

# The Baumgertner Affair: an Oligarchic Win-Win

A nearly four month long “potassium war” between Minsk and Moscow has come to its logical conclusion. It has provided another example of Russia provoking Belarus' president and then quietly accommodating him.

As Uralkali manager Vladislav Baumgertner found himself back in Moscow, both Lukashenka and Putin have reason to celebrate their under-the-table potash deal. The Kremlin has successfully navigated yet another nagging conflict with its problematic ally, while Lukashenka has eliminated a serious economic threat to his power, a conflict that was created by a now-disgraced Russian oligarch.

## **History of the potassium dispute**

The potassium conflict between Russia and Belarus broke out in July 2013. Uralkali, the largest Russian potassium producer that was controlled by the oligarch Suleyman Kerimov, broke off its consortium with the state-owned Belarusian potassium monopoly Belaruskali on 29 July.

The reason for the break-up turned out to be the incompatibility of each companies' respective sales strategies, as both accused the other of selling potash bypassing their agreed upon joint sales channel. Despite the increasing competition on the global potassium market, Belaruskali insisted on maintaining high sales prices. Uralkali, which controlled the sales channels of the consortium, insisted on lowering the sales price and planned to compensate their losses by increasing the amount of potash mined.

In the wake of the break-up of the consortium, which

controlled over 40% of world potassium sales, the global potassium market has slumped. Major potash consumers in India, China and Brazil postponed their purchase orders due to market instability and expectations that potash prices would soon start to plummet. According to Bloomberg, third-quarter sales of Potash Corp., the largest competitor of Belaruskali, fell 29 percent.

In response to Uralkali's move, the Belarusian Prime Minister Mikhail Miasnikovich invited a high profile Russian delegation to discuss the potassium affair. On August 26, Baumgertner arrived in Minsk alone and, following a heated conversation with Miasnikovich, was [arrested and put in a high-security KGB jail](#).

### **Baumgertner: hostage or pawn?**

Lukashenka's decision to imprison a prominent Russian manager seemed erratic and inflammatory. However, the Kremlin reacted in a surprisingly restrained way. This happened for two major reasons.

First, Moscow realised that Kerimov's desire for higher and quicker profit spelled political trouble for Lukashenka. The export of potassium, along with oil refinement, remain the two main pillars of the contemporary Belarusian economy. In 2012, the net profit of Belaruskali exceeded \$770m, a company that provided nearly 19,000 working places. The disruption of potassium exports would have devastating consequences for the Belarusian economy and constitute a direct threat to Lukashenka's power.

Vladimir Putin learned a bitter lesson of what precisely a cornered Lukashenka is capable of during

However, Vladimir Putin learned a bitter lesson of what precisely a cornered Lukashenka is capable of during the 2010 summer time gas war, when Russia suffered serious image damage

internationally and seriously faltering relations with Belarus. This explains the Russian president's reaction to his October meeting with Lukashenka, where Putin claimed he "wanted to solve the problem, not [reach a] deadlock, which can easily happen if we start an uproar [over the issue]."

Second, and perhaps equally important, Lukashenka has proven to actually possess the evidence necessary to prosecute Uralkali's management. In another aggressive move, he made the evidence public and requested Interpol to issue arrest warrants against Uralkali's top management. On November 22 the Russian prosecutor's office ultimately brought forth charges against Baumgertner after Belarus' concerted campaign.

### **In search of a solution**

Baumgertner's arrest caused a stalemate. Lukashenka craved personal vengeance against Kerimov, sought guarantees against a repeat of his tactics and demanded compensation for Belaruskali's losses. On October 11, during an interview to Russian journalists, the Belarusian president named the nationalisation of Uralkali as his preferred option.

The Kremlin, on the other hand, had different ideas. On September 13, a leak that made international headlines announced the purchase of Kerimov's Uralkali shares by banker Vladimir Kogan, a Putin associate. This solution satisfied no one. Kerimov deemed the proposed purchase price of \$3.7bn too low. Lukashenka lacked guarantees that Uralkali would not again become the target of speculative deals.

However, the deteriorating economic condition of Belaruskali undermined Lukashenka's bargaining power. The company lacked a sales network and faced the potential defection of its top management. As a result, in September 2013 Belaruskali's potassium production plummeted 44.5% to September 2012. A year-to-year decline in October 2013 constituted a weighty 14.2%. This prompted Lukashenka to seek a compromise.

## **Striking a deal**

Both sides reached a deal in November. Kerimov's share in Uralkali would be purchased by Mikhail Prokhorov, who, like Kerimov, is close to the Medvedev clan. This way its most important mining asset remains in its pool of resources. Besides, Prokhorov is seen as a long-term investor who has enough of his own capital to finance the deal.

Lukashenka found the guarantor for his side of the deal in Dmitry Mazepin, the owner of the second largest producer of nitrogen fertilisers in Russia. Mazepin intends to buy the shares of the minor partners of Kerimov – Filaret Galchev and Anatoly Skurov, which come to a total of almost 12% of Uralkali's stock, plus an additional 8% from unnamed holders. With nearly 20% of stock in hand, the oligarch will de facto call the shots in Uralkali, as Prokhorov lacks experience in the mining business.

A native of Minsk, Mazepin started as a Belarusian bank manager in the early 1990s, later moving to Russia to get into the oil and mining business. Lukashenka is looking to him to secure the terms of the deal in the long run and oversee the rapprochement between Uralkali and Belaruskali.

## **Back to the potash business as usual?**

There is little doubt that the new owners of Uralkali will try to reverse the damage done by the potash conflict and restore the broken consortium. Despite this, Belaruskali will hardly repeat its streak of extremely high profits that it enjoyed in the 2000s.

As the global potash market is becoming more competitive, the old strategy of limiting supply to maintain high prices will give way to a more open market, meaning falling profit margins. Neither will the new consortium be a carbon copy of the old one.

As Uralkali has emerged out of the potassium conflict relatively unscathed, it will inevitably act as the leading partner in the consortium. And as the economic situation in Belarus deteriorates, the next big thing in the potassium market may be the takeover bid for Belaruskali by its resurgent consortium partner.

*Alexander Martynau*

---

## Stabilisation of Inflation and the Potassium Conflict – Digest of Belarus Economy

In August and September, the general public's attention was focused on the dispute between Belaruskali and Uralkali, the world's two largest producers of potash fertilisers. The conflict between two economic entities created additional difficulties for the Belarusian potash industry, as well as stimulated lower prices on the global potash market.

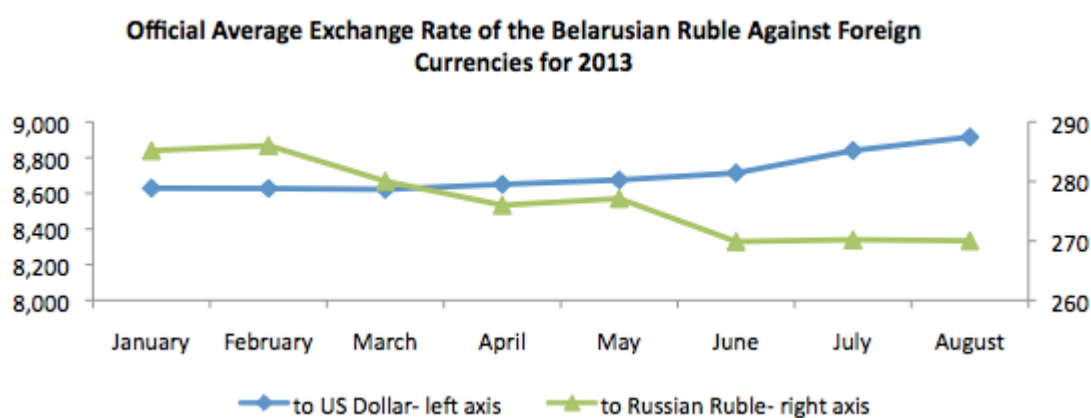
At the same time, positive trends occurred on the foreign exchange market domestically among **Belarusians** as the demand for foreign currency decreased. The end of the holiday season and the growth of deposit interest rates helped to reduce demand. The suspension of consumer price growth is also a positive factor.

### **Improvement of the foreign exchange market dynamics**

There were positive developments in the foreign exchange market locally in August. During the summer period the increase in net demand of foreign currency from citizens was the main problem in this segment of the foreign exchange market. While in April-May the population sold on a net basis

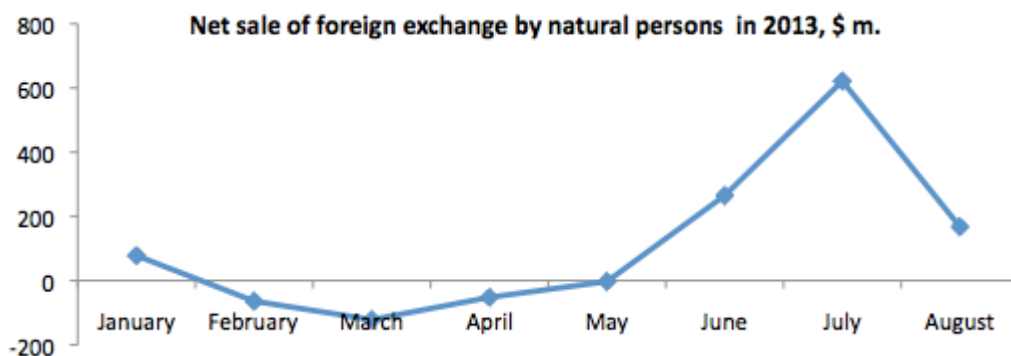
about \$194m, in June-July 2013 net demand amounted to \$886.6m. These fluctuations were the result of several factors.

First of all, fluctuations in the Belarusian ruble increased in June and July. On the one hand, the smooth nominal devaluation of the exchange rate of the national currency is a natural process under the conditions of the moderate rate of inflation in any country. However, even a relatively weak depreciation contributed to the growth in demand for foreign currency by citizens that was caused by a very low degree of confidence in the national currency.



The holiday season was also a stimulating growth factor in the demand for foreign currency. People are more actively go abroad during summer which directly leads to an increase in personal expenditures in foreign currencies. Finally, another important growth factor of purchasing foreign currency was an interest rate decline on ruble deposits in May-June.

The decreasing attractiveness of bank deposits in Belarusian rubles in the context of strengthening fluctuations of the Belarusian ruble against foreign currencies helped to stimulate people to transfer part of their ruble savings into foreign currency savings. As a result, in July, there was a reduction in citizens' deposits in Belarusian rubles by 7 per cent, while foreign currency deposits increased by 4.4 per cent.



The situation improved in August. Although the demand for foreign currency by the population still exceeded supply, its volume significantly decreased. Net demand came to \$167m in August. The positive dynamics are due to the end of the holiday season and to the increasing attractiveness of deposits in Belarusian rubles through some growth rates on ruble deposits. In addition, the slowdown in real income growth influenced the dynamics of demand. It is expected that this positive trend will continue in the currency arena.

### **Ambiguous Situation in Chemical Industry**

One of the commanding positions in the nation's industrial production belongs to the chemical industry. JSC Belaruskali – one of the world's largest producers and suppliers of potash fertilisers is one such example. Belaruskali is a GDP-bolstering enterprise and overall it is the largest exporter in Belarus.

Starting this year, the chemical industry experienced several difficulties. Thus, the volume of industrial production in January-July 2013, when compared to the same period in 2012, decreased by 26.5 per cent. One of the reasons for this decline was a drop in potash fertiliser prices in foreign markets.

The collapse of the union of Belaruskali and Uralkali contributed to a further reduction in the industry's prices. Since the beginning of the conflict between the two companies supply prices of potash fertilisers on the world

market have already declined by 15-20 per cent, which will undoubtedly affect the future results of the Belarusian potash producer.

The need for the rapid development of its own retail network is an additional problem for Belaruskali. In the aftermath of the termination of the joint trade agreement between Belaruskali and Uralkali, known as the joint stock company Belarusian Potash Company, the Belarusian potash producer has to build a goods-producing network independently.

The company is trying to get out unscathed of this difficult situation. So, a decision to create a new trader Belaruskali – JSC Belarusian Potash Company has been already made. A presidential decree has also removed the levy on export duties from 1 September 2013 to 31 December 2013 to ensure that Belaruskali stability with its operations. The duty was €75-85 per ton of potash fertilizers. The amount of the fee depended on the country of destination.

These measures will undoubtedly contribute to an improvement in the company's work and its competitiveness. At the same time, the undeveloped goods/production network and ambiguous situation with the price of potash fertilizer remain the main challenge in the short term for Belaruskali.

### **Slowdown in Inflation**

The limitation of price increases remains one of the priorities for economic policy. Here should be mentioned a record decline of inflation occurred in August. In the reporting month in relation to July 2013 consumer prices were up by 0.1per cent only. Slowdown in inflation is partially due to seasonal factors. Traditionally, there is a decrease in prices for fruits and vegetables in summer, which undoubtedly influences the overall dynamics of prices. Indeed, food prices in August fell by 0.6 per cent mainly due to lower prices for fruits, vegetables and potatoes.



Base consumer price index, which excludes changes in prices for individual goods and services regulated by the state, as well as seasonal goods, grew by 100.8 per cent over a month. In August 2012 this figure amounted 101.7 per cent. Thus, even taking into account seasonal factors, the rate of inflation in the country in August compared with the same period of last year, slowed down.

The prices for services increased most rapidly in the post-crisis period. Increase in prices for services amounted to 119.2 per cent during eight months of 2013. One of the reasons for the rapid growth is a gradual increase in state prices for utility services and public transport. Compensation of costs associated with these services have remained at a low level in Belarus.

*Anastasiya Luzgina, Belarusian Economic and Outreach Center (BEROC)*

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