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Economic Problems Faced by Belarus

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Rapid price increases in Belarus — involving especially food products, utilities and fuels — are a major drag on the population. A fall in foreign exchange reserves is another serious problem affecting the economy. The resulting urgent need to attract foreign investments, loans and assistance in conducting structural economic reforms in the country may therefore offer a chance for the European Union to increase its leverage on Belarus.

Rising Prices and Falling Foreign Reserves. For several months now, the prices of staple food have been on the rise, reflecting international market trends and also economic inefficiencies at home (especially in agriculture), a high degree of the economy's centralization and pervasive state ownership. The private sector's share of the Belarusian economy stands at around 25%, but this also includes the formally incorporated enterprises where the state retains a majority stake.

Rising most rapidly in February (compared to January) were the prices of potatoes (7.2%), cereals (increases by between 6.3% and 32.5%), vegetables, fruit, meat, milk and dairy products, hardly pressing the Belarusians who earmark 37.8% of their expenditure on food (against some 25% in Poland). There were also increases in utility prices, especially natural gas (up 83.7% in February), water supply and sewerage (up 14.6%) and electricity (up 12%). This put the inflation rate, counted against December 2011, at 4.2% after two months, or half the government's target for the whole year. And given the fuel price increases by dozen-odd percent in March, this rapid pace is going to continue. Belarusians' financial flight is further worsened by a fall in wages, with the average pay dropping in January by 8.8% from December, to reach 1, 410,000 Belarus rubles (USD 468).

In addition to accelerating inflation, the Belarusian government has to cope with a steep decline in the country's reserves of foreign exchange, which have been on the decline for five months, shrinking by USD 1 million (to USD 4 million) just between 31 December 2010 and 1 March 2011. Merchandise trade deficit reached USD 902.6 million in January (following a 13.1% drop in exports and a 36.7% rise in imports, as against a month earlier), which signals a durable trend, after a USD 7,425 million deficit registered for the whole 2010.

Petrochemical Sector Problems. Serious problems over the past two months also affected the strategic sector of petrochemical products, where a third of the country's GDP was generated in 2009. Its revenue has been used by the government to cross-subsidize unprofitable enterprises like state-owned farms. Refineries' lower income came as a result of higher prices paid for inputs imported from Russia, which reflected not only the global tendencies but also a dispute between the two countries. The price Belarus pays for a ton of oil was raised by USD 46, which Russia put down to an increase in Belarusian transit charges on Russian oil exports. And the oil price dispute also prodded Russia to substantially lower the level of shipments, thus adversely affecting the profitability of Belarusian operations. It fell 4% from December 2010, reflecting lower throughputs at Belarus refineries which had no access to other supply sources and therefore had to process much lower amounts of crude oil. And the energy-devouring economy was additionally hit by rising prices of natural gas shipments from Russia (up 17% in Q1 2011 against Q4 2010, to reach USD 230 per 1000 cu.m.).

Projection. The pace of inflation is unlikely to slow anytime soon, especially given the removal of price controls for most goods and services in February, and the upward trend in fuel prices.

The government will seek to restore the profitability of oil refineries, which is key for the economy as a whole, and it planned an increase in oil imports to 26 million tons in 2011 (from the previous level of 22 million tons). This signifies an increased importance of the Ukrainian pipeline linking Odessa and Brody, through which Azerbaijani oil has been pumped to the Mazyr refinery since 14 February 2011 (as part of a swap deal in exchange for Venezuelan crude).

The currency reserve problems and aversion to ruble devaluation force the Belarusian government to look for foreign financing. Therefore, despite tense political relations with the EU, the US and Canada, most likely it will be seeking a loan from the International Monetary Fund. Belarus will also show interest in support from institutions such as the European Bank for Reconstruction and Development, the World Bank, or the European Investment Bank (whose previous credit line has been suspended due to political considerations). But such prospects are hardly rendered any more realistic by the increasing scale of violation of human rights and civil liberties in Belarus.

The regime's interest in western credits also reflects the quality of the country's relations with Russia, which are marked by a great deal of distrust and thus make it unlikely for Belarus to get access to the anti-crisis fund of the Eurasian Economic Community. It is true that the government could sell to Russia the key Belarusian companies, such as the oil refineries, but that would be a move of last resort, helping to stabilize the foreign reserves level only in the short term. In the longer run, the regime would lose a source of revenue with which to finance loss-making companies — and the profit-minded Russians would not be interested in subsidizing inefficient sectors. The restructuring of the companies they did purchase will very likely lead to cuts in employment, thus stirring public dissatisfaction and, possibly, reducing the support for Lukashenka from the local *nomenklatura*.

In parallel, the macroeconomic problems will be affecting citizens' finances, and unless the government manages to check the price growth, public dissatisfaction will be on the rise, with the president's popularity sinking.

Recommendations for the EU. Belarus's economic problems should be used by the European Union to intensify its attempts to democratize the country's political and economic system. Two scenarios bear consideration.

The first is to impose economic sanctions against the regime, targeting the biggest revenue earners among Belarusian companies, such as oil refineries, potassium mines and nitric fertilizer plants. On the one hand, that would cause major economic problems for Belarus and bring down the citizens' already low living standards, but on the other it would speed up an outbreak of mass-scale public anger and force the regime to either step down or embark on a far-reaching program of political liberalization.

The other option is to negotiate political reforms and economic liberalization with the regime. In this scenario, the EU should renew its offer of financial support within the Eastern Partnership framework and through international financial institutions in return for the regime's concrete and perceptible political and economic concessions. The EU should also strengthen the Eastern Partnership's flagship initiative, the support for small and medium-sized enterprises (SMEs) which could be provided with legal advice and start-up loans. Such action would be all the more desirable as the emergence and expansion of the SME sector directly translates into an improved condition of the civil society.

Either scenario, though, can bring adverse consequences. In the former case, this is pauperization of the Belarusian society, at least for some time, while the latter option means beefing up an increasingly inefficient system.