

RECENT EVOLUTIONS IN THE BELARUSIAN ECONOMIC SYSTEM

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*„The long run is a misleading guide to current affairs.
In the long run we are all dead”
- John Maynard Keynes*

INTRODUCTION

There is a number of rumours about latest progress in economic transition and the attractiveness of doing business in Belarus. Some local economists claim that the Belarusian government who has been responsible for the conservation of the command economy for so long, has recently changed the direction of its economic policy. Is it true? What's more, Belarusian media (especially the existing independent ones) are full of speculations concerning privatisation of domestic companies. Is it really worthwhile to draw attention to these issues?

The aim of this article is to show that certain changes in the economic policy of Belarus have been taking place recently but they have not been profound and the speed of institutional reforms has not been significant. In fact, the authorities have achieved very little structural reforms through the whole period of transformation¹ – i.e. during the last 19 years². They tend to preserve the *status quo* in the economy as long as possible.

TRANSFORMATION

According to the latest international rankings³, that assess the progress in economic transition, Belarus takes the very last position among all post-socialist countries of Central and Eastern Europe (CEE). *Transition Report 2010 (EBRD)*: shows that among 29 post-socialist countries from CEE, Caucasus and Central Asia only Turkmenistan carried out less structural reforms than Belarus (figure 1.).

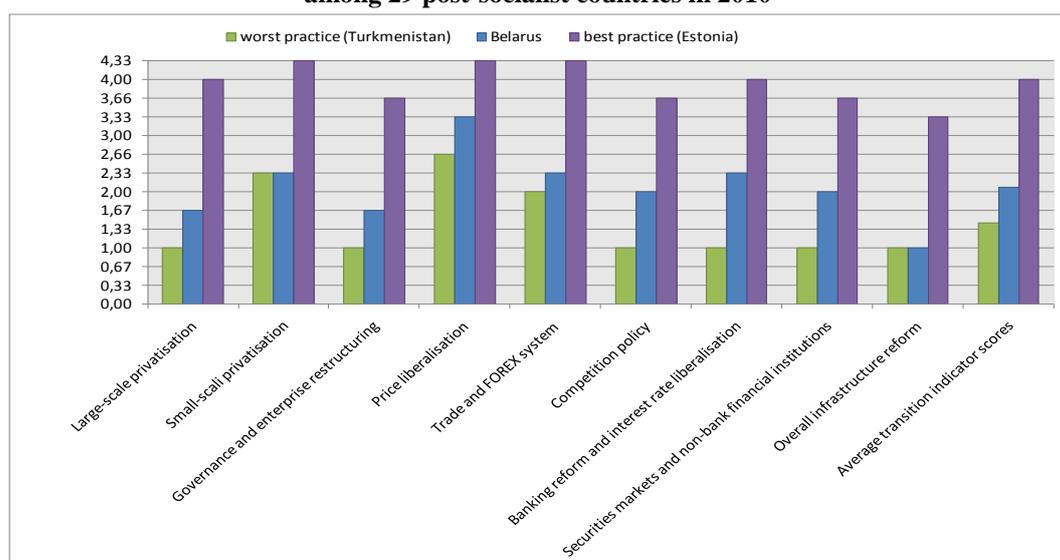
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¹ See EBRD (2010), *Transition Report 2009*.

² The formal dissolution of the Soviet Union took place on 8th December 1991.

³ See EBRD (2010); Heritage Foundation (2010), *Index of Economic Freedom 2010*; Bertelsmann Foundation (2010), *Transformation Index 2010*.

Figure 1. Transition indicators for Belarus and the best/worst practices among 29 post-socialist countries in 2010⁴



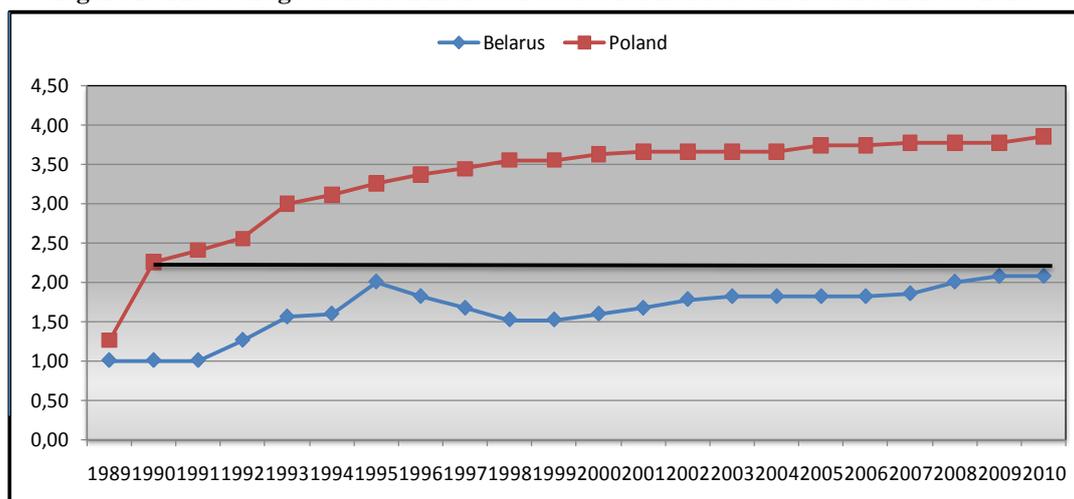
Source: EBRD (2010), *Transition Report 2010*.

Although Belarus delays reforming the economy, in 5 out of 10 areas assessed by the EBRD, noticeable changes have occurred, albeit from a low base. As a result of intensification of negative tendency in the economy caused by the global crisis and worsening of economic relations with Russia, Belarusian authorities have taken measures to reform the economy for the last three years. During that time according to *EBRD* Belarus makes progress in *banking reform and interest rate liberalisation* (from 2- to 2+), *large-scale privatisation* (from 1 to 2-), *governance and enterprise restructuring* (from 1 to 2-), *price liberalization* (from 3 to 3+) and *finally price liberalisation* (from 3- to 3).

Nevertheless, the speed of reforms in Belarus is very slow and their extent is limited even now. To compare, Poland achieved more reforms in the first year of transformation (in 1989) than Belarus through 20 years (figure 2.). Apparently, the Belarusian authorities have not matured to allow the economy to be ruled by market mechanisms. Despite the changes, the average transition indicator for Belarus in 2010 was only as high as it was in 1995, the year when Lukashenko began to increase the control of state under the economy. Thus, the process of transition has not reached *the critic mass* yet and it is still possible to reverse the reforms as it had been done in Belarus before.

⁴ The transition indicators range from 1 to 4+, with 1 representing little or no change from a rigid centrally planned economy and 4+ representing the standards of an industrialised market economy.

Figure 2. The average transition indicator scores for Belarus and Poland in 1989-2010



Source: EBRD (1995-2010), *Transition Report*.

Privatisation of state-owned enterprises is a main structural reform that concerns both political and economic power of government. Only increased market competition is an irreplaceable mechanism that trigger off innovations and effectiveness of the economy and hence the economic growth. The share of the private sector in the whole economy, measured by the share of this sector in formation of GDP, is used as one of the best transition indicators.

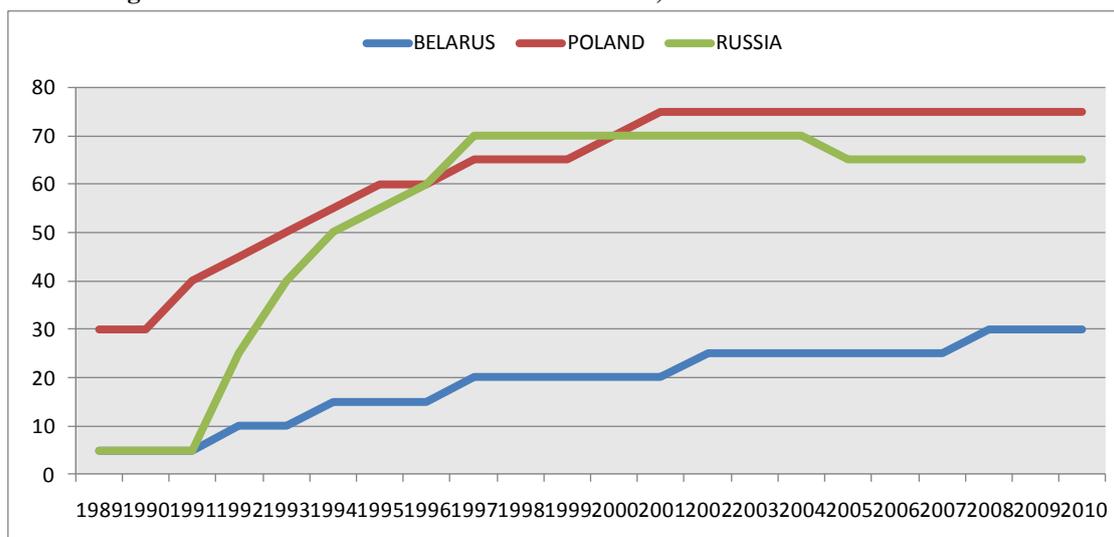
In case of Belarus the share of the private sector in formation of GDP, amounts up to 30% while the same indicators for the neighbouring countries are 75% for Poland and Lithuania, and 65% for Russia and Ukraine. It means that the role of the state in the Belarusian economy is still almost the same as it was in Poland in 1989 (figure 3.). Among all post-socialist countries there are no other examples apart from Turkmenistan where the public sector is still so significant. Even though half of the society works in the private sector⁵, it is the state that continuously controls almost all large and medium-sized enterprises.

There have been almost no significant changes in recent years. As already mentioned, authorities would like to control the economy as long as possible. Therefore, mainly those of the state-owned enterprises that are in poor condition are sold. Moreover, the enterprises are offered for sale under strict conditions, first of all including job security, that may scare off private investors. The progress in the *large-scale privatisation* mentioned by the EBRD concerns a few recent examples of privatization, including the sale of *Belvneshekonombank*, a half of gas monopolist *Beltransgaz*, bicycle enterprise *Motovelo*, wristwatch enterprise *Luč* and some other industrial plants. It is pointless to draw so much attention to the recent progress in the process of privatisation in Belarus. Aforementioned cases have had little impact on the size of the private sector since the magnitude of the companies apart from 'Beltransgaz' was not considerable⁶. The above picture supports the fact that *the mass privatisation* that was conducted in Poland and Russia in the early 90' has not happened in Belarus yet (figure 3.).

⁵ See National Statistical Committee of the Republic of Belarus (2010), *Statistical Yearbook of the Republic of Belarus*.

⁶ e.g. *Luč* that was on the verge of bankruptcy was bought by swiss company *Franck Muller* for only 12 mln USD.

Figure 3. Private sector share of GDP in Belarus, Poland and Russia in 1989-2010



Source: EBRD (1995-2010), *Transition Report*.

Nowadays, the Belarusian economy is functioning more like a centrally planned economy than a free market economy. It results from several factors. First of all, as already mentioned, there is a huge public ownership in the economy. Secondly, there is a relatively high level of income redistribution. The share of public income (budget) in the share of all incomes (GDP) in Belarus in 2009 equaled to 32% (e.x. in Poland it was only 18%). Thirdly, the Belarusian economy is overregulated. Despite significant positive changes in regulation (especially in establishing new enterprises) in recent years⁷, there are still many rules that restrain the development of private businesses and the competition from abroad. The state indirectly determines the prices of a number of strategically important goods (like fuel and electricity) and around 50 arts of groceries. Additionally, local administration may recommend state-owned company to sell their products under specific prices. Furthermore, the legislation is unclear and unstable which additionally discourages private investors from investing in Belarus. Often courts conduct trials in favour of public companies. Last but not least, the authorities finance unprofitable enterprises from the profits of more efficient companies.

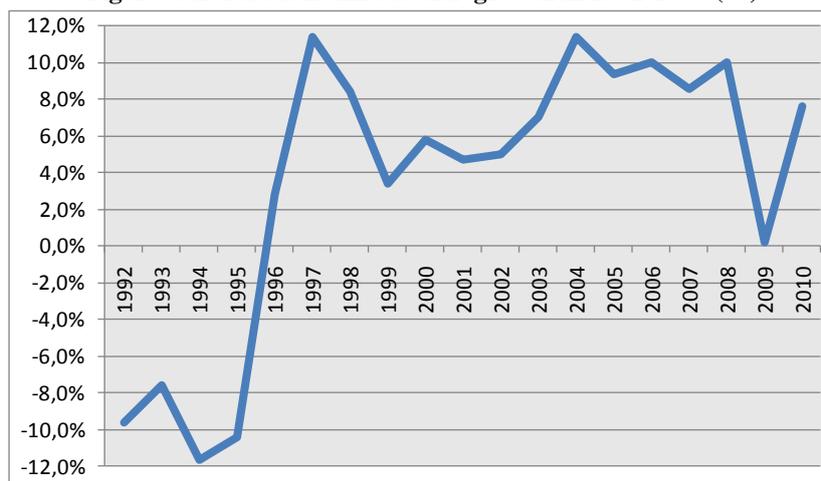
The official statistical data shows an amazing economic growth between 1996 and 2008 – 7,5% annually on average (figure 4.). Although there are some reservations about the precise figures of the economic growth⁸, *the Belarusian economic miracle* is challenging for the traditional theory of transformation⁹ since the high economic growth was obtained with almost no structural reforms.

⁷ According to the World Bank *Doing Business 2010* Report in the last three years Belarus has undertaken a number of reform which significantly improved the ease of doing business – Belarus reached 58th place in the last report from 115th only two years before.

⁸ IMF (2004), *Country Report No. 04/141*; А. Чубрик (2003), *Белорусский экономический рост: загадка или мираж* [В:] *Беларусь: выбор пути*, ИПМ.

⁹ See L. Balcerowicz (1995), *Socialism, capitalism, transformation*.

Figure 4. Belarusian annual GDP growth in 1992-2009 (%)



Source: National Statistical Committee of the Republic of Belarus.

In fact, only **favourable external economic conditions** may explain such a growth. Over many years the conduction of economic policy oriented towards the conservation of the old ineffective economic system was possible only due to unprecedented economic support from Russia. Since the beginning of the long process of integration between Belarus and Russia in 1996¹⁰, Belarus has been developing due to very cheap Russian energy resources (crude oil and gas), re-export of Russian oil to the West at market prices, preferential Russian credits and duty-free access to the Russian market. In exchange Russia expected at least economic integration – a common monetary union and an ability to buy out Belarusian enterprises. It is assessed that the Russian subsidies to the Belarusian economy amounted to 52 bln USD for the last 15 years¹¹ or about 17% of GDP annually although the integration has not advanced much.

CURRENT DISBALANCE

Russian subsidies are losing significance since Russia has been pressing Belarus towards closer integration since 2007. It introduced export duty on oil shipped to Belarus in 2007 and a requirement that Belarusian incomes from re-exported oil should be shared with Russia in 80-85%. Russia has also increased natural gas prices for Belarus steadily from 47 USD per thousand cubic meters in 2006 to 187 in 2010. Oil prices have been raised sharply as well¹².

At the same time, Belarus has been severely affected by the global crisis since Belarus is an export-oriented country – its export to GDP equals 70%. In order to keep the economy in balance during the crisis, Belarus has turned to the IMF and the World Bank. Both institutions are ready to provide the country with credits in exchange for economic reforms. Eventually, the reforms are made in cooperation with the IMF – it provides both technical and financial

¹⁰ The Commonwealth of Russia and Belarus was formed on 2nd April 1996.

¹¹ According to the statement of Russian political scientist Andriei Suzdaltsev at Program *Abjektyŭ* on Belarusian TV *Belsat* on 4th April 2010.

¹² Nevertheless, according to the statement of Vladimir Putin on the press conference in Belavezhskaya Pushcha on 18th March 2010, Russian subsidies in the form of cheap energy resources will bring Belarus about 4,2 bln USD in 2010, i.e. about 8% of GDP.

assistance. In December 2008 the IMF announces plans to lend 2,5 bln USD to Belarus to support the country's efforts to restore economic stability and already in January 2009 after approving a plan of reforms by the Belarusian government the IMF increased the value of credit to 3,5 bln USD.

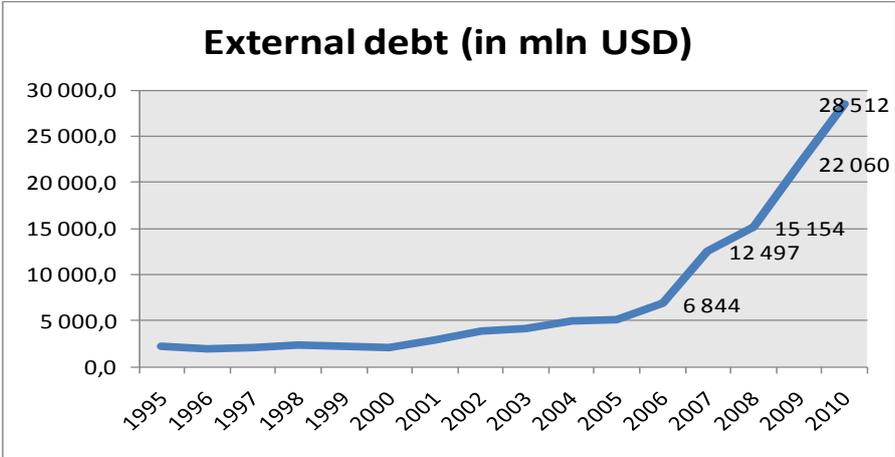
In the nearest future it is likely that the reason for structural reforms and privatisation will be the need to stabilize the economy after the recent worsening of external conditions. In 2010 the current account deficit amounted to 15,6% of GDP whereas foreign direct investment amounted to mere 2,4% of GDP. It means that the remaining 13% of the deficit or almost 7 bln USD was financed by credits since the foreign exchange reserves of Belarus are relatively small and insufficient to cover that deficit. If the Belarusian import will exceed the export further by as much as it did in the last four years (by 9,6% of GDP in 2009, 8,4% in 2008 and 6,8% in 2007)¹³ it may force the government to sell the major enterprises in order to finance the growing current account deficit by injection of international currency.

To sum up, Russia's recent policy to bring energy prices for Belarus to world market levels resulted in a **structural crisis** in Belarus. Some policy measures including improving energy efficiency and diversifying exports have been introduced but external borrowing has been the main mechanism used to manage the growing pressure on the economy. Since 2007 the external debt of Belarus has skyrocketed from 6,8 bln USD to 28 bln USD, i.e. more than four times in four years (figure 5.). On 1st January 2011 the total external debt of Belarus crossed the level of 50% of GDP.

Perhaps the main paradox of the Belarusian economic system is that although it had experienced high economic growth during the last decade thanks to favourable international environment, it is still characterized by energy-consuming enterprises, low level of transition and significant dependence on external factors.

Under changing circumstances the only way to secure sustainable growth in the long term is to force the economic transition to the open market economy since a command economy has proved historically its ineffectiveness.

Figure 5. Belarusian external debt in 1995-2010 (on the end of the year)



Source: National Statistical Committee of the Republic of Belarus

¹³ See IMF (2011), *World Economy Outlook*.

CONCLUSIONS

In my opinion the attention of Belarusian economists and the media should be drawn to the reasons of new shift in the economic policy of state. The negative tendencies in economy are much more visible than the introduced reforms. Without cheap energy resources national companies are no longer competitive at the Russian market and they have been losing their competitiveness with each annual price rise since 2007. Sooner or later Belarus will have to transform the economy due to economic imbalances – high inflation, high current account deficit and the burden of high external debt. The earlier it starts the more favourable the initial conditions will be.