

## **An economy with unrealistic indicators: an evaluation of the economic situation in Belarus and a forecast for 2013**

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The macroeconomic results achieved by Belarus in 2012 laid bare the weakness and the inefficiency of its economy. Belarus's GDP and positive trade balance were growing in the first half of last year. However, this trend was reversed when Russia blocked the scheme of extremely lucrative manipulations in the re-export of Russian petroleum products by Belarus and when the demand for potassium fertilisers fell on the global market. It became clear once again that the outdated Belarusian model of a centrally planned economy is unable to generate sustainable growth, and the Belarusian economy needs thorough structural reforms. Nevertheless, President Alyaksandr Lukashenka consistently continues to block any changes in the system and at the same time expects that the economic indicators this year will reach levels far beyond the possibilities of the Belarusian economy. Therefore, there is a risk that the Belarusian government may employ – as they used to do – instruments aimed at artificially stimulating domestic demand, including money creation. This may upset the relative stability of state finances, which the regime managed to achieve last year. The worst case scenario would see a repeat of what happened in 2011, when a serious financial crisis occurred, forcing Minsk to make concessions (including selling the national network of gas pipelines) to Moscow, its only real source of loans. It thus cannot be ruled out that also this time the only way to recover from the slump will be to receive additional loan support and energy subsidies from Russia at the expense of selling further strategic companies to Russian investors.

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### **The poor financial results in 2012**

According to the official statistics of Belarus, its GDP last year grew by 1.5%; this being one of the poorest results over more than ten years now<sup>1</sup>. The Belarusian government was unable to achieve the rate of 5% to 5.5% it had planned for 2012. It is worth noting that there was a characteristic gradual slowdown in GDP growth throughout last year. In the first five months, it reached approximately 3%, after the ninth month it fell to 2.5%, and at the end of

the eleventh month it was as low as 2% (see Appendix).

A similar trend was observed in foreign trade in goods. During the first seven months of 2012, the positive balance was constantly growing, owing to which the level of US\$2 billion was exceeded at the end of July. This was a great achievement against the same period a year before, when the balance was a loss of US\$3.4 billion. However, starting with August, this trend reversed. As a result, the positive balance melted to approximately US\$200 million by the end of November. At the end of the year, the trade balance was negative and reached minus US\$412 million.

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<sup>1</sup> It was only in 2009 (when the global crisis reached its peak) that the result was worse (0.2%).

These two indicators fell mainly due to the fact that Russia blocked the re-export of Russian petroleum products (kerosene) at the end of July last year. These were being sold by Belarusian companies as thinners and solvents to EU markets. The Belarusian side was thus evading its obligation to pay its profits from export duty imposed on petroleum products to the Russian budget. According to initial estimates, Belarus earned at least US\$2 billion and was thus able to increase its GDP by 2.5% to 3% owing to this trick. Furthermore, Belarus's economic results were adversely affected by the 20% decrease in exports of potassium fertilisers, which – along with petroleum products, food and the products of the machine-building sector – are one of the pillars of Belarus's exports<sup>2</sup>. This was an effect of lower demand from the key importers, i.e. China and India, which have compiled significant stocks of fertilisers and are expecting to be offered lower prices for future supplies.

Last year, the Belarusian government also failed to fulfil its plan of lifting the level of foreign direct investments. Out of the planned US\$3.7 billion, only US\$1.2 billion was received (data for the first eleven months of 2012), and this was mostly income generated by foreign capital which had already been present in Belarus. This income was spent on further developing the investments.

What was fulfilled was the plan to set the rate of inflation. At the end of the year it stood at 21.8%, with the expected level ranging between 19% and 22%<sup>3</sup>. The government also managed to fulfil its promise to raise wages – on 1 January 2013 the average wage in Belarus

was US\$533. Furthermore, the government has been successful in maintaining a high level (for Belarus) of foreign currency reserves – on 1 February 2013 they slightly exceeded US\$8 billion. Belarus's foreign public debt is growing at a slower rate than in the preceding years. According to official data, its debt last year increased by US\$209 million, reaching a total of US\$12 billion<sup>4</sup>. Even though 2013 marks the beginning of the debt repayment peak, and Belarus will have to pay back approximately US\$3 billion, this will not pose any major threat

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to public finances owing to its significant foreign currency reserves. However, it may turn out that, seeing no other way out, the Belarusian government will be forced to severely deplete these reserves and this will adversely affect, for example, its capabilities to intervene on the foreign currency market in the longer term. This scenario appears realistic, given the fact that the government's attempts to sell bonds on EU and Asian markets, worth in aggregate US\$500-600 million, have failed to bring the expected result.

### The ambitious plans for 2013

Regardless of the poor results in 2012, the Belarusian government is planning that the

<sup>2</sup> The potassium sector earns between 20% and 35% of foreign currency income in the Belarusian state budget. In 2011, the profit from exports of potassium fertilisers reached US\$3.2 billion. In 2012, exports fell 20% and earned only US\$2.4 billion.

<sup>3</sup> For comparison, in 2011, as a consequence of the financial crisis in Belarus and two consecutive devaluations of the Belarusian currency, the inflation rate escalated to 108.7%, the highest in Europe. It was possible to keep the inflation rate at a relatively low level in 2012 owing to the stabilisation of the Belarusian currency's exchange rate and postponing part of the price rises until the beginning of this year. At the same time, the money issue level grew alarmingly high last year – the weight of money rate grew over 57%, against the planned rate of 25%.

<sup>4</sup> On 7 December 2012, the Anti-Crisis Fund of the Eurasian Economic Community, which is controlled by Russia, made US\$440 million available to Belarus as the fourth instalment of the stabilisation loan, worth US\$3 billion in total, which was granted in 2011.

The Belarusian side had not received these funds by the end of 2012, though. The official reason stated for this delay were the fund's technical problems. The money was finally received on 31 January 2013.

country's GDP will grow by 8.5% in 2013. This rate is far above even the most optimistic estimates presented by independent Belarusian experts, the World Bank and the International Monetary Fund. According to them, it could grow approximately 4% at the most. The plans concerning foreign direct investments are equally ambitious — these are expected to reach US\$4.5 billion this year. In turn, the inflation rate is planned to reach as low a level as 12%. Such indicators have been chosen due to personal pressure from Alyaksandr Lukashenka, for whom economic policy still means primarily issuing orders, controlling the distribution of benefits and central planning. Furthermore, the Belarusian president has made economic issues

**For Alyaksandr Lukashenka, economic policy means primarily issuing orders, controlling the distribution of benefits and central planning; its overriding goal is to maintain and reinforce his authoritarian regime.**

subordinate to the implementation of his overriding political goal, namely to maintain and reinforce his authoritarian regime. This is the reason why he is putting such great emphasis on GDP growth, which in turn brings about a high level of industrial production, and thus a stable social situation at large companies. This is also the reason why he insists on a continuous increase of wages, regardless of labour productivity, which is the key indicator in this case<sup>5</sup>. At the same time, Lukashenka is aware of the need to improve the efficiency of the national economy, and ordered an extensive technological modernisation of hundreds of Belarusian companies already last year.

<sup>5</sup> According to Belarusian statistics, between January and November 2012, the wage growth ratio was as much as five times higher than the productivity growth ratio.

## The inadequate macroeconomic policy of the Belarusian government

The Belarusian government quotes three factors which reportedly prove the feasibility of the economic plan for this year: the expected favourable situation on foreign markets, the planned influx of significant foreign direct investments, and the improved performance of the modernised companies. However, these assumptions are rather unrealistic. Nothing seems to indicate that Belarus will be able to repeat its success with selling Russian petroleum products in 2013. Moscow has clearly adopted a tougher stance and expects Minsk to invariably perform its obligation to both the duty imposed on products exported by Belarusian refineries and to supply part (2 million tonnes) of the petroleum products manufactured by Belarusian refineries to the Russian market. Furthermore, Russia is currently offering less favourable oil supply conditions<sup>6</sup>. This is apparently aimed at convincing Minsk to sell its oil refineries in Mazyr and Navapolatsk. Due to Belarusian resistance, it has been impossible to establish the supply balance for the entire 2013 as yet, and the parties have only made temporary arrangements for the first quarter of 2013. Given these circumstances, it is difficult to expect any significant increase in the income of the Belarusian oil industry, which accounts for 35% of Belarusian exports and generates approximately 30% of the budget income<sup>7</sup>. An improvement of the situation on the global market of potassium fertilisers is also rather unlikely, and thus foreign currency income in the Belarusian budget will be seriously reduced. One proof for this is the short-term contracts

<sup>6</sup> First of all, Russia offered to reduce the annual level of supplies using the Druzhba oil pipeline — which is the cheapest supply route — to 18.5 million tonnes, while the amount expected by Belarus was 23 million tonnes. Belarusian recipients would have to import the rest of oil using much more expensive railway transport.

<sup>7</sup> <http://www.osw.waw.pl/en/publikacje/osw-commentary/2012-06-19/inexhaustible-source-income-significance-belarusian-refineries>

which were signed at the beginning of this year with the two major recipients of this product: China and India. Everything seems to indicate that the petrochemical sector, which is pivotal for the Belarusian economy, will be unable to generate significant economic growth.

The expectations that the influx of foreign direct investments will increase are even less realistic. The investment climate is still unfavourable, due to the inconsistent and discretionary policy adopted by the government towards foreign investors and domestic capital alike. Such moves as the renationalisation of the food factories *Kommunarka* and *Spartak* in October last year<sup>8</sup> or the ban on quitting jobs imposed on people working in the wood sector in December last year have effectively discouraged and will discourage prospective investors from bringing their capital to Belarus<sup>9</sup>. Furthermore, Alyaksandr Lukashenka, fearing any weakening of his authoritarian regime, has been consistently blocking privatisation and clearly emphasising that he will only agree to sell selected entities to purchasers who will be ready to accept his conditions (for example, concerning maintaining the staffing levels, financing social projects, etc.).

However, what appears to be the most dubious assumption is that the modernisation of hundreds of industrial plants planned for this year will bring a rapid improvement in the performance of industry, which will be felt already

this year. The modernisation projects currently in operation, for example in the wood industry, have proven that the government is not ready for the restructuring of plants, changes in the management organisation or staffing levels, etc. The modernisation actions are restricted to the gradual (oftentimes very delayed and poorly organised) replacement of machinery, which makes the efficiency of these projects doubtful.

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Besides, it is impossible to finance these expensive investments, the estimated cost of which will reach billions of dollars (the modernisation of the plants controlled by the Ministry of Industry alone will swallow up over US\$3 billion)<sup>10</sup>.

### Reform blocking

Alyaksandr Lukashenka, while imposing such ambitious and at the same time unrealistic economic goals, is simultaneously blocking any moves from those few supporters of economic reforms in the Belarusian government. *Siarhei Rumas*, who was in charge of economic affairs in the government, resigned from his post as deputy prime minister on 31 July 2012. According to unofficial information, he decided to resign due to the impossibility of making any rational changes in the Belarusian economic system. This was a clear sign that the president, fearing that his power and grip on the economy could weaken, would back supporters of conservative solutions. One proof of this was the nomination of *Piotr Prokopovich* as deputy prime minister on 18 January 2013. *Prokopovich* was the head

<sup>8</sup> On 12 October, Alyaksandr Lukashenka criticised *Marat Novikov*, a private entrepreneur who then held controlling stakes in *Spartak* and *Kommunarka*, and ordered that the supervisory boards of these two companies be disbanded. The directors were fired and state control of the two entities was reintroduced. Then, the general assembly of shareholders of the two Belarusian confectionery factories, *Kommunarka* and *Spartak*, decided to carry out an additional issue of shares in order to increase the stake held by the Treasury from 22% to 57% and from 13% to 60%, respectively. Through this, the state took over control of these private companies, thus violating Belarusian law and the principle of respect for private property.

<sup>9</sup> <http://www.osw.waw.pl/pl/publikacje/tydzien-na-wschodzie/2012-12-12/wladze-bialoruskie-wprowadzaja-przymus-pracy>

<sup>10</sup> [http://naviny.by/rubrics/economic/2013/01/14/ic\\_articles\\_113\\_180505/](http://naviny.by/rubrics/economic/2013/01/14/ic_articles_113_180505/)

of the Belarusian central bank for many years. Although his evaluation of the condition of the Belarusian economy is realistic, he is still a supporter of manual control and interventionism in the economy. The duties of the new deputy prime minister will include primarily ensuring that the adopted macroeconomic indicators are achieved, that the budget is met and the modernisation plans are implemented. Most independent Belarusian economists agree that the new deputy prime minister will attempt to fulfil his tasks first of all by means of artificially stimulating domestic demand – through increasing wages, money creation, and granting loans for state-controlled investment programmes, including cheap housing development<sup>11</sup>.

## Conclusion

The poor economic results achieved in 2012 have shown how strongly the Belarusian economy relies on the good condition on the markets of a small group of products, including primarily petroleum products and potassium fertilisers. Furthermore, as proven last year, the tricks used in the re-export of petroleum products, which were stopped in the second half of 2012, had significantly contributed to improving the financial situation of Belarus. For obvious reasons, operations of this kind may only provide

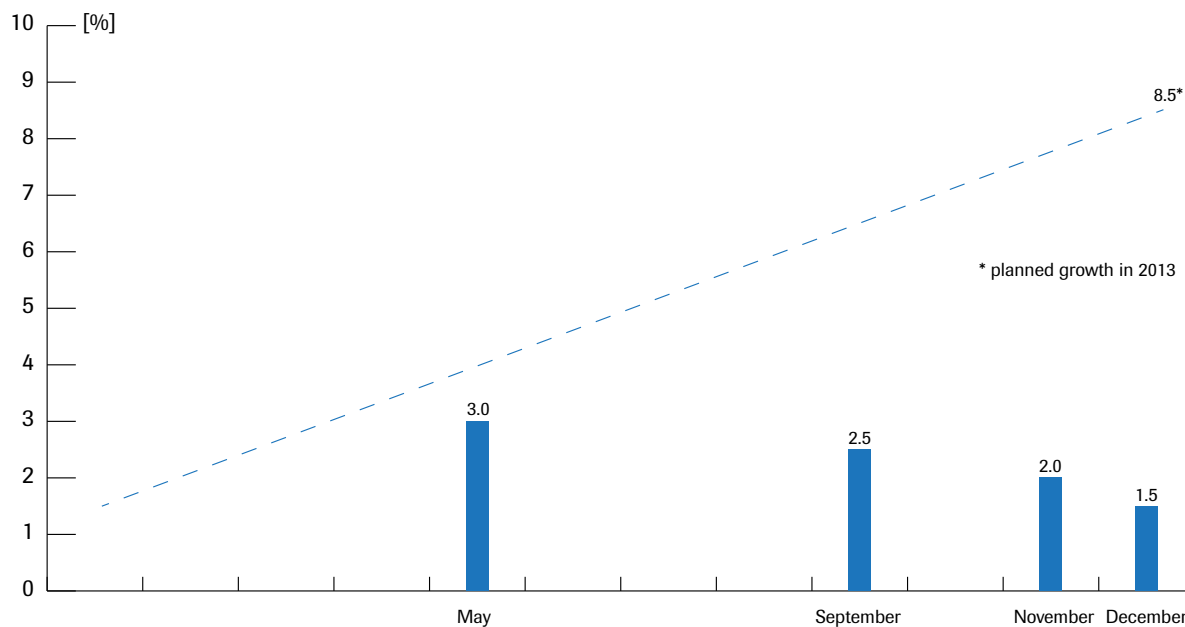
profits in the short run. This means that Belarus has no strong economic system that would be able to ensure stable income to the budget and the necessary economic growth. Besides this, Alyaksandr Lukashenka has been consistently blocking reforms. As a consequence, it will be impossible to reach such ambitious macroeconomic indicators without artificially stimulating demand on the domestic market. Such measures taken by the Belarusian government may – as in 2011 – lead to rampaging inflation and a deep crisis in state finances. Belarus managed to escape a complete economic collapse two years ago owing to support from Russia which, since the breakdown of the dialogue with the West in December 2010, has become Belarus's sole lender. At that time, in exchange for loans and energy subsidies, Alyaksandr Lukashenka granted consent for Gazprom to take over total control of the Belarusian gas pipelines and backed the Russian plans for a reintegration of the post-Soviet area, including the establishment of the Eurasian Union. It seems quite likely that this scenario will be repeated, in which case Minsk will have to make further concessions to the Kremlin, primarily those regarding the privatisation of the strategic companies in the petrochemical, machine-building and food industries. Belarus is thus under no risk of economic collapse in the immediate future, as this would be too serious a political and financial problem for Russia, especially in the context of the implementation of the Eurasian Union project. However, the price Minsk will have to pay for its unrealistic economic policy will be a further increase in its already high dependence on Russia.

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<sup>11</sup> Piotr Prokopovich has a degree in construction engineering and has long work experience in the construction industry. He is actively lobbying for the interests of the construction sector within President Lukashenka's inner circle. This year he is very likely to make efforts to receive financial backing for the construction of 6.5 million m<sup>2</sup> of apartments planned for this year.

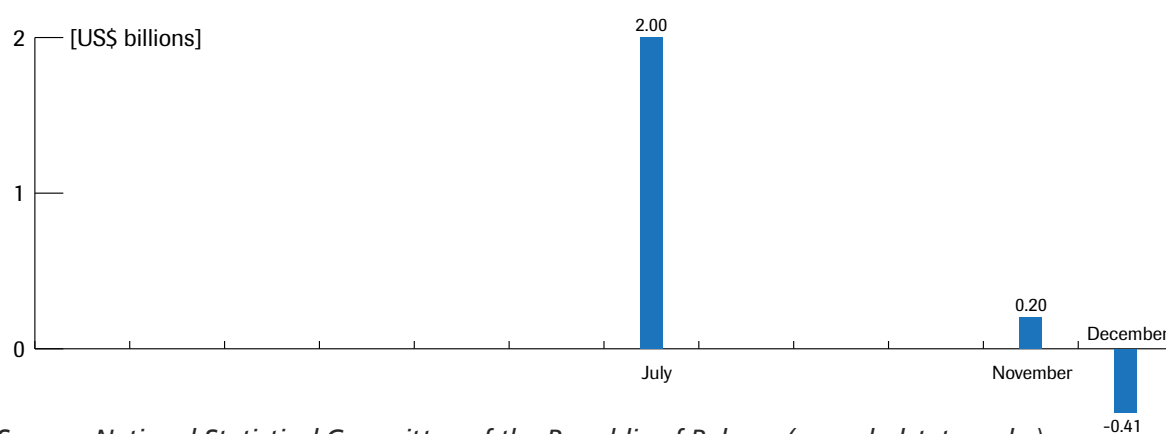
## APPENDIX

### 1. Belarus's GDP growth in 2012



Source: National Statistical Committee of the Republic of Belarus ([www.belstat.gov.by](http://www.belstat.gov.by))

### 2. Belarus's foreign trade balance in 2012



Source: National Statistical Committee of the Republic of Belarus ([www.belstat.gov.by](http://www.belstat.gov.by))

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