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Foreign Debts: a New Curse or Blessing?

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Does growing foreign debt create a new economic context in Belarus? The repercussions of growing foreign indebtedness are not yet clear-cut despite almost a twofold increase in foreign indebtedness over a year. However, some trends begin to appear. First of all, growing foreign indebtedness is very likely to spur additional liberalization measures, including opening the routes towards FDI inflow. Since Belarus is only entering 'the borrowing business' so, for that matter, there is a range of policy options of how to cope with it. Ultimately, the choice would depend on the export dynamics and also on the configuration of Belarus-Russia relationships now heavily diluted by gas price.

- Introduction

By the beginning of 2008, Belarusian economy has appeared in a somewhat novel situation what concerns foreign indebtedness. Apparently, gas price hike and the revision of terms of trade in oil and oil products have notable repercussions for the current account. Naturally, the deficit required financing, so the straightforward reason for mounting foreign debt is the need to acquire foreign exchange since exports growth has provided a partial relief only. Nevertheless, as soon as foreign indebtedness has started to grow so dramatically, a number of questions arise. How far is Belarusian economy approaching the thresholds threatening macroeconomic stability? Ultimately, does growth of foreign debt mean that the 'economic miracle' is now merely postponing its eventual end by using external resources? As both the BISS and the IPM experts have argued elsewhere, exchange rate stability is one of the central goals of macroeconomic policies in Belarus because of the devastating socio-economic implications of devaluation. Therefore, the Belarusian economic authorities would strive to avoid this worst-case scenario. Another important question is a policy-related one: would increase in foreign indebtedness demand changes in the current economic policies? A debt-privatization trade-off exposed by many experts, including those of the BISS, closely overlaps with another important trade-off, that is, between wages and investment, which becomes visible in the course of political business cycle. Put simply, as soon as funds borrowed from abroad are spent to support consumption in different forms (being that higher wages increased for populist reasons, support of unprofitable or loss-making companies, or public construction), and not investment (especially into export-oriented industries) and modernization, either rollover or new debts are required. Since Belarusian banks and companies have not yet acquired more or less continuous borrowing history, it is their reputation is put at stake. Since the authorities are very likely to recognize that, they seem to be strongly inclined to try options other than privatization.

- The debt dynamics over 2007: reaching a threshold?

By the beginning of 2008, the debt to GDP ratio reached the level of 28.4%, rising from USD 6.7 billion (18.2% of GDP in 2006) to more than USD 12.7 billion. As a result, Belarus has moved closer to the lowest security threshold of 30–35 % provided in various studies. Yet, this is far away from the dangerous level of 49.7% of GDP defined for middle-income countries by the IMF. It is argued that after that level, probability of a debt-caused financial crisis is 66.8%.

In contrast to other transition economies, the Belarus' level does not appear to be alarming Belarus is the bottom of foreign borrowing list both measured in terms of debt-GDP ratio and foreign debt per capita. For instance, 2006 data provided by the European Bank for Reconstruction and Development show that Belarus is the least indebted economy among the transition countries of East-Central Europe and the Baltics with a figure of USD 695 per capita, while the CEE average figure was USD 6,806 and the Baltics' average was 9,463, while for the both regions together it was USD 7,603. As for another popular indicator of debt-related security, the ratio of debt to exports, Belarus also appears to be in a relatively safe situation. An alarming figure is debt-exports ratio of 150%, while in Belarus it is about 40%, while in Ukraine is more than 100% (and Latvia is heading to almost 300%).

As for the structure of foreign debt, no substantial change is recorded. Intergovernmental loan provided by Russia resulted in the increase of sovereign debt by almost four times up to more than USD 2 billion. Still, it is banks and non-financial companies that jointly accumulate two-thirds of foreign debts. In fact, this profile is close to Ukraine's one despite the stark difference in the development of financial market.

- Foreign indebtedness: a threat or an opportunity?

Foreign debt does not automatically bring problems since it can also be seen as investment. In fact, high levels of foreign indebtedness of East-Central European and the Baltic economies are driven by foreign investors' expectations of continuous growth in the former socialist economies. As for Belarus' economy, its decent growth rate might look attractive to financiers from abroad. However, for some observers the key question is whether foreign money is to be used for investment purposes or spent for maintaining growing domestic consumer appetites. Put simply, is there a situation that 'economic miracle of Belarus' is now funded externally since the era of cheap gas is over so the economy is closer to a major crisis.

A simplified schema of debt-caused crisis looks as follows. Export revenues can not offset the lack of foreign exchange while foreign creditors refuse to provide new loans or rollover. A story of Mexico in 1994–1995 is illustrative one. The Mexican economy of the 1990s was growing at a stable rate also due to oil exports. However, a period of high inflation left a bad legacy of high interest rates that attracted foreign investors. Inflow of capital was among the reasons that led to the real appreciation of the peso so the authorities considered 12% devaluation. If implemented, it would reduce the real value of funds invested so there was capital outflow. In that situation, devaluation could not be stopped and indeed occurred at a dramatic (90%) scale. Only the loans and guarantees of the IMF and the US banks and government helped to restore the confidence in the Mexican economy.

Several observations can be deducted from the Mexican experience. First, Mexico (in contrast to Belarus) had accumulated a sovereign, and not a private debt. Second, there has been a sizeable private sector, so privatization revenues were not available. Third, there was a helping hand of the IMF and the US, while for Belarus similar role can be played by Russia.

Interestingly enough, Belarus to some now replicates the experience of the former socialist economies like Bulgaria, Poland, or Hungary. In the 1980s, they have started to borrow internationally in order to purchase world-class equipment and thus revitalize the socialist model by introducing new technologies and production techniques. For instance, in 1989, Bulgaria's debt-to-GDP ratio was 19.5%, while Poland and Hungary had 49.3 and 65.8%, respectively. However, a problem these economies faced was foreign trade orientation. They were trading mainly with the Soviet bloc by using 'convertible ruble', and not the hard currency they borrowed in. Throughout the 1990s, trade reorientation was called to solve this problem, but the banking sector and even some sectors of the economy were kept under government controls. However, a series of micro-crises resulting from politically-motivated support (although on a much lesser scale than in contemporary Belarus) demanded expensive bank recapitalizations (like 2% of GDP in

Hungary and more than 7% of GDP in Poland). Bad loans were accumulated because of political controls and codes developed under the late socialism. These issues have been resolved by selling banks to foreigners so by the beginning of 2000, a majority of the banking system became foreign owned. To some extent, this process has also been driven by widespread penetration of multinational companies that preferred to being serviced by affiliates of large European banks adherent to sound financial discipline and free of political interference.

As for Belarus, some elements of the pictures drawn above are present. First, some banks have already been sold, while negotiations are carried out about further sales. This implies the intensification of competition in the banking sector. At the same time, the penetration of Russia's banks was in some cases conditional (for instance, purchase of the share in 'Mesztorgbank' was related to a promise to invest into Belarus economy as much as USD 1 billion by Russia's 'Alfa-Group'). Next, Belarus can be considered as a newcomer to the 'borrowing market'. Belarusian banks enter it via the market for syndicated loans (i.e. loans provided by several banks to a single borrower) just like Ukraine and Russia some time ago. In particular, Belarusian banks obtain loans for a period of 12 months on average, while Russian and Ukrainian banks do that for a period of 34 and 31 months, respectively. There are reasons to expect that both time span and the volume of funds would be extended accordingly.

- Conclusion: where Belarus is heading to with its debts?

Belarus is at the crossroads with its debt situation. It can choose among several scenarios. The first scenario is to mount sovereign debt by relying on closer relations with Russia. In that case, integration into the world economy by borrowing from foreign banks and raising funds at international financial markets would be kept in check. However, it seems that the authorities try to escape that route since it leads to increasing dependency on Russia.

The second scenario is closer integration into the world economy and a partial liberalization inside Belarus. This scenario implies the attraction of foreign direct investment and portfolio investment. It has a number of variations, depending on the degree of seriousness of liberalization. But the very fact that such measures have been implemented suggests that the modification of 'Belarusian economic model' had begun.