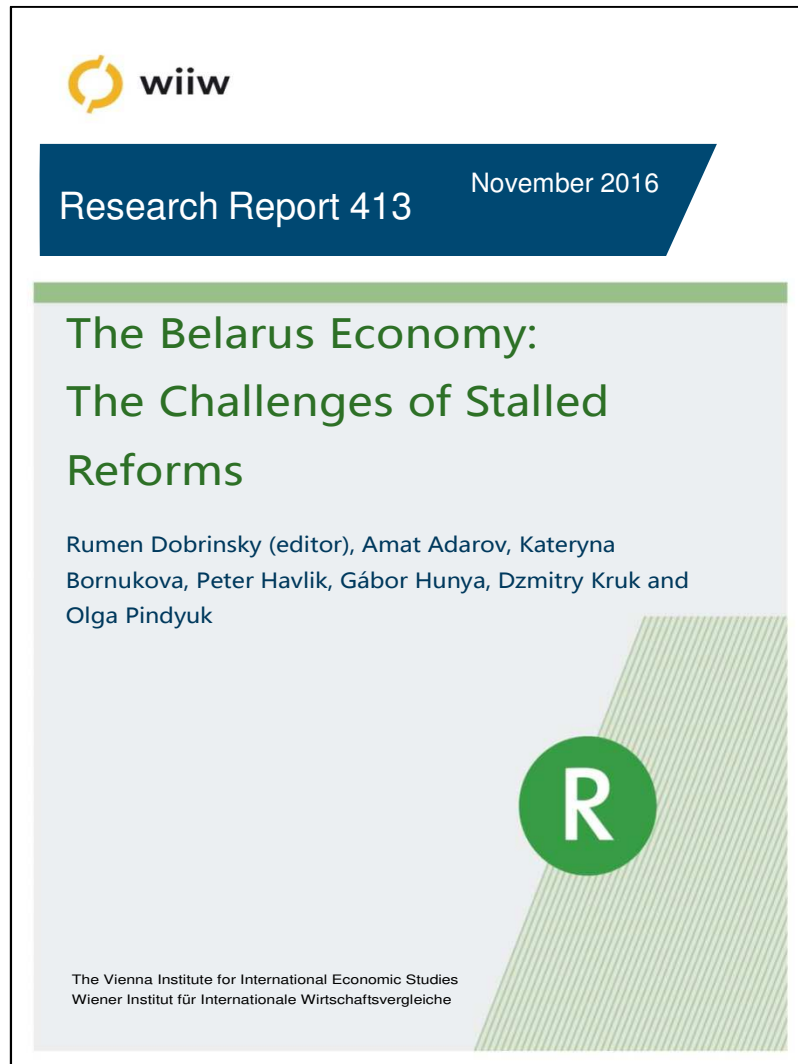


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The Belarus Economy: The Challenges of Stalled Reforms

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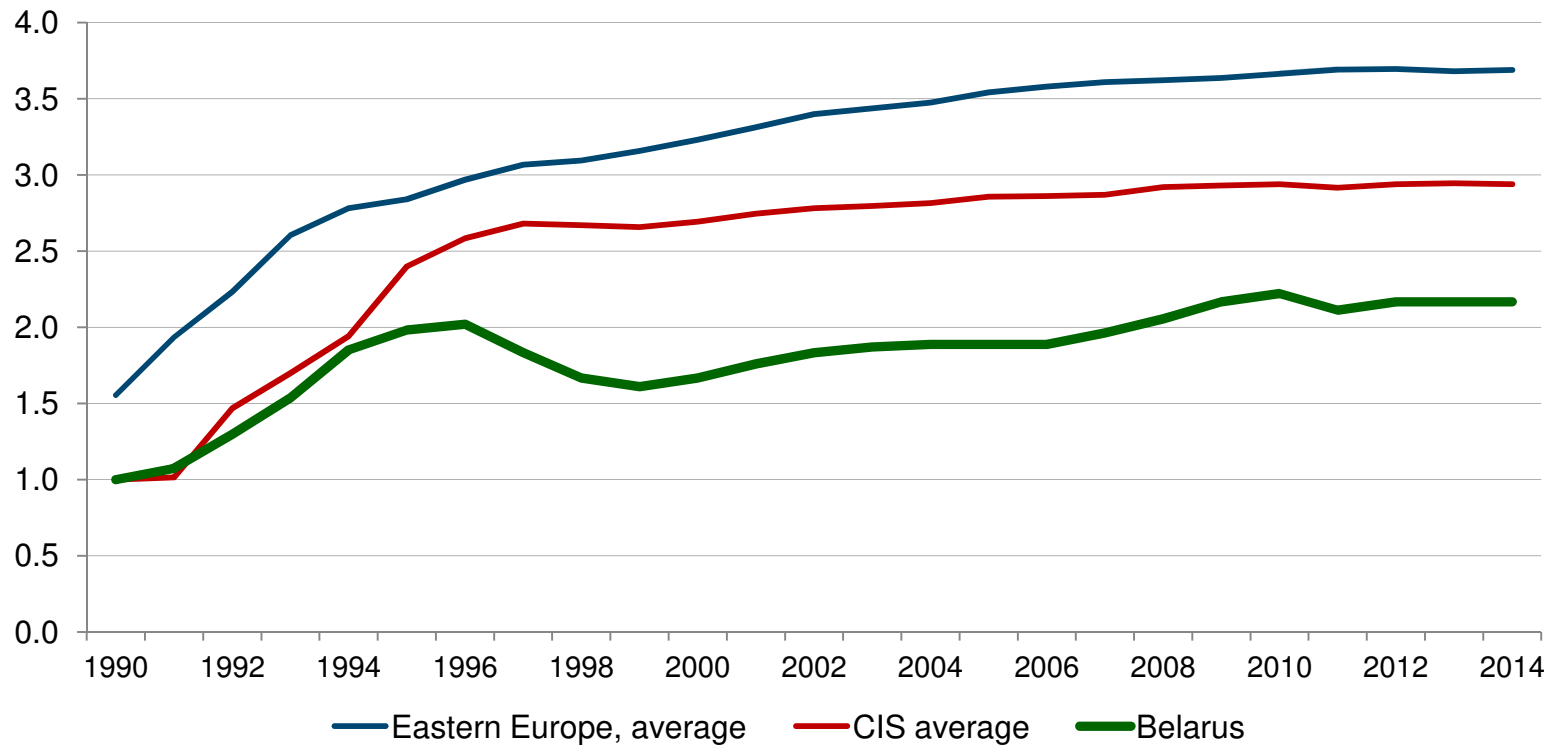
Motivation

- There is not enough information about Belarus in the outside world
- Available publications often present a distorted picture of the country and its economy
- An attempt to fill some gaps in understanding economic and political transformation in Belarus
- An attempt to provide an objective and independent analytical picture of the Belarus economy

Is Belarus a transition outlier?

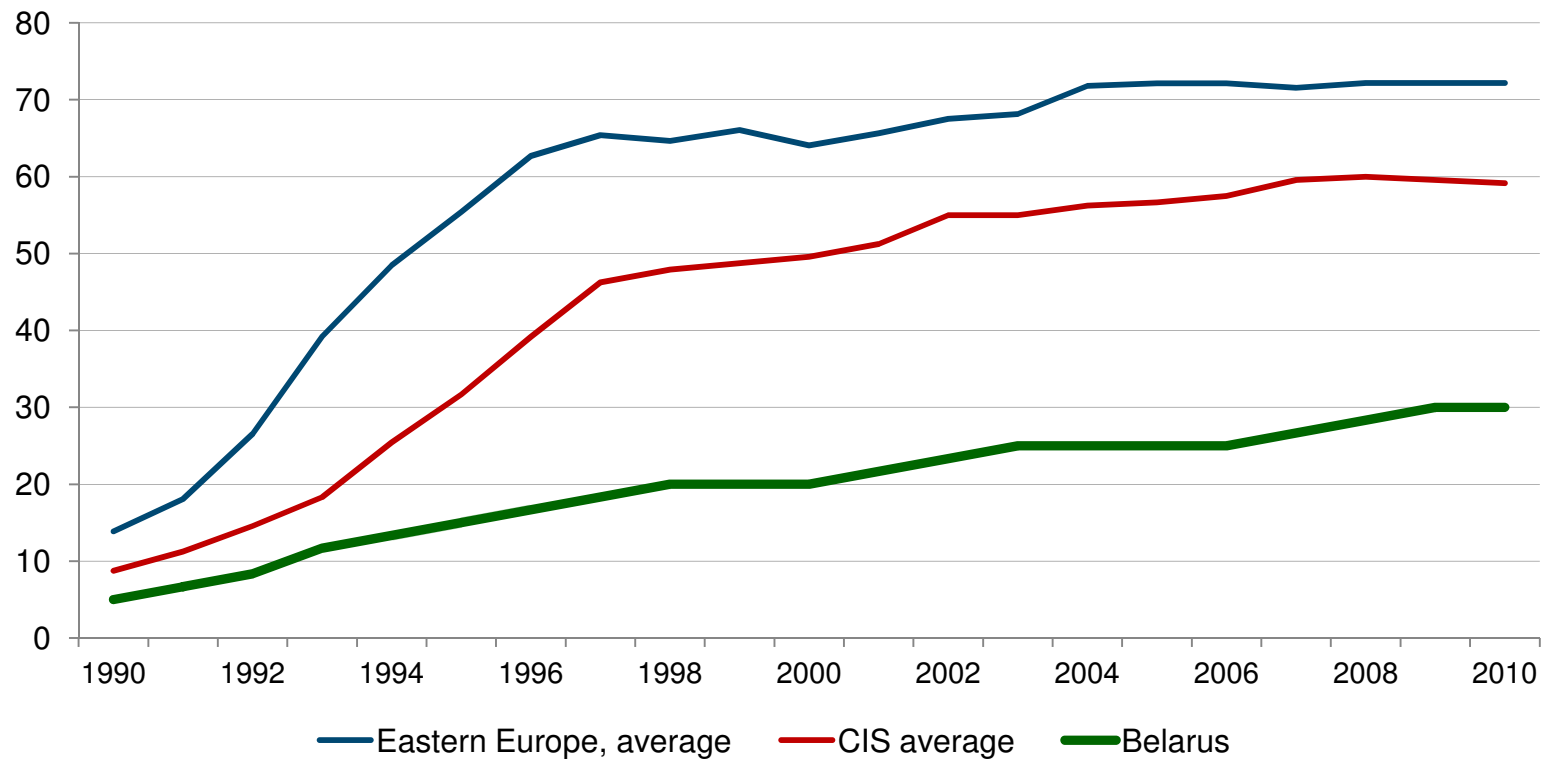
- Belarus' experience defies many beliefs about the process of post-communist transition
- By conventional measures ('progress in market reforms'), Belarus is 'frozen' in a state of unfinished market reforms
- At the same time, during the past two decades, GDP growth in Belarus was among the highest among the TEs
- But also, Belarus was the country with the highest average inflation rates among all TEs

EBRD transition indicators, 1990-2014

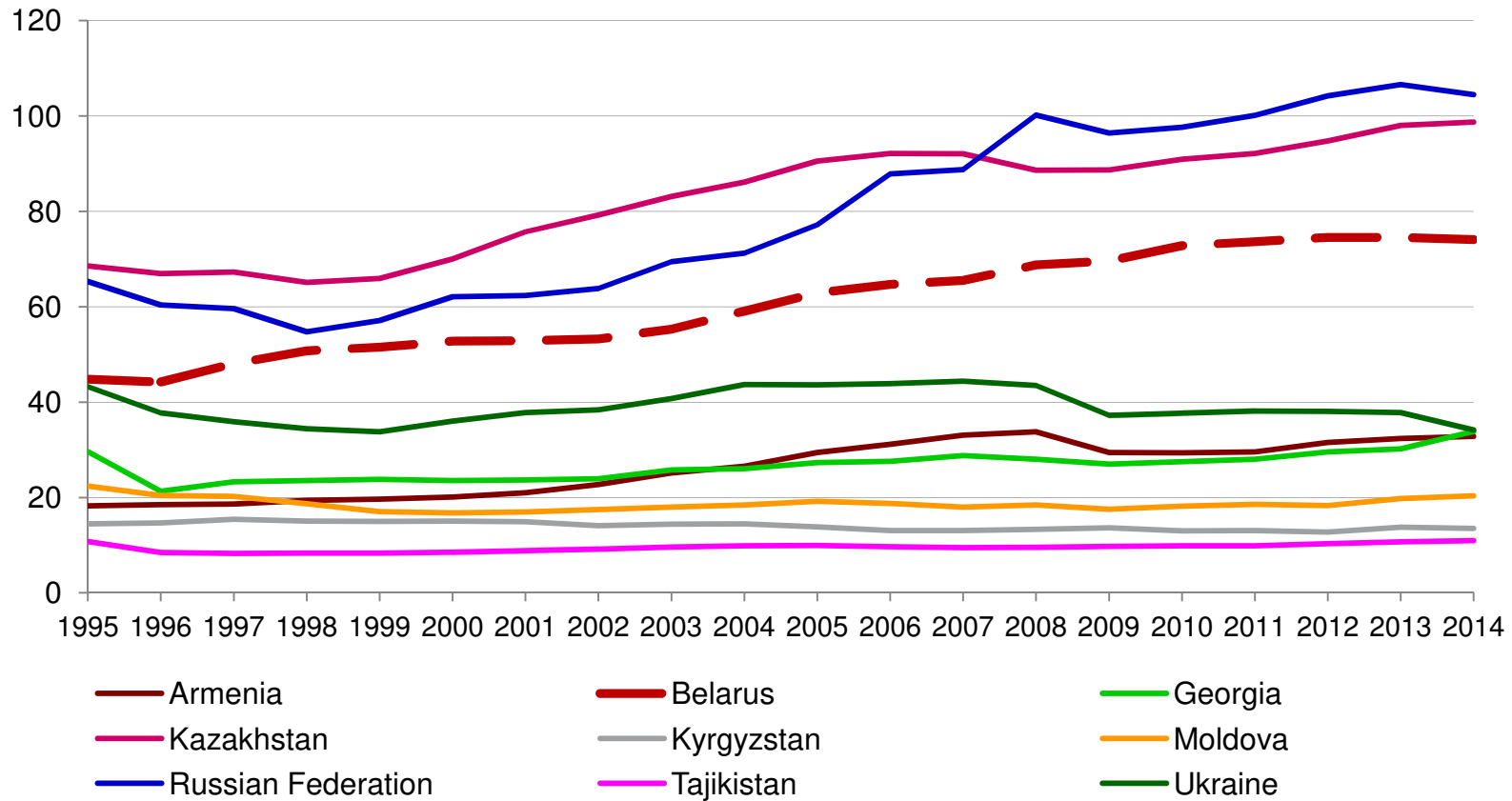


Source: EBRD.

Share of private sector in GDP, %, 1990-2010



GDP p.c. at PPP relative to the CEE-11 average, in %



Source: wiiw Annual Database incorporating national statistics; UNECE statistical database.

Belarus' economic model

A specific brand of 'state capitalism':

- Political system with a highly centralised decision-making pyramid – excessive powers concentrated at the top
- A 'super-presidential' political system: the president de facto has greater powers than the National Assembly
- A large chunk of the economy (especially manufacturing, agriculture and banks) are owned/controlled by the state
- The governance of SOEs is subordinate to state targets
- No direct allocation of resources (typical of central planning) but frequent interference of the state in the working of markets
- Coexistence of rule-based and discretionary policy-making

Belarus' economic model (contd.)

No privatisation but growth of a de novo private sector:

- Unlike in any other TE, so far there has been no large-scale privatisation in Belarus
- Belarus preserved much of the large-scale manufacturing inherited from Soviet times
- In agriculture, Soviet-type collective farms (kolkhozes) are still in existence
- At the other end are retail trade and business services: the private sector is dominant thanks to organic growth of de novo private firms and the entrance of foreign firms

Belarus' economic model (contd.)

A 'social contract' with the population:

- The policy objective: access to jobs for everyone (close to full employment) and rising personal incomes
- The policy instruments: subsidies to SOEs and wage targets (via wage scale for all employment categories)
- How does the 'social contract' work? No handouts to vulnerable groups but job opportunities for everyone
- But: employment protection is low! There are no proper unemployment insurance or unemployment benefits

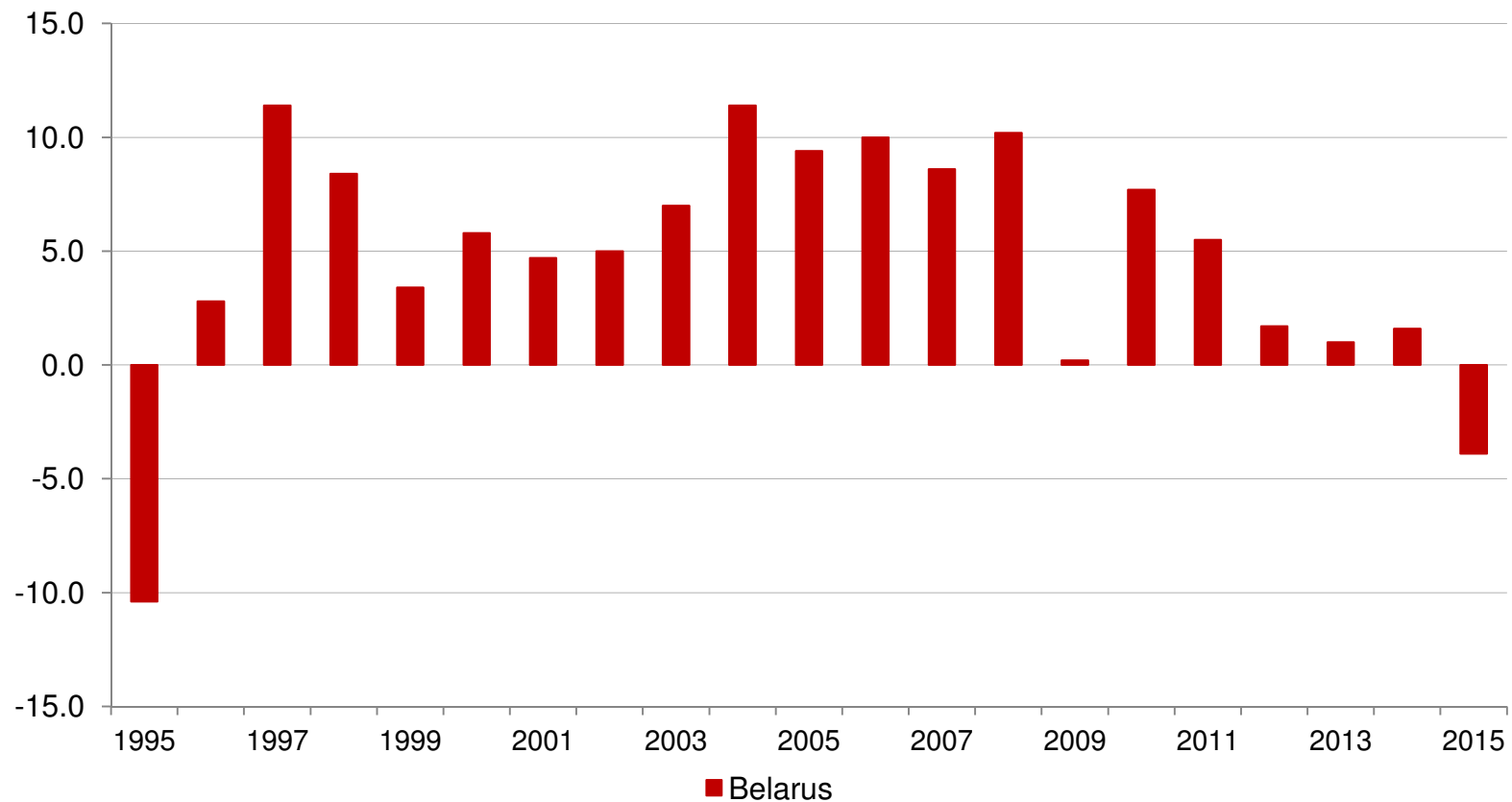
‘Soft budget constraints’ in Belarus

- SBCs are a pervasive issue and problem in Belarus – and an inherent part of the economic model
- Many BY SOEs are inefficient under market conditions and generate losses (quasi-fiscal deficit)
- SBCs mean that the state is ready to act as a lender of last resort for firms in financial distress, rescuing SOEs from bankruptcy
- SBCs are one of the policy mechanisms to sustain the ‘social contract’ with the population: close to full employment and rising welfare
- The ‘energy rents’ (access to energy resources from Russia at below-market prices): a supplementary external resource to support this mechanism

SBCs as a source of macroeconomic instability

- Rescue operations are equivalent to the recognition of extra fiscal deficits (QFD is transformed into open FD) =>
- Extraordinary lending by the central bank is equivalent to the monetisation of this deficit (money creation) =>
- Excessive money creation translates into high inflation and weakening of the currency
- This mechanism has been one of the root causes of persistently high inflation and macroeconomic turbulence in BY (including three episodes of currency crises)

GDP growth in Belarus ...



Source: wiiw Annual Database incorporating national statistics.

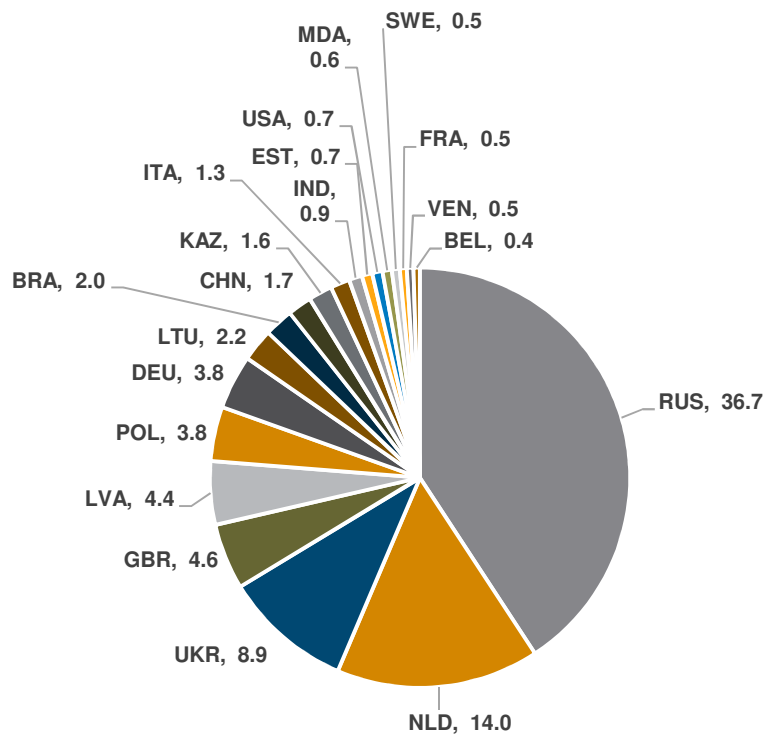
GDP growth in Belarus ...and in Russia



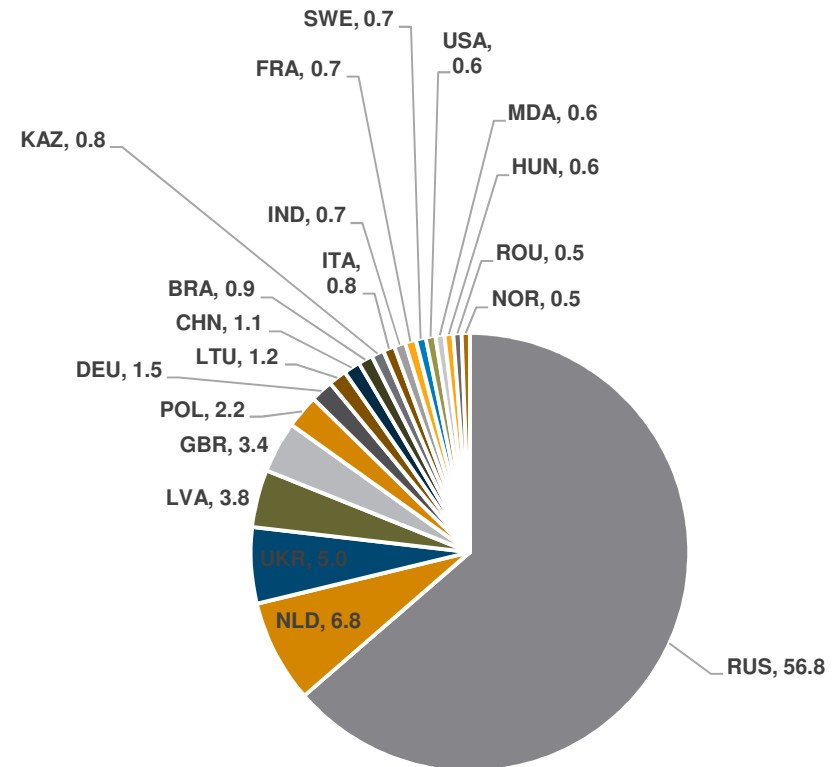
Source: wiiw Annual Database incorporating national statistics.

Belarus top 20 trading partners, average 2005-2014

Exports, % of total



Imports, % of total



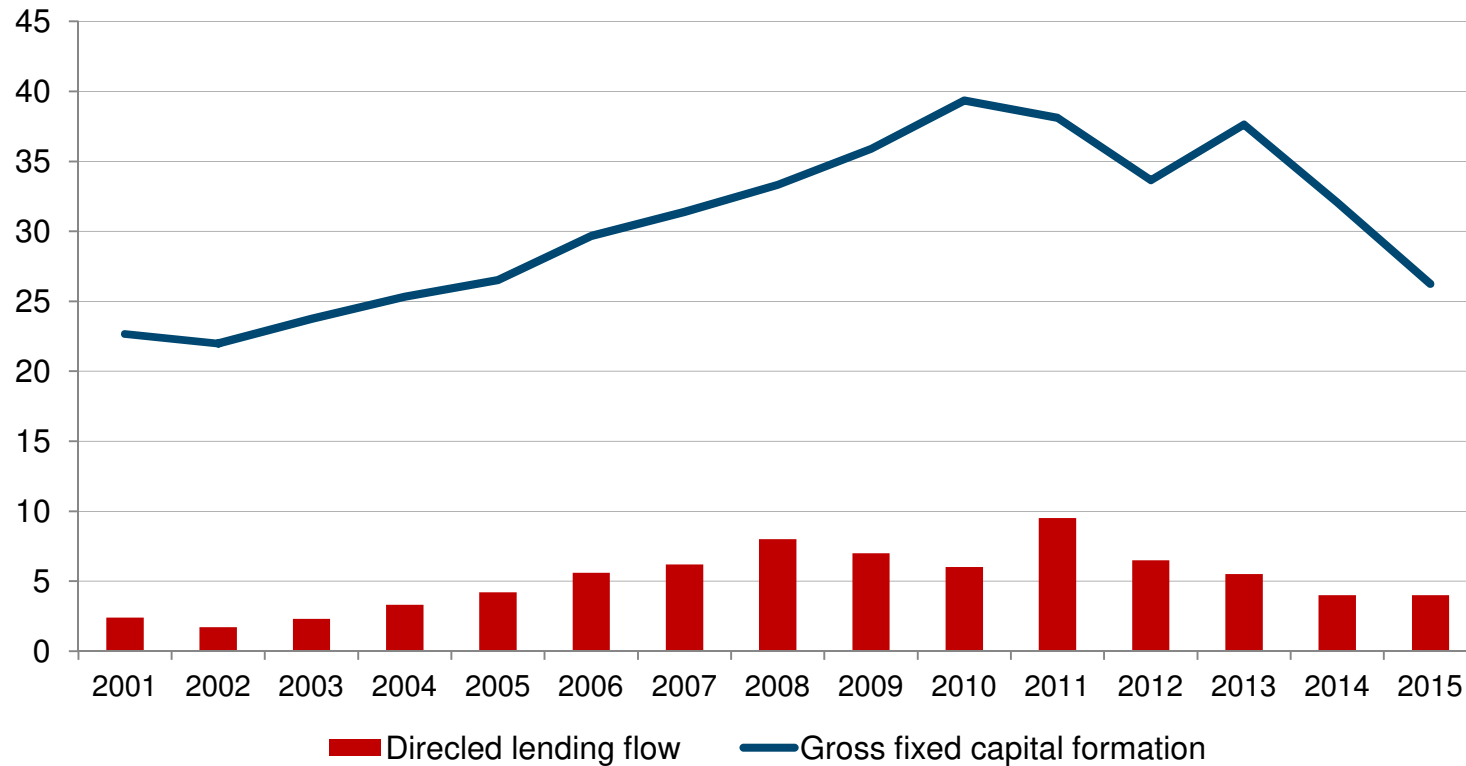
Source: wiiw calculations based on UN Comtrade data.

Belarus' growth model

The drivers of growth in Belarus:

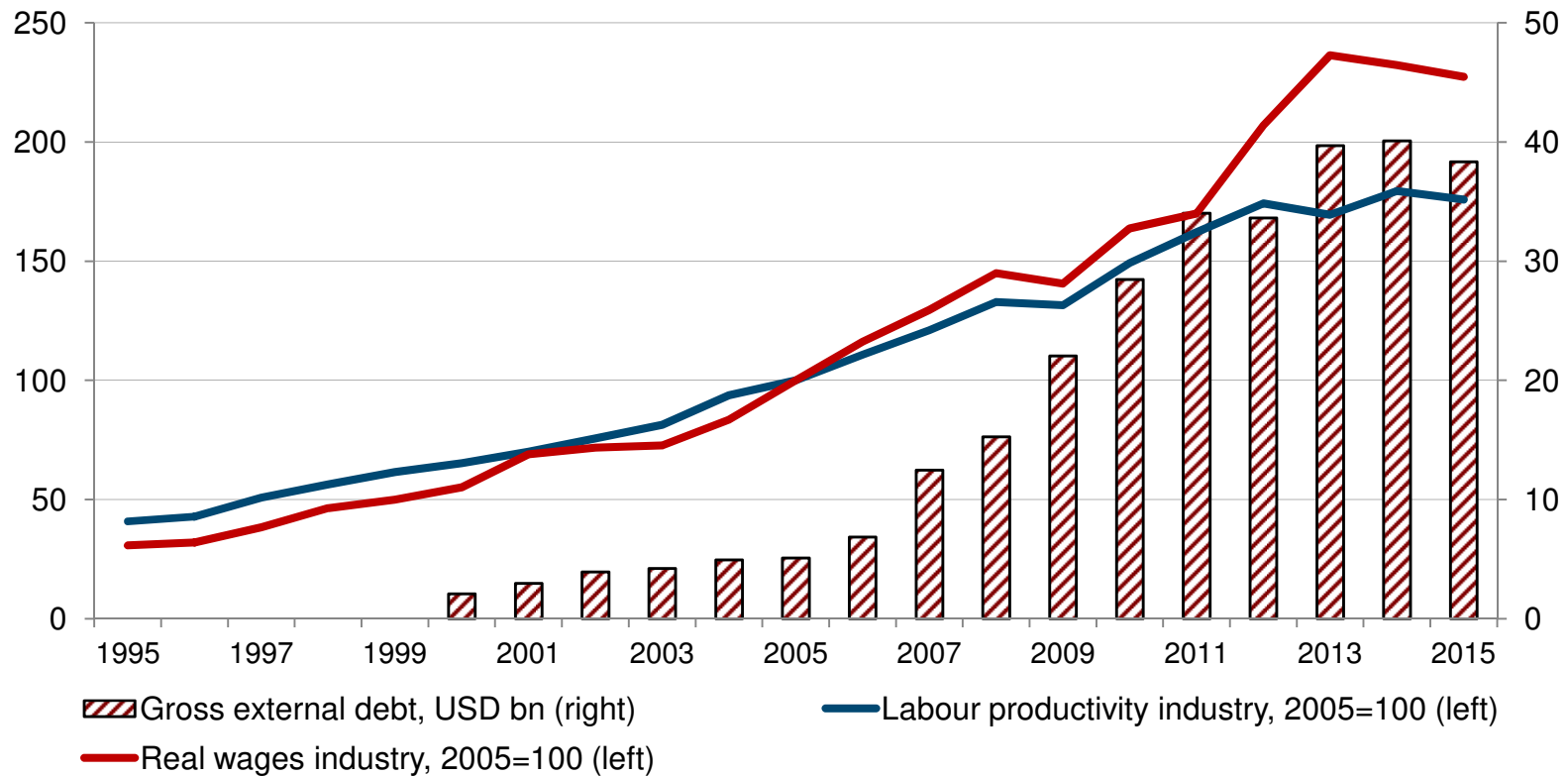
- Invigoration of economic ties with Russia after the introduction of the Customs Union in 1995
- Preserved production capacity and organisational capability
- Targeted policies to support domestic supply and prop up domestic demand
 - Directed lending
 - Wage targets
- The 'rent dividend' (a 'free' external resource)

Directed lending and gross fixed capital formation, % of GDP



Source: IMF; UNECE statistical database.

Labour productivity, real wages and external debt



Source: wiiw Annual Database incorporating national statistics; wiiw calculations.

A growth model that has its limits

- By 2008 this growth model reached its limits
- Belarus experienced three episodes of currency crises: in 2009, 2011 and 2014-2015
- In all cases there was a massive devaluation of the currency reflecting the needed real exchange rate adjustment
- GDP growth slowed down dramatically and in 2005 and 2016 the economy was in a recession
- Policies remained unchanged until 2015 but this resulted in large CA deficits and the accumulation of foreign debt
- **Policies needed to change and this started in 2015**

The current policy agenda

Changes in macroeconomic policies since 2015:

- A shift to a new monetary policy regime: switch from an exchange rate peg to monetary targeting and a floating exchange rate
- Tighter monetary and fiscal stance
- Cuts in public expenditure (in the first place public capital expenditure)
- Scaling down directed lending

The main changes in the macroeconomic policy mix:

Before 2015	2015-2016
Direct stimulation of private consumption (through wage policy)	Closer coupling of wages to productivity growth
Extensive directed lending, large-scale public investment programmes	Shrinking directed lending, reduced public capital expenditure
Accommodating monetary policy	Relatively tight monetary stance
Pegged exchange rate	Floating exchange rate

Main patterns of macroeconomic performance

Before 2015	2015-2016
Large CA deficit and growing foreign debt	CA deficit below 3% of GDP
Persistently high inflation	Disinflation
Systematic trend for REER appreciation	XR close to the equilibrium one
Close to full employment	Growing unemployment
Relatively high (but declining) GDP growth	Recession/stagnation

But macroeconomic policy reforms were not backed by structural/microeconomic reforms

An overall inconsistency in the policy mix:

- Some modest steps towards reforming SOEs: reduction in state targets; efficiency targets for management; independent members in the boards of directors
- But at the same time: targets for new jobs created; re-emergence of wage targets (USD 500 average wage in 2017?)
- No clear strategy regarding deeper SOE reforms and/or privatisation
- Unreformed labour market: no proper social safety net and unemployment insurance to cushion the effect of layoffs

Addressing SBCs – key to macroeconomic stability and policy sustainability

- SBCs are the root source of macroeconomic instability
- It will not be possible to ensure sustained macroeconomic stability without arresting these leaks
- But: SBCs were also a key element of the ‘social contract’ in BY ensuring job opportunities and rising incomes
- Eliminating SBCs would mean denouncing this contract – and proposing a new, different one?
- The authorities’ capacity to impose hard budget constraints on SOEs will be a key test of the long-term viability of the Belarusian model of ‘state capitalism’



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