

The Unwanted Economic Union in Exchange for Money – Digest of the Belarusian Economy

The main economic events for October in Belarus revolve around Russia: the ratification of the Eurasian Economic Union, the continued fighting over the re-export of banned European foodstuffs to Russia, and, finally, an argument over Russia's oil tax manoeuvre.

Russia's actions, both political and economic, further complicate the situation with the Belarusian economy, which is exhibiting subpar growth for the third year in a row. Ironically, its troubled economy is forcing the Belarusian government to seek even more assistance from Russia.

Eurasian Economic Union and the Oil Tax Manoeuvre

The complicated economic relationship with Russia was front and centre in news coverage during October.

As the Belarusian Parliament was contemplating the ratification of the Eurasian Economic Union (EEU) trade pact, Russia threatened the economic stability in Belarus with its [oil tax manoeuvre](#). Under the terms of their bilateral agreement, Belarus has to pay an oil export tariff into the Russian state budget for an oil refinery product produced using Russian oil and that is destined for export.

Before signing the EEU agreement in May, Belarus negotiated a \$1.5bn discount on its oil tariff payments for 2015. But afterwards Russia de facto annulled this preferential deal with its oil tax manoeuvre, a move which partially replaces

the oil export tariff with an oil extraction tax. Instead of saving \$1.5bn in 2015, Belarus would have to pay basically the same amount back to Russia, effectively eliminating much of the income it hoped to bring in.

Belarus has zero interest in Eurasian integration unless Russia is going to pay for it

The disappointment surrounding the Russian ban on EU foodstuffs, which turned out to be not as profitable for Belarus as it had hoped (in particular, [TIR business has suffered](#) and the potential for re-exporting goods was significantly lower than expected), this tax manoeuvre has Belarusian society and the government questioning its choice of integration projects.

Just days before ratifying the trade pact, Russia made a promise to compensate Belarus for the oil tax manoeuvre, though how much it plans to offer has not been specified. Despite these issues, this conflict made one thing clear (and Lukashenka later spelled it out during a press-conference for the Russian regional media) – Belarus has zero interest in Eurasian integration unless Russia is going to pay for it.

Growth Still Slow as the Russian Economy Stagnates

In January-September 2014 the Belarusian GDP has grown only 1.5 per cent. The expected gains from the Russian EU food import ban did not materialise in August or September – the food processing industry is still stagnating, witnessing a 1.9 per cent decline in output.

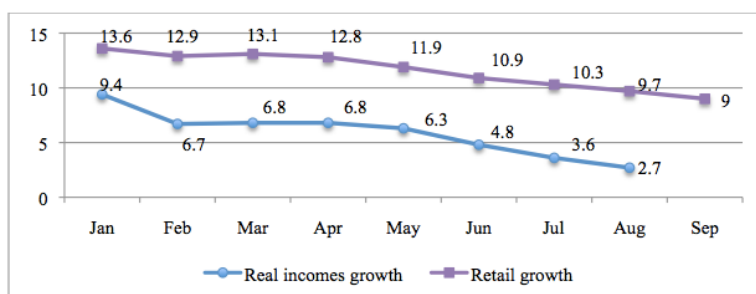
But the other branches of the economy are experiencing decline as a result of the shaky economic situation in Russia. The production of goods traditionally exported to Russia – for example, machinery, transport vehicles or consumer goods like TV sets or refrigerators – has declined substantially.

Exports of these investment goods (machinery etc.) have also dropped due to the high level of economic uncertainty and a lack of financing in Russia, which is itself a result of declining levels of investment. An additional factor affecting the overall economic environment is the devaluation of the Russian rouble, which makes Belarusian goods relatively more expensive in Russia.

The exchange rate factor drives down consumer good exports as well. Moreover, it puts additional pressure on the Belarusian rouble, and the National Bank is already considering whether or not to increase the tempo at which the national currency is devaluated.

Trade, and, in particular, retail remains the main driver of growth in the economy. Retail is developing dynamically due to both the partial liberalisation of the sector and to a high level of income growth. However, as real incomes slow down, retail is slowing down as well. Over 2014 the real income growth declined from 9.4 per cent to 2.7. Retail is reacting with its own slowdown, declining from 13.6 to 9 per cent over 2014 (see Figure 1), and the expectations for the next year are similarly discouraging.

Figure 1. Slowdown in real incomes and retail in 2014



The worsening economic situation in Belarus, ironically, forces it to look for more financial support from Russia. Belarus still needs financing to repay its loans in 2014 and 2015.

Russia is currently facing financing constraints itself, given

the sanctions its largest banks are dealing with. Nevertheless, it promises to help, but with strings attached, of course.

On 21 of September 2014 Russian Prime Minister Dmitriy Medvedev during a visit to Minsk emphasised that Russian corporations are hoping to privatise several Belarusian state enterprises. The enterprises in question are, among others, the truck manufacturer MAZ, the electronics company Integral, military equipment producers MKTZ and Peleng, and the nitrogen fertiliser manufacturer Grodno Azot.

While experts and international organisations, including the IMF and WB, have long advocated for the privatisation of these enterprises, the sale to Russian state corporations would only bring about modest increases in efficiency at best.

A Surge in Bitumen Exports

Bitumen sales schemes are starting to replace the old solvent sales schemes of 2012. Bitumen is a semi-solid that is extracted from heavy crude oil during the refining process and is more commonly known for being used in asphalt. In 2014 Belarus will still be required to make oil export tariff payments for exporting oil refinery products made from Russian oil. It turns out, however, that certain kinds of bitumen are not on the list of refinery goods.

exports of bitumen are disguising exports of other refined oil goods in an attempt to avoid paying export tariffs

In the first quarter of 2014 the exports of bitumen from Belarus increased by 182%. Moreover, according to official statistics the production of bitumen is two times lower than its export figures. From this, one may deduce that the exports of bitumen are disguising exports of other refined oil goods in an attempt to avoid paying export tariffs.

The scale of the operation so far has fallen short of the [solvents smorgasbord](#) of 2012. The Russian side has already expressed its concerns and initiated the creation of the working group to investigate the issue. Thanks to the oil tax manoeuvre, the bitumen scheme will become irrelevant in 2015, and Belarusian refineries will have to find other ways to survive.

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

Can Belarus Retaliate Against New US Sanctions?

Today the U.S. Department of the Treasury sanctioned four Belarusian enterprises of Belneftekhim Concern, Belarus' largest petrochemical conglomerate. Sanctions hit some of the most profitable state-owned companies in Belarus – OAO Naftan, OAO Grodno Azot, JSC Grodno Khimvolokno and OAO Belshina. The U.S. government froze all assets of these companies within its reach and prohibited U.S. persons from engaging in commercial or financial transactions with them.

Ironically, today Belarusian President pardoned nine [participants](#) of December protests against falsification of presidential elections. Names of those pardoned have not been released yet and it is unclear whether some of the former presidential

candidates will be released. According to Belarusian official press, they wrote personal requests to President Lukashenka asking to pardon them.

Although most of the sanctioned companies do little business in the United States, losses to the already struggling Belarusian economy may be significant. Belshina is one of Europe's largest tire manufacturers. Naftan is a subsidiary of Belneftekhim Concern that produces petroleum products. Also a subsidiary of Belneftekhim Concern, Grodno Azot and Grodno Khimvolokno are Belarus' largest petrochemical plants manufacturing fertilizers, fibers and consumer goods. Belarus Government will have to privatize some of its most lucrative enterprises because of the economic crises. Being on the U.S. sanctions list will certainly make these companies less attractive to investors.

Since 2007 the United States targeted several companies affiliated with Belneftekhim for being owned or controlled by Belarusian President Alexander Lukashenka. The U.S. sanctions against undermining democratic processes, human rights abuses and political oppression in the country. Today the State Department reiterated its call on the official Minsk to release immediately and unconditionally all political prisoners.

Proponents of sanctions [argue](#) that they are the only language which the official Minsk understands. Unlike Europe, the United States has almost no economic interests in Belarus and can afford wide-scale sanctions. Earlier this year Europe also introduced economic sanctions against but they [stopped](#) short of any serious measures. Europe depends on oil and gas transits through Belarus. More importantly, it is difficult for all EU member states to reach consensus on how to deal with Belarus. It appears that in the United States both Democrats

and Republicans are committed to follow the same tough policy towards Belarus.

What can do Minsk in response to the new US sanctions? In 2007, following the introduction of the US sanctions, most of the US Embassy staff had been [expelled](#) from Belarus. This time, Belarusian authorities will look for ways to retaliate again but they may be too [weak](#) to escalate the conflict. The country is in the midst of the worst economic crises since the collapse of the Soviet Union and is eagerly [looking](#) for financial aid. Perhaps the only move which the official Minsk could do would be to expel the remaining U.S. diplomats from Minsk.

However, this will not inflict any serious damage to the U.S. interests in the region and will shut down opportunities for direct communication with the world's only remaining superpower. Belarusian authorities still [hope](#) to obtain a loan from the International Monetary Fund, which the United States can easily block.

Official Minsk may also further strengthen repressions against political opponents to demonstrate that they are undeterred by the new sanctions. Under this scenario, Belarus may lose more than gain. This will make the prospect of normalization of relations with the West even more remote. However, when balancing the prospects of losing power and normalizing relations with the West, Belarusian authorities may opt for political survival and more dependence upon Russia.

When Belarusian authorities intensify human rights violations and the West imposes sanctions in response Belarus' dependence upon Moscow [increases](#) even more. Moscow comes out as the only geopolitical winner for the time being.

Regardless of possible long-term efficiency of sanctions, the West should not overlook a more important task of [supporting](#) civil society in Belarus. Weakening the Belarusian regime is

easier but not necessarily more effective than strengthening a real alternative to it.

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