

Skyrocketing economic growth and weak regional development – digest of the Belarusian economy

On 16 March 2018, the official statistical body of Belarus Belstat has announced that GDP growth in the first two months of the year has accelerated.

Meantime, the weak regional development cast doubt on the sustainability of Belarusian economic growth in the future. Decreasing population number, lack of investment, and depressed business climate accompanied by low average wages play here a crucial role.

Finally, on 20 March 2018, the President of Belarus Alexander Lukashenka has announced plans for the establishment of a new ministry – The Ministry of Digital Economy. The digital transformation of the economy needs authorized governance.

Economic growth: Shifting to the fifth gear

According to Belstat, in January-February 2018 the GDP growth reached 5.6 per cent year-on-year. The industrial production has increased by 10.3 per cent and exports of goods by huge 36.5 per cent (in January). Finally, during the first two months of 2018 investment in fixed capital has increased by 24.8 per cent year-on-year.

The current positive economic figures ground on several factors. First, the world oil prices increased during the previous year. Second, because of administrative stimulus real

wage growth accelerated, which led to the expansion of consumer demand.

Third, because of first two factors, the economic mood of economic agents significantly improved. Firms expect more orders, hire more workers, and actively lend and invest. Households, hoping for more income in the future, actively take loans, increasing current consumption. Banks began to lend more actively while continuing to reduce credit rates.

These positive shocks warmed up domestic demand. In addition to domestic demand, new shocks spurred external demand (for example, Russian demand for Belarusian exports began to grow due to increased growth in Russia amid more expensive oil).

Meanwhile, because of active administrative policy, the real wage growth since the 4th quarter of the last year was about 30 per cent. This giant increase gave rise to a wave of consumer optimism and demand but also produced a negative impact on price stability, the dynamics of the exchange rate, the fiscal balance, competitiveness, and profitability of Belarusian firms.

In the case that the authorities in the future will not abandon the artificial stimulus of wages, these negative effects will continue to grow, turning into a full-blown [threat to price and external stability of the Belarusian economy.](#)

Regional development: Weak performance

Meanwhile, the steady decline of the district Belarusian population in general and its working-age part, in particular, reveals [crisis tendencies in the regional development.](#) According to Belstat, the district's population

of Belarus constantly decreases and in comparison with the beginning of the century its number shrank by almost a quarter (see Figure 1), contrary to the urban population of large cities that increased by approximately 9 per cent.

Moreover, the official statistics reveal even more negative trend for the district's working-age population. During last two decades, its number steadily declined by 1.4 per cent each year and in the last few years its reduction even amplified. All these mean that rural life loses its attractiveness to both adult and young Belarusians.



One of the key reasons stays the significant difference in wages between districts and large cities. The average salary in districts constitutes approximately 78 per cent of the average salary in major cities of Belarus.

The dynamics of entrepreneurial activity in the districts adds additional pain. In particular, over the past three years, the number of micro and small organizations has decreased by 5 per cent (Figure 2). At the same time, the additional development of small business in rural areas possesses potential sources for regional economic growth and, first of all, in agribusiness.



Additionally, Belarusian districts significantly lag behind in attracting foreign direct investment (FDI) that represent a major source of new technologies and create a potential for export diversification of regional goods. For example, during 2005-2015, districts on average attracted 4.6 times less FDI per capita than the major cities of Belarus.

IT sector: Building a new regulator

On 20 March 2018, Alexander Lukashenka has announced plans for the establishment of the Ministry of Digital Economy that will bring the entire domestic economy on the digital platform.

According to Alyaksandr Kurbatski, a member of the Council established for the development of the digital economy in Belarus, IT would penetrate into all sectors of the economy. Now virtually any sphere of human activity affects digitalization and this process really needs to be managed and coordinated somehow.

The creation of a new Ministry fully fits into the ambitious task of the authorities to turn Belarus into an IT-country, reorienting the Belarusian IT-sector to a product model. The government expects that this will significantly increase the value added and increase the level of technological equipment.

However, the long-run consequences of this project still stay unclear. The expectations of long-term positive effect ground on the fact that any progress in improving the level of technical equipment and the integration of Belarusian firms into the global chains will add additional benefits to the country.

On the other hand, additional benefits and preferences for the IT-companies may exceed effects obtained. Moreover, the focus on sectoral preferences may adversely affect the transparency and competitiveness of the business environment.

In the short term, the decree may have a beneficial effect, but only in the form of capital inflows to the country's IT sector.

Taking all together, the skyrocketing economic growth of the

first two months of the year added optimism to the whole economy, however slow progress in the regional development cast doubt on its long-run sustainability.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

This article is a part of a joint project between Belarus Digest and Belarusian Economic Research and Outreach Center (BEROC)

Shrinking economic freedom and milk war with Russia – Belarusian economic digest

On 16 February 2018 Belstat, the official statistical body of Belarus, announced that GDP growth for the first month of the year had reached a new high, surpassing the previous month's record.

Meanwhile, the Heritage Foundation's statement on 5 February that the country's economic freedoms have declined dampened the mood in the business community.

Finally, on 1 March, President of Belarus Alexander Lukashenka acknowledged the existence of problematic issues related to the supply of Belarusian milk to the Russian market.

Economic growth: Optimism

after January figures

According to Belstat, in January 2018 GDP growth reached 4.6 per cent year-on-year (see Figure 1). Export, investment in fixed capital and industrial production provide the foundation of this positive economic tendency.



In January 2018, the growth of import of goods slowed down in sharp contrast with the strengthening growth of the export of goods. This pattern of imports mostly resulted from decreasing consumer demand which, for instance, led to declining food imports.

Industrial production recovers gradually, growing by 9.7 per cent in the first month. The effect of “delayed” external demand plays a crucial role here, while the associated growth in imports of intermediate goods largely bypasses the role of domestic demand.

During the preceding four years, depressed investment in the Belarusian economy showed itself most drastically in respect of fixed capital. As a result, the share of investments in GDP has fallen from its peak of about 40 per cent in 2010 to about 25 per cent today.

Meanwhile, according to data announced by Belstat on 26 February, fixed investments have increased by 26 per cent year-on-year (see Figure 1).

The lower level of investments in previous years has raised their quality because economic entities reject less effective projects. The growing return on capital for new investment projects in Belarus therefore [probably indicates that the period of depressed investment has ended.](#)

Trade: Milk tensions on the eastern border

Belarus currently supplies milk to 45 countries, but Russia remains its main market. However, on 9 February Rosselkhoznadzor (the Russian State Service for Veterinary and Phytosanitary Supervision) imposed restrictions on the import of Belarusian dairy products, strengthened laboratory controls and suspended the certification of products from a number of Belarusian plants due to violations of Eurasian Economic Union norms.

In 2017 Rosselkhoznadzor repeatedly limited the supply of agricultural products from Belarusian enterprises to the Russian market. For example, according to the Ministry of Agriculture and Food of Belarus, in December last year 54 Belarusian companies fell under Rosselkhoznadzor's sanctions.

The Belarusian authorities blame the Russian side for unfair claims. According to official estimates, in 2017 Belarus lost hundreds of millions of dollars in the Russian food market due to sanctions imposed by Rosselkhoznadzor.

Last year the enterprises of the Ministry of Agriculture of Belarus increased exports of products by 3.9 per cent, yet the share of exports to Russia decreased. According to Belstat, in 2017 Belarus delivered to Russia condensed and dried milk and cream for \$371.4m – 12.8 per cent less than in 2016.

According to experts, Russia constantly finds “harmful and dangerous substances” in Belarusian milk not because of its low quality, but due to increased production of dairy products by Russia's own producers.

The Director of the Centre for the Study of the Dairy Market of Russia, Mikhail Mishchenko, admits the lower price of Belarusian products compared to Russian. However, Russia also

blames Belarus for significant volumes of re-export that pass through the country and form a significant surplus of dairy products on the Russian market.

All this leads to lower prices in the consumer market of Russia, decreasing revenues of its domestic producers and results in increasing trade tensions between the economic allies.

Entrepreneurship: Losing economic freedom

According to the latest data from the Heritage Foundation, Belarus position in the Index of Economic Freedom worsened (see Figure 2).



Belarus moved from 104th to 108th place in the ranking prepared by the American research organization. The authors of the study note that, due to the stagnating economy, [liberal approaches lost priority in the economic policy of the Belarusian authorities.](#)

Moreover, according to the authors of the study, the violation of private owners' rights continues (for example, through expropriation of private property through de-privatization), as does the spread of state participation and control of the economy. The state share reaches approximately 70 per cent.

These factors seriously impede economic growth, social development and lead to widespread corruption in the country. According to official statistics, the number of corruption crimes in Belarus has grown – 1,922 cases of bribery in 2017; almost twice as high as in 2016.

According to the survey conducted by the IPM Research Centre

in 2017, a third of respondents (representatives of small and medium-sized enterprises) admit that corruption remains a widespread phenomenon in Belarus. The Chairman of the supervisory board of the IPM Research Centre, Igor Pelipas, explains that corruption increases business costs and this, as a rule, leads to an increase in the cost of products sold and services rendered.

Taken altogether, the revival of exports and end of the investment depression have given a positive impetus to the entire economy. However, Belarus still substantially lacks economic freedoms and export disagreements with Russia over food products remain unresolved.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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State-owned enterprises threaten economic prospects – digest of the Belarusian economy

On 24 January 2018, government officials announced new plans for support to Belarusian entrepreneurs in the current year. Meanwhile, according to Belstat, the state industrial sector remains the main driver of economic growth accompanied by a strong recovery of exports. However, the absence of an

acceptable strategy for solving state-owned enterprises' debt problems continues to threaten financial stability and long-term economic growth.

Entrepreneurship: several steps forward

In the second half of 2017, [the authorities adopted a package of documents aimed at facilitating private business development.](#) Legislative innovations greatly simplified the conduct of business, while radically reducing regulatory and administrative barriers. In addition, the government introduced additional tax and regulatory liberalisation for certain entrepreneurial activities; primarily small companies and individual entrepreneurs. Finally, the authorities expanded the possibilities for self-employed individuals (without registration of small businesses), for example, in the fields of craft activities and agritourism.

Next, on 24 January 2018, government officials announced plans to support entrepreneurship in the current year, including increased lending, lowered loan rates and several changes to taxation. In particular, the head of the National Bank of Belarus's department for monetary policy and economic analysis, Dmitry Murin, says that lending will grow by 9-12 per cent, which supposedly will not harm macroeconomic stability.

Moreover, the National Bank expects a small drop in lending rates by approximately 1 percentage point. According to Murin, inflation expectations deter a more radical decrease in rates. Namely, the results of the analytical survey of individuals show that they subjectively feel inflation at 13 per cent, while prices in 2017 increased by two times less.

Finally, according to the deputy minister for taxes and

duties, Ella Selitsky, the government will prepare proposals for comprehensive reforms of tax legislation throughout the year. It is likely that the fiscal system will undergo significant changes in 2019, with stabilising tax legislation the main goal for the next three years.

These measures will support private sector development. However, the key barrier to entrepreneurship remains unequal conditions for economic activity in comparison with state-owned enterprises (SOEs) rather than the regulatory environment.

In this respect, the artificial “bias” in allocating resources in favour of the state sector remains especially important. Without its elimination, the private sector will be stuck in the doldrums and unable to fully realize its potential.

Real sector: rising debts

While measures to develop the private sector have only limited effects, the state industrial sector remains the main driver of economic growth. In 2017, it showed growth of 6.1 per cent year-on-year.

According to honorary chairman of the board of the Business Union of Entrepreneurs and Employers, Georgiy Badey, this growth mostly occurred due to the favourable macroeconomic environment in key trade markets. However, the real sector lacks new drivers of growth and encouraging changes in economic policy.

In particular, financial instability associated with low quality SOE debts remains a serious threat to the economy. Moreover, Belarusian SOE debts continue to rise. For the first nine months of the previous year, the payments on loans and borrowings exceeded the volume of gross value added in the industrial sector as a whole. Therefore, in the past year,

they not only failed to cover their old debts but became further indebted. As a result, the total national debt currently hovers in the range of 45-50% of GDP.

Measures recommended by the IMF to kickstart the process of resolving debt problems include strengthening creditors' rights, permitting bankruptcy procedures for large debtors, and the sale of SOE debts at a fair market value (compared to their nominal value).

At the same time, this tough solution may seriously disturb the real sector (**the sector of the economy that actually produces goods and services**) and has both social and political implications. The "soft" alternative [assumes new subsidies from the state.](#)

However, such an "easy" solution only freezes the problem and limits its negative impact on the current macro dynamics. In the future, the debt problem may reveal itself at any moment and cause a new wave of economic recession.

Foreign trade: imbalances grow

Stable global growth contributes to revived demand for Belarusian commodities and industrial goods exports to Russia. This recovery in exports gave a positive impulse to the Belarusian economy, although growth remains fragile. For example, in the second half of 2017, the physical volume of shipments of "growth leaders" in the first half of the year (oil products, potash fertilizers, tractors and trucks) dropped. In contrast, the delivery of goods that previously lagged behind (food products, tires, refrigerators and shoes) increased.

Instability in export growth therefore remains a challenge for

the whole economy, since the prospects for output growth highly depend on export performance.

Overall, foreign trade turnover of goods during the eleven months of the previous year reached \$54.1bn and increased by 23.5 per cent year-on-year (see graph below). In November, imports of goods exceeded exports by \$600m increasing the negative balance in merchandise trade to \$4bn year-on-year, which surpassed 2016 figures by more than \$800m.



As a result, the traditional imbalances in the Belarusian economy return: the growth of export goods invariably leads to the import growth and a deterioration in the balance of payments. Thus, while the results of measures for the development of the private sector remain invisible, positive dynamics of the economy will sustain only in case of a new round of export growth. Furthermore, the absence of an adequate strategy for solving the debt problem of SOEs continues to threaten financial stability.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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**Blazing the
cryptoliberalisation trail –**

digest of the Belarusian economy

On 22 December 2017, the President of Belarus Alexander Lukashenka signed a presidential decree that identified Belarus as the first country in the world to legalise the blockchain—a digital ledger in which transactions made in [online trading](#) can be chronologically recorded, people have complete freedom [when trading Forex](#) in this country.

In the meantime, improved oil prices have helped the government outpace their economic growth plans for 2017. This has led to forecasts for 2018 to be even more ambitious.

On 18 December, government officials defined plans for wage growth in the coming year. In contrast to economic growth, the new 2018 wage growth target is below the presidential target set at the beginning of 2017.

The IT-sector: A haven for cryptocurrencies

On 22 December 2017, Alexander Lukashenka signed [the presidential decree On the development of the digital economy](#), which is intended to make Belarus a regional IT leader.

President Lukashenka believes the decree will help Belarus become a centre for attracting computing talent, successful companies and international corporations working in the most advanced technological areas, such as artificial intelligence, big data, and blockchain technology.

The decree extends a special legal regime for companies based at the Belarus Hi-Tech Park (HTP) until 1 January 2049. It

also expands the list of business activities to include new industries, such as neural networks, unmanned vehicles, biotechnologies, and more.

Most notably, the decree permits the HTP's residents to conduct transactions with electronic money without limitations and companies no longer need the permission of the National Bank of Belarus to open accounts in foreign banks and other financial organizations and to perform financial operations.

Third, the decree legalizes electronic money in Belarus. The HTP's residents have a right to engage in mining and to conduct the cryptocurrency exchange and use services like [hodl stock price: coinbase custody trust company llc](#).

Finally, individuals also have the right to own and to exchange cryptocurrency for foreign currency and Belarusian rubles, to carry out mining. Income from these operations frees from tax declaration of physical persons and excludes from taxation until 1 January 2023, since there are different markets for cryptocurrency, being solana one of them, and the [solana hype](#) is just starting for those interested in crypto.

Almost all of the decree's provisions will enter into force three months after its official publication. Its developers predict that by 2030 annual export revenues for Belarus's IT sector will increase from the current \$1bn to \$4.7bn and the number of people employed will grow from the current 30 thousand up to 100 thousand people.

Economic development: results, prospects, and risks

On 5 December, Belarusian Prime Minister Andrei Kobyakov announced that GDP growth will reach 2 per cent for 2017 and inflation will not exceed 7 per cent. This is more ambitious

than the 2017 forecast, which assumed 1.7 per cent GDP growth with an inflation rate lower than 9 per cent.

Several factors caused the current rebound of the Belarusian economy as per the experts in [money knowledge](#). They include improved external market conditions for trade, strengthened economic growth in Russia, and increased prices for commodities. These changes stimulated the growth of Belarusian exports and supported business activity in the country.

Furthermore, according to official forecasts from the Belarusian Council of Ministers, GDP in 2018 will rise by 3.5 per cent and goods and services exports by 5.7 per cent. The National Bank of Belarus also projects that inflation will stay at 6 per cent or below, and the money supply will not grow above 12 per cent.

However, certain experts disagree with the Council's optimistic outlook. In particular, the World Bank forecasts GDP growth at 2.1 per cent and the IMF predicts only a 0.7 per cent growth to GDP. Common among the two organisations' reasoning include a worsening external economic environment and the absence of structural changes within the Belarusian economy.

Indeed, it is unlikely prices of imported energy resources grow as much as in 2017. This will lead to lower benefits from commodity exports. Furthermore, the oil subsidy from Russia (a discount on purchased oil) that added substantially to GDP growth in previous years will continue to be reduced.

According to World Bank experts, in past years the Russian oil subsidy account for as much as 15 per cent of Belarusian GDP. A sharp drop in oil prices reduced the size of these benefits. In 2016, the oil subsidy accounted only for about 4.6 per cent, or approximately three times lower than in previous years.

In 2018, Belarus must repay about \$3.7bn in external debts

generated mostly by [inefficient state-owned enterprises](#). Taking into account the absence of serious plans for structural reforms, these liabilities will need additional external financing and greater budget coverage.

As a result, according to the Minister of Finance Vladimir Amarin, the government plans to borrow approximately \$1.2bn in 2018, increasing further the risks for financial stability and the burden on the budget.

Wages: Looking forward



On 18 December, Labor and Social Protection Minister Irina Kostevich announced official predictions for wage growth in Belarus. According to Ministry estimates, average monthly wages will reach up to BYR941 in 2018 or approximately \$466. Wage growth will ultimately depend on the situation of economic development in the country.

However, in April of this year, President Lukashenka said that a salary equal to BYR1000 a month remains the minimum government target. Currently, the average Belarusian earns approximately 98 per cent less than average Chinese, and more than two times less than the average Lithuanian or Pole (see the Average wages figure below).

Nevertheless, even if wages grow to predetermined levels in the coming months, true earnings will remain low. First, the threshold level of BYR1000 excludes taxes. Second, wages in the regions will be substantially minor in comparison with Minsk (the average salary in Minsk is higher by approximately 55 per cent).

Altogether, officials understand the unstable foundations of Belarus's current macroeconomic drivers, but still, they

prefer to ignore the problems of an unreformed economy and continue to dream about potential cryptocurrency benefits.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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Ineffective state-owned enterprises, improved business climate – digest of the Belarusian economy

On 17 November 2017, the official statistical body of Belarus, Belstat, announced that GDP growth for ten months of the year has reached a new high outscoring the previous month's record.

However, state-owned enterprises are still unable to significantly improve their cost-effectiveness, which delivers additional pain to their creditors threatening the banking stability of Belarus. For great business banking options and guidance visit www.wecu.com/business-banking/.

In the meantime, on 23 November 2017, the Belarusian President Alexander Lukashenka has signed a presidential decree aimed at improving Belarus's business climate.

Economic growth: withholding the handicap

According to Belstat, from January–November 2017, GDP growth continued and reached 2 per cent year on year (see Figure 1). The main contributor to economic growth remains to be exports supported by increased demand within Belarus's traditional external markets.



In particular, foreign counterparts (for example, China) display a belated interest in certain Belarusian goods, mainly potash fertilisers, as well as a range of capital goods exported to Russia. As a result, the figures of the first nine months of the year indicate that export of goods has increased by 20 per cent.

Correspondingly, industrial production is steadily recovering. The effect of “belated” external demand plays a crucial role here. Domestic demand, on the other hand, is mostly negated by the associated growth of imports for intermediate goods.

Additionally, Belarusian families are gradually restoring their consumption levels comparable to the “rich” years of the 2000s. This happened mainly because households started to believe that recession in the economy has ended, which subsequently will lead to growth in their real incomes.

However, the reverse side of increased consumption means the growth consumer goods imports. For many households, the normalization of consumption also means more imported goods in their consumer basket.

Finally, another major component of GDP—capital investments—has also grown. After a downturn in the first half of the year, capital investments have gained in size and

number. In October, they grew by 2 per cent year on year.

State sector: stressing the economy

[The state-owned enterprise sector remains the key challenge for Belarus's economy.](#) In 2015–2016, devaluations of the national currency and government financial rehabilitation efforts combined to reduce costs for Belarusian firms. In addition, low domestic demand for imports (in comparison to the past two years) gave some “fresh air” to improve export competitiveness.

However, without permanent state support, a large number of the state-owned enterprises (SOEs) would be unable to sustain operations or generate profits. State directed redistribution of resources limits capabilities for the development of efficient firms and the economy in general.

For example, Jaroslav Romanchuk, Executive Director for Strategy, an analytics centre, notes that 60 per cent of agricultural enterprises and a quarter of industrial enterprises remain unprofitable and are unable to survive without state support. Moreover, Romanchuk says that half of all construction organizations work at a loss.

These inefficiencies compound the increasing inability of state-owned enterprises to repay their debts. This results in budget coverage of their obligations and investments in fixed capital (see Figure 2). Since 2015, Belarusian enterprises have demonstrated a steady decline in the acquisition bank loans with a corresponding build up of overdue debts, which consequently threatens the financial stability of the entire banking system.



The trends described above—a fall in issued loans, and rises in overdue loans and consolidated state budget funds—happened, first of all, due to the high cost of capital for SOEs during the past two years of economic recession. Second, the inefficiency of investment modernization programs from previous years failed to deliver substantial profits.

Doing business: high taxes limit cost-effectiveness

On 23 November 2017, President Lukashenka signed the presidential decree “On Enterprise Development.” The decree contains a package of government-drafted ordinances aimed at improving Belarus’s business climate.

In a major change, the decree introduces a notification system for businesses engaging in activities such as, among others, consumer and tourism services, trade, food services, passenger transportation, and the production of building materials.

This means that a business may merely notify local authorities of its plans to start engaging in such activities, which requires the filling out of electronic form, and then it can begin operations the following day. Additionally, the decree shortens the list of mandatory operational requirements for businesses, removing many sanitary, environmental, and other regulations that have manifested into business-stifling red tape.

The result is that Belarus currently ranks 38th in the World Bank’s Ease of Doing Business 2018—a drop of only one position in comparison with the previous year. World Bank experts have noted the downgrade occurred due to a drop in the tempo of legislative reforms intended to improve [conditions for entrepreneurship in the country](#).

Additionally, World Bank expert and co-author of a study into the Belarusian economy Valentina Saltane argues the second factor that limits the attractiveness of doing business in Belarus, in particular, is the high tax burden for businesses. According to Saltane, Belarus ranks 96th in the world in terms of taxation weight (the first place being the least burdensome).

The overall rate of taxes and duties in relation to an organisation's profit in Belarus is 52.9 per cent. For example, in Europe and Central Asia this figure hovers around 33.1 per cent. In high-income OECD countries, the ratio reaches 40.1 per cent. Therefore, Saltane concludes that Belarus should do more in order to reduce the tax burden.

Meanwhile, in 2016 President Lukashenka set a strategic goal for the government to reduce all types of production and sales costs by a quarter. The aim was to improve the competitiveness of the national economy. However, without reduction of the tax burden on business, this goal still seems unachievable.

Thus, in November Belarus's economy has continued the growth of recent months. The rise in exports and industrial production are delivering positive economic prospects for the year. However, problems with the business climate and the cost-effectiveness of SOEs threaten the stability of the banking system and the sustainability of economic growth in the coming years.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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Economy recovers, but remains structurally vulnerable – digest of the Belarusian economy

During a trip to Minsk on 5 October 2017, Venezuelan President Nicolas Maduro showed strong optimism on economic teamwork with Belarus, but forgot to mention the buildup of outstanding debts.

On 25 October, the National Bank of Belarus gave its overview of the current macroeconomic situation, citing the positive influence of monetary policy.

However, a day later on 26 October, experts from the Eurasian Development Bank were hesitant to confirm good long-term prospects for the Belarusian economy.

Trade policy: diversifying from Venezuela

President Maduro arrived in Belarus on 5 October as part of an official visit. The negotiations with Belarusian President Alexander Lukashenka were concerned mostly with trade and economic cooperation.

In 2016, trade turnover between Belarus and Venezuela equalled only \$2m, which is a 92.6 per cent decrease in comparison with 2015 (see Figure 1 below). From January–July 2017, trade turnover reached \$5.4m and mostly comprised exports of

Belarusian potash fertilizers.



The economic crisis in Venezuela and a sharp decrease in world oil prices are the main reasons for the decline of Belarusian trade with Venezuela, which currently uses its foreign exchange reserves only for the purchase of food, medicines and other socially important goods.

According to Belarusian Scientific and Industrial Association Deputy Chairman Georgy Grits, Venezuela is approaching a default. He bases his view on an appraisal of studies into the country's default risk made by world rating agencies.

Therefore, the main problem for Belarus coincides not with further development of trade with this former high-income country, but with Venezuelan debts accumulated for already shipped goods in previous years.

The total debt has reached approximately \$500m. For example, Venezuelan debts to MTZ (Minsk Tractor Works), a Belarusian producer of tractors, have reached \$50m, debts to MAZ (Minsk Automobile Plant), a truck manufacturer, are at \$170m, and debts to various Belarusian construction companies amount to \$108m.

However, on 8 October, Belarusian Deputy Prime Minister Vladimir Semashka expressed the optimistic view that further cooperation with Venezuela is feasible. He noted that Belarus plans to help increase the production of oil in Venezuela by more than three times. Current production levels sit at less than one million tonnes per year.

Economic growth: the

regulator staying firm

On 25 October, the National Bank of Belarus announced the consolidation of positive changes in the economy and monetary sphere during the first nine months of this year.

Specifically, the monetary authorities have admitted that economic growth has started to recover jointly with slowing inflation. Moreover, decreasing interest rates and a continuing process of de-dollarization are the results of a unified macroeconomic policy.

Correspondingly, declining borrowing costs have led to the recovery of business activity and to increased demand for loans by commercial companies, which further strengthen Belarus's banking system. The regulator also drew attention to the significant growth of foreign exchange reserves (see Figure 2 below) caused by the sale of foreign currency by Belarusian citizens.



Moreover, the Chairman of the Board of the National Bank, Pavel Kallaur, has admitted that within two or three years there exists a real possibility to boost foreign reserves up to \$10b. At present, Belarus currently is about \$3b shy of this mark.

In particular, accumulating net sales of foreign currency by Belarusian citizens, who exchange it to purchase goods and services, and growing exports (for example, from January–August exports increased by 21 percent) may contribute to the achievement of the \$10b goal.

However, along with opportunities, risks also arise. The first risk coincides with trade policies that are heavily concentrated and [focused on Russia](#). The plunge in foreign currency earnings from 2015–2016 showed what can happen to the

economy when Russia's market falters.

Secondly, the increase in demand for imports of consumer goods may apply pressure on foreign reserves, which in turn may lead to an increase in demand for foreign currency from importers.

Finally, the dynamics of foreign reserves depend not only on foreign exchange earnings, but also on debt expenses. Foreign reserves have increased in 2017, because Belarus both undertook external borrowings and refinanced old debts with Russia. Therefore, the resolution of debts—old and new—will directly affect the volume of reserves.

Monetary policy: hidden threats

However, on 26 October, experts at the Eurasian Development Bank warned that despite the significant improvement of Belarus's macroeconomic situation, the rapid easing of monetary policy (through the decrease of interest rates) carry serious risks for the acceleration of inflation, which may occur in early 2018.

Structural problems, including excessive employment in state enterprises and the propping-up of inefficient enterprises, limits the potential for monetary policy to stabilize inflation and further to solve [the issue of repaying of foreign debts](#).

Overall, the current positive macroeconomic situation cannot last long. Each production cycle does not bring substantial profits for the majority of Belarusian enterprises. Indeed, in many cases the cycles generate losses. The more they produce, the more they get bogged down in losses, which in turn leads to the growth of foreign debts.

An expert from [BIPART \(the Belarusian Institute for Public](#)

[Administration Reform and Transformation](#)), Vladimir Kovalkin, compares the general situation in the Belarusian economy to “walking on very thin ice that might crack at any moment and fall in.” In Particular, the Belarusian budget possesses insufficient funds to pay both foreign debts and the interest building upon them.

As a result, according to experts, any problem or any differences in foreign economic relations may first prevent the refinancing of foreign debts from previous years, and then eventually lead to a default.

In sum, while the Belarusian economy gradually recovers, it still suffers from long-standing structural problems. Failure to resolve these problems may not only reduce economic growth, but also lay the groundwork for a new type of crisis for Belarus—a debt crisis.

Aleh Mazol

Belarusian Economic Research and Outreach Center (BEROC)

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The autumn of liberalisation – digest of the Belarusian economy

On 26 September 2017, Belarusian officials declared plans for the liberalisation of the economy by developing a new decree on freeing up Belarusian entrepreneurship.

Moreover, on 28 September, the First Deputy Prime Minister of Belarus Vasily Matyushevsky announced the government's intentions to encourage further growth of the IT-sector.

The latest statistical figures on the development of the Belarusian economy, though optimistic, are still far from promising.

Economic growth: searching for optimism

According to the latest data from Belstat, a government agency for official statistics, the Belarusian economy is slowly starting to recover. In the first eight months of the year, growth of industrial production equaled 6.1 per cent, GDP grew by 1 per cent and the volume of foreign trade rose by more than 20 per cent (see Figure 1).



However, a deeper analysis of the figures reveals that officials' increased optimism rests on shaky ground. First, trade turnover in 2016 dropped by 12.4 per cent, while a year earlier it declined twice as much.

Second, the rise in global commodity prices mostly explains current achievements. For example, compared to last year the price for the Belarusian refinery products rose by 63 per cent, and ferrous metals by more than a third. Overall, export prices increased by 20 per cent, while the physical volume of export supplies improved only by 3.1 per cent.

Third, Belarus's export structure has not changed. It still comprises mostly agricultural products, refinery products, potash fertilizers, and metals. Moreover, the share of high and medium-technology goods in total volume of Belarusian exports to the EU does not exceed 2 per cent.

Finally, despite the best efforts of Belarusian officials, the share of exports to Russia in the first half of the year accounted for more than a half of total turnover (not much different from last year). Accordingly, the trade turnover with EU countries increased only by 14 per cent, with the total share equalling 23 per cent.

Therefore, any optimism about a recovery seems a bit premature, taking into account the absence of assurance that current pricing trends will continue longer into the future.

Entrepreneurship: approaching liberalisation

Meanwhile, on 26 September, the government submitted a key document to aid liberalisation of the Belarusian economy, the draft decree “On the Development of Entrepreneurship,” for consideration by Belarusian president Alexander Lukashenka .

The decree proposes the following changes. First, the government will systematise and reduce administrative requirements (procedures for obtaining certificates, approvals and other permits) in order to simplify entrepreneurial activities.

Second, the decree advocates the formation of predictable tax legislation with the aim of ensuring a stable situation in the tax sphere. In particular, the government plans to introduce a ban on the introduction of new taxes or the increase of tax rates till 2020.

Third, the decree introduces a new notification procedure (by way of “one window” services or by implementing an e-services portal) for some of the most common types of economic activity for small and medium private enterprises (household and travel services, transportation of passengers and cargo, production

of agricultural goods and building materials).

Fourth, the decree cancels the need for licenses for 3 of the 36 currently licensed business activities. It also streamlines 20 additional licensing components for the remaining activities. Finally, the government will attempt to transform the economy to focus on information technologies. Particularly, the First Deputy Prime Minister of Belarus Vasily Matyushevsky has acknowledged [further development of Belarus High-Tech Park](#).

As a whole, the decree aims to change the mechanisms of interaction between the state and businesses. The hope is to minimise state intervention in the activities of private companies and to strengthen the mechanisms of self-regulation for entrepreneurs. However, the government still insists on maintaining a level of control over the economy.

The real sector: waiting for investments

Later, on 28 September, during the Belarus Investment Forum held in Minsk the First Deputy Prime Minister of Belarus Vasily Matyushevsky praised the success of the measures taken by the government to support businesses in general.

Matyushevsky stated that Belarus occupies the 37th place in the latest World Bank's Ease of Doing Business ranking and grades among the ten countries-leaders in the reform of legislation. As a result, the number of companies bringing in foreign capital is growing—40 per cent more in comparison with 2014.

Discussion during forum touched on several topics, including investment in the real sector, technological and human resources of Belarus, and growth drivers for the Belarusian

economy. Additionally, participants have evaluated the possibility for a transition from a “catch-up development” strategy for Belarus to a “harmonious integration into international value chains” strategy, which envisions generating a stream of FDI into the country.

Moreover, the officials have stated that Belarus will continue reforms in order to support promising sectors of the economy, developing modern technologies, and increasing of the role of private sector.

However, World Bank Country Director for Belarus, Moldova, and Ukraine, Satu Kahkonen has argued that, along with the many opportunities, several risks remain in store for Belarus.

Kahkonen noted that Belarus can no longer rely on its traditional position in the market. Global driving forces have changed: the prices of raw materials will not be as high as in previous years. This means for Belarus that it cannot rely further on high commodity prices. If Belarus stops developing and reforming, it will fall into the trap of slow growth.

She added that additional growth factors for Belarus should include high level education, infrastructure development and [taking advantage of its geographic location between EU and non-EU states.](#)

In total, while the government demonstrates commendable efforts in the legislative sphere and tries to assure foreign investors with good economic development prospects, the economy still awaits more proactive steps and shows only temporary signs of recovery.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

This article is a part of a joint project between Belarus Digest and Belarusian Economic Research and Outreach Center (BEROC)

State debt and weak trade policy test Belarus recovery – digest of the Belarusian economy

On 5 September 2017, Belarusian president Alexander Lukashenka once again declared the need to accelerate the government's efforts to improve legislation concerning economic embezzlement and other abuses that are slowing down the economic development of the country.

Meanwhile, exports are recovering briskly, although mostly due to goods based on raw materials. What's more, the debt burden on the economy is rising, reaching a historical maximum. This is now the most significant risk to the national economy.

Trade Policy: exporting to the European Union

In the first half of the year, Belarus increased its export of goods, although this is primarily due to the price factor and goods based on raw materials. The dominant exports include fuel, meat, milk and other food products, chemical products (especially potash fertilizers), and metals.

Thus, the main export items comprise goods with relatively low value added. Meanwhile, on 11 July 2017, Lukashenka officially demanded that export partners be diversified, first of all to the EU market. According to him, all Belarusian economic authorities and enterprises need to 'bite' into the European

market, given its status as the most most effective and technologically advanced.

However, in the first half of the year, the share of EU countries accounted for only about a quarter of Belarusian exports. This is in stark contrast to the early 2000s, when Belarus delivered almost half of its exports to Europe.

In 2012, Belarusian exports to EU countries reached a record of \$17bn, primarily due to the export of petroleum products produced from duty-free Russian oil. Afterwards, disputes with Russia concerning the price of supplied oil and the redistribution of duties from oil products, along with a decline in world oil prices, has resulted in a drop of export to EU countries of approximately 67% in 2014-2016 (see Figure 1).



Nevertheless, the share of raw materials in exports to the EU remains huge – approximately 80 per cent of Belarusian sales still consist of fuel, wood, chemical products, and metals. Therefore, it is evident that an increase in exports of high-tech products remains a very important task for the economy as a whole.

According to the President of the Mises Scientific Research Centre, Jaroslav Romanchuk, Belarus's economy still lacks the prerequisites for increasing and diversifying its exports in the Western direction. On the contrary, [economic self-isolation threatens Belarus](#), as competitors displace Belarusian exporters even on the Russian market.

State debt: increasing

pressure

The debt burden on the economy is on the rise. The national debt relative to GDP has reached 40.4 per cent – a historical maximum. As a result, continuing with existing growth dynamics creates serious challenges for the economic development of the country.

According to [Doug Constable](#), in 1997-2006, the debt burden on the Belarusian economy remained at very low levels – external and internal debt were less than 10% of GDP. Low energy prices from Russia and the growing Russian market allowed the Belarusian economy to grow rapidly in the early 2000s without the need for additional borrowing.

In 2007, however, Russia revised energy prices on oil and gas for Belarus. As a result, in order to ensure a high rate of economic growth and the stability of the exchange rate of the Belarusian Ruble, the government became actively involved in external borrowing.

Thus, starting in 2007, the debt burden on the economy began to rise. From 2007 to 2012, the national debt relative to GDP increased by more than four times. Moreover, due to the devaluation of the Belarusian Ruble and the economic recession of the last two years, by the beginning of this year the national debt has grown by almost half, reaching 39.4 per cent.

As a result, today the debt service costs alone for the national budget make up approximately 10 per cent of its expenditures; to repay the main part of its debt, Belarus needs keep borrowing.

According to the Honorary Chairman of the Business Union of Entrepreneurs and Employers, Georgiy Badei, such dynamics will remain negative until Belarus has an acceptable rate of economic growth: to pay the debt, the economy needs to

generate growth. If the economy grows, the budget revenues will increase and we Belarus can begin to repay accumulated debts.

At the same time, [the reduction of investment in fixed capital](#) over the past several years (such as plant machinery and equipment) does not lead to optimism regarding acceleration of growth of output and employment. Therefore, the only significant steps to be taken to liberalise the economy include reducing taxes on enterprises. This could will stimulate economic activity and help to repay accumulated debts.

The budget: balancing fiscal stability

Meanwhile, the consolidated budget in Belarus has boasted a surplus since 2011, which is used for repayment of state debt (see Figure 2). The structure of revenues and expenditures of the budget has remained stable over the last eight years.



However, securing a surplus is posing more and more of a challenge. In real terms, budget revenues shrank in 2015-2016 because of a recession (although revenues remain relatively stable as a share of GDP), becoming the reason for expenditure restraint from the government.

In recent years, capital expenditures have decreased the most. As a result, fiscal policy has become persistently procyclical. What's more, steady growth in social transfers has become a major instrument of the government to provide a certain level of social protection and limit the poverty level in the country.

Taking together, the physical volumes of foreign trade have

led to strong growth, thus helping the government fulfil budget obligations. However, debt sustainability is becoming the largest risk for the national economy.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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The end of a long-lasting recession? – Digest of the Belarusian economy

On 17 May 2017, Belstat, Belarus's official statistical body, announced that Belarus's economy is growing for the second straight month.

Thus, on 24 May, Deputy Prime Minister Vladimir Semashka declared new investment plans for the industrial sector assuming further economic recovery.

Nevertheless, the economic environment remains complex and the debt burden of enterprises is high, threatening the stability of the banking system.

Economic growth: good prospects for the future

On 17 May, Belstat announced that in January-April, GDP increased by 0.5 per cent in comparison with the corresponding period of the previous year, thus extending March's positive dynamics (see Figure 1).



The main contributor to the recent economic growth remains export. Figures for the first quarter of the year indicate that export of goods has increased by 20 per cent, thanks to the steady recovery of the Russian economy and increase in consumer demand for Belarusian food products.

Another key factor is that the export of oil refinery products has risen from the ashes after the upward correction of world oil prices and [a long-awaited deal with Russian authorities on oil import](#). This will mostly add up in the second half of the year.

According to economist Vyacheslav Yaroshevich, the Russia-Belarus oil deal will encourage the entire economy, thus resulting in 30 per cent year-on-year export growth and an additional 0.7 per cent GDP growth by the end of May.

Furthermore, in the second half of the year, industrial production will also start contributing to overall GDP growth. According to Vyacheslav Yaroshevich, the industry shows signs not only of growth in production volumes, but also improvements in the financial situation, including increase in revenues, efficiency of sales, and net profits.

The financial sector: disappearing savings

According to data from the National Bank of Belarus, as of 1 May 2017 the amount of foreign currency deposits in banks amounted to \$6.8bn – the lowest since December 2013. This trend of constant decline in foreign-currency savings has been observable since November 2015. As a result, after 18 months, savings declined by almost \$1bn.

Three factors explain this trend. First is the the constant decrease in the profitability of deposits for Belarusians both in foreign and national currency.

For many years, the deposit rates on bank savings nominated in Belarusian rubles exceeded two-digit numbers. Even during periods when the Belarusian ruble was stable (the 2000s – a period of generous oil subsidies), their yield came to more than 10 per cent per year. Only in the summer of 2006, due to declining inflation, did the average deposit rate fall to 9.7 per cent.

Over the next decade, it was always expressed in double figures due to the high inflation rate. It even exceeded 50 per cent per annum during the 2011 and 2014 financial crises. However, in 2015-2017, after the National Bank of Belarus committed to reduce inflation, these rates dropped to the historically low level of 8.4 per cent. They will supposedly continue to decrease (see Figure 2).



The second factor is that there are very few profitable investment projects for banks to finance. Moreover, on 1 May, the share of bad assets (generated by current operations of enterprises) in Belarusian banks reached 14.2 per cent.

According to the Senior Director of the Moscow office of Fitch Ratings, Olga Ignatieva, the quality of assets in banks will continue to deteriorate, as the [economic environment is complex](#) and the debt burden of enterprises remains high. Thus, banks have less motivation to attract new deposits.

Finally, Belarusians, who are facing a decline in their real incomes, try to maintain the same level of consumption at the expense of their savings.

Manufacturing sector: modernization 2.0

On 24 May, Deputy Prime Minister Vladimir Semashka announced plans to invest \$500mln in the modernization of MAZ (the largest manufacturer of trucks in Belarus), \$800-850mln in the development of BMZ (a large metallurgical plant), and commit additional financial resources to the modernization of refineries.

According to Vladimir Semashka, MAZ struggles with production volumes. Three years ago, the enterprise produced 24,000 trucks per year, whereas by the end of 2017 it was producing no more than than 11,000. The refineries performed better, but endured financial losses due to the drop in world oil prices and the decrease in oil suppliers from Russia in 2016.

However, in light of the absence of internal financial resources, the government has only two options if it wants to fulfil its plans for modernization and foreign direct investments.

According to the opinion of economists from the investment company UNITER, Belarus must increase the annual inflow of foreign direct investments (FDI) to \$3-4bn if it wants to increase economic development. However, data for 2013-2016

shows that the volume of FDI has stabilised at \$1.3-1.5bn per year without significant changes in recent years.

The second option is obtaining loans from international financial organisations. Once again, negotiations with the IMF remain incomplete (nobody knows for how long), and the Eurasian Development Bank still requires more profound reforms in the Belarusian state sector (including privatisation).

Thus, in May, Belarus's economy showed its first signs of recovery – the rise in export and industrial production point to positive prospects for the second half of the year. However, problems in the financial system, which have accumulated over the previous years, have not disappeared. This threatens the sustainability of the economy.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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Autumn of tough economic decisions – digest of the Belarusian economy

On 17 October 2016, new macroeconomic data from Belstat, Belarus's national statistical committee, indicated that this year's economic decline seems to have finally halted. The GDP stopped falling and foreign trade saw a slight revival.

However, on 21 September the IMF warned the Belarusian

authorities about new threats to macroeconomic stability, namely the high level of bad assets in the banking sector and the sustainability of state debt.

Meantime, the tight embrace of the Russian economy continues to squeeze Belarus – this time because of petroleum product transportation.

Economic growth: waiting for recovery

On 17 October 2016, Belstat announced that the downturn the GDP experienced in January to September reached 2.9 per cent year-on-year against 3.0 per cent year-on-year in January to August (see Figure 1). In other words, after entering a new slowdown phase in June, the economy is showing some signs of recovery.



However, household consumption, which accounts for approximately half of Belarus's GDP, is still failing to contribute to growth, unlike in previous years. For example, in September retail turnover (as a proxy for household consumption) dropped by 4.4 per cent year-on-year.

Thus, Belarusians continue to reduce their spending, expecting the economic recession to take a further toll on their financial resources. An important reason for this relates to the government's aim to link the growth of real wages with productivity improvements.

As a result, due to the weakening economy and a deteriorating external environment, in September real wages dropped by 2.4 per cent, coming to only \$377. Moreover, according to Belstat the real disposable income of Belarusians in January-August decreased by 7.1 per cent year-on-year.

Another major component of GDP – capital investments – has

also exhibited downward dynamics. After some recovery in the second quarter of the year, capital investment has become much weaker in recent months. In January-September it dropped by 19.5 per cent year-on-year.

Net exports, on the other hand, have stopped deteriorating. By the end of August, the trade deficit from the first half of the year had reverted to a trade surplus.

The financial sector: exposing hidden threats

Meanwhile, according to IMF reports published on 21 September 2016, there are two important new threats to the Belarusian economy. The first threat is the high level of bad assets in the banking sector (see Figure 2), resulting from the common practise of prolonging loans and changing their agreement conditions (mainly in order to restructure them).



Moreover, IMF experts have stated that the accumulated nonpayment risks in the banking sector are rapidly approaching the "red zone", which could trigger a new wave of financial instability. In order to prevent such a situation, the banking sector urgently needs to take new stabilising measures. This could mean the creation of a special body with powers to privatise debtors to address the issue of bad loans.

The second threat has to do with the sustainability of state debt, which according to IMF estimates will continue to worsen. Moreover, the state debt consists mainly of loans denominated in foreign currency. Thus, in coming years the debt's servicing and repayment to creditors will become one of the largest problems for the state budget due to the loans' sensitivity to shock from the exchange rate.

The only way for the government to alleviate budget pressure in the current economic climate is by [repaying old debts with](#)

[new ones](#). However, as a result this money will not actually boost the Belarusian economy but merely increase the state debt even more.

The right decision would be to introduce structural and institutional reforms. This sort of twin strategy could stimulate productivity growth and establish a basis for sustainable long-term economic growth.

The transport sector: the road less travelled

On 10 October 2016 it appeared that Belarus and Russia had [almost resolved the oil and gas conflict](#). However, it seems that Belarus overpaid for this deal. In order to continue to receive duty-free oil, Russia may insist on "freezing" the transport routes of Belarusian petroleum products through nearby Baltic ports in favour of Russian carriage bays.

In order to displace the Baltic States (Latvia and Lithuania) the JSC "Russian Railways" (the main operator of railways in Russia) is offering an unprecedented 25 per cent discount on the transportation of Belarusian petroleum products to Russian ports.

Extraordinary discounts from Russia come with substantial pitfalls

The discount will be valid until 31 December 2018 and makes the Russian Railway's tariffs for Belarus comparable with the transportation tariffs at the Latvian port of Ventspils or the Lithuanian port of Klaipeda. However, as is usually the case when it comes to relations with Russia, such an extraordinary discount comes with substantial pitfalls.

In order to force Belarus's hand, Moscow is attempting to include commitments to export certain predetermined volumes of petroleum products via Russian ports into an intergovernmental

agreement. The agreement regulates the duty-free supply of Russian oil for processing at Belarusian oil refineries.

However, such a set-up does not provide much economic incentive to Belarus. The Lithuanian port of Klaipeda and the Latvian port of Ventspils operate most of the transportation of Belarusian goods by sea and offer better conditions.

First of all, the Baltic ports are much closer to Belarus. For example, the distance between Mozyr (the second largest refinery centre in Belarus) and Klaipeda amounts to 783 km, while the distance between Mozyr and St. Petersburg comes to 1031 km. Secondly, Lithuanian and Latvian railways offer better services. Thirdly, such a re-orientation would involve additional logistical expenses.

Unfortunately, Russia is still playing a hard geopolitical game, and it will be difficult for Belarus not to get entangled in its eastern neighbour's ambitions. Therefore, the only remaining question is what toll these impending economic decisions will take on the Belarusian economy.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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Testing the Limits of Investment Crisis – Belarus

Economy Digest

On 25 August 2016 the National Statistic Committee of Belarus (Belstat) publicised new macroeconomic data for July, which showed that the economy is suffering from a lack of investment flows.

Meanwhile, according to the National Bank of Belarus the continuing decline of companies' profits threatens the financial stability of the country.

Finally, the CEO of "Great Stone" Hu Zheng tries to convince authorities of the profitability of the "Great Stone" industrial park, teaching Belarusians about high-level commercial science.

Economic Recession: Investment Drought

In January-July 2016 investment in fixed capital in Belarus has dropped by a fifth since the same period last year. Belarus has not witnessed such a decline in investment activity since the 1990s, a period of investment disaster in the economy.

2016 has brought a third straight year of investment drought, bringing the total amount of years of drought up to four over the last five years. Moreover, the process of investment "deforestation" is speeding up: from -5.9 per cent in 2014 up to 20.6 per cent right now (see Figure 1).



The main explanation lies in the economic structure of the Belarusian economy – the greatest "stake" still belongs to the

state. It thus continues to play the leading role in the investment scenario. As a result, the decline in investment expenditures of public industries has pulled down the whole investment activity in the country.

The second reason concerns foreign investors: they spend money mainly on sectors with high domestic demand – finance, communications, retail trade, restaurants, and so on. With the reduction of the "life-giving" source of superprofits the additional commercial investments have also greatly diminished.

Finally, in order to help the National Bank reduce inflation, the government has committed itself to cut funding of state programmes by approximately BYN28tn this year and by BYN20tn the next one.

Therefore, given the significant dependence of investment programmes of state enterprises on state funding, the government's hopes for an investment recovery in the following years seem dubious.

The Financial System: Destabilising Loss-Makers

According to Belarus's statistical agency Belstat, the profits of enterprises have decreased by a fifth in the first half of the year, while the number of loss-making companies has increased by a quarter compared to the same period last year. On 1 July 2016 the number of loss-makers reached 1,738 (or 22.8 per cent in total) and outperformed the corresponding figures of the previous year by 24.8 per cent.



On 28 July 2016 representatives of the National Bank said that the situation with loss-makers is even more complicated, as

over the last several years, in order to expand production, a large share of enterprises took out more loans without an adequate assessment of their ability to pay them back.

Correspondingly, in the first half of the year the amount of troubled assets in Belarusian banks doubled, thus increasing the risk of financial instability in the country.

Moreover, according to the National Bank, due to the devaluation of the national currency the debt burden (formed mostly by foreign currency liabilities) of the enterprises has increased significantly over the past two years.

As a result, the positive effect of the devaluation on price competitiveness of Belarusian exporters has been cancelled out. In January-July 2016 exports fell by more than a fifth in comparison with the same period last year.

Trade Policy: Low-ball from the Great Wall

On 5 June 2012 President Aliaksandr Lukashenka signed a decree on the creation of the Belarusian-Chinese industrial park "Great Stone," aimed at attracting over 100 companies from China and Europe. However, to this day only eight residents have agreed to participate, and only two of them have started the building process.

On 19 August 2016 the CEO of "Great Stone" Hu Zheng tried to dispel any uncertainty about the future of the project by claiming that the conditions for entering the project are too restrictive (the size of the company and its business area: electronics, pharmaceuticals, R&D, engineering, biotechnology, fine chemistry, new materials, warehouse logistics), which restrains investors.

Hu Zheng has suggested that the criteria for residents must

initially be relaxed and their areas of activity expanded. He gave several examples, including firms engaged in processing of raw materials on a tolling basis (for example, processing of stone or metal).

However, such "extraordinarily helpful" advice may turn the innovative project into a simple excuse to transfer the above mentioned [enterprises with low added value](#) (which are also potentially harmful to the environment) from China to Belarus.

Due to prohibitive tax benefits (10 years of "all inclusive" tax vacation plus a subsequent 10 years of half-priced tax bills) for the investors, acting on such advice could undermine the competitiveness of Belarusian enterprises, contribute to additional job losses of Belarusians and lead to even more severe budget problems.

In Belarus this is an unpopular position: the first Deputy General Director of the "Company for the development of the industrial park" Kirill Koroteyev has admitted that the primary aim of "Great Stone" is to attract only high-tech companies.

Thus, the government is still searching for additional sources of economic growth, preferring to bet on foreigners and forgetting about the entrepreneurial abilities of their own citizens. Meanwhile, investments continue to evaporate and additional fiscal risks threaten the financial stability of the country.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

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The Costs of the Economic Downturn – Digest of Belarus Economy

On 6 May 2016 the Chairman of the Board of the National Bank of Belarus (NBB) Pavel Kallaur disclosed the long-suspected information about problems in the banking system.

Two weeks later, the Prime Minister Andrei Kobyakov has called for market-based instruments in order to cure sinking state-owned enterprises (SOEs).

And on 22 May 2016 the Minister of Finance Vladimir Amarin has announced budget cuts appealing Belarusians to live within one's means. The Belarusian population is paying for mistakes made by the government focused on preserving inefficient state enterprises.

Toxic Assets: Bogging Down in Debts

On 6 May 2016 the Chairman of the Board of the NBB Pavel Kallaur has said that projected dynamics of troubled assets indicate a possible rise of bad debts for banking system in Belarus, but he assured that the situation stays manageable.

Meanwhile, the share of toxic assets in the Belarusian banks increased in March by 4.3 per cent consuming the 11.5 per cent of their total assets. As a result, its current level became the new high for the banking system of Belarus. The previous

record lasted only three months, when on 1 January 2016 the share of toxic assets of the Belarusian banks reached 6.8 per cent.

All these happened due to [high level of debt load of borrowers](#) and the continuing devaluation of Belarusian ruble that negatively influenced the ability of Belarusian enterprises to fulfill credit obligations to banks in time. For example, for the first three months of 2016 the share of loss-makers in manufacturing reached 34.2 per cent.

the rating agency Fitch Ratings the share of troubled assets will grow gradually even if in the second half of year the economy will begin to recover

Further, according to the rating agency Fitch Ratings the share of troubled assets will grow gradually even if in the second half of year the economy will begin to recover. However, 3 per cent GDP drop in the first four months of 2016 seriously questioned such a scenario.

Thus, the agency warned that in order to control the situation the special organisation aimed on operations with such assets should be established.

Market Reforms: Craving for Growth

According to the IMF forecast the Belarus's GDP will fall again this year by 2.7 per cent adding additional pain to economic misery of 2015, when GDP fell below the 2010 and 2008 levels reaching \$54.8bn in terms of average annual exchange rate of the NBB.

A small growth can start after 2018 and only due to the so-called "low base effect", when the fall reaches the bottom and

starts at least some minimal growth.

Meantime, taking above forecasts into account the Prime Minister Andrei Kobyakov on 18 May 2016 has proclaimed that Belarus urgently needs to speed up the involvement of the market-based instruments in next three directions – exports, employment and investment – to stimulate economic growth.

For export promotion Belarus's government expects to diversify sales equally in three destinations (Eurasian Economic Union, European Union, other countries) by 2020 in order to escape from overwhelming dependence on the economic situation in specific countries (first off all Russia).

As a result of [substantial reliance on eastern neighbour](#) trade balance considerably deteriorated (see Figure). Particularly, it damaged sales in the famous Belarusian export "Trucks" category – since 2013 the annual exports decreased by 64 per cent reaching only 3.9 thousand items in 2015.



Concerning labour market the government determined the employment target of 50 thousand new jobs as a priority for local authorities in Belarus. Finally, the investment program for 2016-2020 supposes attraction of foreign investments in the amount of \$30bn for the metallurgy, engineering, electronics, optics and ICT in the first place.

Public expenditures: Cutting the "Edges"

On 22 May 2016 the Minister of Finance of Belarus Vladimir Amarin has announced the reduction of budget expenditures by BYR15trn or about 7 per cent. The optimisation originally concerned non-priority items only (subsidies to local budgets and [reduction of financial support to SOEs](#)) without spending

cuts for social sector (salaries, social benefits and medicines).

The Minister claimed for effective use of budget resources in order to achieve greater results. However, experts doubted about such an emergency decision. According to Belarusian economist Sergei Chaly planned budget cuts represents actually a huge amount – any adjustments higher than 5 per cent may have a very depressive effect on the economy.

Later, on 27 May 2016 the Deputy Minister of Finance of Belarus Maxim Ermolovich has questioned the issue of reduction of public expenditures even further saying that the issue of social cuts still stay under pressure. According to him solution of this problem depends on the possibility to reduce capital expenditures, which are also of high priority for the government.

As a result, the pessimistic forecasts made by economists of the IPM Research Center (about 2.2 percent poverty increase in Belarus measured as the share of the population living below the absolute poverty line) may become a reality even faster and hit more than 7.2 per cent of Belarusians.

According to their opinion children and adults that due to any circumstances have the worst labour market prospects remain the most vulnerable population groups of Belarusians to risk of poverty.

Thus, it seems that the Belarus's economy still pays its bills for wrong economic policy decisions made in previous years. Overindebted state-owned "giants" and dragging down banking system leave no choice for government but to cut budget expenditures. Further, as it always happened the main costs for economic mistakes seem to incur by simple Belarusians.

Aleh Mazol

Belarusian Economic Research and Outreach Center (BEROC)

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The Long Road to Liberalization: Digest of Belarus Economy

On 29 March 2016 Prime Minister Andrei Kobyakov proclaimed the government's intention to speed up the long-awaited process of joining the WTO.

Moreover, after renegotiating different scenarios for pension reform in Belarus, the authorities have agreed to an increase in the retirement age for men and women.

Meanwhile, on 21 April 2016 President Alexander Lukashenka announced that it would be a tough year for the economy, all the while encouraging the government to accelerate its attempts to develop the economy.

WTO: Reforming the Negotiations

On 29 March 2016 Prime Minister Andrei Kobyakov announced that in the near future Belarus jointly with the WTO team would formulate final proposals and terms for the accession to the organisation. In September 2015 Belarus agreed to a WTO roadmap that includes negotiations with 40 countries.

Belarus has been trying to join the WTO since 1993. However, it is only now after almost a quarter of a century that the authorities have finally made the tough decision to speed up this process. The Belarusian government has taken such an "extraordinary" forward looking decision under pressure from the significantly negative internal and external macroeconomic shocks.

A [prolonged economic recession](#), the [skyrocketing negative trade balance with China](#), increased disagreements with Russia, the country's main trade partner, and the successful accession to the WTO of the other four members of Eurasian Economic Union (EEU) trade bloc prompted the Belarusian side to take the decision.

Moreover, Belarus has already met a substantial number of the WTO obligations by virtue of the participation of other EEU states in the trade organisation, including reduced customs tariffs and financial support for state-owned enterprises (SOEs).

At the same time, some trading partners are increasing import tariffs for Belarus, while others are still avoiding signing bilateral trade agreements with Belarus (for example, China). Therefore, in order to challenge tariff barriers and trade restrictions, accession to the WTO is becoming an irreversible process and one of the main challenges for the state.

Pension Reform: a Gradualist Approach

On 11 April 2016, in an effort to preserve the existing ratio of workers and pensioners, Lukashenka signed a new decree that increases the retirement age for the working population in Belarus. From 1 January 2017 the threshold for retirement will gradually increase by six months each year until it reaches 63

years for men and 58 years for women.

The [demographic problem](#) is the main reason for this reform. In Belarus there are ten people of working age for every four pensioners; by 2035, this number will increase to six. As a result, according to the Deputy Minister of Labour and Social Security Valery Kovalkov, from 2020 this trend will lead to an additional substantial burden on the budget. Thus, in order to solve this problem the government is encouraging economic entities to hire elderly candidates.

However, experts express doubts about the interests of employers in accomplishing such a task. According to Svetlana Korosteleva, director of consulting company Kvadrat, in Belarus there exists an unspoken age limit for new workers – approximately 45-50 years for both sexes. In most cases employers "fear" that older applicants will not be up to date with industrial trends, will have poor computer skills and perform tasks slowly.

Moreover, business owners that grew up in the 90s seem particularly "vulnerable" to age discrimination as they tend not to hire new specialists over 35 years. But such a "modern" practice of Belarus's businessmen strongly violates national labour legislation, which prohibits weeding out candidates by age, gender, eye colour and other traits.

Economic Growth: Escaping from Dreams

According to an analysis by Standard & Poor's (S&P) carried out on 10 April 2016, the additional economic problems that Belarus is experiencing are due to the low predictability and efficiency of its institutional system, the very weak external economic position of the country and a lack of flexibility of its monetary policy. S&P experts also believe that Belarus

will continue to experience an economic downturn (see figure 1).



Later, on 14 April 2016, the IMF in turn revised its forecast on the Belarusian economy. IMF experts think that Belarus's GDP growth in 2016 will decrease by 2.7 per cent, which significantly differs from their October 2015 estimates that predicted a contraction of 2.2 per cent.

However, the Belarusian authorities still forecast positive economic growth for this year. But in the past five years the government has accomplished none of the most important socio-economic indicators it identified. For example, official forecasts [assume five-year economic growth](#) equal to 62-68 per cent, but real figures foresee results more than ten times lower.

This has happened mostly due to the prescriptive, declarative nature of such indicators. In most cases local authorities consider such orders as non-binding obligations that do not correspond with economic reality.

In order to break up such a vicious circle, on 5 April 2016 Prime Minister Andrei Kobyakov announced substantial efficiency improvements in resource use by enterprises. From now on, a return on every rouble of investment constitutes one of the main goals of the new government's economic program for 2016-2020.

Additionally, the government has banned the popular practice of local authorities establishing prescribed economic indicators for state and private enterprises, which presupposed accelerated growth rates in previous years.

Thus, after two decades of "easy" solutions to big problems, Belarus seems to be reversing its economic course in the direction of a more liberalised economy, at least in the

labour market, trade policy and management of SOEs. But further, inevitable decisions are still waiting for the right moment.

Aleh Mazol, Belarusian Economic Research and Outreach Center (BEROC)

This article is a part of a joint project between Belarus Digest and Belarusian Economic Research and Outreach Center (BEROC)

Waiting for a Miracle: Digest of Belarus Economy

On 28 March 2016 the Council of the Eurasian Fund for Stabilisation and Development (EFSD) approved the provision of a new loan to Belarus.

In the meantime, the export and real estate market established new numbers of their record fall, questioning the limits of slowdown in Belarus.

In such a situation the government tries to secure state financial support – President Alexander Lukashenka has signed a new decree that grants funding only for profitable strategic investment projects.

Exports: Reaching the Bottom

According to new data announced on 21 March 2016 by Belstat, Belarus' exports in January has decreased by more than 20 per cent (in dollar terms) in comparison with the same month last

year to just \$1.6bn – the lowest level for one month since 2009 (see figure 1).



Moreover, exports declined for 16 straight months in a row. This happened mainly for three reasons. First of all, approximately half of Belarus' exports go to Russia, where growth has been under pressure since 2014.

Second, Belarus' main exports are positioned to markets outside the Eurasian Economic Union; this includes potash fertilizers and oil products. In January, the delivery of these items to foreign markets fell by more than a third in dollar value compared to the same period of the previous year.

However, according to the General Director of Belarusian Potash Company Elena Kudryavets, [the company \(Belaruskali\) increases its share in the world exports](#) and focuses on the real needs of the market while responding to changes in demand.

Next reason concerns refinery. Belarus exports about 14-15mln tones of oil products produced mainly from Russian crude oil and purchased at a reduced price. Therefore, the drop of world oil prices adversely affected the interests of Belarus – the lower world price, the lower the margin between the world and price for Russian oil.

Additionally, export prices for oil products has fallen more in comparison with world oil prices. As a result, foreign exchange earnings of Belarus from the sale of oil products in 2015 fell by 28 per cent compared with 2014.

Real Estate: Repeating the

Bubble

Deep recession and [big financial rescues for inefficient Belarus' state-owned enterprises](#) led to the downfall of households' incomes (nearly by half). However, right now the next wave of economic problems has reached the shores of Belarus' main private companies.

Starting in 2001, the rising oil prices marked the beginning of the "golden age" for real estate investments in Belarus. Sensing the smell of "easy money" local major entrepreneurs have started to turn into [real estate bosses](#). As a result, the average house prices in Belarus almost tripled by the end of 2013 (see figure 2).



However, since 2014 house prices dropped by more than 28 per cent – the nightmare for Belarus' real estate market.

The bubble occurred generally due to three motives: the overconfidence in stability of oil prices and the Russian market; steady growth of incomes of Belarusians subsidised by loose monetary policy of the National Bank of Belarus (NBB); and lack of other possibilities for profitable investment.

Moreover, Belarusian companies helped to ignite the fire of problems by themselves leading to the [rising debts of their operations](#) including real estate transactions.

Additionally, this situation plays both as a consequence of the economic crisis and a big reason for its continuance causing subsequent problems in the banking sector. According to the NBB, in February 2016 the amount of troubled assets of Belarus' banks increased once again and reached 10 per cent share of their whole assets.

State Governance: Swapping the Rules

Step by step the [state machine begins to change its main driving economic mechanisms](#). On 21 March 2016, a new Presidential decree, No.106, changed the system of formation of state programmes and the provision of state support to economic entities.

The main adjustments suppose the transition from an individual towards a programme approach for the granting of state financial support. It cancels the possibility of direct requests of the enterprise for additional financial resources in case of permanent economic troubles.

For now, the government provides financial resources only according to the strategic investment priorities of the economy and the possibility of the fulfillment of strict requirements for achieving efficiency targets.

As a result of such a daring decision, the EFSD, on 28 March 2016, approved the provision of \$2bn loan to Belarus in order to support the economic policy measures and structural reforms proposed by the government and the National Bank of Belarus.

According to EFSD's press centre, Belarusian authorities agreed to insure the control over the monetary policy, through implementation of flexible exchange rate policies and the achievement of a balanced budget. Moreover, structural reforms assume substantial increase in the share of compensated utilities by the population – up to 70 per cent by the end of 2017.

All these should add up to reduction in cross-subsidies and direct lending, playing an important role in the increase of competitiveness in the economy.

However, according to former NBB's Chairman Stanislau Bahdankevich, the economy, right now, is experiencing substantial difficulties with repayment of previously obtained loans (\$3.3bn only in 2016). The inability to accomplish such transactions means default for the economy; Bahdankevich believes that the new EFSD's loan is needed only to avoid such a negative scenario.

Belarus' economy still suffers from recession, stacked in debts enterprises, free falling exports and a declining real estate market. However, it seems that state authorities finally got some insight into the economic troubles and have started the process of finding a way out.

Aleh Mazol

Belarusian Economic Research and Outreach Center (BEROC)

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Belarus Struggles to Reduce Energy Dependence on Russia

At the end of 2015 Belarus published a new energy security concept according to which it remains a country with a critical level of energy dependence.

90 per cent of Belarusian energy imports come from a single supplier – Russia. Moreover, a third of export revenue is traditionally generated by refining Russian oil.

The authorities prefer to retain the status-quo as an easier

and conflictless strategy, but the need to strengthen statehood will sooner or later require a solution to this deep problem.

Dramatic energy dependence on Russia

As the newly published Concept notes, Belarus has a critical level of dependence in most aspects of its energy security. Currently, 90 per cent of imports of all energy resources come from Russia. Moreover, Russian natural gas accounts for 90 per cent of heat and electric energy production.

The growth of energy independence and diversification of suppliers should become a strategic goal for the government in the coming years. The new Concept sets concrete goals up until 2035. Belarus plans to reduce the share of Russia in its energy imports from 90 per cent to 70 per cent. Most strikingly, the government plans to reduce the share of gas in production of electric and heat energy from the current 90 per cent to 50 per cent.



Another related problem the authorities will have to deal with is high energy consumption in the economy. [The heavy industries](#) built in the USSR consume huge amounts of energy, and many of them work on decades-old, outdated technologies.

For example, Hrodna Azot, a chemical industry enterprise, consumes 10 per cent of all imported gas. Apart from high energy consumption, these demand large state subsidies and demonstrate low economic efficiency. Reform of these industrial giants would resolve a whole bunch of problems, but the government [seems unwilling](#) to do that due to high social costs.

Belarusian citizens will also have to change their energy usage habits. The population has for a long time enjoyed discounted prices on public utilities for home use, including energy, as a part of the government's social policy.

While an average Pole or Lithuanian has to pay \$160-170 for communal services, Belarusians currently pay only around \$40. This has caused much criticism from market reform advocates and international creditors of Belarus. Finally, the government has agreed to reform this sector and citizens are seeing their bills grow constantly.

Petroeconomy and the EEU market

In the last decade oil products have accounted for a third of Belarusian exports and brought in up to \$16bn of revenue annually. Together with potash, oil products [filled the Belarusian budget](#), allowing the government to keep a tight grip on the economy without introducing reforms, and preserving the loyalty of citizens.

Russia, of course, remains the cheapest and most profitable option for Belarusian oil refineries located in Mazyr and Navapolack. At times of economic tension, Belarus has in the past attempted to threaten Russia with turning to alternative sources of oil. In 2010-2011 Minsk shipped [oil from Venezuela](#) and Azerbaijan decision that had no economic grounds but brought political results eventually, as Russia returned to more favourable contract terms with Belarus.

However, the Belarusian oil business now faces a number of challenges. Belarus as a member of the Eurasian Economic Union (EEU) remains in an unfavourable position as regards oil consumption. The single market of energy resources in the EEU will come into force only in 2025, a condition that Russia

insists on and Belarus [strongly opposes](#).

More fundamentally though, the sector itself presents a bigger problem for Belarus. Reliance on Russian oil as a major export commodity means backwardness in other sectors, dependence on oil price jumps and of course the supplier. The current drop in oil prices and subsequent economic decline present a good lesson for the Belarusian leadership, but will they learn from it?

Will nuclear power plant increase energy independence?

In the early 2010s a new nuclear power plant (NPP) was proclaimed as the hope of the Belarusian energy sector. It is intended to cover a quarter of the country's energy needs, with its first reactor to be launched in 2018.

However, the case for energy independence in this instance looks doubtful, as Russia [remains the key actor](#) at all stages of the project's implementation. Russia provides its design, supplies its most important components, as well as the nuclear fuel. Finally, the whole project is financed by a \$10bn Russian loan.

An expert from the Institute of Energy at the National  Academy of Sciences who wanted to remain anonymous told Belarus Digest that Belarus can in fact purchase uranium elsewhere, but the issue of utilisation of exhausted fuel will remain nevertheless.

Besides, the NPP is located only 55km away from the Lithuanian capital Vilnius. This poses a number of other security threats which the Belarusian authorities prefer not to talk about. Lithuanian officials and NGOs have been criticising Belarus since the project's inception, saying that Belarusians have

not properly assessed the environmental impact of the NPP and do not want their neighbours to get involved.

Belarusians never witnessed a real public debate on the NPP, rather ridiculous for a nation that suffered dramatically from the Chernobyl disaster. Yet the plant may in the end prove to be the [lesser of two evils](#) compared to gas and oil dependence.

Can Belarus become energy independent?

Belarus remains trapped in energy dependence primarily because of the inertia of its leadership, who are scared to change the status-quo and implement sector reforms. High revenues from oil could be used to develop alternative and local energy resources, which Belarus uses to a minor extent. Belarus has natural resources which have fine energy potential: rivers, woods, swamps and biomass.

Energy efficiency, which the authorities like to talk about but fail to introduce, should become a technical standard in all spheres, from construction and transport to agriculture.

Alternative and green energy is the area where the European Union has vast experience and [will be eager to assist](#) in both expertise and financing. For example, the EU has allocated €8m for local development projects in 2014-2017, where energy is a priority area. Belarus could receive many more funds for green energy were it to demonstrate real interest in cooperation in this area.

Large enterprises with old energy-consuming technologies should be reformed and replaced by an economy based on small and medium business, the service sector and IT. In the long run, this would not only reduce energy consumption, but would also change the structure of budget revenues and dependence on

oil refineries.

Energy efficiency, which the authorities like to talk about but fail to introduce, should become a technical standard in all spheres, from construction and transport to agriculture.

Last but not least, Belarusians should learn how to save energy – something they had no need to know about in the state-run economy. Raising energy prices to market levels should be accompanied by comprehensive education programmes to teach the population how to live in a new energy reality.