Reforms in Belarus after the cancelled IMF program: Totem and taboo*

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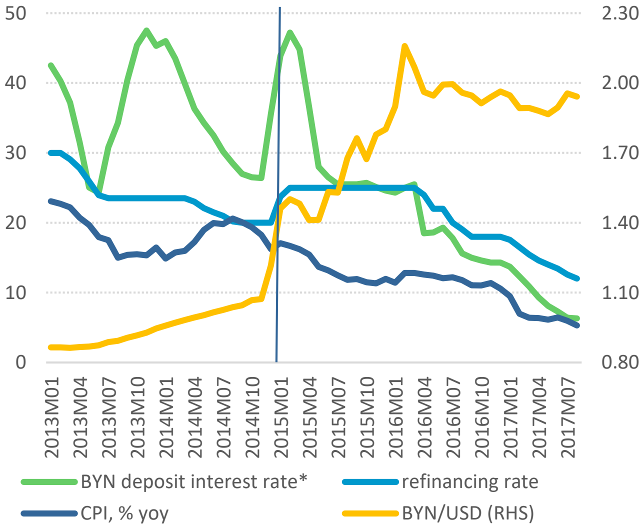
Almost two years ago, in December 2015, Belarusian authorities announced that they plan to complete negotiations with the IMF on the new lending program in the beginning of 2016. A year ago, the Belarusian delegation was expected to bring to Washington signed letter of intent that would had made the issue of the new program solved. In July of 2017, IMF's representative announced that "discussions toward a program are on hold pending clarity on whether there is high level support in Belarus for policies, particularly in the state-owned enterprises and utility sectors."[1] Why Belarusian authorities appeared to be so reluctant to even modest structural change expected by the Fund? Have they abandoned idea of reforms, or have they chosen to follow the reform path, but one of their own?

In the beginning of 2015, Belarus just passed the third currency crisis in six years, entered the most severe recession since 1990th, and faced the necessity of debt service in the amount close to the size of country's gross reserve assets. Of course, we'd asked for aid! But after reform reversals followed the previous stand-by arrangements, the IMF asked for "a clear commitment – including at the highest level – to stability and reform"[2], and *Belarus returned to economic reforms in 2015 without any external support.*

Inflation and regained trust

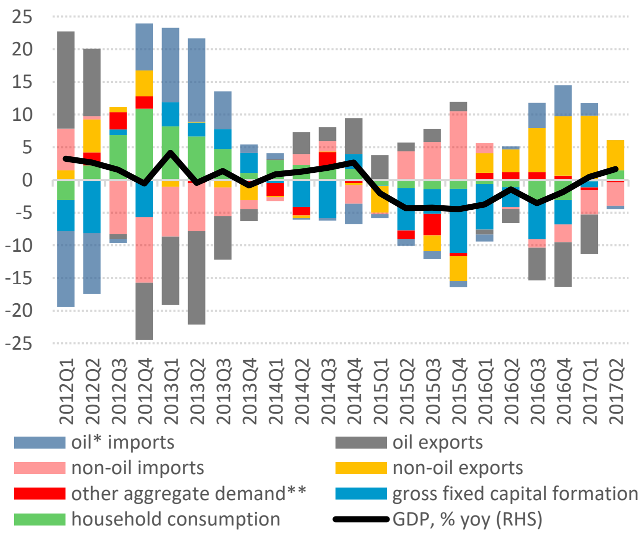
The newly appointed Governor of the National Bank changed the monetary policy regime from devaluation rate targeting to monetary targeting[3] and exchange rate managed float (much less 'managed' than ever before), and support it with several institutional measures aimed at de-dollarization and better bank supervision. Thanks to the fact that macroeconomic stabilization was one of the IMF's prior conditions, the National Bank successfully withstood lobby of the line ministries and other apologists of loose monetary policy. As a result, inflation fell to historical minimum of 4.9% yoy in September 2017. Real interest rate on ruble deposits fell close to the inflation rate, which is a clear indication of regained trust towards the monetary policy and confidence to national currency (Figure 1). The monetary policy met no concern from the IFIs side: it created necessary conditions for economic recovery, an export-driven one, and for serious current account improvement. Hence, an urgent need to get the IMF lending for macroeconomic stabilization passed away.

Figure 1. Monetary policy outcomes



Note. Since the end of December 2014, the new Governor runs the National Bank. * New household deposits; interest rates are in % per annum. *Source*: National Bank, Belstat.

Figure 2. Aggregate demand contribution to real GDP growth, percentage points



* Oil imports include imports of crude oil (HS code 2709), oil products (2710), and natural gas (2711); oil exports – crude oil, oil products, and potash fertilizers (3104). ** Other aggregate demand include other domestic demand and statistical discrepancy.
Source: own estimates based on Belstat data.

* This publication has been produced with the assistant of the European Union.

[1] Transcript of the IMF Press Briefing, July 20, 2017.

[2] Press Release: Statement by the IMF Mission to the Republic of Belarus, October 17, 2011.

[3] Empirical foundations of the monetary targeting were developed in Pelipas, I. (2015). Money as a leading indicator of inflation in Belarus and its implications for monetary policy, IPM Research Center, policy paper PP/15/05.

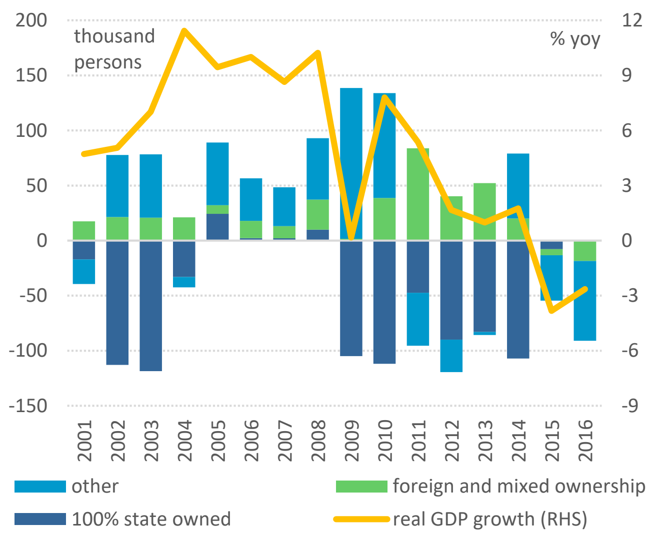
Economic recovery

Exports of services and goods excluding oil and potash has been growing for six quarters (see Figure 2), mainly because of the real depreciation of the Belarusian ruble after the introduction of floating exchange rate regime. Later on, in 2017, household consumption started to recover (in a big extent thanks to the consumer lending); there were also signs of fixed capital investment recovery (partially thanks to very gradual recovery of commercial crediting, partially – thanks to several large scale investment projects financed by the government, first of all construction of the nuclear power plant in Astraviec, Hrodna *oblast*). Non-oil imports (imports of services and goods excluding oil and natural gas) also started to recover in 2017, which limits economic growth potential. However, the recovery is on its way, its pace is faster than it was expected by all forecasters – and it crates positive effects for Belarusian labor market. At the same time, there are less incentives to follow advice of IFIs when an economy is recovering.

Social contract

For a long time, stability of the labor market was one of the cornerstones of Belarusian social contract. Even despite the fact that state owned enterprises (SOEs) permanently released employees between 2009 and 2014 (see Figure 3), private sector (especially micro enterprises) was creating jobs and supporting regional labor markets[4]. But recession of 2015–2016 affected labor market severely. Private companies from SME sector started to release people already in 2014 after collapse of the Russian ruble that paralyzed Belarusian foreign trade for several months. Larger private companies continue to cut labor costs in 2015 and 2016.

Figure 3. Employment change and real GDP growth



Source: Belstat; own estimates based on Belstat data.

And at the height of the crisis, the authorities adopted the Presidential Decree #3 that taxed those who did not ‘sufficiently contribute to the financing of the government expenditures’. That decision affected different vulnerable groups of population[5], especially in the eastern regions of Belarus, and led to social protests that were calmed down by use of force and later pending of the Decree and sending it to revision. Recently, representatives of the Ministry of Labor and Social Protection announced changes of the document – it has the new title (‘On employment enhancing’ instead of ‘On preventing social parasitism’) and the new contents (most likely, authorities will focus on other mechanisms of ‘punishment’ of ‘those who are not involved into economic activity’, e.g. 100% coverage of utilities tariffs, and on employment enhancing policies themselves).

Social unrest caused by labor market hardships increased the authorities’ fear of any actions in the area of SOEs restructuring, which was one of the key elements of the program with the IMF. Additionally, positive effects of recovery started to materialize: in 2016, employment at micro enterprises increased almost to the level of 2014.

SME development: A totem

SME development was set as a policy priority in 2007–2008, and started from that time Belarus has been permanently improving its doing business environment (measured by the World Bank’s *Doing Business* indicators). Prior to the recession of 2015–2016, it helped to expand the number of SMEs and increase their employment economy-wide. However, imperfections of the institutional environment became more evident during the recession[6], and, taking to account important role that SMEs play in regional development, the authorities came with the number of initiatives of further liberalization of doing business in 2017.

The drafts proposed a broad range of measures: further easing of registration; short-term moratorium on inspections; three-years moratorium on tax increases or introduction of additional taxes; reduction of the number of cases of criminal prosecution for economic ‘crimes’ and easing punishment for those crimes; improvements in licencing and certification; introduction of new tax benefits and exemptions for individual entrepreneurs and micro companies that operate in small urban locations and rural area, etc. Business unions and other stakeholders involved into public discussion of these documents positively assessed the planned changes; however, as this package of legislative act has not been adopted yet, thus it is too early to speak about its potential impact.

Unconditioned borrowing and political bargaining

But even all positive factors taken together could not help Belarus to service its external and internal foreign currency obligations. The government spent 5.5% of GDP on its foreign currency debt service and repayment in 2015

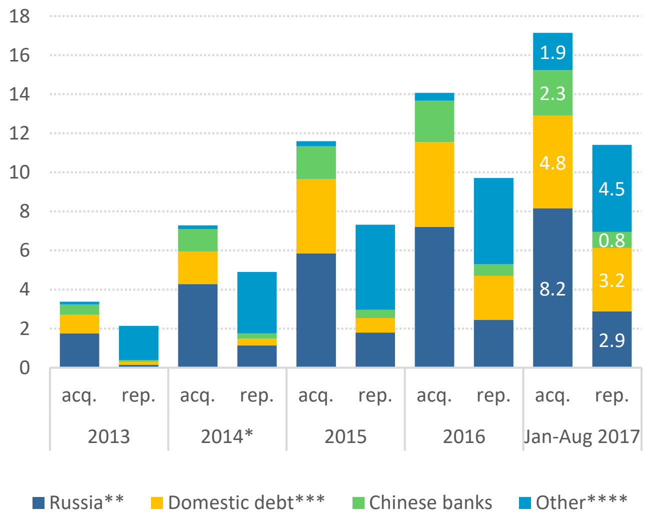
[4] See World Bank (2015). Belarus regional development policy notes: Spatial dimension of structural change, report ACS13961.

[5] See Chubrik, A. (2017). A few remarks on the Decree #3, IPM Research Center, commentary DP/17/01.

[6] See IPM Research Center, yearbook ‘Business in Belarus: Status, Trends, Perspectives’ for 2015 and 2016.

and 6.2% of GDP in 2016, and size of the payments is not falling. In addition, in 2016 Belarus and Russia entered into a conflict on gas prices that cost Belarus serious cuts in crude oil supply from Russia in the second half of 2016 and first quarter of 2017 and respective reduction of Belarusian fiscal revenues. Finally, the presidents of both countries agreed about solutions of this conflict and coordinated conditions of oil and gas trade, which allowed Belarus to improve the country's fiscal position and its image for debt investors. The government issued Eurobonds for $1.4 bn in June 2017, as well as received next tranche of EFSD loan in April 2017 ($0.3 bn), and the loan from the Russian Government in the equivalent of $0.7bn in September 2017. Altogether, between 2013 and 2017 (eight months) Belarus borrowed more than $17 bn and payed back more than $11 bn, see Figure 4. Instead of making agreement on the reform program, the authorities preferred to follow usual approaches – political bargaining with Russia and unconditioned borrowing.

Figure 4. Acquisition and repayment of government debt, $ bn, cumulative



Notes. * excluding bridge-loans from VTB obtained in 2014 ($ 2 bn); ** government, banks, EFSD; *** Foreign currency denominated government bonds; **** IMF, Eurobonds, IBRD, Venezuela, etc.
Source: Ministry of Finance of Belarus.

SOEs restructuring: A taboo

Although in 2016 and even in the beginning of 2017 probability of reaching the agreement between the IMF and Belarus on conditions of the new lending program within extended financing facility framework was really high (the fact that the Belarusian President and the IMF's mission head met twice in the course of negotiations supports this statement), it was 'put on hold' finally. Its condition of SOEs restructuring had become a deal breaker. The authorities preferred to find short-term solutions (conversion of the most problematic SOEs' debt to commercial banks into government debt, creation of a special 'asset management agency' for toxic assets of state owned banks, SOEs debt restructuring, etc.) and try to use further easing of doing business as a remedy for labor market problems. However, effectiveness of this approach is limited by pace of economic recovery, efficiency of SOEs, and risks of budget crisis that could materialize in 3–5 years.

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