

Dzmitry Kruk, BEROC
January 2024

Cognitive Dissonance on Belarus: Recovery and Adaptation or Stalemate?

A closer look at the Belarusian economy over the recent year, produces two initially competing narratives. The first one emphasizes that tough sanctions have led to a deadlock for the Belarusian economy. The second one stresses that output losses have turned out to be much lower than expected, and that the economy has displayed a rather high degree of adaptability – securing an early and rapid recovery. This policy brief shows that these narratives are not mutually exclusive but rather elements of the same bigger picture. A short-term focus gives the impression that the current stance is 'more good than bad'. This reflects the fact that output has recovered and almost reached historically high levels, made possible due to a combination of exports protection mechanisms and compensatory effects on output. However, this does not eliminate the disappointing medium- and long-term prospects for the country. On the flip side of the immediate survival of the Belarusian economy is the country's economic and political stalemate. This includes the lack of opportunities for future sustainable growth and Belarus' enormous and continuously growing dependence on Russia. Within this stalemate, stagnation is the best plausible scenario. At the same time, much worse scenarios, both economically and politically, are also highly likely. Ultimately, breaking the deadlock is the only way to a better future for Belarus.

The Belarusian Economy and the Changing Narratives

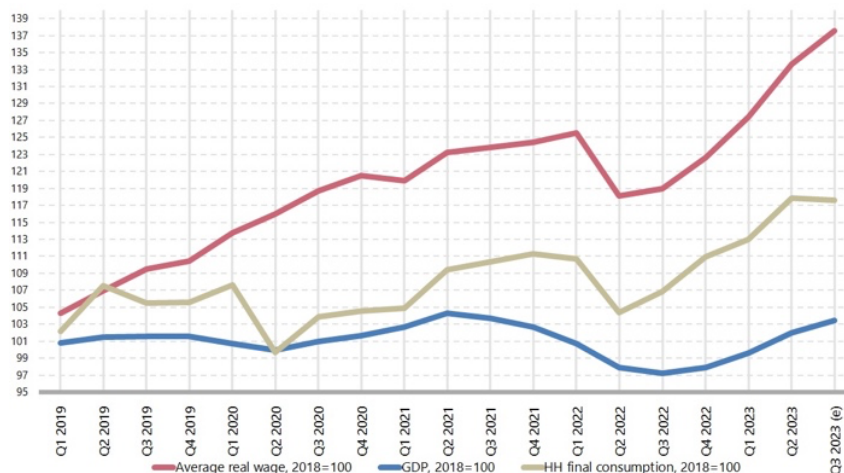
About 1.5 years ago, Western countries introduced tough sanctions against Belarus, punishing the Lukashenka regime for its role in Russia’s invasion of Ukraine. This gave rise to a huge uncertainty regarding Belarus’ economic prospects. A FREE policy brief published about a year ago (Kruk & Lvovskiy, 2022) presented a model-based estimate of a potential rock-bottom for the Belarusian economy in the new environment, which amounted to 20 percent of output losses. The authors however argued that actual output losses might be significantly lower given Russia’s support and policy responses, which were unaccounted for in the model. At the same time, downside risks and a lack of output consistency seem to have become permanent traits of the Belarusian economy.

Expectations of a large and prolonged recession in Belarus prevailed into mid-2023. International institutions (IMF, World Bank) and rating agencies

(S&P, Fitch Ratings) mainly expected a recession in Belarus up to 10 percent 2022-2023. The reality has however turned out to be quite different with the recession being relatively contained and short-lived. The output losses between the peak (Q2-2021) trough Q3-2022 amounted to 6.8 percent. In Q4-2022 a recovery began, and in Q3-2023 the economy had almost fully recovered, reaching nearly the same levels as in Q2-2021 (see Figure 1). Further, in terms of average real wages and household consumption, the situation appears to be even more positive. The real average wage reached its pre-war level in Q1-2023 and has since displayed record high levels, and household consumption follow a similar trend (see Figure 1).

These dynamics have given rise to a new narrative. As of lately, the Belarusian economic situation is at times treated as ‘more good than bad’. Further, most international financial institutions currently forecast a continued weak recovery growth in the coming years (EBRD, 2023; IMF, 2023; Izvorski et al., 2023).

Figure 1. Real GDP, Average Real Wages, and Real Household Consumption (index, seasonally adjusted, 2018=100).



Source: Author’s estimations based on Belstat data.

Factors Behind the Recent Recovery Growth

The underlying reasons for the recovery growth can be divided into two groups: (i) export

protection mechanisms under sanctions and (ii) positive shocks and compensatory effects on output.

Export protection mechanisms under sanctions are twofold. Firstly, the Belarusian regime turned

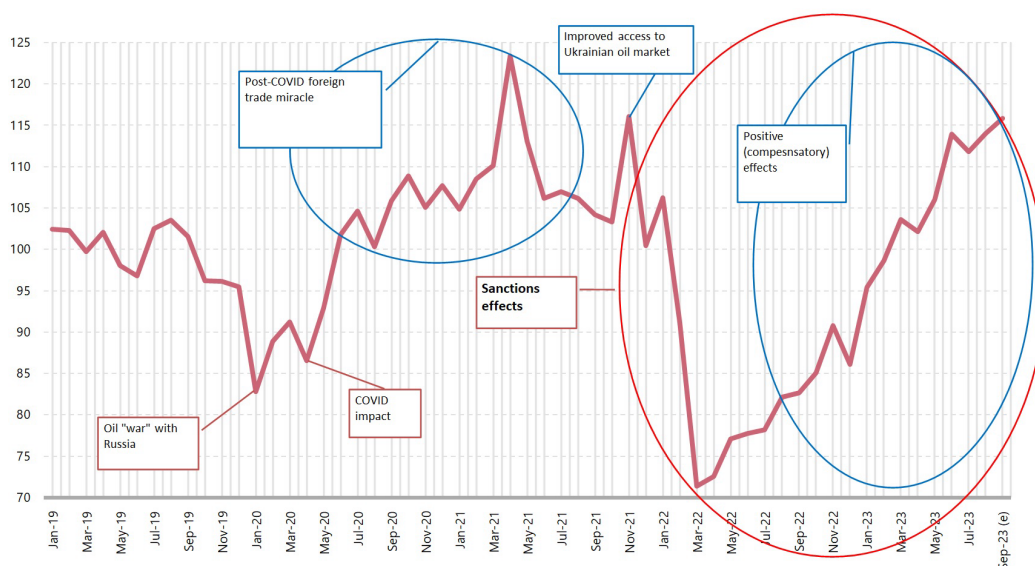


out to be somewhat successful in adjusting to the new sanctions-environment. This partly due to a somewhat geographical U-turn of Belarusian exports, underpinned by new logistics and payment schemes. The best example of this turn is the re-orientation of oil product exports from the EU and Ukraine to Russia (Kharitonchik, 2023). Moreover, some exports to traditional markets, which were challenged by logistics and payment barriers rather than sanctions, were secured by crossing these barriers. The best such example is the recovery of potash fertilizer exports to China, Brazil and India. Since early 2023 these displayed a rapid recovery due to Belarus finding logistic solutions through Russian sea ports instead of EU ports, and by using railway transportation.

Secondly, the practices of sanctions evasion may also have played a significant role. The scope of sanctions evasion is however difficult to assess due to its secretive nature. Moreover, the difference between avoiding and evading sanctions is not always clear.

Export protection mechanisms allowed Belarus to cushion actual export losses, making them transitory (see Figure 2). Actual losses in exports were close to the rock-bottom scenario estimates for only a couple of months. Instead of an expected level shift in exports by roughly 40 percent (from the pre-war level), exports displayed a recovery trajectory. Hence, what was modelled as a permanent shock in Kruk & Lvovskiy (2022), turned out to be transitory.

Figure 2. Physical Volume of Exports (index, seasonally adjusted, 2018=100).



Source: Author's estimations based on Belstat data.

One important aspect to mention is that part of this recovery is due to oil-product exports taking place already in 2022 (Kharitonchik, 2023). In Kruk & Panasevich (2023) the authors show that the oil-refinery industry is of extreme importance for the entire Belarusian economy. Due to inter-industrial linkages, the oil-refinery industry indirectly accounts for about 11 percent of Belarus' output, despite its modest direct contribution to the GDP (slightly more than 1 percent). Hence, due to protecting these exports (and the corresponding production of oil products), a large amount of

output losses was avoided. A similar situation unfolded also for potash fertilizer exports and the chemical industry producing them (although inter-industrial linkages and effects on output are much weaker for that industry).

Besides export protection mechanisms, the recovery of exports and output stem largely from various positive and compensatory effects on output. Some of them arose from Belarus' and Russia's respective regimes responses to sanctions, and from Russia's readiness to support



Belarus. Others are classical external positive shocks (to no degree related to sanctions) while some are a combination of both. They include: (i) increasing energy (gas) subsidies from Russia, (ii) a prolonged period of extra-high price competitiveness, especially in the Russian market, (iii) expanded access to the Russian market, (iv) other forms of Russian support (debt restructuring, budget transfers, new loans), (v) favorable trade conditions and export prices (apart from on the Russian market), (vi) a (macro)economic environment that allow for more room for domestic economic policy interventions.

Taken together, these positive output drivers largely contributed to curbing the recession in 2022 and to the output recovery in 2023. A straightforward decomposition of the actual output growth path is unfeasible (due to the close interconnection of export protection mechanisms and output drivers, and the lack of available statistics). However, approximating the actual path in a model environment results in the following: between Q2-2021 and Q3-2022, about 12 percent of losses due to sanctions (taking into account the export protection mechanisms) and a deprivation of the Ukrainian market, and 5.2 percent of gains due to output shocks, resulted in actual output losses of 6.8 percent. Later in 2023, due to increasing effects from the export protection mechanisms, the sanctions-related output losses shrank to about 6.6 percent, while output shocks expanded output by roughly the same level. This allowed output losses to be zeroed out, i.e. the level of output in Q3-2023 was almost identical to Q3-2021.

An Economic Stalemate

Is the 'more good than bad' economic situation sustainable? Does the recent recovery mean that Belarus has overcome the major challenges to the economy? The short answer is no. Even with short-term thinking, there are still numerous downside risks. Sanctions still form a permanently challenging environment for the Belarusian economy, putting exports and output in jeopardy.

The export protection mechanisms are not persistent, and they largely depend on Russia's political will to support them. Moreover, the updated logistics and payment chains may also be vulnerable and sensitive to changes in the sanctions' environment, and short-term trends in external prices. The aforementioned positive output effects are short-term by their nature and there are indications of them starting to fade already in 2023 (BEROC, 2023). Hence, even short-term projections for 2024 are challenging: the output growth is expected to weaken significantly or even fade away, while inflation spikes and financial destabilization risks are high (BEROC, 2023). Therefore, a return to a stagnant economic environment appears to be the most plausible short-term outlook.

The medium-term outlook seems even worse. According to Kruk (2023), the Belarusian macroeconomic balance (a) is very fragile, (b) is subject to numerous and huge downside risks, and (c) cannot be secured by macroeconomic policies because of the structural weaknesses in their design and the lack of room for maneuver. This means that even the existing weak long-term growth potential cannot be realized in the medium term, while the likelihood of recessions, inflation spikes and financial destabilization is high.

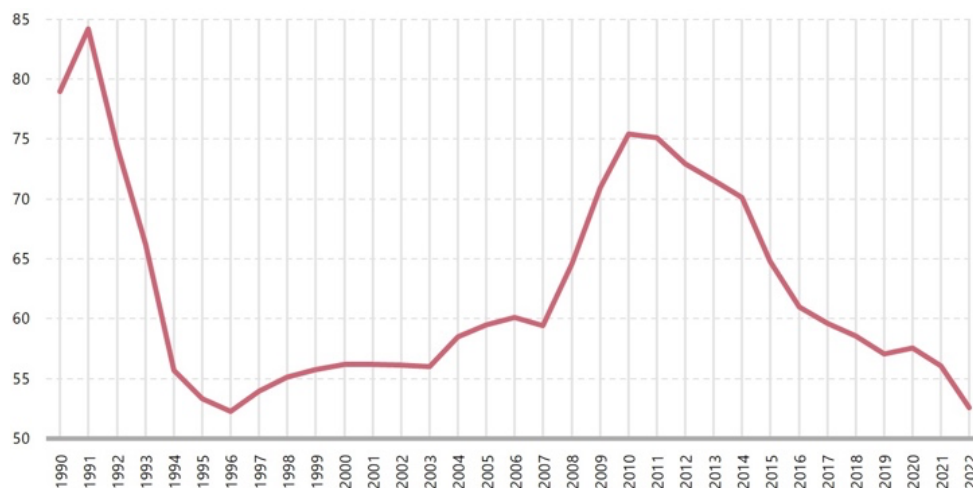
Re-shifting focus to a long-term and international perspective makes the viewpoint 'more good than bad' appear inconsistent. First, the long-term growth potential for Belarus, which was very weak even before the sanctions, keeps on worsening. This as adverse supply shocks and a deterioration of the productivity determinants continue eroding it (Kruk & Lvovskiy, 2022). Estimations of the growth potential (that rely on historical time series) are mainly within the range of 0-1 percent per annum. However, even such disappointing estimates might be optimistic bearing in mind the current political and sanctions-related risks and uncertainty (absent in the historical data). This makes stagnation the best possible long-term outlook, although it cannot be guaranteed.



Second, despite the milder recession and rapid recovery, the well-being gap between Belarus and

its EU neighbors keeps on expanding (see Figure 3).

Figure 3. Well-being in Belarus vs the average among its EU neighbors (Latvia, Lithuania, Poland), 1990-2022, in percent.



Note: The GDP per capita PPP in 2017 constant international dollars is considered as well-being. The average well-being for EU Neighbors is the simple average in GDP in Latvia, Lithuania, and Poland.

Source: Author’s estimations based on World Bank data.

The average well-being in Belarus (measured in GDP per capita in constant international dollars) vs. that among its EU neighbors reached an (almost) historically low level in 2022. After attaining a level of well-being of roughly 75 percent of the average in Latvia, Lithuania, and Poland in the early 2010s, the well-being in Belarus has fall to about 52.5 percent, almost as low as in the mid-1990s. Given the economic stagnation as the most likely outlook, this means that the country will, in relative terms, keep on getting poorer in comparison to its EU neighbors.

A Political Stalemate

The hypothetical way out of the economic stalemate is more or less obvious. For instance, there is somewhat of a consensus among Belarusian economists about strengthening the long-term growth and securing macroeconomic stability (see Daneyko & Kruk, 2021; Kruk, 2023, for an overview of a collective view from a group of Belarusian economists). This vision, however, clashes with the views of the Lukashenka regime, which has inhibited its implementation

throughout decades. Hence, democratic transition, or at least deprival of power of the Lukashenka regime has long appeared to be a highly likely precondition for moving away from the stalemate.

This, however, has changed in the last couple of years. The Belarusian economy’s dependence on Russia has moved from large to absolute. Prior to 2022, Russia was an important market for Belarusian exports (about 40 percent), the single energy supplier, and de facto the lender of last resort. To date, Russia’s role has expanded dramatically. The share of exports to Russia has increased up to about 65 percent. Moreover, the majority of the remaining 35 percent is exported with the assistance of or through Russia, using Russian infrastructure. Therefore, it would be fair to argue that Russia in some form “controls” roughly 90 percent of Belarusian exports. Further, being Belarus’ sole energy supplier, Russia has increased its significance for Belarus through expanded energy subsidies. The size of the energy subsidies reached a historical high in 2022, and the mechanism of the energy subsidies has become a cornerstone for macroeconomic stability in



Belarus. Furthermore, Russia has turned out to be the only effective creditor for Belarus. Overall, Russia has accumulated a significant number of tools to undermine Belarus at any given moment.

A democratic transition or at least deprivation of power of the Lukashenka regime might therefore not be sufficient preconditions for breaking the economic deadlock. Even if domestic political will to do so should emerge, the risk that Russia will successfully suppress it using the above outlined economic tools is very high. Hence, apart from a democratic transition, the way out of the economic stalemate requires a way out of the political stalemate. This seems to only be possible through either a politically weakened Russia, and/or an external political force, allied to the Belarusian democratic forces, and strong enough to suppress Russia.

Conclusions

Recently, the narrative on the Belarusian economy has changed. The prevailing expectations of a large and prolonged recession has been substituted by expectations of a gradual recovery. The narrative ‘the jig is up’ has somehow been crowded out by the ‘more good than bad’ viewpoint on the Belarusian economy. However, these narratives are not mutually exclusive. Behind the current ‘more good than bad’ viewpoint on the Belarusian economy, a severe economic and political deadlock prevail. Moreover, future economic and political deadlocks is the actual price being paid for the recent survival and recovery of the Belarusian economy.

From a positive perspective, the economic and political deadlock means that the country is likely to, at least, be bogged down in stagnation. Belarus’ total dependency on Russia makes the country hostage to Russia’s political preferences and country-specific risks. Should Russia decide to exert further economic and/or political influence over Belarus, it is likely to succeed. Consequently,

any economic downturn faced by Russia would automatically impact Belarus.

From a normative perspective, breaking the economic and political deadlock might be the only solution, and for this, the order might matter. Prior to 2020 there was a widespread opinion that breaking the economic deadlock must be prioritized, and that it could – in turn – break the political deadlock. As of now, the tables have turned. The current order postulates the political deadlock comes first, as it seems to be the only way of breaking the economic stalemate. However, breaking the political deadlock appears to require external political will.

With these conclusions in mind, the recent Belarusian democratic forces’ manifest regarding Belarus’ EU membership aspiration, deserves attention (BDF, 2023). At first, such aspiration might appear schizophrenic given the actual political situation inside of the country. However, taking a Belarusian EU membership serious (within the EU and among Belarusians) might be the answer to Belarus’ political and economic deadlock. From this perspective, the task for the Belarusian society is thus to convince EU counterparts that this is not madness, but rather a feasible solution. It is rather evident why this solution is both desirable and feasible for the Belarusian society. The main question to be answered is therefore whether, and why it would be desirable and feasible for the EU.

References

- BEROC. (2023). Macroeconomic Forecast for Belarus—2024. BEROC. <https://beroc.org/publications/view/makroprognoz-dlya-belarusi-2024-god/>
- Belarusian Democratic Forces. (2023). Declaration of Future Membership of Belarus in the European Union. <https://tsikhanouskaya.org/en/news/a2b6d33809a9197.html>
- Daneyko, P., & Kruk, D. (2021). Which Reforms Does Belarus Need? (108; BEROC Policy Paper Series). BEROC. https://beroc.org/publications/policy_papers/kakie-reformy-nuzhny-belarusi-/?sphrase_id=6882



EBRD. (2023). The EBRD in Belarus: Overview. <https://www.ebrd.com/where-we-are/belarus/overview.html>

IMF. (2023). World Economic Outlook, October 2023: Navigating Global Divergences. IMF. <https://www.imf.org/en/Publications/WEO/Issues/2023/10/10/world-economic-outlook-october-2023>

Izvorski, I., Kasyanenko, S., & Singer, D. (2023). Europe and Central Asia Economic Update, Fall 2023: Sluggish Growth, Rising Risks. Washington, DC: World Bank. <https://doi.org/10.1596/40389>

Kharitonchik, A. (2023). The Return of Oil Rent. BEROc. <https://beroc.org/publications/view/vozvrashchenie-neftyanyoy-renty/>

Kruk, D. (2023). What is needed to reinforce macroeconomic stability in Belarus? (85; BEROc Working Paper Series). BEROc. https://beroc.org/publications/working_papers/chtotno-dlya-ukrepleniya-makroekonomicheskoy-stabilnosti-v-belarusi/

nuzhno-dlya-ukrepleniya-makroekonomicheskoy-stabilnosti-v-belarusi/

Kruk, D., & Lvovskiy, L. (2022). Belarus Under War Sanctions (Policy Brief Series). FREE Network. <https://freepolicybriefs.org/2022/10/17/belarus-under-sanctions/>

Kruk, D., & Panasevich, V. (2023). Industrial linkages in the Belarusian economy and their role in the macroeconomic landscape (86; BEROc Working Paper Series). BEROc. https://beroc.org/publications/working_papers/mezhotraslevye-vzaimosvyazi-v-belarusi/

National Statistical Committee of the Republic of Belarus (Belstat). <https://www.belstat.gov.by/en/>

The World Bank. <https://databank.worldbank.org/source/world-development-indicators>





Dzmitry Kruk

Belarusian Economic Research and Outreach
Center (BEROC)
kruk@beroc.org
www.eng.beroc.org

Dzmitry Kruk is a Research Associate at the Belarusian Economic Research and Outreach Center (BEROC). He obtained his BA in economics (2002) and his MA in banking and finance (2004) from the Belarusian State University. Currently, he is a PhD nominee at Cracow University of Economics.

His research interests are mainly in the fields of economic growth and finance, and monetary economics.

freepolicybriefs.com

The Forum for Research on Eastern Europe and Emerging Economies is a network of academic experts on economic issues in Eastern Europe and the former Soviet Union at BEROC (Minsk), BICEPS (Riga), CEFIR (Moscow), CenEA (Szczecin), ISET-PI (Tbilisi), KSE (Kyiv) and SITE (Stockholm). The weekly FREE Network Policy Brief Series provides research-based analyses of economic policy issues relevant to Eastern Europe and emerging markets. Opinions expressed in policy briefs and other publications are those of the authors; they do not necessarily reflect those of the FREE Network and its research institutes.

