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Research Report

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Brief Respite for Lukashenka

Russian Loans Alleviate Minsk's Immediate Financial Woes, but Deepen Dependency

Janis Kluge

Late on 3 April 2017 in Saint Petersburg, Vladimir Putin and Alyaksandr Lukashenka announced the end of the Belarusian-Russian energy dispute. New loans from Moscow appear to be the central outcome for Minsk. This provides relief for Lukashenka, whose regime currently finds itself squeezed between economic difficulties and social protests. But the agreement leaves Minsk's underlying economic problems unresolved, while the additional debt ties it even tighter to Moscow. In exchange for its support, the Kremlin could at some point demand Minsk make concessions that contradict the EU's interests. To date, however, Lukashenka has sought to retain a degree of autonomy from Moscow, with Minsk's dialogue with the EU providing an important counterweight.

The talks in Saint Petersburg followed a noticeable deterioration in bilateral relations. In 2016 Belarus paid only \$107 per thousand cubic metres for Russian gas, rather than the agreed price of \$132. Lukashenka argued that Belarus was entitled to a reduction because the oil price had fallen, whereas Moscow asserted that Minsk had accrued arrears exceeding \$726 million. In response, Russia significantly scaled back the volume of oil delivered to Belarus from autumn 2016. And at the same time the Moscow-controlled Eurasian Fund for Stabilisation and Development (EFSD) blocked the release of the \$300 million third tranche of a major loan. The dispute came to a head on 26 December 2016, when Lukashenka boycotted two summits in Saint Petersburg: the meetings of the Eurasian Economic Union (EEU) and the Collective Security

Treaty Organisation. At the EEU summit the heads of state of all member states had been due to sign the Union's new Customs Code.

Putin and Lukashenka talked for five hours on 3 April, before holding a brief press conference to announce that all bilateral issues had been resolved. But the most important aspects of the agreement have only gradually come to light. On 13 April Minsk paid the arrears demanded by Gazprom and Lukashenka signed the EEU's Customs Code. In return Russia restored oil deliveries to the originally planned rate of 24 million tonnes per annum (following the cut to 18 million tonnes per annum in 2016). On top of this, Minsk will receive about \$1 billion in new loans from Moscow, plus deferment of repayments on older loans falling due in 2017 (about \$750

million). Finally, the release of two tranches of the EFSF loan is also expected this year (\$600 million).

It is, however, unclear whether other disputes have been resolved. A simmering trade dispute over Belarusian food exports recently came to a head, with Moscow accusing Belarus exporters of using false declarations of origin to market embargoed goods from Ukraine and the EU in Russia. Moscow restricted market access to its markets for certain Belarus suppliers and made legal preparations to completely ban the sale of certain EEU re-exports in Russia. There was also friction over new Belarusian immigration rules, after Belarus suddenly permitted visa-free entry for citizens of eighty states (including all EU member states and the United States) in February 2017, without consulting Moscow. Moscow responded – also unilaterally – by establishing a border strip monitored by the state security agency FSB.

Economic Travails

The promised new loans grant Lukashenka a little respite in difficult economic and political times. In the past two years Belarus has fallen into a deep recession, with GDP shrinking by 3.9 percent in 2015, 2.6 percent in 2016. The economy is suffering from the low price of oil, which has dragged down margins in refining too. The loss of Russian markets has also caused difficulties for Belarusian industry.

In fact, Lukashenka faces stability risks much greater than the current visible crisis. Minsk's foreign debt has ballooned, as state-controlled credit-funded growth filled the gap left by declining Russian energy subsidies from 2007 onward. The Belarusian rouble has devalued markedly, causing the country's foreign debt to multiply relative to GDP (without the new loans from Russia: 78.6 percent). With export revenues depressed and scarce currency reserves of its own (\$5 billion) Belarus will soon find itself facing new pressure to find funds to roll over its loans.

Additional risks ensue from a deterioration in the portfolios of state-owned Belarusian banks, which hold significant non-performing loans to other state enterprises. Minsk has sought to avoid insolvencies on account of the social repercussions, but the crisis is nevertheless very tangible. Disposable income has fallen 13 percent since 2015 and Lukashenka's promise of an average wage of \$500 appears further away than ever (current average \$378). The old "social contract", under which the regime guaranteed economic security but operated without democratic controls, is rapidly coming apart.

Dissatisfaction with Lukashenka's economic policies has now become visible on the streets, with demonstrations in many Belarusian cities since 17 February. The protests reveal that a growing section of the population blames Lukashenka's regime for the crisis. The specific target of the demonstrations is a decree "against social parasites" of 2015 that forces citizens working less than 183 days in a year and not registered as unemployed to pay an annual tax equivalent to €230. The objective is to rein in the informal economy while scapegoating "idlers" for the crisis.

The regime has clamped down increasingly harshly, with several hundred peaceful protesters arrested during the last wave of protests on 25 March. This represents a departure from Lukashenka's policy of the past two years, where demonstrators could usually expect only to be fined. But unlike during the crushing of the December 2010 protests most of those detained were released within a few hours. So repression has tightened, but without reaching the level of 2010 when the EU imposed sanctions in response to the crack-down.

Quid pro Quo?

The agreement with Russia gives Lukashenka a political boost, but does nothing to resolve the underlying problems of the Belarusian economy. It is currently almost out of the question for Minsk to repay its

debts in full. The heaviest burden is the nuclear power station under construction at Astravets, which is financed with a \$10 billion loan from Moscow (and built by Russia's Rosatom). For this project alone Minsk will have to repay fifteen annual instalments of almost \$1 billion each, starting in 2021. Belarus is also negotiating with the IMF, but the Putin/Lukashenka reconciliation makes new IMF loans – and the associated painful economic reforms – an unlikely proposition.

Even if the Saint Petersburg agreement grants Minsk relief for 2017, loan repayments are sure to be back on the agenda by 2018. There are a number of potential concessions Minsk could offer in return for new aid. For example, Lukashenka could agree to permit Russian investors to take over Belarusian state enterprises. There is precedent for this: in 2012, after a long tussle, Moscow persuaded Minsk to sell its stake in Beltransgaz to Gazprom in exchange for new loans and cheaper gas prices. Since then the Russians have expressed interest in other major industrial enterprises.

In view of its confrontation with the West, Moscow is also likely to be interested in foreign policy and security concessions. Concretely, Minsk could agree to the establishment of a Russian military base in Babruysk, which Lukashenka has been resisting since 2015. More broadly, Moscow expects Lukashenka to demonstrate greater loyalty in foreign policy matters, for example in the Ukraine crisis and on Syria. In these arenas too, Minsk has to date insisted on distance from Russia, with a notably reserved response to the US air strike in Syria in April 2017.

Consequences of EEU Integration

In addition to its debts, EEU integration also ties Belarus closer to Russia. From Minsk's perspective – having almost no trade with the other members (Kazakhstan, Armenia and Kyrgyzstan together account for 1 percent) – the EEU to all intents and

purposes represents quasi-bilateral economic integration with Russia (50.5 percent). The economic risks of this one-sided relationship became clear when the Russian recession caused demand for many Belarusian exports – such as vehicle components – to collapse in 2014.

Moreover, the recent history of the EEU demonstrates that the theory of an unpolitical economic union of equals is a fiction. Although the EEU's highest organs require unanimous agreement, Moscow remains in charge. The EEU's administration is recruited in proportion to population and therefore 84 percent Russian. And Russia possesses the means to exert great bilateral pressure on any other member.

Russia could potentially draw the other member states into its politically motivated import embargo by way of their Customs Union. One example of how this could occur is the import ban on meat from Moldova, which Russia imposed in October 2014 in response to Chişinău's overtures towards the European Union. Although Minsk initially criticised the Russian ban, it was expanded to include Belarus following controls by officials of the Customs Union (the EEU's predecessor). Russia also used the EEU to increase pressure on Minsk during their bilateral gas dispute, for example holding back the third tranche of the EFSD stabilisation loan, which should actually have been released in October 2016.

Challenges for the EU

Even if economic difficulties force Lukashenka to demonstrate greater loyalty towards Russia, Minsk will continue to look for possibilities to distance itself from Moscow. Here the dialogue with the EU represents an important counterweight for Lukashenka. While an independent Belarus is also in Europe's interest, the question for the EU is how to respond to the increasing repression. The European Parliament passed a resolution condemning the latest arrests, with some MEPs calling for new sanctions.

Brussels should not rush into such a move. Lukashenka's efforts to improve relations with the EU have brought about small improvements in the human rights situation. New sanctions could endanger that progress and should only be imposed as a last resort if the repression again reaches the intensity seen in December 2010. First of all the EU should expand its support for civil society actors and independent media in Belarus and strengthen exchange programmes for students and young professionals.

Loans for Belarus make no sense as long as Minsk refuses full cooperation with the IMF, but technical cooperation could be expanded. The idea that a dialogue between EU and EEU would offer a way to improve economic cooperation with the region – bypassing the strained relationship with Russia – is often discussed in this context. The dismantling of trade barriers would be especially important for EEU member Belarus, because it is also dependent on good economic relations with the EU and Ukraine. A dialogue between EU and EEU at technical level could explore the potential for harmonisation of standards and lowering trade barriers. But nobody should expect the institutions of the EEU to hedge Russian influence in Belarus.

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