

THE WIND OF CHANGES IN BELARUSIAN ECONOMY

Volha Dudko

November 2007

This paper is the independent analysis of the author. Views expressed in the report are not necessarily those of Association for International Affairs.

INTRODUCTION

The hike in energy resource prices changed the relationship between Russia and Belarus and shifted it to a more commercial plane. For many years the Belarusian government succeeded in keeping a substantial growth in the Belarusian economy with the stimulation of consumer demand and high prices on exported products (refined oil, potash fertiliser) plus a duty-free excess in the large Russian market. But at the same time the economy remained practically unreformed (only sectors in which government was interested were modernised, others were in decline). High prices on oil products gave an opportunity for the government to finance social programmes and to keep unprofitable enterprises afloat. At the same time there exists tiny private sector with a relatively developed market, but with continuous pressure from administrative control.

As the relationship between two countries became market oriented, problems regarding the ineffectiveness of government management of the economy became obvious. There became a need for gradual changes and further liberalisation of the market. Belarus today is standing on the threshold of such changes, but in what direction these changes will be provided depends on the government's future economical decisions. Meanwhile, at the same time it is a chance for the opposition to exert influence over possible changes and make them more favourable for Belarusians.

Main challenges for Belarusian economy are as follows:

1. THE LOSS OF THE COMPETITIVENESS OF BELARUSIAN GOODS

Belarusian producers' goods are rapidly losing competitiveness in traditional (Russian) and domestic markets.

What is needed to increase the competitiveness of Belarusian production?

- Modernisation and the restructuring of enterprises, diversification of export partners, and search of new commodity distribution networks.
- New effective management which will provide a better marketing policy.

There is a need of new marketing ideas to penetrate new markets and to retain the current one. Most of Belarusian producers considered the low price of their goods as one of their main competitive advantages. But the rise of people's income in the traditional markets (Russia) mean that Belarusian goods are in less demand.

2. THE DEFICIT OF TRADE BALANCE AND THE NEED FOR AN INFLOW OF FOREIGN CURRENCY

The deficit of trade balance appeared concurrently with the price hike in energy resources. At the same time the economic performance of Belarusian enterprises worsened. In the first six months the number of unprofitable enterprises rose to 50.6%. The largest number of unprofitable enterprises was seen in industry (20.3%), including the fuel industry (44.1%), light industry (30.4%) and the tractor and agriculture machine building sector (29.2%).¹ The Belarusian government has to search for financial resources in the form of foreign currency to cover the trade deficit.

¹ "Government assistance: without white spots but with dark holes" N.Novozhilova, Naviny.by; http://naviny.by/rubrics/economic/2007/10/01/ic_articles_113_153094/ (1.10.2007) in Russian

The possible tools which can improve the situation:

- **privatisation (FDI)**

The inflow of direct foreign investment can solve the most urgent problems present in the Belarusian economy not only in short-term but also in the long-term as well. Strategic investors, which invest in Belarus not only transfer their capital, but also provide technological modernisation, bring their know-how and management skills. Or it is better to say, they bring elements of the market to an economy in transition. FDI also helps improve the performance of the economy as a whole. Nevertheless, even though government officials claim that Belarus is open for foreign investors, the Belarusian economy is still characterised by a bad investment climate and is not very attractive for foreign investors because of complicated legislation and unpredictable political decisions.

- **IPO (Initial public offering)²**

IPO is the first sale of stock by a private company to the public. IPO can be a good long term source of investment resources for Belarusian enterprises. But in the short-term perspective Belarusian enterprises appear unprepared to undertake initial public offering as it requires at least 2-3 years preparation to make company's accounts in order with international standards. Also it requires the introduction of internal company information including expenses, revenues and earnings of the company's management.

Government officials made an announcement about its plans to offer minor (10–15%) holding of stock of oil refineries to the public³.

² More about IPO: "Privatization of large enterprises through IPO: pro and con" E.Rakova; <http://nmnby.org/pub/0706/18m.html> (18.06.2007), in Russian;

"Raising Funds at Western Capital Markets: Opportunities for Belarusian Companies", Kiryl Haiduk and Ricardo Gucci, October 2007; <http://www.research.by/pdf/pp2007e03.pdf> (30.11.2007)

³ Semashko about gas, credits and IPO; <http://news.tut.by/economics/88001.html> (19.05.2007) in Russian

- **Borrowing from abroad**

The rise of external debt is a decision aimed at reducing short-term problems with trade deficit, but it can't be abused as credits have to be returned with interest.

For the moment the Belarusian government is actively encouraging enterprises and banks to take foreign loans. For government currency depreciation sees as a worse-case scenario than the acceleration of external debt. In first half of the year the external debt has already rose to 37.5%⁴ and it continues to rise.

- **To keep the inflow of import or reduction of aggregate demand (to cut salaries)**

The Government is currently undertaking a protectionist policy, by trying to limit the inflow of imported goods. At the same time it announced an import substitution programme. But it hasn't seen many positive results regarding these measures, as the number of imports is rising nevertheless. Import restriction measures can't be in place for a long time if Belarus plans to become WTO member, as the government states.

At the same time such measures limit the competition in Belarusian markets, put home producers in favourable positions which do not motivate them to be more effective, to reduce costs and produce higher quality goods.

Today's government actively stimulates borrowing from abroad to keep unprofitable enterprises afloat and to ensure the payment of salaries. At the same time higher salaries stimulates the consumer demand for import which the government actively tries to limit.

⁴ "Is it dangerous for Belarus to have an anti-record of external debt" E.Novozhilova; http://naviny.by/rubrics/finance/2007/09/21/ic_articles_114_152941/ (21.09.2007), in Russian

- **inflow of investment in energy-saving technology**

Investments in energy-saving technology can improve not only the performance of enterprises but also be a source of foreign currency needed to cover trade deficit.

THE BELARUSIAN PRIVAT SECTOR

The Belarusian private sector can be conditionally divided into several groups of representatives:

- **individual entrepreneurs (in the new year representatives of small private enterprises)**

This group of people is concentrated mainly in trade and characterised by continues government pressure and control. Their possibilities for making business will worse after the New Year, when, according to new presidential Decree No.750, they would be forbidden to employ people (except relatives) and directed to create private enterprises. It will worsen the current situation of this group who already is in a not particularly good economic position.

- **small and medium sized businesses**

Small and medium-sized Belarusian businesses can be characterised by some extent of success and profitability. People have learnt to work under continual government control and unpredictable legislative conditions. Many of them use acquaintances with government officials to avoid pressure and sanctions. And at the same time government control over the economy (private sector especially) slows down their development. Among the main braking factors to development are the regulations on price and salary.

The improvement of business with reduction of tax burden and legislation restrictions would be a stimulus for Belarusian private companies for further economical development.

- large businesses concentrated among people close to government

Large-sized business in Belarus does exist, but it is characterized by noticeable government support. It is provided mostly by people close to government authority, to higher levels of nomenclature officials or is provided by their relatives. Further structural changes are unfavourable for this group of people, except in the situation when they will be able to influence economic policy according to their interest.

THE MAIN WEAKNESSES OF THE BELARUSIAN PRIVATE SECTOR

- Capital outflow

Because of the bad business climate many successful and perspective entrepreneurs were forced to move their business to Russia (mainly to Moscow), where the business climate is much better. Such a trend can still be observed today.

A better business climate will open new opportunities for Belarusian entrepreneurs with further inflow of investments.

- Fear of foreign competition and market openness

Most of Belarusian small and medium businesses are very suspicious about opening up the Belarusian market and in some extent support the protectionist policy of government, as it places them to more advantage position.

Without free and fair market competition there can't be any economic development. Competition between market subjects give ordinary people access to cheap and quality goods and raises the welfare of the society as a whole.

- Business is used to work under administrative control and is not ready for development. Stability became a bad habit.

According to the last research provided by IPM⁵ most of the representatives of small and medium Belarusian business are already used to working under the present conditions and have little ambition to develop further.

With the further enforced widening of market elements in the economy there will raise a demand for market institutions among representatives of small and medium businesses. Opposition leaders just have to listen attentively to their needs at the time of drawing up a programme of economic reforms.

- The need to divide business and governance. Politics make policy - business makes business

The division of business and politics is actual not only for Belarus, but for most post-Soviet republics. Large business, close to government, has influence to direct the further economic development according to their business interests. Whether these interests coincide with interests of Belarusian society is a big question.

THE MAIN ADVANTAGES OF THE BELARUSIAN PRIVATE SECTOR

- Good potential for development in a case of market liberalisation, reduction of legislative barriers and other restrictions.
- private enterprises show success in those sectors where state owned enterprises and companies are ineffective and unprofitable (services, communication technologies, programming, light industry, woodworking and others)
- this group of population is most favourable to market reforms

⁵ "Reforms and private practice", E.Rakova; <http://nmnby.org/pub/0709/18m.html> (18.09.2007), in Russian

WHAT IS GOVERNMENT DOING AND TO WHERE IT CAN LEAD

From the nervous and stochastic decisions which government began to make after the price hiking it is obvious, that it has no any long term strategy. All problems it is solving relate only to the short term situation.

The government understands the need to provide privatisation because it is not able to finance unprofitable enterprises any more. Ineffectiveness of administrative control over state-owned companies became more noticeable. But as all essential principals of every economical model are based on property rights, the government will try to keep in state ownership the most strategic companies and put aside the large-scale privatisation as long as possible.

The latest privatisation deals (the sell of motorcycle and bicycle plant “Motovelo” and “Velcom” GSM network operator) where characterised by closed operations, without announcements or public auctions and without any concrete information about the terms of transaction. Journalists and experts were lost in conjectures. Only lately have the details of Velcom takeover emerged with some assumptions about the possible price of the transaction. Velcom was collateralised and later sold to an Austrian company in return for assistance to the National Bank of Belarus (NBB) during mass withdrawals of deposits from banks amid the gas dispute with Russia in December 2006⁶.

In such condition it becomes obvious that the government would provide only target privatisation of those enterprises which are considered to be not so strategically important as a tool of macro economical stabilisation in the case of economical shocks. The only market principle which our government has already learnt is how to sell state property and at a high a price as possible or with large profits for “its people”. Now government officials are actively seeking for investments in

⁶ "Is privatization inevitable?", BISS monthly expert panel;
http://www.belinstitute.eu/index.php?option=com_content&task=view&id=120&Itemid=1 (29.10.2007)

modernisation of the technological base of some enterprises, so they can sell it for a higher price.

Who will be among those foreign investors who would agree to buy Belarusian property on the conditions suggested by government? The largest probability is that it would be bought with the idea of re-selling. It is also uncertain if there would be nomenclature privatization in Belarus. Bureaucrats are mostly eager to manage the property but not to own it and take responsibility for possible business risks⁷. But at the same time there is a possibility that it can settle in the hands of large business close to highest levels of government nomenclature.

What can be predicted in the long term regarding the measures our government is currently taking?

- Target privatisation of Belarusian enterprises in case of economic shocks
- Further crediting of the economy with accumulation of external debt.
- Rise of prices on consumer goods and food; deficit of some commodities in the home market.
- Lowering of peoples living standards.
- Lowering of competitiveness of Belarusian products.
- Migration of specialists - Brain drain.

⁷ "Is privatization inevitable?", BISS monthly expert panel;
http://www.belinstitute.eu/index.php?option=com_content&task=view&id=120&Itemid=1 (29.10.2007)

The deficit of qualified workers can be already noticed on Belarusian labour market. Specialist and skilled workers are leaving the country for better opportunities and better living standards. It can be expected that the niches on labour market would be filled up with emigrants from Asian countries. It can lead to social extension in the society.

WHAT HAS TO BE DONE TO RAISE THE COMPETITIVENESS OF BELARUSIAN ECONOMY?

1. DECENTRALIZATION OF POWER

The vertical structure, created by the government leads to irresponsibility of officials and the government itself to people. Decentralisation of power would help to lower corruption and make government officials more responsible to the processes which are happening in the country.

2. TRANSPARENCY OF THE WHOLE SYSTEM

People have to know what government economical policy looks like, how it is effective (ineffective) and to what results it can lead in long-term perspective.

3. GOOD MANAGEMENT

Belarusian enterprises and companies in near future (even now) begin to feel the lack of good managers, which would be able to manage not only under old soviet rules, but also according to a developed market. The Belarusian economy needs specialist top management, who would make the economy effective in the long-term.

4. EDUCATION

Belarusian universities and its education became less competitive in comparison with European universities. Graduates from Belarusian universities became useless at home and leave the country. Many of them have to work not reflecting the education they got. There is need to reform the system of education and to open Belarusian universities in terms of wider cooperation with foreign universities.

5. PRIVATISATION

Only with private ownership can Belarusian enterprises reach effectiveness and be competitive in domestic and foreign markets. The government had proved its inability to reach high levels of effectiveness of production with administrative methods.

There has to be people interested not just in production for export but also interested in the domestic market as well. Further orientation of Belarusian producers on export (as it is seen today) would make Belarus one large industrial estate, but not a well developing competitive market.

6. INFLOW OF THE INVESTMENTS

Belarus needs foreign investments to improve the present situation. A bad investment climate breaks the realisation of the most profitable projects (the example of Volkswagen which is about to leave the Czech Republic and looks for partners in Eastern countries will most probably invest in Ukrainian or Russian markets, but not in Belarus). Unstable legislative bases and unpredictable government decisions make barriers for those who are eager to invest in Belarusian economy. Belarus is loosing abilities which can help to reform its economy and to raise paying capacity and welfare of Belarusian population.

7. CREATION OF COMPETITIVE DOMESTIC MARKET

people need an open and fair market to have space to realise their potential.

Fair competition of economic all subjects is advantageous for the whole of society.

What can the realisation of such measures can give for Belarus?:

- Belarus as a valuable economical partner for all neighbours with closer political, economical and cultural cooperation with European Union
- The raising of people's welfare, protection of property rights, the rise of social protection.
- Further deindustrialisation of the Belarusian economy with orientation on services, IT-technology, innovation (with direct investments in this sphere). Belarus has to produce what is effective and perspective at present period of time, but not what is unprofitable and ineffective but traditional.

WHAT CAN THE OPPOSITION DO IN SUCH A SITUATION?

- To think and plan in with long-term perspectives in contrast to the government short-term decisions, which do not increase the effectiveness of the economy, but just avoid the possible crises.
- Try to influence the present government's economic policy and promote its own economic program.

- Not to wait for the crises to come, but try to prevent accidental government decisions that would lead economy into the further problems.
- Promote the advantages of a free and transparent market system.
- Warn about the effectiveness of government management and its mistakes.
- Promote the respect of property rights and private ownership as a basis for an effective economy.
- Try to raise the responsibility of people in the processes which are happening in the country. Appeal to the lowest levels of government officials and warn them that they all are taking responsibility for the possible economic problems.
- Try to get support of different groups in the population (business, students, pensioners, workers). To find what is the most urgent for different social groups and to appeal to their needs.
- To promote an alternative model of economical development. Not just generally speculate on EU accession and the promotion of European values but concentrate on the most urgent problems of the Belarusian population.
- The present situation carries not just risks of economical decline and crisis but also gives an opportunity for changes. It is important not to lose this chance.

Volha Dudko

Member of AMO Research Center's Eastern European Program. A master program student, Faculty of business administration, University of Economics in Prague.



ASSOCIATION FOR INTERNATIONAL AFFAIRS

The Association for International Affairs (AMO) is a non-governmental organization founded to promote research and education in the field of international relations. Our main goal is to increase awareness of international affairs. Thanks to its activities and more than ten-year tradition, AMO has established itself as a preeminent foreign policy think-tank in the Czech Republic.

AMO Strives To:

- publish analyses and research papers;
- organize international conferences, expert seminars, round tables, public briefings;
- promote educational projects;
- provide critical assessment of current affairs for Czech and international media;
- foster development of a new generation of foreign policy experts and scholars;
- encourage interest in international relations among the general public;
- cooperate with Czech and international like-minded institutions.

RESEARCH CENTER

Founded in October 2003, the AMO's Research Center has been dedicated to carrying out research into and raising public awareness of international affairs, security and foreign policy.

The Research Center strives to identify and analyze issues important to Czech foreign policy and the country's position in the world. To this end, the Research Center produces independent analyses; encourages expert and public debate on international affairs; and suggests solutions to tackle problems in today's world. The Center's activities can be divided into two main areas: First, the Center undertakes research and analysis of foreign policy issues. Second, the Center fosters dialog with the policy-makers, expert community and broad public.