Problems of Economic Transition

ISSN: 1061-1991 (Print) 1557-931X (Online) Journal homepage: http://tandfonline.com/loi/mpet20

Guest Editor's Introduction : Trends, Reforms, and Challenges in Belarus: An Overview

ERIC BRUNAT

Problems of Economic Transition, vol. 48, no. 1, May 2005, pp. 3–9.

ISSN 1061–1991/2005 $9.50 + 0.00.

ERIC BRUNAT

Guest Editor's Introduction

Trends, Reforms, and Challenges in Belarus: An Overview

Upon independence in 1991, the Republic of Belarus inherited one of the highest standards of living in the former Soviet Union. Since then, the country has passed through several political and economic phases. Between 1991 and 1995, the country initiated preliminary reforms toward transformation to a market economy. Over the past decade, Belarus has embraced a gradual pace of change, eschewing the more radical market-oriented reforms pursued elsewhere in Central and Eastern Europe and the Commonwealth of Independent States (CIS). As of 1995, the government began attempting to insulate the country from the pain of radical reform by protecting jobs and wages. Belarus has retained a high degree of state ownership and central control over wages, prices, and production, in both industry and agriculture. Market-oriented reforms remained very limited.

Since 1996, these policies have yielded significant economic growth, which has accelerated since 1999. Real wages have risen significantly. Poverty rates, though still high, have declined. According to national statistics, the proportion of the population living below the national subsistence level fell from 38.4 percent in 1995 to less than 20 percent in 2004.

Eric Brunat was United Nations Development Programme senior economist–adviser in Moldova and Belarus until March 2005. He is currently affiliated with the University of Savoie, France. The views expressed here are those of the author and do not necessarily represent the position of the UNDP.

However, such gradualism has left the economy with weaknesses that, if not remedied, could undermine future growth. First, the country has preserved the substantial state sector, which slows productivity growth. According to official data from the Ministry of Statistics and Analysis of the Republic of Belarus (MOSA), labor productivity in state-owned enterprises in the industry is much lower than in mixed-ownership enterprises and foreign companies. Second, the economy is still insufficiently specialized, offering too broad a range of products for a small country; at the same time, it remains dependent and narrowly focused, in both volume and value, on a few industries and markets. Third, in terms of energy and metal intensity, Belarus is far behind the developed world. The country relies almost entirely on imported energy inputs and metal, mainly from the Russian Federation, which is responsible for no less than a third of all imports. The only viable remedy for this threat is to move to energy- and metal-intensive modern technologies on the broadest front possible. However, the MOSA data indicate that the obsolescence and depreciation of fixed assets used in production in the national economy exceed 60 percent; and almost 50 percent of core technologies used in industry were introduced prior to 1985. The investments required to save energy are considerable. Fourth, the economy still uses extensively state-funded credits and targeted lending to boost output. Consequently, fifth, the country is not sufficiently prepared to cope with international competition in the medium and long run. Some 40 percent of industrial firms and 60 percent of agricultural firms operate at a loss. The business environment is challenging. Numerous conversion constraints arise related to technology, know-how, and localization of firms; foreign direct investment (FDI) is low; and small and medium-sized enterprises (SMEs) play a marginal role.

The share of research and development in gross domestic product (GDP) in 2003 was 0.73 percent (less than the critical threshold of 1 percent), whereas the average for European Union (EU) countries is a much higher 2 percent and even more in Japan and the United States. In the world economy, innovation is the basis of competitiveness, resource saving, and market expansion. Thus, without significant improvements, the forthcoming years could be problematic. Clearly, the key challenge facing the country is to build sturdier foundations for the sustainable growth of the level and quality of the population's living conditions and for the development of human capital.

To meet this goal, further economic adjustment is needed. The growth of SMEs must be encouraged, both to create new jobs and to diversify the economy. Access to finance must be simplified. A wholehearted commitment to market reform is necessary to strengthen the business environment and thus attract more FDI, to ensure that Belarus benefits from an infusion of modern technology and managerial methods. The steps needed to promote better business conditions include: improved protection of intellectual property rights; the adoption of international standards for product certification; acceptance of a knowledge-based economy and society; the creation of business incubators, technology parks, and special economic zones; the adoption of more flexible labor market rules; and the provision of improved social protection and retraining for redundant workers.

An economic policy based on the main principles of an open economy is needed, as nontariff barriers (in the form of complicated product standards, administrative restrictions, volatile regulations, and a difficult business environment) still impede trade. Exports and imports are highly concentrated by sector as well as by country of origin and destination. In many industries, there is a need to create conditions for better competition. These barriers ought to be relaxed to facilitate greater integration with the world economy and to ensure that Belarus enjoys the full benefits of competition and trade.

There are at least three platforms for economic integration in which Belarus can play a role. First, within the CIS, closer integration can be achieved through the realization of planned undertakings such as the Single Economic Space with Russia, Ukraine, and Kazakhstan, which offers an opportunity not only to promote trade but also to further cooperation on cross-border development projects and initiatives. Second, Belarus could benefit by adopting EU norms in such areas as corporate law and competition policy insofar as the EU expansion in May 2004 has made Belarus an EU border state and opened the way for a new dialogue under the European Neighborhood Policy. Third, Belarus applied for World Trade Organization membership in September 1993, but negotiations have proceeded slowly. While membership would provide beneficial market access it would require significant legislative change and the resumption of a deep process of reforms including a reduction in subsidies to industry and agriculture, which also fuels inflation rates higher than in the surrounding countries of the region. Persistent inflationary pressures could be reduced by limiting the amount of off-budget financing and refraining from wage increases in excess of productivity.

These are some of the major challenges facing the Belarusian economy in maintaining macroeconomic stability and consolidating the robust growth in GDP and industrial production that has been demonstrated since 1996—at a time when almost all other countries of the former Soviet Union continued to experience a decline—and has persisted through the regional economic crisis of 1998–99. In 2003, both GDP growth and industrial output accelerated to a reported rate of 6.8 percent, before accelerating to an impressive official 11 percent growth in real GDP in 2004, mainly due to expanding household consumption and fixed capital investment. Nonetheless, the twin deficits in the state budget and current accounts and rather low reserves, limited access to international financial markets, and a low sovereign credit rating assigned by international rating agencies do not help Belarus to relaunch its transformation and modernization process and to sustain its growth and development.

This special issue of *Problems of Economic Transition* offers readers some guidance in understanding the complexities and special characteristics of the Belarusian economy. The authors of the articles presented here are affiliated with different governmental and public institutions, independent think-tanks, and international organizations. All of them express their personal views, thus giving the issue an original and most valuable factual and empirical focus on this specific European transition economy.

In the first article, Vladimir Shimov, minister of the economy of Belarus from 1996 through 2002, focuses on one of the three platforms capable of playing a major role in Belarus's integration into the world economy. The author offers some original analysis regarding the impact of the European Union's enlargement on the economy of Belarus. Of course, the history of the new EU and Belarus is not long enough to make a full assessment. However, Shimov presents the relative positioning of Belarus in the region as well as in the globalization process. He points out the importance of neighboring countries such as Poland, Latvia, and Lithuania, with which Belarus has significant economic cooperation. Given that in 2003, the European Parliament adopted a strategy of ten-year cooperation with the countries whose accession to the EU is not planned (among them are the "closest neighbors"), Shimov thinks that the most likely prospect for Belarus seems to be integration with Russia through setting up a free trade zone and a Common European Economic Space with the EU, which will require significant coordination both with Russia and the European Union. The author concludes that the enlargement requires that Belarus develop a system of measures to evaluate the possible economic damage related to the accession of some of Belarus's partners to the European Union. He also calls for the identification of a long-term strategy of cooperation both with the EU and Russia.

In the second article, Igor Zheltkov presents an empirical study of the drivers of industrial growth in Belarus for the period 1996–2003. The nature of industrial growth is considered in the context of processes taking place in transitional economies of the CIS member countries. The dynamics and state of growth factors are analyzed on the basis of statistical data and market survey questionnaires. A time series analysis based on market surveys shows some peculiarities, strengths, and weaknesses of Belarusian industry and its recent relatively positive output results.

In presenting the teething problems of the Belarusian private sector, Ludmila Istomina opens one of the most important issues related to Belarusian competitiveness and sustainable economic growth as well as the significance of small business in all modern economies. The author reminds us that the recent history of private enterprise in Belarus spans less than fifteen years. Following a quantitative assessment of the weight of small enterprises in Belarus, Istomina tries to identify the main constraints to small business development, including the government's failure to fully appreciate the contribution of private enterprise to economic development, the prevalence of top-down governance methods, and the proliferation of administrative barriers to private sector activity. These include in particular the costs of registration and reregistration, as well as procedures for enterprise registration, and liquidation. Belarus remains a European state in which business start-ups must obtain permission from the authorities to operate, rather than simply to notify the authorities of their intention to enter the market. The author also points out the unstable legal and regulatory environment, the number of supervisory and auditing authorities with overlapping functions, the frequent and often unnecessary audits of small businesses, as well as the excessive tax burden and onerous reporting requirements. Istomina notes that current budgeting procedures at various administrative levels do not encourage local authorities to support the development of small business in the regions. Local taxes and charges accumulated by local budgets do not typically compensate for the costs associated with tax collection and supervision. Finally, Istomina focuses on the inadequate access to real estate markets, stalled privatization, and poorly developed business support services. The main consequence of this adverse environment for private sector development is that a large proportion of the general public does not view private enterprise as a solution to social and economic problems. However, the national socioeconomic development program for 2001–5 outlines a vision of SMEs as a flexible component of a dynamic economy. The program calls for the SME share in total sales to be increased to 25 percent, or more than twice the 2003 level. Meeting this target would require rapid private sector penetration into manufacturing industries, transport, agriculture, science, and other parts of the economy—a necessity in order for Belarus to avoid the risks of widening the gap between itself and its neighbors in this regard and thus missing the window of opportunity for harnessing the potential of SMEs.

In analyzing labor markets trends, Zuzana Brixiova and Vera Volchok identify some major challenges in Belarus and point out that the transition from a planned to a market economy has led to significant distortions in the labor markets of most countries of Central and Eastern Europe (CEE) and the CIS. At the outset of transition, it was expected that high unemployment would emerge for a short period, owing to the rapid elimination of jobs in the state sector, which are not being fully replaced by new jobs in the emerging private sector. However, unemployment remains high in many CEE and CIS member countries even today, and this has become one of the most difficult aspects of transition. With persistently low official unemployment, Belarus is an exception in this respect and also compares favorably with most European countries. However, Belarus is still in the early stages of transition from a centrally planned to a market economy, including in the area of labor market reforms, and a portion of the labor force may be equipped with skills that do not match the needs of a market economy. The experience of recently acceded EU countries shows that tackling the employment situation during the transition requires creating a favorable business environment as well as increasing labor market flexibility and redesigning labor market institutions. An immediate concern for the Belarusian government in the area of labor market reforms and reducing the role of the public sector in the national economy is how to facilitate the reallocation of workers across sectors and regions, and to encourage the labor force to acquire the skills demanded by the market, while minimizing the social costs.

In the fifth article, Pavel Daneyko and Dzmitry Kruk present a detailed historical and economic analysis of the reform of the banking system and financing structure of the Belarusian economy. The article starts with a factual presentation of institutions as well as the process of reform over the past fifteen years. The macroeconomic environment, banking regulation, and administrative measures greatly influence and distort banking activity in Belarus. Analysis of the Belarusian banking system shows its significant monopolization and differentiation in clusters. The first cluster consists of the two largest banks with almost 100 percent state ownership mainly financing the state sector; the second cluster consists of "others," authorized banks allowed to service the state sector as well, mainly profitable and more export oriented; the third cluster consists of private banks; and the fourth consists of nonbank financial institutions. This situation is the consequence of state policy carried out mainly from 1996 to the present. The role of the two main banks in the system is strongly emphasized: Belarusbank and Belagroprombank act as the government's financial agents in the banking sector and provide extensive financing for state sectoral priorities. Thus, the government uses banking activity as an additional measure for compensating quasi-fiscal operations. Conditions created for these banks strongly restrict the positions of other banks, which creates difficulties in attracting foreign capital. At the same time, Daneyko and Kruk note that the low capitalization of the Belarusian banking system is a key recurrent problem.