

## VIENNEAST COMPASS - BELARUS: COUNTRY PROFILE

### SUMMARY:

- **Belarus is a post-communist outlier, shunning transition to liberal democratic capitalism following the election of Alexander Lukashenko in 1994;**
- **The country is characterised by its authoritarian governance centred around Lukashenko; a state-dominated economy; structural dependence on Russia; and hybrid foreign policy;**
- **This system is by its nature conducive to corruption, despite Belarus having improved its standing in international rankings in recent years;**
- **The upcoming presidential election is uncharacteristically competitive and will undermine Lukashenko's authority even if he wins;**
- **Political, economic and legal uncertainty is likely to increase in the 1- to 2-year outlook.**

### POLITICAL SUMMARY

*POPULATION:* 9,408,400

*CAPITAL:* MINSK

*GOVERNMENTAL SYSTEM:* UNITARY PRESIDENTIAL REPUBLIC

*ACTIVE GOVERNMENT:* CABINET OF NOMINALLY NON-PARTISAN PRESIDENTIAL APPOINTEES

*Overview:* Formerly a member of the Soviet Union, Belarus declared its independence in August 1991. In the first three years of the country's post-Soviet transition, its leaders sought to pivot strategically towards the West. This changed after 1994, when the pro-Soviet chairman of parliament's anticorruption committee, Alexander Lukashenko, won the presidential election. Lukashenko subsequently reinstated Soviet-era functions and strengthened economic relations with Russia. Since then, the investment environment in Belarus has been shaped by five primary characteristics.

#### *1. Authoritarianism*

Belarus is unique within Europe on account of its **Soviet-style institutions and economy**. The president appoints the executive, whose cabinet is headed by a prime minister. Legislative authority is vested in the National Assembly, which is comprised of a lower chamber (the House of Representatives) and an upper chamber (the Council of the Republic). The Constitutional Court is the highest legal authority.

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In practice, however, these institutions are extensions of President Lukashenko, **with whom virtually all powers are centralised**. Lukashenko personally appoints almost all senior officials, including the cabinet and the majority of judges. He may enact decrees that have greater weight than those of the National Assembly, as well as veto the state budget. The ruling majorities in both chambers of parliament are not commanded by political parties but by independents subservient to Lukashenko. Political parties are tolerated in as far as they are supportive of the government. There is a single opposition representative in both chambers, rendering their significance symbolic. **Elections are neither free nor fair**. According to Freedom House's *Nations in Transit 2020* index, Belarus scored on average 7 out of 100 points in terms of its level of democracy, thereby classifying as a **'consolidated authoritarian regime.'**<sup>1</sup> The Lukashenko family loom large, with two of his three sons holding senior state positions, including that of National Security Advisor.

## 2. *Statist economy*

In rejecting free market capitalism, Lukashenko instead championed **state ownership of the economy**. According to the International Monetary Fund ('IMF'), fully and partially state-owned enterprises ('SOEs') account for approximately 60% of economic output - rising to 77% in the industrial sector - and 55% of employment.<sup>2</sup> This provides a lever through which political pressure may be exerted on much of the workforce. **Most SOEs are inefficient and highly subsidised**, with their management assigned on the basis of their political connections and loyalty. The **regulatory burden remains high**, despite some loosening, given market distortion, nontariff barriers and sectoral restrictions. According to the Heritage Foundation's *2020 Index of Economic Freedom*, Belarus ranked in 41<sup>st</sup> place out of 45 European countries.<sup>3</sup>

The government has **nonetheless courted foreign direct investment ('FDI')** in recent years, pursuing a 'multi-vector' foreign trade policy (see section 4). According to the United Nations Conference on Trade and Development ('UNCTAD'), FDI inflows amounted to nearly USD 1.3 billion in 2019, increasing **the overall stock to USD 14.5 billion**.<sup>4</sup> The formation of the Eurasian Economic Union ('EEU') in 2015, of which Belarus is a founding member, provides investors frictionless access to a large single market including Russia and Kazakhstan. Good infrastructure and low-cost skilled labour provide further incentives. The government is **actively seeking joint ventures**, and notably established six Special Economic Zones ('SEZs'), the residents of which conditionally enjoy preferential tax treatment. The relative success of the government's hybrid approach to FDI is reflected by the World Bank's *Doing Business 2020* index, which ranked Belarus in 49<sup>th</sup> place out of 190 (albeit down from 37 in 2019).<sup>5</sup>

## 3. *Dependence on Russia*

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<sup>1</sup> <https://freedomhouse.org/country/belarus/nations-transit/2020>

<sup>2</sup> <https://www.imf.org/~media/Files/Publications/CR/2017/cr17384.ashx>

<sup>3</sup> <https://www.heritage.org/index/country/belarus>

<sup>4</sup> [https://unctad.org/en/PublicationsLibrary/wir2020\\_en.pdf](https://unctad.org/en/PublicationsLibrary/wir2020_en.pdf)

<sup>5</sup> <https://www.doingbusiness.org/en/reports/global-reports/doing-business-2020>

The political economy of Belarus has been sustainable owing to its privileged access to the Russian market, as well as preferential energy prices. The post-Soviet foundation of this relationship is the Union State, a supranational treaty between Belarus and Russia dating to 1997, which envisaged economic integration with a view to eventual union. The provisions of the treaty have largely been unfulfilled, but the Union State is nonetheless of symbolic value. Institutional integration has rather been pursued in the context of the Russian-led EEU.

Belarus is thus **structurally dependent on the Russian economy**, which accounts for 50% of foreign trade (increasing to between 70-95% in certain export sectors, such as machinery) and 60-70% of the FDI stock. Belarusian SOEs, especially in the industrial sector, rely on cheap Russian gas to offset their energy-intensive operations, which would otherwise be financially unsustainable. Similarly, tax-discounted Russian oil exports to Belarus effectively subsidised its petrochemicals refineries, which exploited this price differential to become the most lucrative exports sector: at its peak in 2009, petrochemicals accounted for 30% of the exports market, since falling to 20%.

Yet Russia has often used its asymmetric economic relations with Belarus as geopolitical leverage. Reforms to Russia's tax framework for the oil sector in 2019 ended the export subsidies regime enjoyed by Minsk, **the suspension of which in 2010 caused an economic crisis the following year**. The prospect of future pricing, as well as compensation, is thus being used by Moscow as a bargaining chip to force closer integration with Belarus. The pricing of Russian gas exports is also an issue, with negotiations continuing through 2020.

#### *4. Hybrid foreign policy*

The dynamic between Belarus and Russia is **increasingly uneasy**. President Lukashenko regards Belarusian sovereignty as an utmost priority. This reflects Lukashenko's calculation that closer union with Russia would undermine his own political supremacy. Yet it has also informed a pragmatic **rebalancing of Belarusian foreign policy away from Russia** since the mid-2000s. Belarus joined the European Union's Eastern Partnership in 2008, after which most sanctions on the country relating to human rights issues were abolished. Although tariffs remain in place, Minsk has diversified trade towards the EU over the past decade, increasing the bloc's trading market share by 45% to 18.1% in 2019.<sup>6</sup> Elsewhere, Minsk took a historic step in March 2020 by importing its first oil shipment from the US, despite being subject to a sanctions regime. With respect to security, Minsk has also diverged from Russia, pursuing a strategy of situational neutrality. **China is an increasingly strategic partner**, whose hitherto modest trade and investment presence will be upscaled in 2020-2021 as part of the Belt and Road Initiative.

#### *5. Corruption*

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<sup>6</sup> <https://ec.europa.eu/trade/policy/countries-and-regions/countries/belarus/>

President Lukashenko has cultivated an image of an anticorruption crusader, having *prima facie* achieved considerable progress. In 2008, Transparency International ranked Belarus as the 151<sup>st</sup> most corrupt state (out of 180). As of 2019, it is the 66<sup>th</sup> least corrupt state, compared to Russia (137<sup>th</sup>) and Ukraine (126<sup>th</sup>).<sup>7</sup> Despite this progress, the authoritarian political system and state-dominated economy are by their very nature **a breeding ground for corrupt schemes**. The judiciary is not independent, having been captured by Lukashenko, who is responsible for the majority of appointments. **Public procurement is clientelist and non-transparent**, given the state monopoly in most sectors, especially industrial factories. This poses a **particular risk to foreign investors** engaged in joint ventures. The case of **the Atlant white goods manufacturer** is illustrative of the risk: in January 2020, Lukashenko intervened directly to publicly question its ultimate shareholders about the company's finances.<sup>8</sup> The shareholders are variously a former deputy prime minister, a deputy minister and an MP. Elsewhere, Lukashenko's sons occupy senior state positions, the eldest of whom was previously active in state-owned arms export companies.

*Outlook:* Amid mismanagement of the Covid-19 pandemic by the Lukashenko administration and a secular decline in living standards, we assess that it is likely that **Belarus will experience uncharacteristic political instability in the 1- to 2-year outlook**. Presidential elections are scheduled to be held on 9 August 2020. Normally, Lukashenko could count on a comfortable victory, but independent (albeit unreliable) online polling suggests that popular support for Lukashenko has shrunk dramatically. The contest is competitive to the point that the Belarusian authorities have taken the unprecedented step of detaining two of the opposition candidates, who will nonetheless run. Although we assess that it is unlikely that Lukashenko will be unseated by the vote itself, his authority will be undermined to the point that **a regime change is foreseeable**. Change thereafter will neither be rapid nor unidirectional, but it will nonetheless **increase (geo-)political, economic and legal uncertainty**.

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<sup>7</sup> <https://tradingeconomics.com/belarus/corruption-rank>

<sup>8</sup> <http://www.ctv.by/aleksandr-lukashenko-atlant-menya-davno-napryagal-u-vas-tam-s-finansami-nesladko>