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Scaling up green investment and finance in Belarus





SCALING UP GREEN INVESTMENTS AND FINANCE IN BELARUS

CAN PRIVATE INVESTORS FINANCE THE GREEN,
LOW-CARBON AND ENERGY EFFICIENT DEVELOPMENT
IN BELARUS

OVERVIEW OF GREEN FINANCE IN BELARUS

Background paper

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Abbreviations

BeISEFF	Belarus Sustainable Energy Financing Facility
DAC	OECD Development Assistance Committee
DBRB	Development Bank of the Republic of Belarus
EaP	EU Eastern Partnership
EBRD	European Bank for Reconstruction and Development
EDB	Eurasian Development Bank
EU	European Union
GDP	Gross domestic product
GHG	Greenhouse gas
IFC	International Finance Corporation
IFI	International Finance Institution
IMF	International Monetary Fund
INDC	Intended Nationally Determined Contribution
NBRD	National Bank of the Republic of Belarus
NEFCO	Nordic Environment Finance Corporation
NPL	Non-performing loan
OECD	Organisation for Economic Co-operation and Development
SME	Small and medium-sized enterprise
UNECE	United Nations Economic Commission for Europe
UNFCCC	United Nations Framework Convention on Climate Change
UNIDO	United Nations Industrial Development Organization
USD	United States dollar
VAT	Value added tax

Units of measure

CO ₂	Carbon dioxide
GW	Giga watt
MW	Mega watt

Overview of Green Finance in Belarus

Introduction

This report aims to inform discussion at the workshop on green finance in the Republic of Belarus to be held on 14 March 2018 in Minsk by the Organisation for Economic Co-operation and Development (OECD). The workshop is financed by the European Union (EU) “Greening Economies in the Eastern Neighbourhood” (EaP GREEN) Project which is being implemented by the OECD in conjunction with its partners United Nations Economic Commission for Europe (UNECE), UN Environment and United Nations Industrial Development Organization (UNIDO).

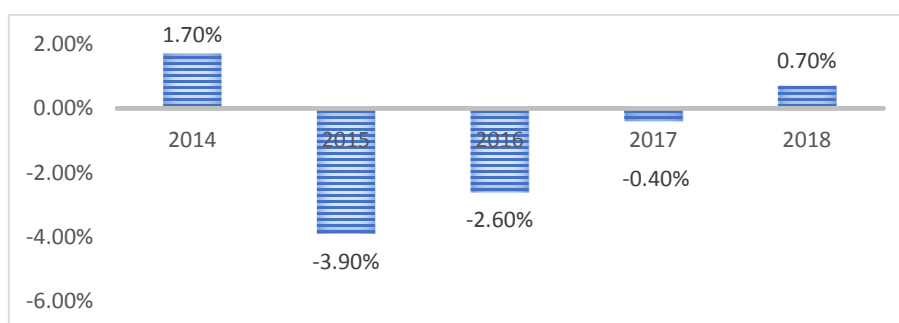
The report reviews the development of the market for green finance in Belarus.¹ Beginning with an overview of recent macro-economic performance, it then sets out the developing situation in Belarus’ banking and financial markets. The report provides an overview of policies and targets that support environmental investment, before detailing examples of environmental finance and associated projects. It concludes with a set of questions that help frame a discussion on scaling up green finance the country.

It draws upon earlier findings from a discussion paper and summary from a recent conference on environmental finance (OECD, 2017a 2017b).

Recent economic situation

Belarus was the second most developed Soviet economy and has continued to maintain a strong infrastructure and industrial base during the independence period.

Figure 1: Belarus GDP growth 2014-18 (projected)



Source: World Bank, World development indicators database.

After 19 years of uninterrupted growth between 1996-2014, and the two years of recession in 2015-16, the Belarusian economy is recovering albeit slowly, supported by better fiscal and monetary policies, stronger domestic demand, and a more favourable external environment. Near-term external financing pressures have eased following mid-2017 energy and financing agreements with the Russian Federation and a USD 1.4 billion Eurobond issuance in June 2017. The industrial sector, representing approximately 25% of the economy, has continued to expand. Inflation has fallen from 11% in October 2016 to 5.3% in October 2017, which has in turn supported real wages and retail sales. Agricultural production is also strong. Exports are growing rapidly, reflecting the recovery in the Russian economy as well as increased exports to Moldova and Ukraine.

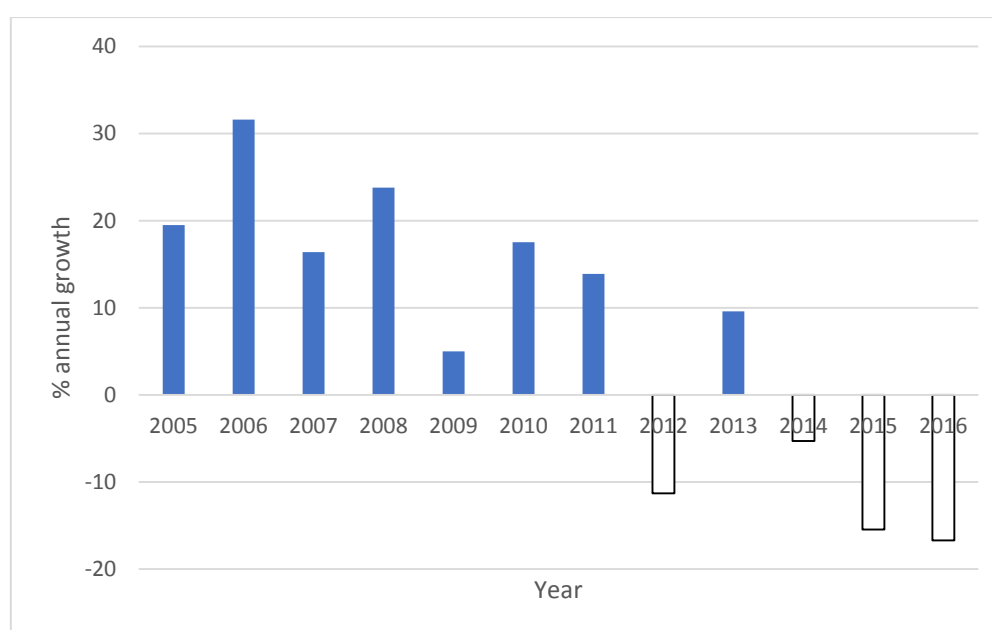
¹ Green finance is used here to refer mostly to investments in low-carbon development and energy efficiency.

According to the Ministry of Economy, most recent national data show that growth in 2017 was much higher than shown by the World Bank and amounted to 2.4%. National authorities expect growth to continue to rise in 2018 and go as high as 3.5%. With inflation slowing rapidly, the National Bank of the Republic of Belarus (NBRB, the central bank) is now supporting the economic recovery by easing its monetary policy. Nonetheless, the Belarusian economy remains susceptible to shocks. The influence of the state in the economy has the potential to distort resource allocation and reduce economic efficiency, creating ongoing longer-term liabilities for the government.

Belarus heavy industries tend to be highly energy-intensive, while citizens have become accustomed to artificially low energy prices. The country has been closely integrated with the Russian Federation, which is its major trading partner and energy provider, also receiving reduced rate loans and subsidised supplies of oil and gas. Russian subsidies have amounted to up to 20% of Belarus' GDP and half of Belarus' exports go to the Russian Federation. Approximately one third of Belarus' export revenues come from refining and re-exporting Russian oil. Questions about the price of oil imports from the Russian Federation have been a focus of disagreement between the two countries.

Overall, fixed capital formation has been declining over recent years, with significant drops in 2015-16.

Figure 2: Gross fixed capital formation 2005-2016 (% annual growth)



Source: World Bank, World Development Indicators database.

Financial markets overview

The Belarusian banking sector has developed during the last 5 years. When measured as bank assets as a share of GDP the banking sector grew from 64% in 2013 to 75% of GDP, overtaking Ukraine (63%) and narrowing the gap to Poland (91%) and the Russian Federation (103%). The number of banks declined from 31 in 2014 to 24 in 2015 as several banking licenses were withdrawn due to concerns about capitalisation. However, the banks that were closed were not systemically important, representing less than 1% of total assets.

The Belarusian market is dominated by state-owned banks with a combined market share of 63% of total assets. The sector is also highly concentrated, with a trend towards further concentration. The

top 5 banks hold 82% of the market, with the 2 banks (Belagroprom Bank and Belarusbank) holding a market share of 58%. Although the Russian banks represent 27% of the private banks they account for only 10% of assets. The Russian-owned BPS-Sberbank holds an 8.5% market share, while the largest bank with EU shareholders – Priorbank – holds only a 4% share.

State directed lending makes up a substantial proportion of loans, particularly in the industrial, agricultural and housing sectors. This has been typically channelled through commercial banks but is increasingly done through the new Development Bank of the Republic of Belarus (DBRB) created in 2011) for which directed lending represents about one third of its loan book.

Directed lending fuelled overall lending growth in the past decade and accounted for more than 40% of the banking sector's stock of loans at end-2016, with about 18% (equal to about 7% of GDP) secured by central and local government guarantees. It contributed to distorting the market due to high differentials in interest rates. For example, in 2016, interest rates on state-directed loans were 9%, compared to rates for non-subsidised borrowers of 34%. Recently it has been scaled back as it represented a significant contingent liability for the public-sector balance sheet.

Overall, the banking sector's new lending fell 4.6% in 2015 and 7.9% in 2016. Prior to 2015, the banking sector had reported several years of low non-performing loan (NPL) levels. However, NPLs increased sharply during the economic slowdown, reflecting the strained position of many state-owned enterprises. Most bad debt is associated with the manufacturing and agricultural sectors where directed lending is at its highest. State-owned banks accounted for about 70% of sector NPLs. NPL ratios peaked at approximately 15% towards the end of 2016, and then began to fall slowly. However, this was in part to do with the transfer of non-performing assets to the new Asset Management Agency, with these bad loans removed from reporting statistics. The government is replacing state-guaranteed 'problem loans' with long-term bonds issued by local governments.

Capital adequacy ratios of the banks were estimated at 18.6% at the beginning of 2017, above the regulatory norm of 10.6%. However, these have the potential to fall sharply under another stress scenario. Going forward, lending volumes in the banking sector remain relatively flat, reflecting ongoing issues with asset quality and high leverage ratios of existing borrowers. Banking sector results have been positive, but this has been helped by delayed provisioning for impaired loans. High-levels of dollarisation create potential issues for exchange risk within the sector.

There are in addition three licenses for non-Banking Financial Institutions (Home Credit, SSIS, INCASS), although the emergence of alternative financial platforms has been slow.

Environmental and investment policy

Belarus has several policies that support low-carbon, climate-resilient development, including the Energy Security Concept, the Law on Renewable Energy Sources, the National Programme of Local and Renewable Energy Sources Development, the Law on Energy Savings, and the Concept on Energy Security. The National Programme of Local and Renewable Energy Sources Development sets out the target to achieve no less than 30% of domestic energy production by 2015, which has yet to be achieved to date.

The National Programme on climate change mitigation measures for 2013-2020 also outlines measures to reduce the country's greenhouse gas (GHG) emissions by 12% by 2020 compared to 1990 levels. This National Programme is aligned with the other legislative documents outlined above. For the period between 2021 and 2030, the National Strategy for Sustainable Development in the Republic of Belarus until 2030 forms the basis for sustainable low-carbon growth. The importance of adaptation has been noted in the Intended Nationally Determined Contribution

(INDC) and several policy documents as well as reports to the United Nations Framework Convention on Climate Change (UNFCCC). The country plans to establish a legislative and institutional basis for adaptation between 2016 and 2030.

Investment support mechanisms

There are a range of domestic mechanisms and policy frameworks that can support the investment climate for environmental and low-carbon development. These include:

- A feed-in-tariff scheme entered into force in 2011 for installations up to 750 KW. In 2014, projects (mainly biogas) received USD 5 million.
- There is a tax relief scheme for investors in renewable energy (value added tax (VAT) exemptions on goods and property, exemption from land taxes and rents).
- Reform of energy tariffs and subsidies (e.g. removing VAT exemption for household electricity, gas and heat in 2015), representing circa USD 200 million in foregone tax revenue

The main policies are set out in Table 1 below.

Table 1: Summary of main environmental policy measures in Belarus

Policy	Description
National Strategy for Sustainable Development in the Republic of Belarus until 2030	The strategy is divided into two phases and sets out high level objectives, rather than detailed policy measures. The first phase is meant to cover the period 2016-2020. It aims at a transition to balanced economic growth via structural transformation of the economy based on environmental friendliness, with high-tech manufacturing prioritised. The second phase will take place in 2021-2030.
Concept of the Law on Climate Protection adopted by Presidential Decree in 2010	The Concept of the Law provides legal framework for mitigation and adaptation policies and measures, instruments for regulation of GHG emissions.
Resolution of the Council of Ministers of the Republic of Belarus No 510 of 21 June 2013 "On approval of the State Programme of Measures on Climate Change Mitigation for 2013-2020"	The State Programme, approved by the Resolution, determines a wide range of policies and measures aimed at mitigation and adaptation in the country, and defines responsible governmental bodies and financing from the state budget.
The National Energy Saving Programme for 2011–2015	The Programme set ambitious targets of reducing the energy intensity of GDP by 29-32% by 2015 compared with 2010 and increasing the share of local energy resources in the fuel balance to 28% by 2015 (to date, the targets have not yet been achieved, although significant progress was made).
Law of Republic of Belarus № 204-Z of 27 December 2010 "On Renewable Energy Sources"	This law creates the legislative basis for economic support for renewable energy sources (RES), including solar, wind, geothermal, hydro, fuel wood, and other types of biomass, biogas, and other renewable sources. The law defines rights and responsibilities of RES producers and list of authorities responsible for control over the sector.

The National Programme for the Development of Local and Renewable Energy Sources for 2011–2015	The programme sets the targets and policies for increased use of domestic energy sources between 2011 and 2015. By 2015 the share of local energy sources in the energy balance was supposed to be no less than 30%.
Decree № 625 "On Some Issues Related to the Reduction of Greenhouse Gas Emissions"	The Decree confirms and updates the rules for carbon pricing through a voluntary GHG emissions reduction scheme under the UNFCCC and Kyoto Protocol, including reductions by non-nationals. It allows for non-nationals to buy carbon credits from voluntary GHG emission reduction projects. The revenues from the sale of GHG emissions reduction units are allocated to the National Fund for the Protection of the Environment.

Source: OECD (2016).

Green investments

There have been several large-scale capital investments in Belarus in renewable energy and energy efficiency. Total investment in wind energy have amounted to about USD 40-45 million in 68 MW of wind energy investment. This investment, made up of 66 individual developers/licenses, is fragmented and a result of the current small quotas in the regulatory regime (up to 2 MW per site). These have been primarily delivered by private investors, supported by government policy.

Belarus also has several solar parks under development or already in operation. These include:

- 109 MW (Mogilev) – under commissioning;
- 55 MW (Rechitsa);
- 22 MW (Brahin).

Belarus has significant plans for additional capacity by 2020, including 961 MW in renewable energy (biomass, biogas, hydro, solar, wind), a 2.4 GW nuclear power plant and a large state programme for peat-based power. Overall electricity demand is projected to be flat in the near/mid-term.

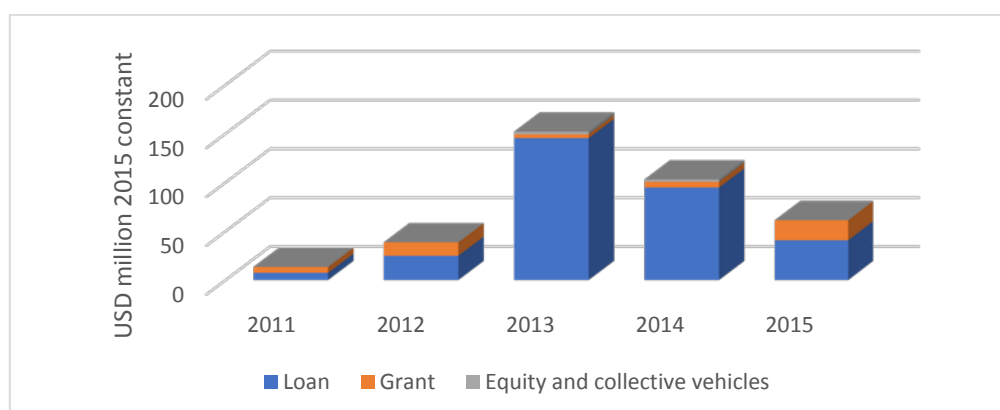
In terms of capital investments in energy efficiency, the World Bank has committed USD 215 million in 2009 and 2013 under the “Belarus Energy Efficiency Project” which aims to improve energy efficiency in heat and power generation in selected towns in Belarus through, for instance, the combined heat and power generation plants in Mogilev and Gomel. The World Bank has also made investments in energy efficiency and renewable energy through the Belarus Biomass District Heating Project (2014) to which it committed a total of USD 89 million to upgrade district heating and develop co-generation capacity. Other projects include investments in the transport, forestry and agriculture sectors.

Financing sources

Belarus has provided capital for investment in green projects. There are environmental pollution charges (contaminant releases into the atmosphere, waste water pollution, storage and disposal of production residue). There are also taxes on natural resource extraction. However neither of these are hypothecated for green investment. Nonetheless, the government itself invests directly in environmental activities. National and local governments provided financial support to energy saving measures, amounting to USD 1 439 million between 2011 and 2015. Renewable energy projects have also benefitted from the country’s feed-in tariff scheme. The government budget supports maintenance of the state forests and forestry administration body.

For large investments, financing comes from corporate and financial institutions, often supported by international donors. In terms of development finance, the OECD Development Assistance Committee (DAC) estimates approximately USD 370 million of development financial flows relevant to climate change since 2011, of which more than 85% has been in the form of loans at market or concessional rates, but with also some equity investments. Donors have also provided grants for technical assistance.

Figure 3: Development flows for environmental and climate finance to Belarus 2011-15



Source: OCED DAC database.

Development partners also fund environmental finance through local financial institutions. The European Bank for Reconstruction and Development's (EBRD) Belarus Sustainable Energy Finance Facility (BelSEFF) provides a USD 50 million credit line and has since 2012 supported 5 local banks (Belinvestbank, Belgazprombank, MTB Bank, BelVEB and BPS Sberbank).

A number of International Finance Institutions (IFIs) such as the Nordic Environment Finance Corporation (NEFCO), International Finance Corporation (IFC) and more recently the Eurasian Development Bank (EDB) have also provided energy-efficiency credit lines. These credit lines help local companies to buy and install more energy-efficient equipment, appliances and materials, together with small scale renewable technologies. These include modern production facilities, double-glazed windows, insulation, gas boilers, solar water heaters and rooftop solar panels. Credit lines often come with technical assistance support where necessary to help design and appraise projects.

Figure 4: Summary of IFI funded environmental credit lines to local financial institutions in Belarus

Year	Donor	Recipient FI	Value	Target
2017	EDB	CJSC Alpha-Bank	USD 10 mln	Small and medium-sized enterprises (SMEs)
2016	EBRD (BelSEFF)	Belinvestbank	EUR 8 mln	SMEs, Corporate
2014	NEFCO	MTB Bank	EUR 4 mln	SMEs, Corporate
2013	EBRD (BelSEFF)	Bank BelVEB	EUR 10 mln	SMEs, Corporate
2013	EBRD (BelSEFF)	BPS-Sberbank	EUR 10 mln	SMEs, Corporate
2013	EBRD (BelSEFF)	Belgazprombank	EUR 10 mln	SMEs, Corporate
2013	NEFCO	Belarusky Narodny Bank	EUR 1.5 mln	Transport
2012	EBRD BelSEFF	MTB Bank	USD 4 mln	SMEs, Corporate
2011	IFC	MTB Bank	USD 5 mln	SMEs, Corporate

Source: EBRD, NEFCO, EDB, IFC websites.

Key questions for discussion

On the basis of this analysis, a number of key questions arise for discussion:

- How does the current economic situation and financial sector development support and/or constrain the scale up of green finance in Belarus?
- What policy or market barriers exist to developing a more active community of financial institutions and other investors to support green investment, and how might they be overcome?
- How existing best practices that help scale up green investment within the region can be transferred to Belarus?
- What should be the respective roles and responsibilities for policy makers, financial institutions and project developers to improve financing flows into green infrastructure?

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The report was prepared to support discussion at a workshop on green finance in Belarus which was held on 14 March 2018 in Minsk.

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