, which is the level from 2007. It points to the scale of the devaluation of the Belarusian ruble over the last few years. The main reason for the continued decrease of the country's GDP has been

the poor situation of the Belarusian oil industry which has accounted for 15% of Belarus's industrial production in the recent years. The sector reported a fall of over 19% in production due to two factors: the recession in the world's oil and oil-based markets¹; and the reduction of sup-

¹ According to calculations of Belarusian economists from the independent Institute of Privatisation and Management, the dependence of the Belarusian economy on the situation on the world's oil markets is so large that even an increase in the oil price by 15% may lead to an increase in Belarus's GDP by 1 percentage point. For more information see <http://www.research.by/webroot/delivery/files/ps2016r02.pdf>, pp. 18-19.

plies of Russian oil², as much as 6 million tons a year of which has been sold to both Belarusian refineries at less than market price as part of Russian energy subsidies for Belarus³. This has triggered a fall of 40% (from US\$ 6.8 billion to US\$ 4 billion) in revenues from exports of Belarusian oil products⁴.

In 2016 the importance of one of the main sources of revenues for Belarus, exports of oil-based products, substantially decreased.

Thus the importance of one of Belarus's main sources of revenues has declined—in 2015 (when Russian oil was supplied to a maximum of 24 million tons a year) it accounted for as much as one quarter of all revenues from exports. Nevertheless, in 2016 the share the petroleum industry makes up of Belarus's export revenues shrank to only one sixth. The situation is further compounded by the decline in revenues in another sector which is important for Belarusian exports – the production of potash⁵ which fell by as much as 23% to US\$ 2.2 billion, and was caused by a fall in prices.

As a result, in 2016 Belarusian exports dropped by over 12% and amounted to US\$ 23.4 billion and imports decreased by 9% to US\$ 27.5 bil-

lion, which led to a negative trade balance of US\$ 4.1 billion⁶, compared to US\$ -3.6 billion in 2015. In comparison with 2015, the trade deficit with Russia fell by over US\$ 1 billion (from US\$ – 6.7 billion to US\$ – 4.4 billion), which was above all due to falling imports of Russian oil. It is trade with the EU, where Belarus has exported oil products for many years, which recorded the largest decrease – by over US\$ 2.5 billion (from a surplus of US\$ 2.7 billion to US\$ 160 million). Belarus's trade with the member states of the Eurasian Economic Union (Russia, Kazakhstan, Armenia and Kyrgyzstan) has also decreased by US\$ 1.5 billion, which means that the negative trend of 2015 is continuing and proves that criticism of the effectiveness of this integration structure, established under Moscow's auspices, are well-founded. As for Russia, it remains Belarus's main trading partner with just over 50% of Belarus's total trade.

In this difficult situation for public finance, the Belarusian central bank succeeded in maintaining financial discipline and was thus able to increase foreign-exchange reserves – they stood at nearly US\$ 5 billion at the end of January (compared to US\$ 4.1 billion at the beginning of 2016). Similarly, foreign debt was limited by nearly 10% to US\$ 13.6 billion, despite the fact that the government used the first two instalments, worth a total of US\$ 800 million, from the Russian-controlled Eurasian Fund for Stabilisation and Development.

The worsening condition of Belarusian businesses is another manifestation of the economic crisis in the country. According to the latest data, from January to October 2016 the number of unprofitable companies rose by nearly 15% and now stands at over 20% of all companies in Belarus. Since the beginning of 2016, the issue of problem loans (loans which are nearly or totally unpayable) which have been granted by banks,

² Data based on the official communiqué of the Belarusian company Belneftekhim regarding its financial results in 2016. For more information see <http://www.belrynok.by/ru/page/news/4647/>

³ Russia's preferences in energy and trade are the result of Belarus's participation in all integration initiatives launched by Moscow in the post-Soviet area, close military co-operation and the (increasingly virtual) process of integration of both countries within the framework of the Federation State which has been developing since the mid-1990s.

⁴ It is worth noting the importance the Ukrainian market has on the increase. In 2015 Belarus exported 3.2 million tons of oil products and 4.3 million tons in 2016, which is 1 million tons more and represents one third of all goods exported from Belarusian refineries in 2016.

⁵ Unlike all the remaining strategic sectors of Belarusian industry, the production of potash is based on the country's own potassium salt fields and is thus independent of its co-operation with Russia.

⁶ Over the last six years this was not the record low in Belarus's foreign trade. Between 2010 and 2015 the trade balance vacillated between US\$ - 9 billion to US\$ - 3 billion (except for the exceptionally good 2012).

usually under pressure from the government to state-owned companies in industry or the food and agriculture sector, has become serious. The fact that it is impossible to repay these loans has led to blockages and seriously affects banks which are thus de facto forced to subsidise often unprofitable sectors of the Belarusian economy. The safe threshold of the share of problem debt in total loans is an upper level of 15-20%.

Two years of the recession revealed the extent to which Belarus is dependent on the situation on the world's markets of oil-based products and on Russian subsidies.

At the end of 2016 this indicator stood at 12.8%⁷. However, it cannot be ruled out that a portion of the debt is hidden, not showing up in statistics.

According to unofficial information from Belarusian banking circles, the total debt of the largest Belarusian production plants may now exceed US\$ 6 billion and this amount is higher than the current level of the Belarusian central bank's foreign-exchange reserves⁸. The deteriorating situation of companies and their problems with cash flow, the related ailments of the banking sector and smaller revenues from exports have led to an important drop in internal investments which have been one of the foundations of the Belarusian economy in recent years. In 2016 the investment activity of domestic companies, above all in public investments, decreased by nearly 18% and hit a record low in 2003 of 19% of GDP. This result is lower than the safe threshold of 25% which the Belarusian

government has allowed for. Important investments have been stopped in the housing sector and in the area of modernisation in the production sector. They have been accompanied by a decrease in foreign investments which are so desired in Belarus, and no privatisation contract was signed in 2016⁹.

Two years of recession have clearly indicated to what extent Belarus's economic condition depends on changing external factors, above all the situation on the world's markets of oil and oil-based products and artificial fertilisers, on Russian subsidies, and access to the Russian market. The Russian factor, highly politically determined, is particularly dangerous to the stability of the Belarusian economy. Given the fact that in 2015 only the recession in Russia had a negative impact on the economic situation in Belarus, in 2016 the Kremlin gradually reduced its subsidies for the energy sector in order to force Alyaksandr Lukashenka to make concessions and to gain full control of Belarus. The dispute between Minsk and Moscow, which has been ongoing since January 2016, has extended to almost all areas of economic and energy co-operation. This has led to the access of Belarusian products to the Russian market (which is of strategic importance for a portion of Belarusian industry, above all the food and machine-manufacturing industries) being limited even further. Furthermore, it may be clearly inferred from statements Russians have made in recent months that the Kremlin's pressure may increase throughout 2017¹⁰.

⁷ In the last two months of 2016 this indicator fell substantially, probably due to transferring part of the liabilities to the Assets Management Agency which has recently been established. However, despite the improvement in the statistics, it cannot be said that this trend, which is dangerous for the Belarusian economy, has been durably reversed.

⁸ For more information see <https://news.tut.by/economics/530974.html>

⁹ Aleksei Vasilev, the Vice-president of the State Committee on the Treasury (the body responsible for privatisation) publicly admitted this at a press conference held on 21st February. When explaining the reason for this, he pointed to a complete lack of interest on the part of investors. He did however say he believed the situation might improve due to the attempts made by the government to attract Chinese capital. For more see <http://naviny.by>

¹⁰ Due to the present commentary's focus on the economy, the vast subject of the crisis in relations between Russia and Belarus has only been briefly mentioned. It seems that the principal reason for this is Moscow's discontent with Alyaksandr Lukashenka's excessively autonomous politics, which is discussed in the Kremlin, in the context of the events in Ukraine, as a token of far-reaching disloyalty. For more see <https://www.osw.waw.pl>

Illusions of a 'new' economy...

The long-standing recession has brought a change in the rhetoric of the Belarusian government and certain corrections in the strategic planning of economic development. In the premises of the economic policy and the budget for 2017, which Alyaksandr Lukashenka approved at the beginning of October 2016, economic growth was planned at the level of 1.7% of GDP¹¹. However, as representatives of the government themselves admitted – it is quite unlikely that this objective will be achieved.

The Belarusian Ministry for the Economy has pointed to the innovative production and the sector of small and medium-sized enterprises as new sources of economic growth.

The sources of revenues to date – the good situation of the world's oil and potash markets, reduced prices of Russian energy resources and preferential access to the Russian market – will no longer ensure the economic growth which Belarus witnessed several years ago (in 2005-2014 it was on average 5-6% of GDP). With regard to this, the Belarusian Ministry for the Economy defined three new sources of economic growth for the country's economy: innovative production, the sector of small and medium-sized enterprises, and the Chinese-Belarusian industrial park¹². It seems that pointing to the project of the 'Great Stone' industrial park which is being implemented with

Chinese investors is little more than propaganda and will not provide an important impetus for Belarus's development in the immediate future. However, the development of the two other sectors could lift the Belarusian economy out of the recession in the long run.

The IT sector, which has been developing dynamically over recent years, provides a good example of this. According to the latest data, at present there are approximately a thousand software manufacturers in Belarus, the majority of them are based in the Belarus High Technologies Park in Minsk where they benefit from preferential terms and conditions of economic activity. Due to the low capacity for absorption on the domestic market, most of their products are sold abroad and in 2015 the revenues of Belarusian coders reached already over US\$ 800 million. Independent Belarusian experts estimate that exports in this sector will increase by approximately 20% in 2016-2017 and revenues from sales will exceed US\$ 1 billion in 2017.

Due to the success of this sector, which stands out against the backdrop of problems in traditional sectors, the theory of parallel growth has been gaining increasing popularity among circles close to the government. The concept, which was presented by experts of the Belarusian Ministry for the Economy at the beginning of the year, is based on the premise of rapidly increasing the share of new sectors (e.g. IT) in GDP growth and a gradual reduction of the role of outdated sectors of the economy (such as heavy industry). According to the ministry's forecast, as early as in 2020 three quarters of economic growth in Belarus will be generated by more innovative sectors¹³. However, a highly bureaucratic approach of the government may prove to be rather a serious impediment to the further development of this area. The government has not lifted all limitations on IT companies. It has also been trying, in its own

¹¹ The international financial institutions were far more cautious in their forecasts about Belarus. According to the assessment of the International Monetary Fund, the Belarusian economy will see a drop of 0.5% and the World Bank predicts this fall will be 1%. Analysts from Russia's Sberbank offered the most optimistic forecast but even they predict a 0.2% fall in GDP.

¹² For more information see http://www.zautra.by/art.php?sn_nid=22693, <http://news.21.by/economics/2016/12/16/1274988.html>

¹³ For more information see <http://naviny.by/article/20170120/1484895345-vlasti-belarusi-budut-sozdavat-parallelnuyu-ekonomiku>

bureaucratic way, to persuade IT companies to become more involved in the modernisation of less profitable industries¹⁴. Furthermore, representatives of small and medium-sized enterprises, whose share in GDP is at present below 25%¹⁵, have been pointing to numerous barriers to the expansion of the sector.

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Many factors indicate that Alyaksandr Lukashenka is beginning to grasp the necessity of moving away from the distrustful approach to private companies he has displayed so far.

In recent months he has often spoken highly of the private sector, ordering his subordinates to introduce solutions which would facilitate its activity as much as possible, in particular by reducing the burdensome inspections¹⁶. Furthermore, at the end of January this year, the first session of a newly formed working group responsible for boosting economic ac-

tivity was held and chaired by the head of the Belarusian Presidential Administration, Natalia Kochanova, with the participation of ministers responsible for economic policy, representatives of business associations, and entrepreneurs¹⁷. The group has been entrusted with the task of developing a comprehensive programme of solutions for businesses which would facilitate their activity. The solutions will be implemented by presidential decrees.

Following in the footsteps of the president, his subordinates have also been quite critical of the Belarusian economic model. In February this year the former director of the National Agency of Investments and Privatisation Natalia Nikandrova openly admitted that the low level of foreign investments the previous year was somewhat justified since neither the legal regulations nor the government's approach to investors encourage them to locate their capital in Belarus. Thus, in her opinion, it is necessary to introduce a fundamental reconstruction of the model of co-operation between Belarusian state-owned companies and investors¹⁸.

...and the lack of real reforms

Liberal refrains in the government's rhetoric and a realistic choice of priorities in planning the country's development do not mean a comprehensive change in the economic policy in Belarus. Alyaksandr Lukashenka is increasingly aware of the failings of the Belarusian economic model but is not ready to give up the state's control of key sectors of the economy, particularly of heavy industry, which is decreasingly profitable. He fears that a thorough restructur-

¹⁴ While conducting research in the IT sector, independent analysts from the Belarusian Institute for Strategic Studies (BISS) identified a series of problems which hamper the free development of IT in Belarus, such as an insufficient education base for the training of young people, the lack of guarantees of preferential terms and conditions of economic activity within Belarus's High Technologies Park, limited opportunities for a flexible system of salaries, and a method of employing foreign subcontractors. For more information see <http://reforum.info/node/516>

¹⁵ In the EU countries the standard share of this sector in GDP is at least 60%.

¹⁶ One of the first measurable results of this unprecedented rhetoric of Belarus's president is the decision of the management of the Belarusian fire brigade (announced at the beginning of February this year) to stop routine inspections of private companies. Reservations and conclusions following these inspections have often complicated or even made impossible the activity of many private businesses in Belarus. It was also announced in February that inspections in retail and wholesale companies will be suspended. Inspections will be replaced by a general monitoring of the situation in the sector.

¹⁷ According to the available data, these are above all entrepreneurs linked with the government who benefit from its support in conducting their economic activity, e.g. a mogul in the food industry, Alyaksandr Moshenskiy, one of the richest people in Belarus.

¹⁸ For more information see <http://naviny.by/article/2017-0214/1487072435-nevozmozhno-vesti-biznes-ne-narushaya-zakony-znachit-takie-zakony-nuzhno>

ing¹⁹ of strategic companies in the sectors of petrochemicals, machines and metallurgy will lead to them being closed down or sold to the only potential buyers – Russian companies. In the first case, this could cause discontent among Belarusian citizens who would lose their jobs²⁰.

Nevertheless, the president is not ready to give up control of key sectors of the Belarusian economy, above all heavy industry.

In the second case it would exacerbate Belarus's dependence on Russia, which is already important. Therefore Alyaksandr Lukashenka has been reiterating already known theses about the necessity of maintaining state assets in the industry and has not only been blocking privatisation²¹ but also any vital changes in its management model.

It cannot however be ruled out that in the long term the Belarusian government will be favourable to a slow transformation in the structure of employment (which will be safe for the internal stability of the country) towards reducing the number of workers in heavy industry since its

potential has been decreasing. According to recent available data, in 2010-2015 (data for 2016 is incomplete) the share of workers of the production sector in Belarus in the overall number of employed has fallen from 47.6% to 44.3% (e.g. in the capital it is only 28%)²².

The government's fight to preserve at least selected elements of the state's policy of social welfare is another factor which blocks market reforms. The main objective is to maintain calm in society and the passivity of the majority of Belarusians towards the regime. It is particularly important given the fact that the income of Belarusian citizens fell by 7.3% in 2016²³ and that protests against the application of the decree aimed at 'preventing social parasitism' have been growing across the country²⁴. On this issue, Lukashenka has in the recent weeks repeatedly stressed that it is necessary to raise the average monthly salary to US\$ 500 by the end of the year. Although this announcement is not very realistic given the present circumstances, it represents an attempt to continue

¹⁹ Certain production plants which have been deemed as having the most potential for development have been undergoing modernisation for years in order to increase their competitiveness on the international markets. However, these changes have not been accompanied by any important restructuring of the employment and management models. The multiannual programme of modernisation of the refineries in Mazyr and Navapolatsk has been the most important. As a result, the capacity of oil processing will increase to 90% in both plants (it is currently approximately 72-73%). The programme was to be completed in 2016, but will be delayed for several years due to the crisis.

²⁰ In two plants manufacturing lorries and tractors (MAZ and MTZ) in the capital alone there are nearly 40,000 workers.

²¹ During the televised debate 'Big talk with President' held on 3rd February (which was energetically organised and appropriately directed), Alyaksandr Lukashenka in a polemic with an independent Belarusian economist Jaroslav Romanchuk firmly denied the possibility that key production plants will be privatised in the immediate future. In this context the lack of any privatisation transactions in the previous year is understandable.

²² The share of workers employed in the service sector (according to Belarusian statistics, this includes education and administration) has increased to over 55%. In parallel, the share in GDP has changed to the advantage of services, which in 2015 already represented over 50% of the total product of the Belarusian economy. Belarusian experts are unanimous in stating that the trend of the gradual reduction of the production sector is steady and will continue in the long-term. Furthermore, it seems that the government is trying to further encourage this process. According to unofficial information, the management of large-scale production plants were ordered in the previous year to use all available measures (e.g. violation of workers' rights; discipline, termination of contracts, reduction of the pension age) in order to gradually reduce the number of workforce. As a result, in the previous year as many as 107,000 workers lost their jobs. For more information see <https://probusiness.by/statistics/2858-sfera-uslug-stanovitsya-opredelyayushchey-v-belorusskoy-ekonomike-vyvody-dmitriya-ivanovicha.html>, <https://banki24.by/news/2026-za-2016-god-v-belarusi-bylo-uvoleno-na-1072-tys-chel-bolshe-chem-prinyato-a-stroysektor-poteryal-kazhdogo-7-go-rabotnika>

²³ For more information see <http://news.21.by/economics/2017/02/16/1297691.html>

²⁴ The decree which came into force in spring 2015 extends to the period from 2015 and compels all Belarusian citizens who work less than 183 days a year to pay a special fee (the equivalent of over US\$ 200 a year) to the state budget.

the policy of administrative regulation of the economy which has been pursued in the last years and which is in contradiction to the promises to liberalise the economy. Furthermore, the Belarusian government is still trying use the state budget to subsidise payments of rent and utilities fees of citizens, who pay only 50-60% of real costs.

The reluctance of the Belarusian government to make economic reforms and the maintenance of its social welfare policy have for months been effectively blocking the signing of the agreement with the International Monetary Fund regarding a stabilising loan of US\$ 3 billion. The IMF consistently calls for an immediate restructuring of industry and for rent payments and related fees to be raised to the market level. President Lukashenka has recently conceded that this will be met with firm opposition from Belarus.

The outlook: a continuation of instability

The strategy adopted by the Belarusian government, which consists in seeking new sources of growth while refraining from comprehensive economic reforms, appears unrealistic. It

can hardly be expected that innovative sectors of the Belarusian economy (e.g. IT) and small and medium-sized enterprises will develop so rapidly as to generate enough revenue for the state not only to maintain heavy industry (which is becoming decreasingly profitable and depends on external factors), but also to spur GDP growth. Furthermore, as the protracted negotiations with the IMF prove, the Belarusian government cannot rely on loans from the international financial institutions without introducing fundamental reforms. Many factors indicate that in the present situation, particularly given current social discontent, the Belarusian government will approach economic reforms with even more caution. The lack of a decision to restructure the economy not only makes it substantially more challenging to lift the economy out of recession, it also makes the present condition of the Belarusian economy dependent on the development of relations between Russia and Belarus and on the volatile situation on the oil and oil-based market. Given the intensification of tensions and many misunderstandings between Moscow and Minsk, this situation is becoming a direct threat to both the further functioning of the Belarusian economy and the country's sovereignty.

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