



*Dzmitry Halubnichy is an analyst of the Center for Strategic and Foreign Policy Studies, Minsk, Belarus.*

*Raman Kachurka holds an MA in International Economics from the University of Warsaw. Earlier he worked in Brest State University.*

## BELARUSIAN ECONOMIC PROSPECTS IN 2015

The economic rivalry between the west and Russia does not bypass Belarus. At the end of 2014 the government started to take steps that proved the situation was not good at all. Experts argue that any positive growth in 2015 would be a huge success. Even though the reasons behind the unwelcome situation lie deeper in the need for structural reforms, economic sanctions and Russia's shrinking economy topped an already bad situation for the Belarusian authorities.

Moreover, the possible recession just before the Presidential elections signals an uncertain political landscape in Belarus in 2015. Is the Belarusian government capable of managing such a crisis? What are the possible scenarios? This

issue of the Bell tries to deal with these questions. In the first article, Belarusian analyst Dzmitry Halubnichy overviews the main threats for the Belarusian economy and looks at the sectors that are suffering most. He also suggests that Eurasian Union could act as a safeguard for the economy of the country in the long run, but structural reforms are needed in any event.

In the second article, Raman Kachurka argues that the 'hidden devaluation', which happened at the end of 2014, is a strong signal for the possible end of Lukashenka's rule. He offers three possible scenarios for the pre-election period, which is strongly influenced by Russia.

*Vytautas Keršanskas, Editor*

## WILL THE EURASIAN UNION HELP THE ECONOMY OF BELARUS?

*Dzmitry Halubnichy*

Times are still tough for both the economy and diplomacy in Belarus. The country is at the cross roads of immense power centres where the geopolitical interests of the EU, Russia and other countries clash. Long-time experience shows that attempts by Belarus to balance its cooperation among the different partners always lead to crises in the economy and an actual misbalance in foreign policies.

Exposed to multiple risks and threats, such as military conflicts, political confrontations, and an unstable energy market, the global economy makes this pattern even more dramatic.

Domestic economic policies of Belarus are also facing noticeable issues, e.g. the need to modernise industries, the turbulent national currency and the situation of small businesses.

This incomplete list of challenges has a huge impact on a country, which relies on its human capital as a key economic value and predominantly on one person's skills in diplomacy.

The status quo seems alarming to many experts in Belarus and abroad. Importantly, the people of Belarus feel the impact of the economic crisis very heavily, too. As an experienced politician, Aliaksandr Lukashenka realises the need to absorb the pain in the run-up to the presidential elections, even though his political resources are still strong.

### Inside the Belarusian economy

Outdated policies are responsible for the economic problems of Belarus. Economic growth has slowed down considerably during the last few years, with the average GDP growth being just 3.2% per year between 2009 and 2013, compared to an annual growth of 10% from 2001 to 2008.

Engine-building and car manufacturing are in crisis. The rural sector is suffering. Many warehouses are full of unsold products, while the neighbours and key consumers are in war and are unlikely to be in need of any such products soon.

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**Many warehouses are full of unsold products, while the neighbours and key consumers are in war and are unlikely to be in need of any such products soon.**

With the current inflation rates of the Belarusian rouble, there are reasonable concerns that inflation may come close to 100%. Having lost trust in the national currency, the public is preoccupied by queuing up for foreign money. The only way the government found to kill the currency boom was to introduce a 30% handling fee for purchasing foreign currency for several weeks.

The Belarusian government's plan for 2015 is the GDP growth between 2% and 2.4%, export growth by 4.3%, and inflation down to 12%. The increase of labour productivity is expected to outdo the salary growth, a clearly overoptimistic scenario.

For years, the government has been wasting money earned by successful state-owned companies and banks for subsidising unprofitable factories. The strategy has never proved fruitful.

According to reports by the Ministry of Finance, many flagship industries failed in the first half of 2014.

*Homelshklo* (*Gomelsteklo*, glass production) suffered the most severe losses in the amount of around USD 11.1 million during the first half year of 2014. *Krasnaselskbyudmateryyaly* (*Krasnoselskstroyaterialy*, concrete production) has a debt of over USD 7.9 million. The sugar refinery in Skidziel has joined the top 10 of the country's worst enterprises, with losses reaching around USD 5.7 million. The well-known beer from *Krynitsa* proved uncompetitive, resulting in losses of USD 4.1 million after the first semester 2014.

After many years of being successful in winning capital for the country, the meat and dairy industries were also vulnerable to the crisis, as meatpackers in Barysau and Sluck went into the red with losses of USD 7.4 and USD 4.2 million respectively.

As the state industries are obviously unprofitable, they need to be privatised to ensure economic growth in 2015. The Belarusian business sector is in quite good shape at the moment. Belarus ranks 63<sup>rd</sup> out of 189 in Doing Business 2014 by the World Bank and the International Finance Corporation. However, domestic businesses really do not have sufficient capital to save the major companies from the crisis.

Foreign direct investments could right the ship in the future; however, multiple state regulations, the unstable Belarusian currency and high level of taxation discourage many possible rescuers of Belarus' unprofitable companies. Changes to the economic policies

are crucial to break the vicious circle.

Irrespective of whether foreign capital is available or not, significant cuts in subsidies for state-run companies are essential to prevent money being squandered. Despite the threat of closures for some state-owned factories and the subsequent rise in unemployment, there is no other natural way to get rid of the dead wood companies.

The collapse in the price of oil was yet another shock for Belarus. Oil refining industries are seeing a decline in profits after years of being the bulwark of the Belarusian economy thanks to Russian discounts. Due to the oversupply of oil on the global market, prices have fallen from USD 110 per barrel in early 2014 to the present price of USD 55. Russian media blames the mining of shale gas in the US, while Belarus is losing the long-enjoyed privilege of reselling cheap oil supplies. Oil and petrochemicals constitute 1/3 of Belarusian exports and over 20% of imports.

Against this background, the IMF is still recommending deep reforms to Belarus. Led by David Hoffman, a mission of IMF noted in 2014 that macroeconomic policies targeted to stimulate growth; slowdown in trade partner countries and decreasing competitiveness resulted in a current account deficit reaching 10% of GDP in the previous year. The country needs more money to repay its foreign debt. Prospects for getting external funds are still uncertain amid the exhaustion of international reserves.

#### What Eurasian Union means for Belarus

Belarus has been active in Eurasian integration projects for years. This is a logical and indispensable choice by Lukashenka, given a lack of demand for Belarusian goods in the EU and his dictatorial image in the Western world, as compared to discounted oil-products and access to a huge export market as a result of the integration with Eastern partners. Belarus sees participation in Eurasian integration projects as a resource for economic modernisation and competitiveness, primarily by establishing transnational corporations.

Having joined the Customs Union in 2011 and the Eurasian Economic Union later on, Belarus has acquired barrier-free access to a single market of over 170 million people as well as privileged access to Russian lending resources and discounted energy prices; thanks to the so-called integration rate, Belarus pays just USD 167 USD for 1,000 m<sup>3</sup> of Russian natural gas, compared to the average price of USD 380 paid by Europe.

**The collapse in the price of oil was yet another shock for Belarus.**

**One should be cautious about seeing the Eurasian Union as an engine for economic development, since this unit needs time to start operating properly.**

The member states of the Eurasian Union still dominate Belarusian foreign trade, absorbing 47.5% of exports and supplying 53.4% of imports. Belarus' participation in Eurasian integration goes along with major joint projects with Russia in infrastructure and industries. In 2010, Belarus agreed with Russia on a loan of USD 10 billion for the construction of the 2,400 megawatt Belarusian nuclear power plant. In 2011, Belarus and Russia set up a road map for five manufacturing cooperation projects with joint holdings between MAZ and KamAZ (trucks), Hrodnaazot and Eurochem, Peleng and Roskosmos, Integral and Roselektronika, MZKT and Rostechologies (production of wheeled tractors, including for the needs of defence). Russia granted USD 2 billion in loans for these goals in 2013.

Further down the path of integration, Belarus co-established the Eurasian Economic Union on 1 January 2015, a vast economic entity. Based on the Customs Union created in 2010, the new Union included Russia (140 million population and GDP of USD 2.1 trillion), Belarus (9.5 million, USD 72 billion GDP), Kazakhstan (14 million, USD 178 billion GDP), and Armenia (3 million, USD 10 billion GDP). Kyrgyzstan is expected to join in May, with a population of 5.5 million and USD 850 billion GDP. Tajikistan (8 million and USD 8.5 billion GDP) is yet another aspiring candidate.

However, Belarus' membership in the Eurasian Union implies many weaknesses. First, Russia, the biggest member state of the Union, faced a major economic crisis just as the project was being launched. Western sanctions hit Moscow hard. The Russian minister of finance is predicting a recession of 4% in 2015. The Russian crisis has affected Kazakhstan significantly, as its currency's exchange rate per Russian rouble grew by 50% as compared to the first semester 2014. Developments in the Russian currency market have affected Belarusian businesses and citizens. As industries lost trillions of roubles in profits, the purchasing power of common Belarusians shrunk considerably.

Second, despite numerous references to the huge Eurasian market, there is always the question of whether state-owned companies and private businesses are competitive enough to utilise this benefit.

Figures provide an answer to this question. Statistics indicate that vital Belarusian exports to

Russia diminished in the first semester 2013, e.g. exports of trucks dropped by 54.5%, truck tractors – by 43.9%, tractors – by 21.7%, and agricultural equipment – by 22%. Belarusian exports to Russia decreased between January and March 2014 in such groups of businesses as “vehicles, equipment and transportation” (by 11.7%), “metals and metal products” (by 16.9%), and “chemical industry” (by 14.4%). Due to Russia's unwillingness to consume Belarusian goods, financial indicators of companies deteriorated considerably. A total of 53 companies became unprofitable just over several months in 2013. The share of Belarus constituted 11% in Russian imports in 2000, but it hardly exceeds 5% now.

Belarusian businesses need to work hard to be competitive in the Eurasian market. To compete with Russian and Kazakhstani producers globally, Belarusian businesses need favourable conditions at home. The fluctuating Belarusian rouble, unattractive lending conditions, high interest rates and raging inflation jeopardise the chances of Belarusian businesses to beat competitors from other members of the Eurasian Union. Fair competition is in fact hardly possible, since the old ally can easily undermine the whole Belarusian economy by suspending imports for a couple of years.

The Belarusian economy is facing negative trends today because of the crisis in Russia and systemic domestic challenges for non-modernised production. One should be cautious about seeing the Eurasian Union as an engine for economic development, since this unit needs time to start operating properly.

Studies of the Eurasian Bank of Development show that Belarus will enjoy the strongest positive effects of growing foreign trade and scale economy by 2030, the end of the study period. The export to the Union member states will constitute up to 35% of Belarusian GDP in 2030. The GDP of Belarus is predicted to be 15% higher thanks to the Eurasian integration. Calculations indicate that integration processes are critical for the development of the Belarusian economy in the long run.

It is worth noting that, Belarus and Kazakhstan followed their economic interests in joining the Eurasian Union, while Russia has an important geopolitical reason for cooperation. Belarus has to make every effort to avoid becoming part of a geopolitical confrontation and contributing to the escalation of dangerous global tensions.

# HIDDEN DEVALUATION IN BELARUS: THE BEGINNING OF THE LAST DAYS OF THE REGIME?

Raman Kachurka

According to all the signs a new crisis is on the way and may well become the last one for the ruling regime.

From 19 December 2014 Belarusians pay a 30% tax for the purchase of foreign currency. De facto the Central Bank secretly devalued the Belarusian rouble in order to decrease the demand for foreign currency. In such a situation experienced Belarusian consumers began to buy durable goods to reduce losses from the expected inflation. According to all the signs a new crisis is on the way and may well become the last one for the ruling regime.

did not willingly open new bank deposits in Belarusian roubles because they distrusted the policies of the National Bank. Consumers bought not only US dollars but also durable goods on the black market. Fixed prices with a high demand for imported goods led to a shortage of goods and further depreciation of the Belarusian rouble.

## Hidden Devaluation in Difficult Circumstances

The Deloitte Touché Tohmatsu Company had expected that the Belarusian economy would become non-hyperinflationary from 1 January 2015. Ironically, on 19 December 2014 the National Bank increased the *overnight* rate to 20%, the interest rate to 25% and obliged exporters to sell 50% of their foreign currency revenue on the Belarusian exchange market. The present devaluation started in an unusual way due to the 30% tax on buying foreign currency.

Such a monetary policy stressed the market. Since 19 December 2014 many importers and exporters stopped working because of losses and risks. The tax on buying foreign currency was gradually reduced and was phased out on 8 January 2015. During these 20 days the Belarusian rouble has devalued by 26% against the US dollar. However it is not enough to keep the exports at the same level because the Belarusian currency has appreciated against the Russian rouble.

The economic crisis in Russia and the negative trade balance are the reasons for the current hidden devaluation in Belarus. For instance, according to the Belarusian Statistical Committee the share of Russian imports remains high – around 55%, see Table 1. Devaluation and recession in Russia directly affect Belarusian economy: devaluation is considered necessary to maintain or increase the current volumes of Belarusian exports to Russia.

Classical devaluation normally helps exporters to keep or gain a competitive price advantage, but since 20 December 2014 exporters have to sell foreign currency at the low official exchange rate. Furthermore, Belarusian authorities actively use administrative methods of economic management: for example a prohibition on an increase in the price of pharmaceuticals till the

## Devaluation as a Typical Process

In the short time since its independence the Belarusian national currency has been devalued many times. Thereafter importers increased prices to keep profits at the same level. Thus, prices were almost doubling every two months in 1992–1993. Subsequently in 1995–2000, generally after the Russian default of 1998, the official exchange rate of the Belarusian rouble tumbled 30 times. Then in 2009 the national currency dropped 20.5% and during 2011 – around 200%.

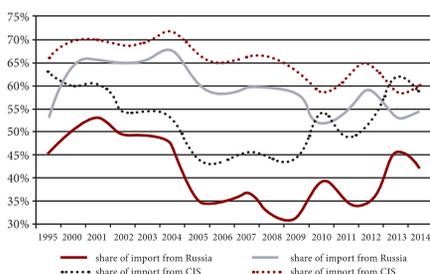
In 1992–2010, the National Bank of the Republic of Belarus conducted a generally soft monetary policy of monetary and credit expansion. Monetary expansion and profits from credit expansion increased state income but decreased real income and savings of Belarusians. In other words, such income redistribution policy hit consumers and enriched the government.

The dual exchange rate policy became popular in Belarus in early 1990s for two main reasons: non-professional policymakers and the fraud committed at the state level. In 1999, the real exchange rates of Belarusian rouble exceeded the official one by a factor of two. In 2011, the exchange rate on the black market significantly exceeded the official exchange rate.

Importers close to the authorities and black market players gained because of double exchange rates. For instance, importers close to Lukashenka could easily buy foreign currency at the low, official rate and resell at the high, market one. On the other hand, exporters had to sell part of their revenues in US dollars at the official rate and therefore lost their profit.

Generally the National Bank raised the interest rate to reduce the money supply. But consumers

Table 1. Share of Belarusian trade with CIS countries and particularly with Russia



source: The National Statistical Committee

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end of 2014 – which can lead to a deficit in the future.

On 23 December 2014 Belarus became the only country with a negative spread between USD/BYR bid and ask, when The National Bank allowed commercial banks to increase only the USD/BYR bid. The ask quotes, however, remained at the same low level, because they do not include the 30% tax paid directly to the budget. This demotivates commercial banks to sell foreign currency from their reserves in order to reduce losses.

This peculiar hidden devaluation, along with the lack of structural reforms and privatisation will not help the Belarusian economy. The inefficient monetary policy and governmental regulation harm exporters, commercial banks and consumers. In their turn, Belarusians reacted predictably, buying up durable goods and foreign currency on the black market.

#### **Economy Troubles Affect Political Arena**

According to all the signs the new crisis may well become the last for the ruling regime. To a large extent this depends on the situation in the Russian economy and Putin's willingness to support Lukashenka financially. Serious internal problems in Russia may cause a change in the Belarusian political landscape, and Putin obviously will do everything possible to prevent the emergence of a pro-European President of Belarus.

The presidential elections in 2015 could well become a challenge for the Belarusian regime. The shrinking of the Russian market affects the salaries of Belarusian workers. For example, the Bobruisk Machine Building Plant cut down the number of workers from 1340 to 460. Gomselmash, MTZ, MAZ, Horizont plants decreased the work week or put their workers on long holiday leave, because there was no demand for their products.

Increased unemployment will cause social tension. Many Belarusians who worked in Russia will return home because of decreased real wages there. And what can Lukashenka offer them? – tax on unemployment, banned free media and further degradation of labour rights. In such difficult circumstances early Presidential elections become more and more probable.

The pragmatic Lukashenka thinks in terms of money and understands that at the moment it

is more profitable to cooperate with Russia. But relations with EU are also important for him as insurance in case of changes in Russian external policy towards Belarus.

The most probable scenario for 2015 – even during the crisis in Russia, Putin will finance Lukashenka. In order to extort more money from Russia, Lukashenka will speak with the EU about reforms and privatisation; most likely his words will be just empty promises. The only serious sign proving the intentions of Lukashenka to cooperate with the EU remains the release of all political prisoners. Democratic reforms – the main EU requirement for cooperation with Belarus – in the meanwhile are the main barrier between the EU and Lukashenka. He perceives reforms in election law, the court system and media as a direct threat to his power and will agree to such concessions only if the situation is hopeless.

It could also happen that Putin would not support Lukashenka or support some other candidate. Putin could do this because of the high losses from the ineffective Belarusian economy. In this case Russian media propaganda will certainly blame Lukashenka for his betrayal. This would lead to a situation where Russia would become a direct threat to Lukashenka's power and he would turn to the EU. There is a small chance that Lukashenka would not lose power after these events. So, Belarus could follow a similar path to Azerbaijan. However, the EU would have more influence on Belarus because it is dependent on the energy supply.

Labour strikes and civil unrest because of the economic crisis in Belarus could have a significant impact on each of the abovementioned version of events. However, in a critical situation pro-Russian groups will have an advantage. Putin does not need a pro-European Belarusian President, and Russian propaganda can also use instability in Belarus to show people that “democracy means chaos”. The most favourable for the EU, and least probable scenario in 2015, would be significant changes inside Russia because of the economic crisis and sanctions, which will change its external policy.

The Russian crisis hit Belarus very quickly. And the EU should use this situation in negotiations with Lukashenka and not underestimate his cunning; Lukashenka will not turn to real cooperation with EU unless a direct threat to his power emerges. The first sign of political changes remains the same – the release of all political prisoners and massive reforms.

TO CONTRIBUTE TO THE NEXT ISSUE OF  
“BELL”, PLEASE CONTACT:

Vytautas Keršanskas

Phone: +370 5 2705993

Fax: +370 5 2736953

Email: vytautas.kersanskas@eesc.lt

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