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NEWSLETTER

German Economic Team

BELARUS

The economic impact of the Russian oil tax manoeuvre

While most observers focus on the current turmoil in global oil markets and the resulting steep price decline, Belarus is currently facing an additional challenge. By the end of 2024 the price of oil imported by Belarus from Russia will increase by 30% due to a reform of oil taxation in Russia – the so-called "Russian tax manoeuvre". It is clear that the manoeuvre will have a significant impact on the Belarussian economy – especially on its oil refineries which contribute significantly to exports and budget revenues. An analysis by GET suggests that the main impact will stem from increasing prices for fuels on the domestic market as refineries pass on the higher cost of oil which is bad news for private households and companies alike.

Worse though will be the situation for refineries when exporting fuels as they cannot increase their prices as this would inevitably lead to a loss of market share. Instead refineries will be forced to absorb the entire oil price increase. The resulting losses for refineries are expected to reduce GDP by 1.5%.

The main impact however, will be on public revenues which are likely to decline by as much 15% once the tax manoeuvre is completed in 2024 compared to the situation without the manoeuvre. The only good news amidst such a bleak outlook is that there is still time to enact decisive reforms such as privatisations of state-owned enterprises and the diversification of imports and exports (including for energy) to mitigate the worst of the impact.

Background oil trade

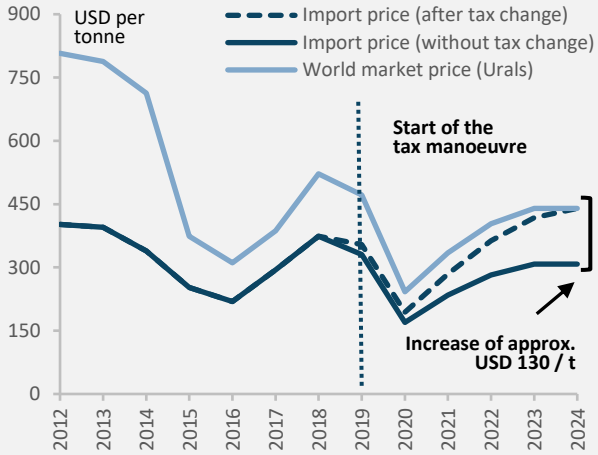
Each year Belarus receives about 24 million tonnes of crude oil from Russia. As oil exported from Russia to Belarus is exempted from export duties, the oil price Belarus used to pay was about 30% below the world market price. This oil price discount constitutes a considerable subsidy to Belarus. Six million tonnes of oil (from the total 24 million tonnes) are sold by Russia on the international market on Belarus' behalf with Belarus receiving the margin between the world market price and discounted import price (so called "peretamozhka") which goes directly into the Belarussian budget.

The remaining 18 million tonnes of oil are processed in Belarussian refineries with about two thirds of the production exported. Thus, on the back of cheap Russian oil, the oil processing sector has become an important contributor to the economy and to budget revenues.

Tax manoeuvre

However, a recent Russian reform of the way Russia taxes oil will put an end to that as it implies that Belarus' oil price discount will fully disappear by 2024. Specifically, Russia has started in 2019 to replace the existing oil export duties by an extraction tax. While this extraction tax is introduced gradually, once it is charged fully in 2024, Belarus' import price for oil will equal the world market price.

Change in the oil price



Source: Belstat, EIA forecast starting 2020, GET calculations

Economic impact

Such a 30% price increase would have meant additional costs of USD 130 per tonne of oil in 2019. Although the full effect will be only felt after 2024, an increase of this magnitude will have significant ramifications for the Belarussian economy. To understand this better, GET simulated the economic and fiscal effects of a complete removal of the oil price discount assuming there will be no compensation replacing the existing discount.

The results suggest that the Russian tax manoeuvre will affect Belarus in three ways:

1. Declining domestic demand for fuel as prices increase,
2. Losses for the oil-processing industry as refineries have to bear additional cost,
3. A stark revenue shortfall as "peretamozka" disappears and state-owned refineries are less profitable.

Declining domestic demand

Faced with increased cost for oil, oil processing companies selling oil on the domestic market are likely to pass on most of this cost increase to final consumers. This is bad news for households and companies alike as they face more expensive oil products.

Although demand for fuel is usually not very price sensitive, domestic demand for fuels and other oil products will decline by about 18% as the oil import price increase translates into higher prices for consumers and companies.

Losses for Belarussian exporters

About two thirds of the fuels produced by Belarussian refineries are not consumed on the domestic market but exported. Unlike on the domestic market, where Belarussian companies can determine the price, on the international market Belarussian refineries do not have the option to pass on the price increase as international buyers would turn elsewhere. Thus, refineries need to absorb the higher cost of Russian oil in order not to lose their market share. Absorbing the cost of dearer Russian oil, Belarussian refineries will have to bear additional cost of about BYN 2.4 bn (approx. EUR 1.0 bn). This alone will reduce GDP by 1.5% and severely affect the economic viability of the oil procession sector.

Loss of budget revenues

While all this is regrettable, the main impact from the Russian tax manoeuvre will be a revenue short-fall of BYN 7.3 bn (approx. EUR 3.1 bn) which equals 15% of budget revenues. About BYN 6 bn of this revenue loss stems from the disappearance of the "peretamozka", the direct transfer of export duties from the sale of six million tonnes of Russian oil to the Belarussian budget. What is more, since Belarusian refineries are fully or partially state-owned enterprises, the state will see its shareholder income decline by about BYN 1.7 bn per year as refineries have to absorb the higher cost of oil imports.

Impact on budget revenues (annual)

Type of budget income	Expected change (BYN m)
Export duties from oil products	**no change**
Import VAT charged on imported oil and oil products from Russia	**+ 300**
Transfer from Russian budget of the amount of export duties received from "peretamozhka"	**- 5,900**
Domestic VAT (20%) motor fuel selling on domestic market	**- 100**
Excises on fuel sold on the domestic market	**- 100**
Shareholder income of state-owned enterprises	**- 1,700**
Total fiscal effect	**-7,500**
Compared to 2019 budget revenues	**-15%**

Source: GET calculations

Conclusions

A complete loss of the oil price discount would have a significant negative impact on the Belarusian budget and economy. This comes on top of the previously discussed global oil price fall, which also affects Belarus in a negative way. While a partial compensation for the tax manoeuvre might be secured in the future, it is unlikely to be enough to absorb its full impact. Amidst a loss of about 15% of revenues, the state budget will be in need of additional sources of income or reduced expenditures in order to avoid a surging deficit.

On a positive note, as the manoeuvre is implemented gradually, it leaves time for policy makers in Belarus to mitigate some of its impact through decisive economic reforms. Wide ranging structural reforms, especially privatizations, are needed to ensure robust economic growth and additional public revenues. In this context a diversification of exports and imports (also in the energy sector) needs to be considered. However, the gradual implementation should not lead to a "wait and see" approach, as a late reaction may endanger fiscal stability and increases the pressure to agree to unfavourable compromises.

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A detailed analysis is provided in Policy Briefing 02/2020.

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