

Can new companies replace state giants in Belarus?

Deputy Prime Minister [Uladzimir Syamashka](#) recently announced that full-cycle car production is to start in Belarus this month; this will be a first for the country. So far, only Chinese-designed cars have been assembled in Belarus.

Meanwhile, the holding Amkodor presented its first tractor at the Belagro exhibition on 6-10 June in Minsk. This means that the Belarusian government has made another concession to the privately-owned holding, allowing it to challenge the national industrial giant MTZ, which has manufactured tractors for many decades.

As most major Belarusian machine-building firms such as MAZ and MTZ struggle with problems, the government supports them to avoid social disturbances. Nevertheless, it also supports new projects, which create competition for existing enterprises and thus tacitly change the political economy of the state.

Chinese cars for Belarusian public servants

Once, there was a private-sector initiative to launch joint car production with the American company Ford and the Iranian company [Iran Khodro](#). Both projects were terminated after assembling only several hundred cars. Thus, the forthcoming launch of a full-cycle car production factory makes the joint Belarusian-Chinese project a remarkable achievement.



Assembly production of Chinese-designed [Geely cars](#) began in Belarus in 2013. The new factory, near the city of Barysau, is set to reach a production level amounting to 60,000 cars a year by the end of 2017.

From the outset, the government has emphasised that 90 per cent of these cars would be exported. Some exports to Russia and Kazakhstan have succeeded, albeit perhaps with Beijing's assistance.

However, Minsk has also taken measures to ensure sales within the country. In April 2016, president Lukashenka announced that 'There will be no imported cars for civil servants, except for the prime minister, vice premiers, and top-ranking officials,' and stipulated that only Geely cars manufactured in Belarus be used for state needs. Moreover, as *Tut.by* noted, the new law regulating taxi firms looks as if it compels taxi drivers to buy Geelys.

Shakutin rising

Another new project in the machine-building sector involves launching the production of a tractor by the holding Amkodor; this will compete with models offered by MTZ, a state-owned firm. The government has not only allowed [Alyaksandr Shakutin](#), a co-owner of Amkodor, to challenge MTZ, it even intends to use Chinese loans to fund the project, including construction of a new plant.

At first glance, this seems logical. Belarusian authorities consistently support the rising business empire of Shakutin. For example, on 24 May, Industry Minister [Vital Vouk](#) remarked on Shakutin's holdings Amkodor and Saleo's intention to invest

\$2.1bn in further expansion in 2016–2030.

Both holdings have enjoyed success. Saleo was established by Shakutin and his partners in 2014 as a firm producing hydraulics for mobile machinery which had earlier been imported. By now, as Vouk emphasises, 30-60 per cent of necessary hydraulics are manufactured in Belarus.

A patriotic business?

Shakutin emphasises that his business is all about manufacturing and insists on his patriotism.



The Belarusian web-portal *Tut.by*, however, has pointed out that a very large share of his firms' sales involve Belarusian state purchases. He has also acquired several formerly state-owned enterprises without competition and for little money. Likewise, Shakutin used to employ a number of formerly high-level Belarusian state officials, such as Lukashenka's former economy assistant [Siarhei Tkachou](#), BRSM (a pro-government youth union) leader Alyaksandr Nakhaenka, MAZ director Mikalai Kasten', transportation minister Ivan Shcherba, and others. This obviously strengthens his ties to the government, *Tut.by* points out.

Shakutin responds to these comments by emphasising his efforts to export, underlining that the factories he bought were destitute and he salvaged them. He also claims that he employed former officials because of their superb managerial qualities.

Nevertheless, Shakutin's ties to the government are obvious. For many years, he worked in the upper chamber of the Belarusian parliament and held a key role in the organisation of the pro-government Belaya Rus' movement. There has even been talk of [EU sanctions](#), as he is 'Lukashenka's oligarch.' However, this is an unfair characterisation, as Shakutin is [merely a tool](#) for the Belarusian leadership.

MTZ vs. Amkodor

The government's decision to allow Shakutin to launch a project which could have an adverse impact on a Belarusian state-run company must be understood in context. A number of older, state-owned companies are seriously struggling. While three years ago MAZ was producing 24,000 trucks a year, this year the enterprise expects to manufacture less than 11,000.



The government plans to provide financial support for the branch. On 24 May, Deputy Prime Minister [Syamashka](#) announced that the government was to invest \$500m in MAZ, and \$645m in Homselmash, an agricultural equipment manufacturer.

For 2016-2030, MTZ needs \$1.1bn of investments and has almost no funds of its own.

It will take Minsk a significant amount of money to develop the plant, but the struggle may succeed. The case of BelAZ has served as an example for the Belarusian government: it invested \$800m into the firm, which manufactures huge trucks. As a result, BelAZ developed new models and succeeded in increasing its share on the global market, which is now estimated at almost 30 per cent.

Between Russia and China

Where exactly Minsk will find the money to invest in its machine building industry remains unclear. Government officials refer, *inter alia*, to Chinese loans; [recent contacts](#) with Beijing also support this hypothesis. Less clear is how Minsk will involve Russia in developing Belarusian industry: will it strive to limit cooperation or will it be willing to give the Russians anything if they can save companies from bankruptcy?

Most probably, the government policy on Russian involvement will remain *ad hoc* and pragmatic. On 24 May, Deputy Prime Minister Syamashka revealed that during the recent [Belarus-Russian negotiations](#) on oil and gas, the two governments agreed to prepare proposals on three industrial integration projects – these concern the petrochemical and machine building enterprise.

In 2011–2014, Belarus and Russia had already agreed on five [industrial integration projects](#) involving the Belarusian firms MAZ, Intehral, MZKT, Pelenh and Hrodna Azot. In recent years, however, Minsk and Moscow have kept silent on these projects.



Minsk will certainly use cooperation with Russia to develop its machine building sector, but the Belarusian government is considering all its options. Thus, the authorities are promoting new privately-owned production projects. In the future, these could replace giants like MTZ. In addition, Minsk hopes to use China as a source of loan-funding and technology.

In general, the development and state support of [major Belarusian businesses](#) such as Shakutin's holdings resemble the famous post-WWII South Korean business conglomerates called *chaebols*, the most famous of which are Samsung and Daewoo. These helped the government adapt and develop the national economy in exchange for state support.

Creeping Signs of the Approaching Crisis – Belarus Economy Digest

The first half of the year has shown clear evidence that the Belarusian economy needs better incentives to revive its industrial strengths.

In July the authorities announced their plans to provide financial assistance to several "giants" of industry. However, this decision has cast doubts over whether or not other taxpayers will ask the same from the state.

Also, this month the government carried on negotiations with the IMF and Eurasian Fund for Stabilisation and Development and are seeking to attract additional potential sources of loans. After their preliminary meetings all parties have decided to continue consultations showing striking unity on the necessity of economic reforms.

Economic Data: Spinning Down

Belarus' GDP fell 3.3 per cent in first half of the year, which raises questions about the government's official

forecast growth rate of 0.7 per cent and fears that the country's efforts to bring a halt to the nation's current economic turmoil by the end of August may not be enough.

The hardest hit were mostly exporters to the Russian market

Belstat, the official state statistical body, released on 6 July its report on loss-making enterprises in Belarus for January-May 2015. Net losses for these enterprises hit around \$0.8bn and more than doubled in comparison with the same period from last year. The hardest hit were mostly exporters to the Russian market, where shrinking demand was compounded by the further decline of the Russian ruble.

Yet in June, in comparison to May, industrial production rose by 3.8 per cent. Manufacturing seems to be in better shape, while the industrial activity of Russia continues to shrink by 4.8 per cent. If Russia's economy does not start seeing a recovery in the near future, things will get nastier for its strategic partner as well.

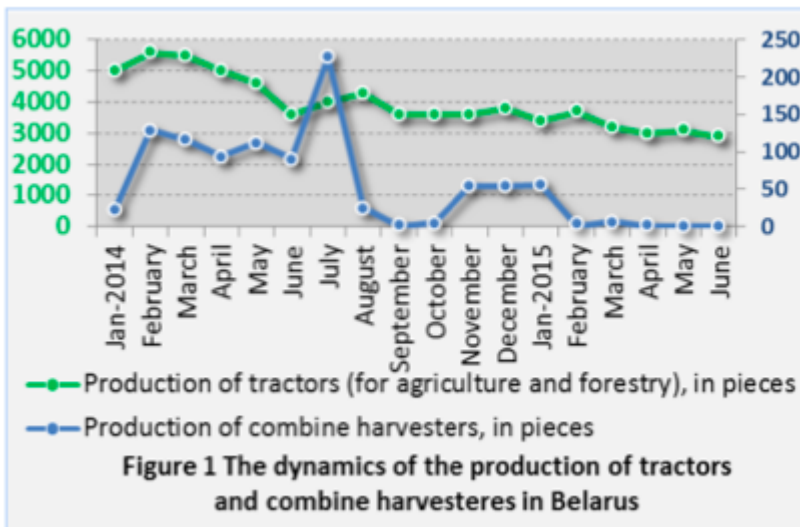
The problem of [wage arrears](#) presents a particular concern. According to Belstat, by the beginning of July 555 enterprises (mostly from the agriculture, hunting and forestry sectors) not paid 95,200 of their employees. The overall amount of overdue debt has increased from May by a considerable 37 per cent.

The numbers indicate that economic reforms are taking much too long. But where to begin? So far the government has failed to show a proactive approach to improve the situation.

State Support: Saving the "Giants"

Belarus' economy needs new ways to kick-start economic growth. However for the moment the government is relying mostly on increasing public borrowing. On 1 July, the President signed several decrees in order to support and stabilise the

financial and economic [situation at MTZ and Gomselmash](#) (see figure 1) – two manufacturing "giants" dragged down by low sales.



Given this grim picture, Belarus has clearly decided to bear the burden. The Ministry of Finance provides the main chunk of state financial assistance by issuing \$425.8m in foreign currency bonds. This currency injection is

supposed to act like a shot of adrenalin for Gomselmash – a leading manufacturer of combine harvesters and agricultural machines.

The MTZ, producer of a wide-range of tractors, is the second party to receive the states help, it will receive currency bonds worth around \$150m underwritten by the company's assets. Operations with these bonds are exempt from taxes, which in reality is a tax credit for those who will buy the bonds.

This mechanism, supposedly, aims to hide the prohibition of direct financing of the economy using the printing of the domestic currency in order to restructure the bad debts of the loss-making industrial "giants". Apparently, in terms of the current regime of monetary targeting a broad money supply, this will lead to its expansion, which strictly contradicts the IMF rules.

In light of this, the only way to get around the IMF's tough stance on this issue is the gradual closing of the pipeline of state support for all of the other collapsing manufacturers, meaning the remaining "giants" will be slowly edging their way towards extinction. However, in order to avoid the worst

scenario imaginable from unfolding, the government may decide to utilise a policy by which it would create artificial demand for "machines" by distributing them to other companies in the country and paying for them out of the national budget.

In any case, all of this unavoidably leads to more money printing, and, thus, creates the necessary conditions to jump start the next round of the familiar inflation-devaluation cycle.

New Credit Negotiations: the Long Way to Make a Deal

The IMF turned down Belarus' preliminary agenda of economic reform. The snail's pace progress on freeing up the economy and implementing reforms has cast doubts on a new credit line of \$3.5bn from IMF. The IMF calls for something more radical than just "formation of a legal framework" meaning the actual liberalisation of prices, a reduction in subsidies, the cancellation of mandatory plans for enterprises, and really carrying out privatisation.

In July Belarus tried to sell new promises of structural reforms to the Eurasian Fund for Stabilisation and Development

A deal with the IMF would help the country to pay for its imports and to refinance its previous debts. From the beginning of the year, Belarus' foreign-exchange reserves have shrank by 9 per cent from \$5,059m to \$4,620m, less than what is needed to pay for one month and a half of imports. Without a deal [debt payments during the year](#) will eat up more than half of the country's international reserves and leave it with less than one month's worth of imports.

In July Belarus also tried to reduce the tempo of their declining reserves by selling new promises of structural reforms to the Eurasian Fund for Stabilisation and

Development, but they were also largely unsuccessful. However, the real obstacles of negotiating with the Fund have always been the political constraints implicit in working with it, particularly when it is taken into account that Russia holds the largest share of power in it.

Nevertheless, in order to not sink the economy of its strategic partner, the Russian authorities approved a loan of \$760m for the repayment and servicing of Belarus' debts to Russia and the Eurasian Fund for Stabilisation and Development□.

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

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Why Belarus Struggles to Stop Subsidising Its Enterprises

This month, the Belarusian Ministry of Finance will issue bonds for \$425.8 million to bail out Gomselmash (abbreviation for Homiel Rural Machine Building), the most important industrial holding company of the second largest city in the country. The large cost of issue reflects the size of Gomselmash's problems.

The holding fails to sell its products, is reluctant to lay off people and cannot pay salaries to its employees. Many other Belarusian enterprises face similar problems. The state recently limited assistance to state-owned enterprises, which

still dominate the Belarusian economy but has no choice but to provide even more help.

The Main Problem of Homiel

In May, Prime Minister of Belarus [Andrej Kabiakou](#) stated that the authorities should assist Gomelselmash because it remains a Belarusian national brand. In fact, the factory has a long history: it emerged in the late 1920s, during the Second World War it was evacuated, but was still producing mines. After the war it became one of the five largest manufacturers of agricultural machinery in the world.

Today Gomselmash is one of the main companies of the [Homiel region](#). It has around twenty thousand employees and offices not only in the post-Soviet region, but also in China and Argentina.

Now the plant is going through its worst times. Sales fell several times, and the plant shortened its employees working week to four or three days in winter, spring and summer. The reduction in sales was primarily a result of the economic crisis in Russia and high prices. Salaries in the company fell by 3-4 times. Moreover, the number of staff members decreased by 10% in one year only

Holding Companies	The number of employees in 2014	The number of employees in 2015
OJSC "Gomselmash"	9492	8203
OJSC "Gomel Plant of Foundry and Fasteners"	4755	3810
OJSC "Research and Development Centre of Combine Harvester Engineering"	683	600

OJSC "Svetlogorsk Machine-Building Plant"	251	251
OJSC "Gomel Factory of Special Instruments and Technological Equipment"	no data available	no data available
OJSC "SP-Build"	no data available	no data available

Data: Ministry of Finance

The enterprise appeared at second place among the most unprofitable enterprises in Belarus in the first quarter of 2015. The newest data remains unavailable, but introduction of the bailout program means that the second-quarter results can bring no difference.

Gomselmash is no longer able to service its loans or cover the costs of electricity and gas necessary for production. Gomselmash cannot even issue its own bonds, so the Ministry of Finance would have to do it instead. Minsk Tractor Plant, who will also get help this month.

Unstoppable Belarus

Belarusian authorities believe that Gomselmash remains too big to let it fall. Belarus, however, no longer has the money for direct state subsidies, as the amount of [exchange reserves](#) does not allow to keep printing money. Therefore, the authorities came up with the idea of issuing bonds for \$425.8 mln that will be acquired by four banks.

Without this state aid Gomselmash would be unable to pay its debts and that would lead to serious problems in the banking sector

According to [Aliaksandr Chubrik](#), Director at IPM Research Center, "this measure does not contradict to stabilization efforts of the authorities and is in line with their general

approach: not to allow further aggravation of problems in financial sector". Without this state aid, he told Belarus Digest, Gomselmash would be unable to pay its debts and that would lead to serious problems in the banking sector. Therefore, Belarus subsidises state companies to keep them afloat, even though these same enterprises led the economy to the current state in the first place.

The International Monetary Fund, that is currently negotiating a new program with the Belarusian authorities, could as well, according to Chubrik, understand the reasons behind the help to Gomselmash. Moreover, the Belarusian authorities never promised to stop enterprise bailouts and start economic reforms. And possible donors, like the IMF, know that things cannot change for the moment.

Keeping the Status Quo

Given the state of Gomselmash, it makes sense that the Belarusian authorities decided to help the holding. However, these tactics will probably not save it, but rather increase its debt and worsen the economic situation of the whole country.

Today, Gomselmash's problems are associated with low levels of innovation, but the money it will receive will not go to research and development. The law signed by [Lukashenka](#) does not provide extra subsidies for Research and Development of the Centre of Combine Harvester Engineering, Gomselmash's R&D subsidiary. The poor quality of machinery does not appear to bother the authorities at all.

Most major enterprises in Belarus belong to the state and, according to the Ministry of Finance, a quarter are not profitable

According to Chubrik, the money will go to pay off previous

debts and to ensure the basic functioning of Gomselmash. However, it remains unknown whether the holding will be able to upgrade its production or repay its debts. It also seems that this is not the last check picked up by the government for the company.

The bailout of Gomselmash would not be a topic for discussion if it did not open the gate for other enterprises to seek government money. Most major enterprises in Belarus belong to the state and, according to the Ministry of Finance, a quarter are not profitable. They certainly would like to have some financial help from the state.

According to a report released this month by the Ministry of Statistics production in machine building fell by 20%, while in rural machine building, as in case of Gomselmash, it fell even further.

The situation clearly shows the dilemma that Belarus faces: if it wants to keep the economy afloat, it has to continue to subsidise its enterprises. Other options, like privatising or discussing how to restructure dysfunctional enterprises with the IMF's help, remain on the table, but the authorities remain reluctant to choose them.