

How to get out of the crisis without reforms? The Belarusian authorities confront growing economic problems

Kamil Kłysiński

2015 saw a drop in Belarus's GDP for the first time in almost 20 years, which is primarily the result of a significant reduction in levels of production and export. As a consequence, there was also a serious depletion of the country's foreign exchange reserves, as well as a progressive weakening of the Belarusian rouble. The macroeconomic figures from January and February 2016 show that these trends are not only continuing, but they are also becoming even more severe, which confirms that Belarus now finds itself in a prolonged economic crisis. On one hand, the reason for this state of affairs is the protracted economic recession in Russia, which is Belarus's main economic partner, together with the drastic global decline in prices for fuel, which is a key Belarusian export. On the other hand, meanwhile, an equally important reason for the current crisis is the failure of the Belarusian economic model. President Aleksandr Lukashenko, out of fear that his authoritarian system of government will be dismantled and that public discontent will rise, has categorically rejected the proposals for even partial reforms put forward by some of his entourage, who are aware of the need for the immediate transformation of the country's anachronistic and very costly economic model, based as it still is on quasi-Soviet management policies.

In this situation the Belarusian authorities have adopted a familiar tactic in order to obtain large, low-interest stabilisation loans, principally from the International Monetary Fund and the Russian-controlled Eurasian Stabilisation and Development Fund. In the context of Minsk's new opening in its relations with the EU, a possible thaw with Washington, and its close cooperation with Russia, it seems quite probable that it will obtain financial support. And despite the fact that these two institutions, in particular the IMF, have demanded reforms, we should not expect Minsk to bow to their pressure and undertake a comprehensive reconstruction of its inefficient economic system. Lukashenko's current policy of survival based on loans is only postponing the inevitable reforms, while further increasing their social and financial costs when they arrive.

Symptoms of the crisis

In the past year Belarus's GDP has decreased by 3.9%, which means the end of the country's 19-year trend of growth. One of the main reasons for this is certainly the significant drop in Belarusian exports, which make up more than half of GDP. In 2015, the value of exports from Belarus amounted to US\$26.6 billion, which is up to US\$9.3 billion (26%) less than the previ-

ous year. This was accompanied by a decrease in imports of US\$10.1 billion (25%). However, this did not affect the downward trend in Belarusian foreign trade, which has been continuing for many years, and last year also closed with a negative balance of US\$-3.6 billion. It is worth noting that the largest drop in exports (30%) was to the markets of the CIS countries, and in the case of exports to Russia (which remains the main trading partner for Belarus),

this meant a loss of US\$4.7 billion in potential income¹. This is a result of the deep economic recession in Russia, as well as in other post-Soviet markets important for Belarus (mostly Ukraine and Kazakhstan). Also subject to economic downturn (although to a lesser extent than Russia) was the goods trade with the EU; the sales value of Belarusian goods to the EU fell by 19%, slightly more than US\$2 billion.

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This significant reduction of income in foreign currency from exports, combined with the need to repay US\$3.6 billion of foreign debt in 2015, has resulted in a drop in the Central Bank of Belarus's currency reserves of over US\$800 million throughout the year. So as of 1 January this year their level stood at only US\$4.175 billion, which is insufficient to cover the value of three months of Belarusian imports, the level normally considered safe for a state's finances. All indications are that the above-mentioned trends will worsen this year, as GDP has already dropped by 4.3% this January, the monthly balance of foreign trade amounted to US\$-50 million (while in the same month last year it amounted to almost US\$+180 million), and the level of foreign exchange reserves during the first two months of this year fell by almost US\$65 million. At the same time, in accordance with its schedule for repaying foreign debt, Belarus should repay US\$3.3 billion to its

¹ The last decline in GDP was recorded in 1995, when Belarus was in a deep economic slump caused by the breakup of the Soviet Union and the loss of most of its cooperative links with the other Union Republics, and of funds from the central budget in Moscow. President Lukashenko's path towards reintegration with Russia, initiated in the mid-1990s, has brought lasting economic stability, which for many years was one of the regime's propaganda strengths.

creditors (primarily Russia and China) this year, which with such a critical (and still falling) level of reserves is already virtually impossible².

The economic downturns in Russia and other markets important for Belarusian exports have also led to a serious deterioration in the health of Belarusian industrial companies, which for the most part are still based on Soviet infrastructure and management principles, and so are less competitive. According to official statistics, in 2015 up to 60% of Belarusian enterprises had reported losses, or at most minimal profits; compared with 2014 the number of such businesses had risen by 24%³. This was accompanied by a drastic decline in revenues in the manufacturing sector, of up to 42.2%. It should be noted that this group also included entities of considerable importance for the Belarusian economy, such as MTZ (tractors), MAZ (trucks) and BMZ (engine production for heavy vehicles), all based in the capital, and the agricultural machinery production plant Gomselmash, located in Gomel. Among the biggest so-called strategic companies still turning a profit is the potassium company Bielkalyi, and two oil refineries. Another important aspect of the crisis in the Belarusian economy is the depreciation of the Belarusian rouble, which has been ongoing for many months. Over the last year, its value in relation to the so-called basket of currencies (the US dollar, the euro and the Russian rouble) decreased by 37.8%, and in relation to the dollar alone it fell by 55.9%. In the first few weeks of 2016 there has been a further decrease of at

² In assessing the state of the Belarusian currency reserves, it should be borne in mind the fact that some of them are collected in gold, precious stones and units of account from the IMF (so-called SDRs) that can only be used in exceptional cases. According to expert assessments, the Belarusian central bank may have as little as US\$2.2 billion in liquid cash available for transactions and interventions on the market.

³ In statistics concerning the situation of businesses in Belarus, only one indicator has improved: the level of stocks of finished products in relation to monthly production. The annual average in 2015 was 68%, compared to 75% in 2014. This is above all a result of the decline in industrial production, related to the reduction in the work week for factory personnel, and in any case is not a symptom of positive trends in the industry.

least twelve percent⁴. This significant weakening of the rouble has led to a decline in the real value of wages; whereas the changes were not so drastic in 2015, the dynamic fall of the rouble rate in January this year when calculated in dollars has reduced the amount of the average salary by almost US\$90 (to US\$315). For that part of Belarusian society which keeps its savings in foreign currencies and goes shopping to the neighbouring countries of Poland and Lithuania, this has led to a clear decline in their standard of living. Meanwhile, the whole of society has long been affected by the rise in commodity prices in the stores, which has made Belarus one of the most expensive countries in the world⁵.

The government's dogmatic policies

Much seems to indicate that, even last year, some members of President Lukashenko's circle had begun to sense the seriousness of the situation and the consequent need for change. The President's economic adviser, Kiril Rudy, has come out as the main promoter of reforms; in October 2015 he publicly spoke in favour of a departure from the traditional command-and-policy distribution system based on 'manual control' and regulating development by drawing up specific plans to be implemented⁶. Moreover, he

also stressed the need for a broad programme of privatisation and the elimination of unprofitable enterprises, which was already a very far-reaching idea in the context of the Belarusian authorities' clearly anti-liberal economic policy.

Lukashenko has acknowledged that any deep changes in the current economic model could weaken his entire autocratic system of government, and could even cause an outburst of public unrest.

However, in another statement made a few weeks later at the Economic Forum in Minsk, Rudy admitted that such reforms were not so essential, and that there was a lack both of public demand for them and of administrative personnel able to draw up and implement such systemic changes to the economy⁷. All indications are that the President's advisor was forced to publicly withdraw his proposal, and thus he cannot be said to have any significant influence on the evolution of the country's economic policy⁸.

In his own statements over the last few months, President Lukashenko has firmly reiterated his thesis – as encountered in his rhetoric for many years – that he would not permit any reforms which would in his opinion only bring “confusion among citizens, thus destabilising the situation”, and could “cost considerably more than repaying the current foreign debt”. At the same time, the Belarusian leader has spoken openly in favour of economic ‘manual control’, including by granting specific support to un-

⁴ To illustrate the scale of this process, it is worth mentioning that at the beginning of 2015 €1 bought 14,380 Belarusian roubles and US\$1 11,850 Belarusian roubles, while on 4 March the rates were 23,210 and 21,356 Belarusian roubles respectively. In connection with this, the Belarusian press has long carried ironic comments on the ‘country of millionaires’, and the authorities finally took the decision (which had already been postponed for several years) to redenominate the rouble as of 1 July this year, to lower the rates and facilitate trade.

⁵ Earlier this year the popular newspaper *Komsomolskaya Pravda v Belarusi* conducted an experiment that compared purchases of the same products in the capitals of several European states, including Belarus. As a result, it turned out that shopping in Minsk was more expensive, not only than in Warsaw or Kiev, but even Moscow, which has hitherto had a reputation for high prices. In turn, according to a ranking by the American magazine *Time*, the cost of living in Belarus turned out to be higher than for example in Poland, Saudi Arabia, Kazakhstan, the Czech Republic, Estonia, Lithuania, Ukraine, Spain, Russia, Portugal and Croatia.

⁶ For more see <http://ej.by/news/economy/2015/10/24/kill-rudy-protiv-ruchnogo-upravleniya-ekonomikoy.html>

⁷ For more see <http://news.tut.by/economics/471159.html>

⁸ It is worth mentioning that, although Rudy is still in his post, he now presents his still-liberal positions in a manner more reminiscent of a scientist-expert, as for example in the form of his recently published book *Финансовая диета* [A financial diet], containing comprehensive recommendations for economic reforms in Belarus; http://naviny.by/rubrics/economic/2016/02/05/ic_articles_113_190915/ It seems that his presence in President Lukashenko's inner circle is intended to be an asset in Minsk's discussions with international financial institutions expecting economic reforms, such as the IMF, the European Investment Bank and the European Bank for Reconstruction and Development.

profitable companies threatened with bankruptcy⁹. As in previous years, Lukashenko has declared that any deeper changes to the current economic model could undermine the entire authoritarian system of power, and even the outbreak of social discontent. The Belarusian president has tried to retain at least some elements of social guarantees, including above all a high level of employment in state industry.

The reforms proposed by the government are another attempt at “commanding growth” according to the traditional principles of the command economy which Minsk has hitherto preferred to apply.

On the one hand, this eases public sentiment, and on the other hand – through a system of short-term contracts, extended every few years – it allows control over a significant part of Belarusian society. While avoiding the elimination of unprofitable businesses, the Belarusian authorities also take a cautious approach to the issue of privatisation. In the privatisation plan for 2016 announced this January, only 56 companies were included, and in most cases only smaller share packages were to be offered for sale. There were no companies of strategic importance on the list, and the planned total income from all the transactions is only expected to reach around US\$20 million. It can thus be concluded that not only is the Belarusian government not ready to reform the economy through privatisation, but it also does not see this method as an effective source of income to supplement its dwindling currency reserves¹⁰.

⁹ For more see http://naviny.by/rubrics/politic/2016/01/26/ic_articles_112_190823/

¹⁰ This approach is probably also conditioned by a lack of interest from potential investors, who fear that the costs of acquiring obsolete industrial infrastructure requiring costly modernisation will be too high. Moreover Russia, which has for many years been committed to taking over key assets in Belarusian industry, has temporarily eased its pressure on Minsk due to the current recession. However, it cannot be ruled out that privatisation in Belarus will once again become a priority for Moscow in the next few years.

The Belarusian authorities’ dogmatic economic policy also translates to the unrealistic structure of the state budget. The income and expenditure plan for 2016 is still based on the assumption that the oil price will remain at US\$50 per barrel; and contrary to initial announcements that the budget would be revised, there has been no action in this direction. Although Belarus itself has no significant oil deposits (annual national extraction amounts to about 1.5 million tons), the country has two refineries with a total capacity of over 20 million tonnes per year (producing mainly for export), and so the Belarusian economy is greatly dependent on the state of the oil market¹¹. Belarus imports crude oil according to fixed rates agreed with Russia; its petroleum products must then compete on the European market in a situation of economic downturn, which means a reduction in the profit margin for Belarus. The share of oil products in Belarusian exports is almost 30%, making the sector one of the key pillars of the Belarusian state budget. Another important element for Belarus’s finances is the revenue from export duties on Belarusian petroleum products made from oil imported from Russia. The scheduled proceeds of US\$1.1 billion for this year were crucial to signing off the budget in the black. However, in the face of a significant drop in oil prices, this inadequate budget will further deteriorate the condition of the state’s finances.

In this situation, the necessary reforms have once again been blocked and postponed, and the overall economic policy is being subordinated to the political strategy of maintaining social order and the full power of the state, regardless of the real condition of the economy. At the same time, however, wherever the authorities have had to reduce the social package due to a lack of resources, Lukashenko has publicly chastised his subordinates for going too far, thus

¹¹ According to Bloomberg’s ranking published at the beginning of 2014, Belarus was the world’s third most dependent country on oil revenue. In the authors’ opinion, the value of export of Belarusian oil products in 2018 will rise to 13.9% of GDP (currently the figure stands at around 12-13%). For more see <http://bdg.by/news/economics/27821.html>

presenting himself in the role of the defender of 'the ordinary people'. The most conspicuous example of such a superficial action is Lukashenko's reaction to the significant increases (from 40% to 70%) in municipal charges this January, which resulted from the agreements during negotiations with the IMF on a new credit line¹². On 22 February, during his regular discussions with the cabinet, Lukashenko harshly criticised the "inadequate" increases, recommended that the charges be reassessed, and that the guilty officials be punished. As a result, the State Control Committee (SCC) opened up 22 criminal proceedings against employees in the housing sector on charges of 'abusing official powers'.

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In addition, the authorities are taking decisions which are presented as reform measures, but in fact are all about improving their public image. On 23 February, President Lukashenko signed a decree 'on efforts to improve the efficiency of the socio-economic sector'. Among the other measures proposed, state-owned enterprises have been obliged to reduce production costs by 25% and attract foreign capital; and the central government, together with the administrations of individual regions, are to work on increasing the number of new jobs. Another important aspect of these reforms is an additional aid package for the poorest social groups. However, this comprehensive document is not a package of bold and comprehensive reforms,

¹² Currently, the public covers only about 30% of the charges for gas, electricity, water, heating, rubbish collection and other municipal charges. The IMF, like the Eurasian Stabilisation and Development Fund, has made opening a new line of credit for Belarus dependent on the state ceasing to subsidise these fees.

but rather another attempt at "commanding growth" according to the traditional principles of the command economy which Minsk has hitherto preferred to apply.

Hang on for a loan

Regardless of his pro-social economic propaganda and the imitation of genuine reforms, Lukashenko is aware of the real scale of Belarus's macro-economic problems, primarily the likely collapse of the state's finances. Bearing in mind his priority of retaining full power in the country, he has chosen the safest tactics (from his point of view), namely raising large, low-interest stabilisation loans from the IMF (US\$3 billion) and the Eurasian Stabilisation and Development Fund (US\$2 billion). In connection with this, Minsk had already made efforts to win favour in both institutions last year, taking advantage of the favourable context to hold talks with the EU after the relatively benign course of the presidential elections in Belarus last October, as well as the conciliatory role of Belarusian diplomacy in the Russian-Ukrainian conflict. After the abolition on 15 February this year of EU visa and economic sanctions, Belarus's chances of obtaining a credit line from the IMF increased significantly, and a day later President Lukashenko publicly admitted that his government should move away from the policy of socially painful budget cuts, because "the situation after the EU'S decision is now different"¹³. Next, the IMF itself sent a positive signal to Minsk by doubling the country's credit limit, which in practice means Belarus can now apply for a maximum of US\$4 billion¹⁴. Currently Minsk is conducting detailed negotiations on the conditions for an IMF stabilisation programme for Belarus, which will certainly include the controversial issues mentioned above of state subsidies for municipal charges, the support of

¹³ For more, see <http://www.belta.by/president/view/lukashenko-pravitelstvu-rezat-po-zhivomu-ljudej-otbiraja-poslednie-dengi-nikomu-ne-pozvoleno-181831-2016/>

¹⁴ This was the first modification to Belarus's participation in the IMF since 1999.

unprofitable enterprises, and privatisation. The interest rate on this loan may amount to 2.28%, although Belarus is hoping (despite this already low rate) that it will be reduced further to 2.1%. Simultaneously, Minsk is holding talks with Moscow on obtaining a loan from the Russian-controlled Eurasian Stabilisation and Development Fund. Although the Fund has formally set macro-economic conditions similar to the demands of the IMF¹⁵, a political understanding between Belarus and Russia will be crucially important. As in the case of the negotiations with the IMF, a final decision is still lacking; however, all indications are that over the next few weeks, Belarus will receive support in the planned amount of US\$2 billion, most likely without even having to make any concessions, such as the deployment of an important air base in Bobruisk, which is important to the Kremlin¹⁶. It seems that it will be enough for Russia to weaken Minsk's interest in reopening relations with the EU. In this way, by expertly handling the situation in the region and Minsk's relations with the West and Russia, Aleksandr Lukashenko has been able to realise his plan of short-term survival by increasing his country's foreign debt.

¹⁵ The ESDF places special emphasis on three issues: reducing the ratio of wage raises to inflation, the introduction of municipal fees, and removing limits on the prices of goods and services.

¹⁶ On 26 February Aleksandr Surikov, the Ambassador of the Russian Federation to the Republic of Belarus, claimed in an interview for Belarusian TV that the final decision to grant Belarus a loan from the ESDF Belarusian of US\$2 billion had already been taken, and its implementation was "only a matter of time". According to analysts from the Russian consulting firm WTB Kapital, the first tranche of US\$1.1 billion could reach Minsk in 2016, which would almost entirely cover this year's repayment to Russia.

Perspectives

By giving up on any serious economic reforms in favour of increasing Belarus's external debt, Lukashenko has once again proved that he is first and foremost a tactician, not a strategist. The loans from the IMF and the Eurasian Fund will be nothing more than an *ad hoc* boost to Belarus's inefficient and very costly economic model, which is increasingly lagging behind the changing international context. A systemic reconstruction of the Belarusian economy over the next few years is unavoidable, and the current policies of the authorities are only postponing it, while raising the financial and social costs of these future changes. The stability of Belarus's finances, based on credit, will therefore be merely superficial and short-term; and most importantly, the Belarusian authorities will be unable to stop the progressive decline in the public's standard of living and the further degradation of the mostly outdated state-owned industrial plants. While planning its macroeconomic policy on a short-term basis, the regime will first and foremost be considering the mood of the public, especially before the parliamentary elections scheduled for September 2016. It is thus hard to assume that if the aforementioned loans are granted, the Belarusian authorities will allocate these funds to finance reforms. Most likely some of the money will be used to rejuvenate the Central Bank's exhausted foreign exchange reserves, and some to cover the costs of the social aid package designed to alleviate the dissatisfaction of Belarus's citizens, more and more of whom will be affected by the consequences of the economic crisis.

EDITORS: Adam Eberhardt, Wojciech Konończuk

Anna Łabuszewska, Katarzyna Kazimierska

TRANSLATION: Jim Todd

DTP: Bohdan Wędrychowski

Centre for Eastern Studies

Koszykowa 6a, 00-564 Warsaw

phone: +48 | 22 | 525 80 00

e-mail: info@osw.waw.pl

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