

## The cost of a police state: Belarus's economic problems

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Although the COVID-19 pandemic did trigger a recession in Belarus, the greatest blow to the country's economy has been its deep political crisis. This was caused by the authorities rigging the results of the presidential election, which in turn provoked mass opposition from the citizens. Alyaksandr Lukashenka, focused on remaining in power, resorted to unprecedented repression, which over the following months completely shattered many years of efforts to improve the investment climate and to achieve a partial liberalisation of the economy. These efforts included a flagship initiative to develop the Belarusian IT sector. 2020 revealed the Belarusian economy's great sensitivity to the global economic slump and the regime's inability to launch free-market reforms. As a consequence, although in 2020 Belarus's GDP fell just 0.9%, the country found itself in an extremely difficult situation due to the magnitude of other threats to its economic stability. Belarus's inability to effectively refinance its foreign debt using funds offered by Western institutions, its significant budget deficit (approximating the level recorded in the crisis years of the 1990s) and the state sector's largely unpayable debt to the local banks will all result in continued aggravation of the economic crisis. Alongside this, they will provoke a rise in Russia's importance as the only ally and lender to an internationally isolated Belarus. Without Russia's assistance, the risk of the Belarusian economy collapsing will increase significantly in 2021.

### SARS-CoV-2 and politics: the 2020 economic recession

In 2020, the Belarusian economy recorded a 0.9% decline in its GDP, which equates to an end of the three-year spell when it displayed an insignificant growth rate of 1–3%. However, in contrast to other countries, in Belarus the crisis triggered by the COVID-19 pandemic was not the major reason behind the recession. Fearing the high economic costs, which would have resulted, Minsk has failed to introduce pandemic restrictions similar to those in place in most European countries. It should also be noted that Belarus's GDP is largely dependent on industrial production in the subsidised and frequently unprofitable state sector. This distorts the indicator's reliability in correctly assessing the Republic of Belarus's economic situation.

The crisis started as early as January 2020, when a 1.9% decline in GDP was recorded.<sup>1</sup> This was caused by a fall in the volume of Russian oil supplies to the Belarusian petrochemical sector recorded at the

<sup>1</sup> Data compiled by the National Statistical Committee of the Republic of Belarus, [belstat.gov.by](http://belstat.gov.by).



beginning of the year (a drop of nearly 80% in Q1). This decrease was caused by a bilateral dispute over what shape the two states' integration under the Union State of Russia and Belarus should take in the future. The reduction in supplies was a major blow to one of the most important branches of the Belarusian industrial sector, which generates around 10% of the country's GDP, 25% of its exports and 20% of its state budget revenue. Another negative factor involved a slump on the global potassium fertiliser market (potassium fertilisers are one of Belarus's major exports). This meant that in Q1 2020 the volume of foreign trade shrank by almost 15% or US\$1.3 billion.<sup>2</sup> 2020 as a whole saw a decline in foreign trade of US\$10 billion (to US\$62 billion). At the same time, the traditional dominance of imports over exports in Belarusian foreign trade was preserved. In 2020, the negative balance was US\$4 billion, i.e. around US\$2 billion less than in 2019; this was due not so much to an improvement in export figures as to the decline in the import of Russian oil at the beginning of the year.<sup>3</sup> It should be noted that Belarus's exports declined by US\$4 billion, with the fuel sector accounting for more than half of this decrease. Once again, the strongly export-oriented economy (61% of production is exported) turned out to be dependent on Belarus's relations with Russia, which are increasingly unstable and riddled with tensions (Russia accounts for up to 50% of Belarus's exports), and on fluctuations on the global fuel and artificial fertiliser markets.

The pandemic, which started to spread in Europe in March 2020, has further aggravated the difficult economic situation. Even the gradual restoration of Russian oil supplies in April and May did not lead to 2020 ending with positive

**” For several years, in Belarus the average salary has been around US\$500–600, which is similar to the salary level recorded during Lukashenka's election campaign in 2010. One consequence of this is a continued decline in Belarusian society's living standards.**

economic growth figures. March 2020 saw the first signs of the depreciation of the Belarusian rouble (which was due to a major increase in demand for foreign currencies at currency exchange bureaus, among other things) which accelerated rapidly in the second half of the year, i.e. following the presidential election. As a consequence, by the end of 2020 the Belarusian rouble had lost 34% of its value against the euro and 22% against the US dollar.<sup>4</sup> In addition, it should be noted that the income earned by Belarusians has remained unchanged for many years – it stands at around US\$500–600 monthly, which is similar to the average salary level recorded during Lukashenka's election campaign in 2010. This, combined with an annual rate of inflation of several per cent, has resulted in a gradual decline in the Belarusian people's living standards.

### **Problematic corporate debt**

The situation in the manufacturing sector has also deteriorated, in particular in the ineptly managed and outsized state-controlled industrial sector, which still accounts for 75% of Belarus's GDP. Due to their liquidity problems and mounting debt, the largely technologically obsolete state-owned companies are a burden, which the state budget has to shoulder. In 2020, unprofitable companies accounted for more than 15% of all Belarusian companies (both privately-owned and state-controlled), and the total value of their losses was nearly US\$2.5 billion, i.e. 3.5 times more than in 2019. The total profit generated by the manufacturing sector decreased by more than 40%, with state-owned companies accounting for a major portion of that decline. However, the genuine scale of this problem has partly been underestimated due to the government's "creative accounting". In a special decree,

<sup>2</sup> Т. Маненок, 'Нефтянка «уронила» белорусский ВВП', Белрынок, 21 May 2020, belrynok.by.

<sup>3</sup> See information on foreign trade offered by the Ministry of Foreign Affairs of the Republic of Belarus: 'Общая информация о внешней торговле: направления, задачи, итоги за актуальный период', mfa.gov.by.

<sup>4</sup> В. Лужнёв, 'Девальвация 22%: как менялся курс белорусского рубля в 2020-м. Одной картинкой', Myfin.by, 5 January 2021, myfin.by.

the government approved shifts in some items of the financial statements companies compiled, enabling them to report their losses resulting from the devaluation of the rouble in 2022.<sup>5</sup> In addition, in 2020 the government abandoned its practice (in place since 2016) involving the reduction of so-called forced lending to companies, i.e. offering them economically unviable loans to sustain the operation of their unprofitable businesses. This reduction had been recommended to Belarus by several organisations including the World Bank. The value of these loans granted in 2020 exceeded the planned limit threefold, and stood at almost US\$1 billion.<sup>6</sup> As a consequence, an increase in the value of non-performing loans was recorded: at the beginning of 2021 the share of such loans in Belarus's GDP was as much as 14%. This equates to increased pressure on the banking sector, which is de facto forced to subsidise the industrial sector; in the long term this may pose a threat to its stability. Alongside this, the extensive lending activity has translated into a high rate of inflation, which in 2020 stood at 7.4% (the highest since 2017).

### **Budget deficit, increased debt and a decline in investments**

In 2020, the negative economic trends translated into a budget deficit for the first time since 2013. Despite cuts in several spending categories, including social security benefits, education, culture and sports, the deficit amounted to over US\$700 million (almost 2% of Belarus's GDP). This was due to the need to increase spending not only on fighting the pandemic, but also on financing the activity of state security bodies. The main motivation behind this decision was the rising importance of the law enforcement sector facing the unprecedented wave of post-election protests.<sup>7</sup> In addition, it should be noted that in previous years Belarus's budget surplus was mainly due to Russian subsidies, were targeted at the energy sector in particular. In 2012–19, the total value of these subsidies was US\$45 billion. The value of subsidies offered in consecutive years gradually fell: from more than US\$11 billion (17% of Belarus's GDP) in 2012 to US\$3 billion (4.8% of GDP) in 2019.<sup>8</sup>

Another important challenge is posed by the mounting foreign debt, which in 2020 increased by US\$1.4 billion (8.4%) to US\$18.6 billion, accounting for

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more than 30% of Belarus's GDP. According to the available statistics for 2019, Belarus's biggest creditors include Russia (more than US\$8 billion), followed by China (US\$3.4 billion) and foreign buyers of Belarusian sovereign bonds (more than US\$2 billion).<sup>9</sup> Aside from repaying foreign currency loans (in 2020 the total sum of such payments was US\$1.6 billion), the central bank had to intervene on the domestic market, which had been destabilised thanks to the depreciation of the rouble. As a consequence, in 2020 the value of foreign currency reserves fell by US\$1.9 billion to US\$7.5 billion (i.e. by 20.5%), which corresponds to the value of goods Belarus imports over 2.5 months, whereas the minimum safe level is three months' value.<sup>10</sup> In the first half of 2020, Minsk continued to maintain its relative credibility on financial markets, enabling it to choose the most favourable foreign debt refinancing facilities relatively freely. This is evidenced by the fact that in June 2020 Belarus issued Eurobonds worth US\$1.25 billion, which were bought by European and US investors.<sup>11</sup>

<sup>5</sup> 'В Беларуси потери убыточных предприятий превзошли 6,3 млрд BYN', Banki24.by, 17 February 2021, banki24.by.

<sup>6</sup> 'Директивное кредитование экономики грозит стране новым кризисом', Naviny.by, 1 February 2021, naviny.online.

<sup>7</sup> Е. Корнеевич, 'Бюджет Беларуси в 2020-м недополучил более 2 млрд рублей от налогов. Но сэкономили не все (в том числе и строительная сфера)', Realt.by, 6 January 2021, reallt.by.

<sup>8</sup> Ю. Титова, 'Сколько Россия заплатила за дружбу с Лукашенко за последние 10 лет', Forbes.ru, 26 August 2020, forbes.ru.

<sup>9</sup> 'Всемирный Банк показал, кому задолжала Беларусь', Reform.by, 31 March 2021, reform.by.

<sup>10</sup> 'Рубль падал, крупные госы с трудом платят по долгам, а деньги утекали из банков. Нацбанк о масштабах и перспективах', Tut.by, 29 January 2021, tut.by.

<sup>11</sup> 'Беларусь разместила евробонды, деньги уже поступили в бюджет', Белрынок, 25 June 2020, belrynok.by.

However, the international isolation of Lukashenka's regime in the wake of rigged elections has reduced Belarus's choice of lenders to Russia alone. Russia, for its part, is expecting complete subordination from Belarus, and is making the actual amount it lends conditional on the scale of Minsk's political concessions. Since the beginning of 2020, the value of lending support offered by Russia has been a mere US\$1.5 billion, including US\$500 million extended by the Russian-controlled Eurasian Fund for Stabilisation and Development. Thus far, Belarus has received a total of US\$1 billion from the sum pledged. China, which Minsk is presenting as its strategic ally, has failed to express any interest in providing additional credit to the Belarusian economy other than the loans it offered in previous years.

The decline in Belarus's credit rating has been accompanied by a reduction in its investment attractiveness: the value of foreign investments has halved (to US\$320 million) and the value of foreign currency loans granted by foreign

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banks to domestic businesses has decreased by more than 50% (to US\$70 million). The COVID-19 pandemic and the political instability following the 9 August 2020 election have discouraged many potential investors from entering the Belarusian market (these included the French company Leroy Merlin), and forced those businesses which have been operating in Belarus for some time to reduce their investment outlays (these included the A1 Telekom Austria mobile telecommunications operator). Alongside this, a major decline in the investment activity of Belarusian companies was recorded: at the end of 2020, a mere 10% of business owners planned to expand their activity in the near future.<sup>12</sup>

## The economy of the police state

Due to the economic recession, which was aggravated by the consequences of the pandemic, the Belarusian authorities decided to withdraw from the liberalisation measures launched in previous years. In addition, they stepped up the 'manual control' of the economy and increased central planning. As a consequence, since spring 2020, the government's anti-crisis measures have mainly focused on offering loans to the state sector and on regulating the prices of basic foodstuffs and manufactured goods. Contrary to official declarations, private companies (including those operating in the tourism and catering sectors which were most affected by the pandemic) did not receive genuine support. Business owners view this practice as discriminatory.<sup>13</sup>

The situation of private companies (which generate around 25% of Belarus's GDP) deteriorated considerably following the 9 August election as many of them were targeted for supporting the protests or taking part in them. The problem is particularly evident in the IT sector, which up until the election was considered the most promising sector of the Belarusian economy, generating 25% of the country's export of services (worth US\$2.5 billion). The repression, which targeted this group, forced a portion of IT specialists to relocate their operation to neighbouring Lithuania, Ukraine and Poland (around 10,000 Belarusian IT specialists are now working in Poland<sup>14</sup>). Although in 2020 this sector's share in Belarus's GDP increased from 5% (recorded in 2019) to more than 7%, in the longer term this may reduce its involvement in the country's economic development.

Another factor of major significance from the point of view of shaping Belarusian economic policy has been the increase in the importance of the law enforcement sector (for example General Ihar

<sup>12</sup> Д. Заяц, 'Беларусь превращается в мертвую зону для иностранных инвесторов', Naviny.by, 15 February 2021, naviny.online.

<sup>13</sup> *Id.*, 'Год с вирусом. Как выживал белорусский бизнес и что будет делать дальше', Naviny.by, 1 March 2021, naviny.online.

<sup>14</sup> M. Grzegorzczak, 'Białorusini najczęściej wybierają Polskę', Puls Biznesu, 25 April 2021, pb.pl.

Sergeyenko, a former deputy head of the KGB, has served as head of the president's office since December 2019) which began at the end of 2019 and accelerated following the August election. This process has been accompanied by the marginalisation of the civilian employees working in the Belarusian state apparatus. This trend is evident not only in the staffing policy but also in decisions regarding funding: in 2020 Belarus spent US\$350 million on its state security bodies, 26% more than the 2017 figure. Despite the mounting deficit, in the budget approved for 2021 spending in this category will rise further, by 12% to US\$390 million.<sup>15</sup> This increase in spending – mainly on law enforcement bodies, and to a lesser degree on the army – is a natural consequence of the government's intention to prioritise the state apparatus, and to continue to repress society and keep it under surveillance. As a consequence, over the last eighteen months, the ministries dealing with the economy have lost considerable influence because they are no longer useful from the point of view of fighting the regime's opponents. Alongside this, they are considered a nuisance because most of their officials have a realistic view of the Belarusian economy.<sup>16</sup> Since autumn 2020, the Belarusian central bank has been under particular pressure. The bank's head Pavel Kallaur is opposed to excessive money printing and the unrestricted lending activity, which is generating losses in the state sector. This resulted in repeated rumours, thus far unconfirmed, of his imminent dismissal.

## Conjuring reality

Belarus's economic collapse has been aggravated by the government's anti-liberal policy launched at the beginning of 2021. President Lukashenko, a politician shaped in the Soviet period who is now the key figure in devising the country's economic model, has resumed the rhetoric, which was typical of the first years of his rule in the late 1990s. On 12 January 2021, during a meeting focused on industrial development, he said that it was time to end "this free-market babble", by which he allegedly meant that strict observance of the rules of central planning in the economy should be recommended.<sup>17</sup> In a similar spirit, several days later he spoke about privatisation and argued that "selling off what the nation has built" should be prohibited.<sup>18</sup> The present orientation of Belarus's economic policy, which is populist and ill-suited to present-day realities, was confirmed at the 6<sup>th</sup> National Assembly of Belarus, held in Minsk on 11–12 February 2021. The Assembly is a mass gathering of the representatives of local authorities, business employees, scientific and cultural workers, and social organisations from all regions of the country; it is held periodically in the spirit of such gatherings in the former USSR. The delegates approved a five-year plan (2021–2025) to boost Belarus's development. The assumptions of the economic section of this strategy envisage, for example, increases in GDP, in labour efficiency, in investment (by 20%), and in exports (by as much as 40%, i.e. to US\$50 billion). In addition, plans have been made to raise the average salary to US\$670 from the present level of just above US\$500. According to the document's authors, the reason behind the failure of the previous five-year plans was "the unfavourable external economic situation" alone.<sup>19</sup> In addition, in his several-hour-long speech delivered at the Assembly, President Lukashenko offered harsh criticism of the private sector for failing to show "loyalty and responsibility for the state". Alongside this, he announced that more inspections would be carried out and taxes would be raised.<sup>20</sup>

<sup>15</sup> 'Сколько денег государство тратит на силовиков', Ex-Press.by, 5 October 2020, ex-press.by.

<sup>16</sup> K. Kłysiński, 'The regime's fight to survive: 100 days of political crisis in Belarus', *OSW Commentary*, no. 366, 27 November 2020, osw.waw.pl.

<sup>17</sup> 'Лукашенко призвал промсектор заканчивать рыночную болтовню и жёстко придерживаться планов', Интерфакс, 12 January 2021, interfax.by.

<sup>18</sup> 'Александр Лукашенко: по приватизации мы концептуально определились. То, что создано народом, не трогайте', СТБ –Новости 24 часа, 21 January 2021, ctv.by.

<sup>19</sup> Д. Заяц, 'Программа на новую пятилетку будет провалена досрочно?', Naviny.by, 12 February 2021, naviny.online.

<sup>20</sup> А. Владыко, '«Мы вас будем вырезать каленым железом». От чего предостерег частный бизнес Лукашенко', Onliner, 12 February 2021, people.onliner.by.

The negative consequences of these unrealistic economic policy assumptions have already become clear in the statistics compiled for the first two months of 2021 on the budget deficit, which in this period was more than US\$520 million (in the corresponding period in 2020 Belarus had a budget surplus of around US\$220 million). This was the first instance of such a major deficit in public finances being recorded as early as the beginning of the budget year since the 1990s. In addition, this sum accounts for up to 25% of the exceptionally high annual budget deficit planned in the 2021 budget (more than US\$2 billion or 3.5% of GDP).<sup>21</sup> The March 2021 statistics suggest that this trend will likely continue, posing a major threat to the stability of Belarus's finances. This threat is in no way alleviated by the 0.9% increase in GDP recorded in Q1 2021, as this was mainly due to the low figures recorded in the corresponding period in 2020. In addition, Q1 2021 saw a further fall in foreign currency reserves (by US\$520 million). The rate of inflation has accelerated: in the period between January and March 2021, it exceeded 8%, which forced the central bank to raise interest rates from 7.75% to 8.5% (for the first time since 2015).<sup>22</sup> The government does seem to be aware that the situation is difficult. However, President Lukashenka's priority is to maintain control of the state at all costs. This is hindering any attempts to adjust the macroeconomic policy in a more pragmatic direction.

The regime is concealing controversial information, which could provoke additional social tension. The government order regarding Belarus's socio-economic development in 2021, adopted on 17 February 2021, has been restricted to official use only, triggering speculation regarding the government's intention to hide certain decisions from the public opinion. These include further welfare cuts, the freezing of salaries in the public sector and of old age pensions, and the increase in spending on the state security sector.<sup>23</sup> Putting political motives before economic considerations has also led Minsk to attempt to introduce its own economic sanctions to retaliate against the West for its criticism of the regime and the visa and economic restrictions that followed. On 30 March 2021, Lukashenka signed a decree introducing a mechanism to ban the import of goods and services from those states, which had previously imposed restrictions on Belarusian legal and natural persons. Should this mechanism be widely applied (so far no details have been revealed regarding the decree's enforcement), Belarus may deprive itself of Western technologies and imported goods, which are difficult to replace, a move which will further aggravate its economic problems.<sup>24</sup>

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## Is Belarus facing an economic collapse?

Because the regime continues to rule out any reforms and preventive measures that would improve the current situation, its present economic policy is exposing the Belarusian economy to the threat of collapse. Unable to receive loans from the West, the government needs to find funds to repay the US\$3.3 billion of foreign debt due in 2021. The rumours that appeared in February 2021 regarding Minsk's attempts to receive another loan from Russia (this time worth US\$3 billion) have not thus far been confirmed. However, at present the regime can only temporarily postpone the moment when it will need to seek additional support from Moscow, because the price for this will involve giving up successive attributes of sovereignty in favour of the Kremlin. Belarus's foreign currency reserves, which

<sup>21</sup> 'Страшные цифры дефицита бюджета Беларуси, каких еще не было. На что пошли народные деньги?', Infobank.by, 6 April 2021, infobank.by.

<sup>22</sup> 'Впервые за шесть лет: Нацбанк повысил ставку рефинансирования', Naviny.by, 14 April 2021, naviny.online.

<sup>23</sup> Н. Короткая, 'Вместо плана развития Беларуси нужен план спасения', Naviny.by, 31 March 2021, naviny.online.

<sup>24</sup> 'Президент Беларуси подписал Указ № 128 «О применении специальных мер»', Национальный центр правовой информации Республики Беларусь, 31 March 2021, pravo.by.

at present are at a level that guarantees minimum financial security, are another weak protection mechanism. Alongside this, the ongoing rise in this year's budget deficit may force the government to print money on an even greater scale, and to make radical spending cuts, which will likely bypass the state security sector. These actions may result in a high rate of inflation, the continued devaluation of the rouble, and finally in a decline in the country's GDP of up to 10% by the end of 2021. These developments will likely aggravate the already high level of social discontent.