

# The Belarusian Economy Under Sanctions Since the Start of Russia's War in Ukraine

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## Introduction

Following Russia's invasion of Ukraine in February 2022, the Belarusian economy suffered an unparalleled economic shock and entered a severe downturn. Belarus has lost almost all of its exports to its third largest trading partner, Ukraine, and trade volumes with its second largest trading partner, the European Union, have more than halved. A steady 10-month fall in gross domestic product (GDP) still dominates domestic economic trends at the time of writing. To cope with the crisis, the government has resorted to intensifying economic relations with Russia, hiding data in order to disguise the true state of the economy and increased economic interventionism.

## Chronological Overview

Western nations imposed targeted sanctions on Belarusian officials and businesses at the beginning of the country's political crisis in 2020. These sanctions were not intended to harm the overall economy or inflict any significant macroeconomic damage on Belarus.

In 2021, the actions of the Belarusian authorities against the political opposition and neighbouring states, such as the use of Middle East migrants in a hybrid attack on the Polish and Lithuanian borders and the hijacking of a Ryanair aircraft, constituted violations of international law.

As a result of those actions, the EU, the United Kingdom and the United States implemented sectoral sanctions that were estimated to affect exports to the value of 5% of Belarus' GDP. The mainstream scenario at the time was that efforts to avoid sanctions and reorient exports would allow a significant proportion of any potential losses to be recovered. The International Monetary Fund (IMF) predicted GDP growth of 0.8% in 2022,<sup>1</sup> while the European Bank for Reconstruction and Development (EBRD) predicted a 0.5% increase.<sup>2</sup> Given the potential for growth in the Belarusian economy of around 2% per year, experts therefore expected the negative impact of sanctions to be between 1.2 and 1.5% of GDP. After Lithuania decided to ban the transit of potassium through its territory from 1 February 2022, however, forecasts became more negative. In January 2022, the World Bank updated its predictions and estimated a contraction of GDP by 2.8% in 2022.

On 24 February 2022, Russia began its war against Ukraine, using Belarusian territory to deploy troops and launch missiles. The international community recognized Belarus as complicit in this aggression. In response, the West imposed the most severe sanctions in Belarusian history, compounding the losses already incurred as Russia and Ukraine were previously among Belarus' top three international trading partners.

## Sanctions and Trade Distortions

In June 2021, the EU and the UK imposed sectoral sanctions that prohibit the export of oil products, nitrogen products, potash, synthetic materials, wood, rubber, cement, metal and machinery. Exports of such products to the EU previously accounted for 7.3% of Belarus GDP. Belarus was able to partially recover these losses due to the high price of oil and potash during the post-pandemic economic recovery, however, as well as the increased demand for agricultural machinery in Russia, the West and the African countries. Nonetheless, Belarus faces significant obstacles, notably the high level of international condemnation as companies and logistics firms avoid doing business with the country. One significant example is a Lithuanian political scandal that resulted in a ban on the export of potash through Lithuanian territory. Furthermore, financial sanctions have added to export and import difficulties, and reorienting exports from the EU is complicated by the fact that some exports were specific to certain business segments. For example, although Belarus used to export wooden furniture to both Russia and the EU, these were completely different markets. The EU used to buy custom-made luxury furniture while Russia typically demanded cheap furniture at bargain prices.

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1 See IMF World Economic Outlook from April 2021, by December 2021 IMF updated their forecast to 0.5% GDP growth in 2022 <https://www.imf.org/en/Publications/WEO/Issues/2021/03/23/world-economic-outlook-april-2021>, <https://www.imf.org/en/News/Articles/2021/12/17/republic-of-belarus-staff-concluding-statement-of-the-2021-article-iv-mission>

2 In June 2021 EBRD projected 0.5% GDP growth for Belarus in 2022, but then revised their estimate to 0.2% growth in their regional report from November 2021. <https://www.ebrd.com/what-we-do/economic-research-and-data/rep.html>

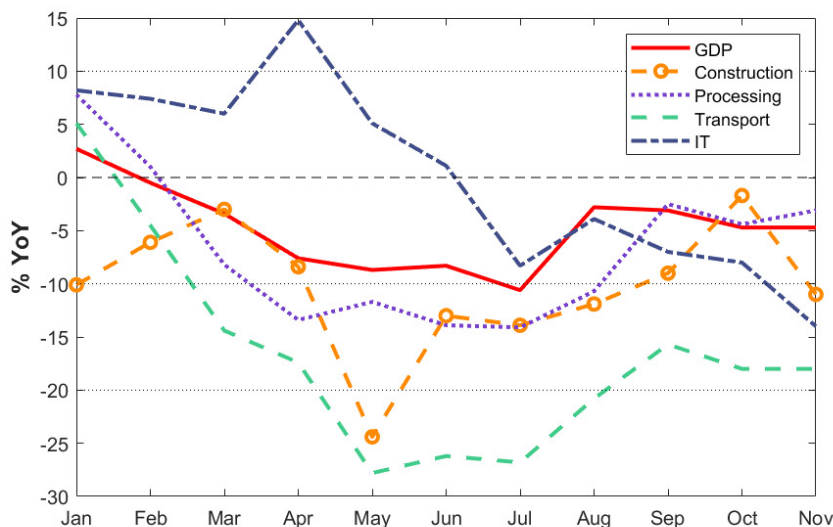
The loss of Ukraine as a major trading partner has also had a significant negative impact on Belarus. Exports to Ukraine constituted 5.5% of Belarus GDP and imports up to 2.5%. Most trade with Ukraine was effectively halted on the first day of the invasion and it is unlikely that trade will return to previous levels any time soon. This is particularly challenging as 70% of exports to Ukraine were oil products, which cannot easily be redirected to other markets. Belarus' closest trade partners, Russia and Kazakhstan, already have their own supplies of petroleum and bitumen.

Another important area of the Belarusian economy to be negatively affected is its exports of services, particularly transportation services and IT, which were previously worth around 6% and 7.5% of GDP respectively. The EU banned Belarusian cargo trucks from entering its territory in April 2022 and Belarus banned European carriers from entering the country in response. In addition, the IT sector – which used to generate 0.5% GDP growth annually, half of total annual GDP growth – has also shrunk due to the mass exodus of IT companies from the country.

## The Economy Under Sanctions

The Belarusian economy has been in recession every month since the beginning of the war. Figure 1 shows that the sharpest decline was during the summer, before the economy slowly began to adjust. In July 2022, real GDP was down by 10.6% relative to July 2021, but the overall decline in 2022 was around 4.7%.

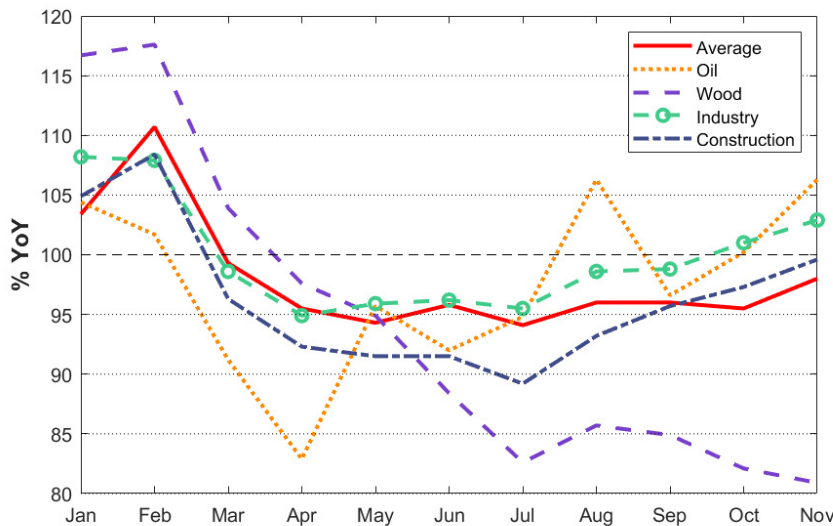
Figure 1 also illustrates another notable dynamic of the Belarusian economy, the IT sector, which had previously grown at an average rate of 8% per year in the past ten years. It stopped growing in June and started to contract in the autumn and winter months of 2022. Unlike other sectors, IT was never targeted by sanctions. The main reason for the decline was the international toxicity of Belarus. Some clients started to avoid dealing with a co-aggressor, investors did not want to bring money into the jurisdiction and some crucial service providers stopped working with Belarus. The IT sector has seen a significant loss of employees. Medium-sized and large Information Services companies have lost more than 14,300 workers since the start of 2022. This represents a significant contraction in the sector, which employed around 52,000 people in 2021. It should also be noted that some IT company employees who live abroad might still be registered at their Belarusian offices for tax purposes, so the actual number of lost specialists could be even higher.



**Figure 1.** Real GDP and selected sectors in 2022 relative to the same month in 2021. *Source:* Belstat.

Figure 2 shows changes in real salaries in selected sectors relative to the same month in 2021. The overall trend resembles the one for real GDP. Average real salaries began to decline soon after war broke out, reached a low point in the summer period and somewhat recovered in the final months of the year. As a result, November average real salaries were just 2% lower than in November 2021. The partial recovery by November can be mostly explained by a fall in inflation rather than by the overall economic adjustment.

When sanctions against Belarus were declared in 2021, the government began to disguise information about the performance of affected industries. Changes in real salaries provide experts with a hint of the situation in those sectors. For example, although there are no available statistics on exports of oil products or the added value of this sector, there was an obvious steep decline in the average real salaries of employees in the sector in March and April 2022. Salaries in the oil sector started to recover in May 2022, which suggests that the government either found ways to reroute Belarusian oil products to Russia or found a loophole in the sanctions regime. The largest decline in real salaries was seen in the wood-cutting and lumber-processing industries and, unlike the situation in the oil sector, there are no signs of recovery.



**Figure 2.** Real salaries in 2022 for selected industries relative to the same month in 2021. *Source:* Belstat.

## Policy Response by the Government

The Belarusian government has implemented three general strategies to address the economic problems of the country: (a) concealing information and manipulating economic expectations; (b) increasing Russian economic support and an export reorientation to Russia; and (c) increased government involvement and greater mobilization of internal resources.

### Information Concealment and Manipulation of Economic Expectations

Initially, politicians and government officials in the economic sector denied that the war and sanctions were having any impact on the Belarusian economy. On 25 February 2022, First Deputy Prime Minister Mikalai Snapkou stated that businesses and the consumer market were experiencing no significant difficulties, and that the only problem was the closure of Odesa seaport. He believed that this logistical issue would be resolved within 10 days.

On the same day, Prime Minister Raman Galouchanka attributed the devaluation of the Belarusian ruble to the actions of “destructive forces” and to “panic”, which he believed would end shortly. Senior officials repeatedly denied that the sanctions and war would have any negative impact on the Belarusian economy. They even suggested that it could bring positive opportunities for Belarusian goods to fill the niches left by foreign companies in the Russian market. These statements appear to have been part of a strategy to manage economic expectations, which seems to have been widely adopted by government officials.

Katsiaryna Rechits, an analyst at the government-backed Belarusian Institute for Strategic Research, articulated a concept that prioritizes managing people’s and companies’ expectations rather than focusing on economic growth factors. According to this concept, it is possible to achieve a positive effect by manipulating expectations, even in adverse conditions.

Hiding socially significant information has been a longstanding practice in Belarus. The most recent phase of this trend began with concealment of COVID-19 mortality data. Subsequently, the format of reports on non-performing loans and bad assets in banks’ balance sheets was altered, and statistics on exports in sanctioned sectors were classified after sectoral sanctions were imposed.

In July, the Ministry of Finance ceased publication of data on budget performance and delivery, and removed information for the previous months of 2022 from its website, claiming that the information was being used for “all sorts of insinuations”. The National Statistics Committee (Belstat) also stopped publishing detailed export statistics in the same month. In August, the National Bank halted the release of information on the composition of its foreign exchange reserves after it was revealed that the country’s gold and foreign exchange reserves had decreased by over 10% since the beginning of 2022.

In 2021, an amendment was added to the Criminal Code that criminalized the distribution of “false information” on the economic situation in Belarus. Following the outbreak of hostilities in Ukraine, the National Bank ceased publication of its regular reports on the economic situation. Access to public information portals was also limited for foreign entities, and subscription-based data sales to independent institutions were discontinued.

Since limiting access to factual data, the government has continued to provide mass media with selective positive statements that lack context. In a major television interview on 24 May, for example, Galouchanka cited a record-breaking level of foreign direct investment (FDI) as evidence of the positive economic situation, while ignoring the fact that this figure was achieved by preventing foreign companies from withdrawing their dividends.

In early August, Galouchanka gave a long interview in which he highlighted record exports to Russia, a significant increase in the profitability of enterprises, a halving of the number of unprofitable enterprises and unprecedented FDI. This was just one week before publication of GDP statistics that showed a double-digit decline in GDP. Deputy Finance Minister Dzmitry Yarashevich had earlier stated that the economy could not fail and that economic forecasts were unimportant. He also urged people to note the record-breaking foreign trade balance rather than judge the economy by GDP, and stated that the Belarusian economy was “gaining stability”.

When officials inadvertently reveal negative information, it is quickly removed from official sources, as happened with National Bank Chair Pavel Kalaur’s statement that bad debts in the banking sector had reached their “limit”. The quote was initially published on the website of the state-owned news agency, Belta, on 4 August but the news was later “corrected”.

## **Falling Into Russia's Arms**

At the outbreak of the Russian-Ukrainian war, Aliaksandr Lukashenka expressed support for Russia's invasion and his readiness to assist Russia in any way. He later stated that, together with Russia, Belarus would survive sanctions and live "better than in the Soviet Union". Belarus is currently the only post-Soviet state to openly express support for Russia's invasion.

Before the war began, Lukashenka repeatedly told Putin that he expected Russia to provide financial support to help Belarus withstand sanctions. However, the extent of this support continues to be limited and does not cover all the economic losses brought about by the war.

Belarusian officials have announced an agreement to delay debt payments to Russia until 2027–2028. Russia will also provide Belarus with low-price energy and allow payments to be made in rubles. As a significant proportion of Belarus' debt is to Russia, this delay provides significant short-term relief and allows Belarus to use its foreign currency reserves for the most pressing needs of its economy.

Another key aspect of the relationship between Belarus and Russia is trade. In pre-war times, Russia's share of Belarusian exports typically fluctuated at around 40 to 50% but by the end of 2022 this figure was closer to 70%. The contraction of the Russian economy has resulted in a 10% decrease in disposable incomes, which has turned out to be good news for Belarusian producers as the country's goods have a general reputation for being "cheaper than European, better than Russian". This effect has been enlarged by the depreciation of the Belarusian ruble against its Russian counterpart. Additional gains came from the fact that international companies leaving Russia opened up opportunities for Belarus to take some of their markets.

Finally, in October 2022 Russia agreed a \$1.7 billion loan for an import substitution programme. Despite much discussion about the potential for import substitution, however, no clear examples have been reported in the media. In fact, Belarusian truck manufacturer MAZ is losing market share in Russia to Chinese competitors. Its sales to Russia fell by 31% in the first seven months of 2022. This suggests that the new loan will be used to cover current economic gaps rather than to start new, profitable companies.

## **A Stronger Grip on the Economy**

Another traditional Belarusian crisis management strategy is to increase the role of the government in the economy. Even before the war and related sanctions, the country began to tighten its fiscal discipline by raising taxes and cancelling exemptions. Since the outbreak of the war, officials have resumed their practice of detaining prominent businessmen and groups of professionals on charges of corruption or tax fraud, and offering to release them in exchange for a payment to the state.

Government intervention in the economy has expanded throughout Lukashenka's time in office. In 1995, he promised to "eliminate the last entrepreneur" and referred to business people as "lousy fleas".<sup>3</sup> The state's anti-market stance weakened over time and in 2017–2019 the former president even acknowledged the successes of private business and the IT sector. Since the 2020–2021 protests, however, this stance has shifted back and leading business figures have been detained, commercial bank directors have lost their accreditation and private sector businesses have been accused of disloyalty and contributing to inflation.

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3 [https://www.gazeta.ru/politics/2014/07/10\\_a\\_6108669.shtml](https://www.gazeta.ru/politics/2014/07/10_a_6108669.shtml)

The government has also become more active in controlling prices, accusing private retailers of artificially inflating prices and detaining the owner of a large retail chain. A list of goods on which prices are controlled by the Ministry of Anti-monopoly, Regulation and Trade was published in the spring of 2022, leading to a further increase in prices.

On 6 October 2022, Lukashenka ordered a ban on any price increases in Belarus. The measure took producers and retailers by surprise, and citizens were encouraged to report any violations of the directive to the authorities. By 18 October, 70 violations had been reported, 34 criminal cases opened and 20 entrepreneurs arrested.

Within two weeks, recognizing the dangers of this measure, officials close to Lukashenka, convinced him to soften the policy. As a result, the decision to freeze prices was replaced by a new state regulation system on 19 October.

The new system involves monitoring the prices of 370 categories of goods, which comprise the entire consumer basket in Belarus. A network of local and central committees was also established to evaluate the fairness of entrepreneurs' requests for price increases and approve prices for new products entering the market. However, the document regulating the new system does not provide a clear definition of what constitutes a fair price, leaving local committees without clear guidance. This puts both officials and entrepreneurs at risk of criminal prosecution for unfair price increases.

The regime has also strengthened its grip on the banks. The state has taken control of Belgazprombank, which was previously led by Viktor Babaryka. In 2020, six directors and board members of Belarusian commercial banks were deemed not to meet qualifications and reputation requirements. This number increased to 12 in 2021 and there were 10 instances in the first five months of 2022. The number of "disqualified" executives of commercial banks in Belarus had previously ranged from two to four per year in the period 2017–2019. This measure is being implemented to force commercial banks to be more willing to write-off loans to state-owned enterprises, comply with the regulator's "recommendations" and not disclose information that is in the public interest.

## **Government Investment**

Due to its inability to secure significant foreign loans and unwillingness to cut spending, the government of Belarus continues to increase taxes as a way to address the growing budget deficit. Excessive issues of the Belarusian ruble are also being used as a means to fill the budget gap.

The government's belief in the superiority of the state economy leads to a conviction that it can invest money more efficiently than private sector entities. Galouchanka has pinned his hopes for economic growth on a new state investment cycle. In September 2022, he announced that the government expects 3.8% GDP growth, with the main driver being a 22.3% growth in fixed asset investments.

The expectation that a large proportion of expected investment growth will come from the state was confirmed in November 2022 when the 2023 draft budget was published. The budget plan includes an increase in both the budget deficit and tax revenues, as well as an increase in the public debt ceiling.

The government's main agent for public investments is the Development Bank, which has received all the available funds and special rights. In November 2021, the National Bank allowed the Deposit Insurance Agency to invest its available funds in bonds issued by the

Development Bank. Later, through a series of Presidential Decrees, the Development Bank was able to issue bonds worth several billion dollars. It is likely that this is a form of hidden money creation rather than a market placement of securities.

## **Tax Rises**

The trend for increasing certain taxes began at the start of the 2020 political crisis. Several changes were made between 2020 and 2021, such as cancellation of the preferential rate of VAT on children's goods, an increase in income tax for IT sector employees, an increase in the excise tax on cigarettes, an increase in the tax on parking spaces and the floor space of business centres, and the introduction of a transport tax.

Following the outbreak of war in Ukraine and the implementation of sanctions, the government's efforts to increase tax revenues intensified. New taxes were introduced, such as a tax on owning an apartment, a special fee for advertisers, an increase in VAT on data transmission services for mobile operators and internet providers, the imposition of VAT on foreign online stores, and fees for gardeners and mushroom pickers. In addition, changes to the procedure for crossing the Belarusian state border by road resulted in new fees, the excise tax on alcohol was increased in April 2022 and a further increase in excise tax on cigarettes is planned for 2023.

The rationale behind most of these new taxes is to take money from those who have it and not to affect others. It is assumed that people who own apartments and cars, and even more so those who work in the IT sector, have "extra" money, which means that the social tensions arising from the introduction of taxes will be negligible. However, these taxes often also only have a minimal impact on the budget deficit.

The Business Union of Entrepreneurs and Employers reported that the government was considering increasing VAT, a major source of budget revenue, from 20% to 23% in July 2022. The report was later deleted. In the current context, however, an increase in this tax, which accounts for up to one-third of budget revenues, is highly plausible.

## **Money Supply**

In 2014, the National Bank of Belarus, led by Pavel Kalaur, promised to promote macroeconomic stability and low inflation by ending directed lending and excessive printing of money. However, it appears that the bank has since shifted to quantitative easing and increased money issuances, leading to a multi-year high in the banking system's liquidity. Kalaur may have only resorted to excessive money issuance as a last resort, as forcing banks to lend to insolvent state-owned enterprises and accepting "junk" securities as debt repayment may have reached its limit in terms of the stability of the banking system. Kalaur has also stated that loose monetary policy is now a priority and that a significant proportion of loans in the country were already concessional and had a negative real interest rate.

In 2022, the National Bank of Belarus started to inject funds into the country's banking system, increasing funding from slightly over 3 billion Belarusian rubles to slightly over 5 billion Belarusian rubles in the first half of 2022. This led to a multi-year high in the banking system's liquidity in June. These funds seem to have been distributed to banks to allow them to maintain their specifically directed lending activities. Kalaur again stated that a loose monetary policy is now a priority and that 30% of loans in the country were already concessional and had a negative real interest rate.



## Conclusions

After the Belarusian regime allowed the Russian army to attack Ukraine from its soil, unprecedented sanctions were imposed on its economy. These sanctions have caused the steepest economic downturn since 1995 and an annual decline in real GDP of 4.7%. Part of the damage has been recovered by deeper cooperation with Russia and a degree of sanctions avoidance.

The government resorted to information concealment and greater economic interventionism, manifest by artificial price controls, tax hikes, printing money and other ways of rerouting resources to government investment agents. The bundle of economic policies enacted is unlikely to help the economy in the medium to long term but might partially stabilize it from a short-term perspective.

To date, the sanctions imposed have not resulted in a dialogue between the Belarusian regime and democratic forces, the release of political prisoners or new free and fair elections. The status of Belarus as co-aggressor in the war against Ukraine and the Lukashenka regime's rapprochement with Moscow limit the room for manoeuvre by the West. Nonetheless, several policy options could be considered in the West's future approaches to Belarus.

- **Provide support to Belarusian democratic forces.** Government actions and statements prove that they are concerned about the economy, and it should be assumed that economic losses will eventually bring it to the negotiating table. It is therefore essential that the democratic forces in Belarus maintain their political potential until that time. The EU should continue and even increase its support for Belarusian democratic forces, NGOs, businesses and forced migrants from Belarus. Measures aimed at countering the emigration of Belarusians and Belarusian businesses, such as visa restrictions and obstacles to opening bank accounts, should be lifted.
- **Take Russia into account while developing sanctions against Belarus.** The issue of sanctions must be approached comprehensively, taking account of Russia's role in circumventing sanctions and mitigating the negative impact on the Belarusian economy. The risk of losing Belarusian sovereignty must also be considered. Its economic situation makes Belarus more vulnerable to sanctions than Russia. For example, Belarus' main export goods (potash and petroleum products) were banned much earlier than the EU's sanctions on the export of Russian oil. At any given moment, sanctions against Russia must be stronger than those against Belarus. Additional restrictions should be imposed on Russian enterprises that assist Belarus.
- **Roadmap for lifting sanctions.** It is important to remember that the ultimate goal of sanctions is to restore the rule of law in Belarus. To demonstrate a willingness for dialogue, a roadmap must be created for the lifting of sanctions in exchange for specific steps taken by the Lukashenka regime.



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