Belarus’s petro-chemical industry has contributed to economic growth and supported domestic demand, but made the economy exposed to volatilities in global oil markets and energy trading with Russia, thereby calling for stronger mitigation of external shocks.

One way to reduce Belarus’s vulnerability to energy supplies and global oil prices would be to increase competitiveness of traditional export industries.

Using oil duties towards building of fiscal buffers instead of financing additional public spending would help offset the negative impact of oil product export windfalls on competitiveness of traditional exports.

Belarus imports most of its crude oil and natural gas from Russia, and refined oil products are a significant proportion of the country’s exports. Belarus imports crude oil and produces oil products, mainly for exports, at its two refineries whose combined annual capacity is 24 million tons. Since early 2000s, Belarus has benefited from importing crude oil from Russia at a steep discount, while exporting refined oil products at world market prices. As a result, oil products exports generated about one-third of total merchandize export revenues (see Figure 3). Between 2001 and 2009, implicit transfers associated with subsidized imports of oil from Russia are estimated on average at 7.4 percent of GDP per year (see Figure 1).

In recent years, direct benefits associated with oil product exports have eroded due to the periodic disputes over the terms of crude oil supplies from Russia, and the steep decline in world oil prices. By 2010, the size of the subsidy had dropped to 3.3 percent of GDP from 10.1 percent of GDP in 2006 due to protracted bilateral controversy with Russia on gas and oil supplies. At the end of 2010, the two countries reached an agreement, and subsidized supplies were resumed, doubling the average annual oil subsidy up to 7.2 percent of GDP in 2011–2014. However, with the steep downward trend in world oil prices since mid-2014, the subsidy element also took a dive. In 2016, the oil subsidy received by Belarus dropped further to 5 percent of GDP from 7.6 percent of GDP in 2015. This reduction occurred due to (i) the introduction of additional taxes by Russia, which effectively increase the crude oil import price for Belarus, (ii) the decline of world oil prices, as the average oil import price for Belarus in 2016 was about $30 per barrel compared to the world price of US$43 (in 2014, the respective prices were US$48 and US$96 a barrel); (iii) a global industry-wide fall in refining margins since mid-2015; and (iv) a reduction of oil supplies due to the bilateral dispute on the gas price (see Figure 2).

Harnessing an opportunity for boosting competitiveness

High dependency on processed oil exports has undermined the competitiveness of Belarus’s traditional exports, while making the economy vulnerable to changes in global oil prices. Since 2000, sizable inflows of foreign exchange, associated with exports of oil products, have been used to support expansionary fiscal and monetary policies. This in turn fueled a rapid expansion of domestic demand. At the same time domestic resources – capital and labor – shifted towards non-tradable sectors, which responded to an increase in domestic demand, and the Belarusian ruble...
appreciated in real terms due to high inflation triggered by large increases in domestic money supply. The growth
diagnostics for 2011–2015 shows that only five sectors out of 24—construction, mining, transports, communications, and
finance—had positive productivity dynamics (measured as Total Factor Productivity). The fastest productivity growth was
observed in construction, which accounted for almost 10 percent of gross value added. Similarly, there was a tendency
towards real exchange rate appreciation between 2000 and 2008, as oil prices trended steeply upward. Over the last
twelve months, the BYN appreciated in real terms with respect to the US$, in contrast to the BYN/RUR real exchange rate
(Figure 4), making it more challenging to diversify Belarus’s traditional export goods to new markets outside Russia and
other CIS countries. Belarus’s merchandise export structure developed higher dependency on oil related products at the
expense of machinery and labor-intensive sectors, thereby making the country’s exports more vulnerable to shifts in global
commodity prices. Similarly, recent changes in the partner-specific terms of trade have made non-oil exports of Belarus
increasingly dependent on Russia’s market.

In April 2017 Russia agreed to restore its oil supply volumes to Belarus, but the relatively moderate recovery in
global oil prices have eroded the benefits to Belarus from processing imported crude oil. According to the World
Bank’s Commodity Markets Outlook of January 2017, crude oil prices are projected to rise from US$43 per barrel (US$314
per ton) to US$55 per barrel (US$403 per ton) in 2017, following agreements among some producers to limit output in the
first half of 2017. World Bank estimates oil prices to increase to US$60 a barrel (US$ 438 per ton) in 2018, assuming a
balanced market and no additional supply restraint from the OPEC. Furthermore, further increase in crude oil import price
to Belarus is envisaged throughout 2017–2018 as a result of tax maneuver in Russia, global prices will recover very slowly
and limit the size of the effective level of subsidy from Russia.

Today there is an opportunity to lay foundations towards a new vision—competitive, inclusive and dynamic
Belarus. Belarus missed the opportunity to capitalize on the favorable external environment, including on sizeable energy
subsidies by Russia. The windfall benefits from oil trade and refining could be used to reorient the economy towards
stronger export diversification and lay down the foundations for faster income growth. Without a competitive non-oil export
sector, low world oil prices will continue to undermine the sustainability of Belarus’s export revenues. Boosting the
competitiveness of the traditional export sector would require measures aimed at increasing its productivity by gradually
reducing misallocation of capital and labor resources and improving the business environment. There is a need to consider
offsetting the existing and potential negative effect of oil windfalls on the competitiveness of traditional exports (the Dutch
Disease effect). One of the options would be to use the oil duty revenues to support fiscal savings instead of supporting
expansionary fiscal and monetary policies. Some positive steps have already been made as oil duty revenues are used
to pay off the foreign public debt. Large oil-producing countries have relied on sovereign wealth funds to ensure that
 savings would be available for use by future generations. Belarus’s endowments—highly educated work force and
favorable geographical location at a crossroads between East and West—would help to facilitate the integration into a
more globalized world economy and towards a more sustainable economic growth trajectory.

Figure 3: Shares of commodity and oil exports in total exports and GDP, 2003-2016 (percent)

Figure 4: Indices of real exchange rates of Belarusian Ruble vis-à-vis US Dollar and the Russian Ruble (December 2008 = 100)

Source: World Bank Staff estimates on the basis of official data.

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