

EXPERT OPINION

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Summary

- **LACK OF UNDERSTANDING OF THE NEEDED ECONOMIC POLICY AND OBJECTIVES DEPRIVE BELARUS OF THE OPPORTUNITY TO START EXITING RECESSION**

In 2022, the economic policy of the Belarusian authorities was limited to attempts to respond to new problems and challenges. Most of the taken decisions did not have a positive effect, and some – such as strict price regulation and untimely expansion of the money supply – may have side effects in the near future. In general, the government has neither a vision of economic policy that is relevant for the current period, nor a clear understanding of where the country is heading. This deprives Belarus of the opportunity to start getting out of the recession rut in the medium term.

- **CONSEQUENCES OF THE WAR IN UKRAINE ARE FELT BOTH THE CONFLICT PARTIES AND THE GLOBAL ECONOMY**

Russia's military aggression has led to Ukraine's colossal losses: human, infrastructural, and financial. Belarus and other countries have faced serious, but not so devastating consequences. Taken together, the effects of Belarus' complicity in the military aggression cast doubt on the country's economic growth potential. In the future, development prospects will depend on the state of Belarus after the war ends.

- **THE SECOND NPP UNIT IS ALMOST READY, BUT THERE ARE MORE QUESTIONS THAN ANSWERS ABOUT OPERATIONS OF THE BELARUSIAN NPP**

The only effect noticeable in the BelNPP's operations is a reducing natural gas procurement. The first NPP unit has a 50% efficiency. It has been idling more than operating this year for reasons unknown. The second NPP unit is planned to operate at a full capacity in Q1-2023. However, the question is still relevant: whether the electricity generated by it will be in demand given the current economic situation and foreign markets closed to Belarus. Next year, it is planned to start repaying the main loan associated with the construction of the nuclear power plant. In this regard, the issue of electricity cost and fulfillment of promises to reduce electricity tariffs that the authorities used to make to the public will arise.

The Expert Opinion Bulletin (“Belarus Economy Monitor: Trends, Attitudes, Expectations”) presents a subjective expert review of the key short-term trends in the Belarusian economy. Each bulletin issue selects three key trends based on a survey of three experts: the BEROC staff members and third party experts. The summary captures these trends, as well as the expectations of the three experts interviewed for future economic dynamics. The body of the bulletin provides individual expert opinions on one of the challenges, their expectations and situation development scenarios.

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THE FUTURE IS TAKEN FROM BELARUSIANS

Economics and finance expert who wished to remain anonymous

Manual regulation worked out when addressing the challenges of state-owned enterprises

Assessing the economic policy of the government of Belarus in 2022, I would rather not discuss proactive actions, but a situational reaction or attempts to respond to problems and challenges. In general, the outcomes — both bad and good — have been achieved due to external factors, and they have largely become the consequence of the domestic policy (not economic): tightening political reprisals against dissenters and the default of the law.

One of the first decisions in response to the looming crisis was to establish the Operational and Situational Headquarters and to manually solve local issues of large state-owned enterprises. This had a positive effect, allowing manufacturing enterprises to adapt to new realities rather quickly. However, in this case, too, the opportunistic luck has made its contribution, allowing Belarusian enterprises to occupy the place of curtailed supplies from developed countries to the Russian market. If we talk about a good picture of exports in the US dollar terms, then strengthening of the real exchange rate of the Russian ruble had a noticeable effect: prices in Russian rubles grew with a simultaneous increase in value against USD. However, this is a temporary phenomenon, the impact of which will not be long lasting either: the economy will swing back to equilibrium, which will adjust the foreign exchange rate. At the same time, it was important that the flow of these funds be used not so much to increase wages as to repay debts, which allowed external debts of enterprises to reduce.

Other decisions were most often untimely and ineffective

At the same time, there was no policy in the labor market as such. The human capital drain problem was ignored completely. Moreover, the authorities not only did nothing to stop it, but, on the contrary, they added additional problems thus stimulating people to make more active decisions about emigration. In parallel, layoffs of qualified personnel continued. In fact, we can talk about the destruction of the human and social capital of Belarus. In the long run, this problem will put an end to the country's ability to emerge from a permanent recession.

As for the monetary policy, at the very beginning of the year, when banks raised interest rates and there was no excess liquidity, it might have made sense to expand the money supply at the expense of the National Bank. However, this was no longer necessary in the summer. By that time, the money supply had grown significantly, in particular due to large foreign exchange earnings and growing deposits of business entities. At the same time, the volume of cash in circulation increased, which was a response to accelerating inflationary processes

and the limitation of the options for payment systems due to sanctions imposed on a number of banks.

Further, we can recall the famous price containment, which was resorted to, although it is known that no one has ever been able to hold inflation in the long term by strict regulations. This decision may result in a deficit of goods and a surge in prices after lifting the ban. If there are no changes in price regulation, then we will see retail chains facing problems with their financial performance in 3-4 quarters. In addition, it was unlikely that additional costs had been estimated: the costs associated with the administration of this process that would fall on the regulatory system, the judicial system, and retail chains.

The resolution on prices will also have an impact on the state budget, because in the context of low economic growth, price growth was important in terms of replenishing the treasury. The state budget will feel the change in the situation already when quarterly taxes are paid.

Forecasts for 2023 raise questions in terms of balance

The socio-economic forecast for 2023 assumes GDP growth of 3.8%; inflation is planned not to exceed 7-8%; growth in real incomes of the population is expected at 4.1%; investment in fixed assets is expected to grow by 23.3%; and exports are expected to grow by 5.5%. It is unknown what this forecast is based on, because there is no publicly available resolution by the Ministry of Economy, which would explain how it is planned to achieve these indicators. Nevertheless, from the balance point of view, there are a number of claims to these plans. In particular, the increase in economic growth rates significantly above the potential level (estimated at about 0.5%) suggests the economy to overheat. In this case, there is always an acceleration of inflation, and we have an inflation slowdown in the forecast, which is rather challenging from the viewpoint of the balance of the model.

Second point: the National Bank and the government project the Belarusian ruble exchange rate to weaken. Based on this, a serious devaluation of the Belarusian ruble should occur in 2023. In this case, again, we should expect prices to rise.

The planned increase in wages against the backdrop of the worsening situation in the foreign exchange market in the past few weeks will increase the population's demand for foreign currency, which will also accelerate devaluation and the inflationary spiral.

There are many questions about investment growth. Let's start with the sources of investment: objectively speaking, one can forget about foreign investment for the time being in the current context; investment supply from private domestic investors will be minimal, and there is no money in the state budget. Leveraging Russian loans looks doubtful to me both in terms of the possibility to disburse the funds within one year and in terms of their allocation in principle. The next question

is about the direction of investment. I can hardly imagine what domains can currently accommodate such an amount of investment. This is due to both the uncertainty of prospects and the restrictions on the imports of equipment. Moreover, excessive liquidity in banks indicates that there is nowhere to invest credit resources, which also indicates the absence of feasible investment projects. The third question concerns the balance of the forecast: the additional USD 1.5-2 billion needed to achieve the government's planned investment growth suggests a sharp increase in domestic demand. In this case, deterioration of the foreign trade balance should be expected. And the forecast states that it will grow. It doesn't work like that.

Due to all these inconsistencies, it seems that the forecast has been drawn because everyone wants to see nice-looking numbers, and it doesn't matter if there is an internal connection between them or there isn't, while there is no understanding of how they can be achieved. In many ways, this is a consequence of the elimination of independent expertise and, therefore, there is no professional dialogue on economic development opportunities.

Another important issue relates to foreign trade. Next year will probably run out of opportunities for the export miracle to be continued. Most likely, one should expect export volumes to decrease, while they are projected to grow. On the one hand, this will be due to the reversal of the Russian ruble from strengthening to weakening. On the other hand, this will be due to the lack of physical opportunities to increase production volumes as far as key export items are concerned. The most interesting thing is that we will see some growth given the low baseline in March-May 2022. This will allow authorities to report on achievements. And then – when the export challenge becomes apparent – it will be too late to respond to the situation. Although, it is not clear how to respond: Belarus has a seriously limited access to markets, except for the Russian one.

The government does not have a clear understanding of what kind of economy we are building

When analyzing the available forecast documents, one gets the feeling that the government does not have a clear vision of what economic model should implement in Belarus: there is neither a goal, nor an understanding of possible tools, nor the ways to use them. So, the reactionary policy will continue.

Tax increases are planned for next year (which, according to Finance Minister Yuri Seliverstov, will not lead to a tax burden increase, which sounds strange at least). However, let us not forget about the changing tax base. The most probable is the cessation of the business, both due to the continued pressure from the authorities and due to the lack of prospects in the medium term. Ultimately, there is no guarantee that tax revenues to the state budget will grow or even remain at the same level as before.

In addition, the limitation of retail price growth (discussed above) was hardly taken into account when calculating the state budget for the next year. It should have been canceled to ensure the state budget replenishment. However, it will not be possible to abandon it quickly given the inability to admit mistakes, as well as the positive perception of this decision by the general public. Most likely, the reaction will be belated when both retail chains and the state budget will have faced problems. As a result, there can be a risk of monetization of the (quasi) budget deficit through money printing: authorities have already opened this Pandora's box earlier this year.

In summary, one can generally say that the government does not have a clear understanding of where we are going. This is a big problem, which implies the impossibility to offer any social contract to replace the lost one. If the government has nothing to offer, there is no hope for an investment influx, an adequate response to verbal interventions, and rational behavior in response to the introduced incentives.

Today, the government no longer even draws pictures of a bright future; a significant improvement in the well-being of citizens as a goal is off the agenda, too; there is no flaunting the status of an IT country, a transport and logistics hub in the center of Europe, the image of a “prosperous” Belarus. The rhetoric boils down to the fact that there is no war, hot water and food are available, and this should be rejoiced. Such a message undermines Belarus' opportunity to start getting out of the recession rut in the medium term. Therefore, my medium-term forecast is fluctuations around zero growth rates. If the current destructive policy towards human capital, attitude towards entrepreneurship as to a hostile class, and further violation of property rights continue, one should expect further degradation of institutions and economic recession. In fact, our future has been taken away from us.

THE WAR IN UKRAINE HAS SERIOUSLY HIT THE ECONOMY OF THE WHOLE WORLD

Katerina Bornukova, Academic Director of BERO C (Kyiv), visiting professor at Charles III University of Madrid

Ukraine: thousands of deaths, migration and huge losses for the economy

The greatest tragedy of Russian aggression against Ukraine is the human lives lost. According to the UN, the number of victims among civilians exceeded 15 thousand people by October. At the same time, it is possible to talk about other losses, which are expressed in many forms and types and have an impact both on Ukraine itself and on other countries of the world.

If we discuss the economy of Ukraine, the first thing that can be assessed most easily is the impact of the war on the country's GDP. According to the IMF, it will shrink by more than 30% this year. This is about 60 billion US dollars. In addition to this abstract indicator, there is also a more tangible impact: these are physical destructions or infrastructural losses. According to the estimates of the experts involved in tracking all the destructions, the amount of losses has already reached ca. 500-600 billion US dollars. The longer the shelling of infrastructure continues, the bigger these losses are.

The third important aspect in this context is migration, which has become a saving phenomenon for the Ukrainian people. Over 14.5 million citizens have left Ukraine since the war's outbreak. Most of them want to come back after the war; some people return now; however, it is obvious that some people will not return, especially if the war drags on. This is a huge disruption to the economic potential in the future, but it is much more difficult to estimate this damage.

Belarus: increasing dependence on Russia and losing the driving force of the economy

We can move on from the economy of Ukraine to the economy of Belarus. Here we see several ways in which the war affects our country. First of all, this is the cessation of trade with Ukraine, which is why we lost almost 5 US billion of exports and over 1 US billion of imports. Belarus was highly dependent on this trade: hardly any other country had more than 10% of its exports to Ukraine. In addition, the sanctions have a huge effect on the economy of Belarus (and on the economy of Russia). Their effect will be long-lasting. One can also recall the exit of the businesses, which was not the element of the sanctions. This phenomenon manifested itself in the IT industry most notably. As a result, the sector that used to grow at 10% per year is now showing an unprecedented decline. Employment is dramatically declining in this sector: even companies that do not close their business or relocate are suspending hiring, and their personnel are outflowing. There has been almost a 20% staff reduction in medium and large companies. These are direct losses of the driving part of the economy, and it is not clear how much their impact on

the rest of the economy will grow. Therefore, the prospects for this sector and of the economic growth of Belarus in general become very doubtful.

At the same time, Belarus has not suffered from the increased prices for energy commodities, which other countries have experienced. Belarus did not have to bear the costs of supporting Ukrainian migrants either, because most of them fled to other countries.

On the other hand, since Belarus lost its second and third trading partners (the EU and Ukraine), Russia has remained almost the only major foreign trade market despite growing exports to Asian countries. Therefore, dependence on the Russian economy has grown significantly. About 40% of Belarusian exports went to Russia a year ago, and there was still a goal to lower the share of the Russian market in Belarusian exports by growing trade with the EU and the countries of the so-called Far Arc; and now, this is out of the question, and the share of exports to Russia, most likely, reaches 60-70% of the foreign trade of Belarus. Moscow is the only partner Belarus can turn to for funding. It has been the only supplier of energy commodities.

World: food security risks, growing military budgets

Other countries that have not directly experienced military conflict are feeling the economic impact of the war in Ukraine through two main channels. This is trade, primarily with Ukraine. This is both about European countries and other countries. This is about those heavily dependent on Ukrainian grain supplies who have faced food security risks. The second channel is the rise in prices associated with the conflict and its consequences. First of all, this is about rising prices for oil and gas. This has predominantly affected European countries that used to buy Russian commodities.

In general, the consequences of the Russian military aggression have impacted the entire global economy. Thus, the World Economic Outlook prepared by the IMF in October 2022 gives much less optimistic estimates and projections compared to those provided in January this year. It had been initially expected that the global economy would grow by 4.4%, in particular, the Eurozone would grow by 3.9%; then, the October report took the effects of the war into account and projected the global economic growth would be 3.2%. This was 1.2 p.p. lower or over 1 trillion USD. The forecast for the Eurozone fell to 3.1%.

It is obvious that not only the war, but also other factors, for example, the slowdown of the Chinese economy, have been affecting the slowdown in the global economy. However, much of the potential growth loss still stems from the Russian war in Ukraine and its aftermath.

An important long-term effect of hostilities in Europe will be growing military spending in various countries. On the one hand, growing military production will have a positive impact on GDP by stimulating its growth. On the other hand, huge resources will be redirected to

this sector, which will affect budget expenditures. This is a sad fact for everyone, because these are the resources that countries could spend on education or health care.

The second long-term trend that will stay with us after the war is a decline in the degree of globalization and mutual trade. In particular, for Belarus (as for a small open economy), this may be fraught with turning into a small region of the Russian Federation (economically speaking), because trade with other countries will be either limited or transited through Russia.

As for trade relations between Ukraine and Russia, everything will depend on how the conflict ends. However, it is obvious that if no major political changes happen in Russia, it may stay behind the Iron Curtain, and the further, the more separated Russia will be in all large and small points of interaction. This is seen already: Europeans were not ready to give up Russian gas and oil at the beginning of the year, but now they are doing it gradually. Moreover, the process is going much faster than expected initially.

Another big question is whether they will demand indemnities from Russia, confiscations of its blocked reserves. Now Kyiv is serious about finding ways to recover money from Russia, which is generally understandable, because Ukraine's losses are approaching half a trillion US dollars. If the issue is resolved in favor of Ukraine, then part of Russian property abroad, including reserves blocked by sanctions, may well be allocated to the affected country. This will give Ukraine some resources to rebuild. I think other countries will also support this, but this will depend on the political and economic situation at that time. It seems that everyone is interested in Ukraine recovering as soon as possible after the war ends.

Assuming that the war ends in the spring of 2023, the total losses of Ukraine could be about 40% of GDP by that time (this is without taking into account the destroyed infrastructure and human losses). If Ukraine is supported and it actively integrates into the Eurozone, then the country will be able to restore such a volume of the economy in about five years. However, returning to a growth trajectory — as seen from the experience of other wars — can take decades.

As for Belarus, it is not very clear in what condition we will emerge from this war. What will be the scope of sanctions if they are still in force by that time. It depends on whether we return to the previous growth trajectory or whether we will be ten years behind what could have been if Minsk had not become an accomplice to aggression. If domestic political changes happen in Belarus, then the loss of approximately 5% of GDP can be easily recovered in a year, and another year will be needed to catch up with the lost time.

DOES IT MAKE SENSE TO BRING THE SECOND NPP UNIT TO FULL CAPACITY; AND WHAT IS THE EFFECT OF OPERATING THE FIRST NPP UNIT

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The only effect of the NPP's operation is a reducing gas consumption

Minsk borrowed USD 10 billion (of which about USD 7 billion were spent) to construct the Belarusian Nuclear Power Plant (BelNPP). Now we are paying interest on this loan, and principal debt repayment may begin on April 1, 2023. However, the NPP has been having a 50% efficiency: only one power unit has been launched at full capacity; and in 2022, it was idle longer than it operated.

The NPP shall undergo maintenance and repair — including refueling — every 9.5 million kWh of electricity generated. This is how much energy the NPP generates per year on average. It is believed that a nuclear power plant can stand idle for about 10% of its entire service life. This time is needed for the so-called scheduled preventive maintenance. It takes about 35-36 days per year. This year, the NPP was idle for 198 days, i.e. over half of the time. What exactly was happening at the NPP at that time remained unspoken. There are two opinions: firstly, some equipment that was not available could be needed during the repair, and they had to wait for its delivery or production. Secondly, there was no such demand for electricity in the country that the NPP would continue generating. As it is known, monthly electricity generation data has not been published since April; therefore, we do not know how close this theory is to reality.

In any case, such a long downtime raises questions, because according to other nuclear power plants, the maintenance and repair period rarely lasts more than 70 days even with a significant equipment replacement. I have not found a single case of maintenance and repair lasting for more than 100 days. In our case, the downtime has almost come close to the time that it once took to erect a sarcophagus at the Chernobyl nuclear power plant (it took 208 days).

At the same time, there is no reason to believe that such long downtimes at the BelNPP will become the norm. Perhaps the next repair will last 35 days, and the NPP will operate as planned. Otherwise, this NPP will not fit into any economy.

Among other things, even though the NPP has been disconnected from the power grid for a long time, there is one important effect that is already visible. This is a reducing procurement of Russian gas. According to the Ministry of Energy, the first NPP unit has generated 10 billion kWh of electricity since it was connected to the grid, thus replacing 2.8 billion m³ of gas.

Does it make sense to bring the second NPP unit to full capacity?

At each moment in time, electricity generation shall be aligned with electricity consumption: this is a particularity of this sector. We do not have warehouses to produce electricity at night and sell it during the day. Meanwhile, there are times when electricity generation exceeds electricity consumption. To address this issue, many thermal power plants (CHPs) and some boiler houses have been equipped with electric boilers to consume excess electricity by turning it into thermal energy for consumers. When one NPP unit is operational, there is no problem of excess electricity. If the second power unit starts operating at full capacity in the first quarter as planned, then I am not sure that the capacity of these electric boilers will be enough to consume all the excess electricity.

It seems that there is no point in rushing to bring the second power unit to full capacity. The only question is how to repay the loan, because if we have to repay the entire loan, i.e. 7 billion, and, e.g., only one power unit is operational (if this is not stipulated in the loan agreement), then the situation looks rather complicated. In this case, electricity will be very expensive. On the other hand, it seems that if the second NPP unit is launched, its electricity will have no consumers, because there were hopes for economic growth and stimulation of consumption, in particular, due to the construction of houses with electric heating. There is no publicly available data, but it seems that these plans have not materialized, judging by the GDP decline and sectoral performance in the economy.

As for the loan, there is a chance that loan repayments will not be as much of a burden as it might seem. However, this will be the case only if the NPP construction contract stipulates penalties in case of violation of the construction deadlines. We have not seen the loan agreement itself, but it would be logical to write this down. If so, it turns out that if the NPP is not commissioned on time, then not Belarus, but Rosatom Export will repay the debt, or the loan agreement will be amended in favor of Belarus.

No tariff cuts to be expected

Once upon a time, Belarusians were promised that after the BelNPP is constructed, electricity would become cheaper to consumers. Now the situation looks like that the commissioning of the first power unit has not affected the tariffs in any way. Calculations also show that the cost of electricity generation at nuclear power plants is not cheaper than at gas units. It turns out that we simply replaced one fuel with another, and now we pay extra for this at the expense of construction costs and loans, which negatively affects the economy. The last thing said by the Ministry of Energy about electricity tariffs was that the operation of the NPP had already been accounted for in the tariffs; although the tariffs have not changed in fact. Nothing seems to be expected here.

The only ones who can hardly be called beneficiaries in this situation are the people who have started consuming electricity for heating. However, this is only because very low electricity tariffs were designed specially for them: three times cheaper than the electricity generation cost. The Ministry of Energy and the antimonopoly authority (Ministry of Antimonopoly Regulation and Trade (MART)) refer to the electricity generation cost, which allows returning all economically justified costs: about USD 0.09. Households may consume electricity for heating at a tariff of about USD 0,012. This is an obvious subsidy, a large one.

It is planned that Belarus will repay its NPP construction loan in 15 years. After that, the electricity generation cost should significantly reduce, and theoretically speaking, it can become cheaper.

BelNPP's prospects in the context of the energy crisis and climate agreements

If a country has a nuclear power plant, it can better adapt to changing realities and comply with climate agreements. There is some anti-nuclear rhetoric and criticism from environmentalists, but this is because this electricity generating method is not considered safe, and the issue of safe disposal of spent nuclear fuel and radioactive waste has not been fully resolved. On the other hand, nuclear power generation is considered climate neutral (if we do not take into account the NPP construction phase) because it is not associated with greenhouse gas emissions. Therefore, if we reduce our natural gas consumption, this will reduce our greenhouse gas emissions and climate impact.

At the same time, if we touch upon the issue of dependence on Russian energy sources, then this dependence remains, because the only supplier of nuclear fuel for

the BelNPP will be the Russian Federation. You can recall oil or gas supply disruptions for political reasons. Similar situations are quite possible with nuclear fuel for the NPP units. On the other hand, nuclear energy prices are not so prone to spikes. First, in this case, the nuclear fuel price has a much smaller share in the electricity generation cost; second, the nuclear fuel price is not as volatile as the gas price. Therefore, nuclear energy means more stable and predictable electricity pricing.

Political challenges associated with BelNPP

European stakeholders, primarily Lithuania, were very critical of the construction and operation of the Belarusian nuclear power plant. Perhaps, they will not change their attitude even after the political regime changes in Belarus, because it seems that these things are not connected in any way. In this regard, Belarus will face the question: what to do with this NPP? On the one hand, there is the issue of the great potential for economic cooperation with Lithuania and Poland due to the operation of the NPP. On the other hand, decommissioning the newly erected NPP prior to repaying the loan for its construction would also be a painful decision. This issue will arise anyway.

Most likely, it will be necessary to conduct an independent audit of the NPP by engaging the stakeholders and to draw a conclusion regarding its safety. If it is decided that the NPP is safe (or its safety can be upgraded as required), then this can be an argument in negotiations with the neighboring countries. If it turns out that the NPP is dangerous, then it must shut down in any case, because Belarus is not a place for running dangerous NPPs.