

Belarus Between Russia and the European Union – Some Reflections on Belarus’ “Economic Miracle” and Future Prospects*

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1. Introduction

This paper provides a brief analysis of the current economic situation and the recent developments in Belarus, focusing on the patterns and the sources of economic growth, the related structural changes, and foreign trade developments – including the consequences of the accession to the World Trade Organisation (WTO). A comparison of key economic indicators with other countries in the region (Bulgaria, Romania, Ukraine and the new EU member states from Central and Eastern Europe – NMS) is used as a benchmark. Main elements of Belarus’ economic policy, its sustainability and challenges for the future are discussed as well. However, neither political developments nor energy issues are addressed in detail since these are the subject of separate contributions to this volume.

In economic terms, Belarus and even Ukraine are both small and poor. Even in the latter country – the second largest in Europe in terms of territory with nearly 50 million inhabitants – the size of economy amounts to a mere EUR 300 billion (less than 3% of the enlarged EU), in Belarus this indicator stands at 0.7%.¹ Real GDP per capita in Belarus stands at

* This paper is based on the author’s presentation at the Workshop in the National Defense Academy (Landesverteidigungsakademie) on June 27th, 2007 in Vienna which, in turn, relied heavily on the recent contributions by Havlik and Astrov (2007), as well as Vassilevsky et al. (2006, 2007).

¹ At Purchasing Power Parity (PPP). Measured at exchange rates, Belarus’ and Ukraine’s GDP is even smaller – less than EUR 24 billion, resp. 70 billion – since the domestic price levels are just one third resp. one fifth of the EU average (Table 1).

half of the NMS and just one third of the EU level. The development level of Belarus is comparable to that of the latest EU entrants Bulgaria and Romania (Table 1). In contrast to Ukraine – which has not reached the pre-transition GDP levels yet – Belarus has proved more successful on this account. The recent economic growth in Belarus has indeed been rather impressive: between 2000 and 2006, its GDP increased by more than 40% – twice as much as in the NMS. The growth of industrial production has been even higher (more than 50% in the same period) and Belarus' industry also managed to exceed the pre-transition level. Given its largely unreformed economy, this relative economic success represents a “puzzle” – even to the IMF and The World Bank.² Incomes and wages are extremely low, yet somewhat higher than in Bulgaria. At the same time, the registered unemployment is extremely low.³ Belarus is fairly open to trade according to the shares of exports and imports in GDP, but has attracted very little foreign direct investment (FDI) so far. With respect to the latter indicator, Belarus (as well as Ukraine) falls far short not only of the Central European NMS, but also of the latest EU entrants Bulgaria and Romania. This suggests that the investment climate remains generally poor and reform progress has been lagging.

Table 1: Overview of economic fundamentals, 2005

NMS-8: Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Slovak Republic, Slovenia. PPP: Purchasing power parity – wiiw estimates. 1) Without Transnistria. – 2) wiiw estimate. – 3) 1991=100. – 4) Registration data. – 5) Year 2004. – 6) EU definition: expenditures and revenues according to ESA'95, excessive deficit procedure. – 7) Gross wages plus indirect labour costs, whole economy, national accounts concept. – 8) Including flows within the region.

Source: wiiw, CISSTAT, AMECO, Eurostat.

² Personal communication to the author in October 2005 from the IMF representative in Minsk (see also The World Bank, 2005).

³ True, the official unemployment rate may not properly reflect the real situation, since, on the one hand, the unemployment benefits may be too low to give enough incentive to register as unemployed, and on the other hand, much of unemployment has the form of unpaid leave and involuntary part-time employment.

	Belarus		Ukraine		Bulgaria		Romania		NMS8
GDP in EUR at exchange rates, EUR bn	23.73		65.51		21.45		79.26		540.87
GDP in EUR at PPP, EUR bn	71.2		294.1		58.2		176.1		959.81
GDP in EUR at PPP, EU-25=100	0.7		2.7		0.5		1.6		8.9
GDP in EUR at PPP, per capita	7300		6250		7530		8140		13160
GDP in EUR at PPP per capita, EU-25=100	31		27		32		35		56
GDP at constant prices, 1990=100	128	³⁾	69.0	³⁾	103.1		111.0		140.8
GDP at constant prices, 2000=100	143.0		145.0		127.3		131.9		120.4
Industrial production real, 1990=100	153		94.2		80.7		76.7		157.7
Industrial production real, 2000=100	152		164.0		152.3		125.2		131.5
Population – thousands, average	9750		46930		7740		21624		72922
Employed persons – LFS, thousands, average	4315	⁴⁾	20750		2980		9160		29064
Unemployment rate – LFS, in %	1.5	⁴⁾	7.0		10.1		7.0		13.6
Average gross monthly wages, EUR at exchange rate	175		126		163		264		807
Average gross monthly wages, EU-25=100	6.2		4.5		5.8		9.4		28.8
Exports of goods in % of GDP	54		43.0		44.1		28.1		46.3
Imports of goods in % of GDP	56.3		44.3		64.5		37.9		48.4
Current account in % of GDP	1.6		3.1		-11.8		-8.7		-3.6
FDI stock per capita in EUR	206		310		1105		930		2895

Belarus represents a special case in terms of economic policy pursued. Under the authoritarian leadership of President Alexander Lukashenka, the economy remains largely unreformed with the key elements of central planning being retained. To cope with high inflation, in the mid-1990s the country's authorities resorted to price controls (such as via caps on profit margins and directives to public sector organizations to buy goods at prices not exceeding the "officially accepted level") and multiple exchange rates (which were in place until 2000). At the same time, progress in structural reforms has been limited, and the economy is still being dominated by traditional state-owned industrial enterprises. In addition, the government can impose the so-called "golden share" (the right to intervene) on an enterprise of any type of ownership.

2. Sources and patterns of economic growth

Soviet disintegration presented a huge negative shock for all Newly Independent States (NIS) – including Belarus (Williamson, 1993). A number of factors played a role yet the high interdependency on the inter-republican Soviet market was a prominent feature. At the end of the 1980s, nearly all exports and imports were traded within the Soviet Union, the bulk of it with Russia (Vavilov and Vjugin, 1993). Advancing disruption of close, albeit inefficient and not always rational economic ties, the chaos resulting from the collapse of the coordinating centre in Moscow (and of the common currency), price liberalisations and the subsequent monetary squeeze initiated by Russia in January 1992 took other former Soviet republics largely by surprise and had grave economic consequences. In addition to this demand-side shock, these countries were also facing a supply-side shock stemming from a rapid price rise of previously under-priced inputs, particularly energy sources imported from Russia. As a result, the GDP in Ukraine and Moldova dropped between 1991 and 1995 by around half, in Belarus – similarly to Russia – by about one third. The depth of "transitional recession" was of a magnitude comparable to that in the Baltic States yet it lasted much longer. Only in Belarus did GDP start to recover already by 1996 and has been growing rapidly since then. By comparison, the economies of Moldova and Ukraine continued to contract until 1999, although their

subsequent recovery was more robust than in the NMS (Figure 1, Table 2).

Fluctuations in production growth have been accompanied by significant labour market adjustments. However, as shown in Figure 1, trends in GDP and employment varied considerably during the whole period of 1990-2006; there have been also differences between Belarus, Ukraine, Moldova and the NMS, in view of the varying developments in macro productivity. Not surprisingly, the initial transformation crisis resulted in a drop of employment in the first half of the 1990s. However, in contrast to the NMS employment in Belarus declined much less than GDP, thereby indicating delayed economic restructuring and implying huge reductions in macro productivity in the first half of the 1990s (Table 2). Interestingly, after 1995 employment remained flat in Belarus despite a remarkable recovery of GDP, particularly in the early 2000s.⁴

The combined effect of a robust recent GDP growth and declining employment has resulted in significant improvements in labour productivity. Between 1995 and 2006, macro productivity (defined as GDP per employed person) in Belarus doubled. A major part of productivity improvements occurred after the year 2000 as GDP growth accelerated. Generally, the recent (labour) productivity growth at macro level in Belarus has been much faster than in the NMS – not to speak about the EU-15 (Table 2).

Table 2: Long-term productivity catching-up of the NMS, Belarus, Ukraine, Moldova and Russia vis-à-vis the EU(15)

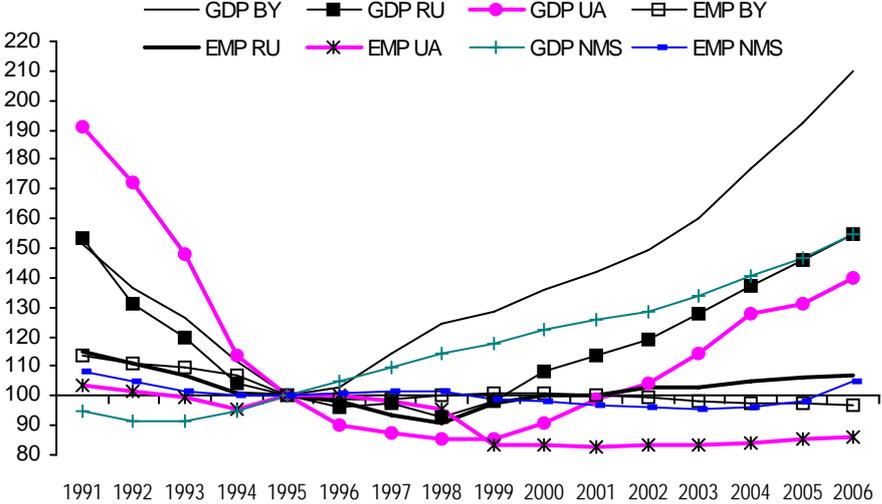
⁴ Between 1991 and 2005, employment in Belarus dropped by 14%, in Ukraine by 17%, and in Moldova by 34%. Generally, population decline is a phenomenon seriously affecting all non-Muslim former Soviet republics. Between 1991 and 2005, population, in Belarus dropped by 4%, in Ukraine by 9%, and in Moldova by 18% (including some 600 thousand living in separatist Transnistria). There are no reliable data on outward migration.

Country groups	1990-1995			1995-2005			1990-2005			2000-2005						
	growth rate			growth differential			growth rate			growth differential						
	in %	cumu- lated	annual average	against EU in pp	cumu- lated	annual average	in %	cumu- lated	annual average	against EU in pp	cumu- lated	annual average				
NMS⁽¹⁾																
GDP	-4.6	-0.9	-12.4	-2.5	46.8	3.9	25.1	1.9	40.0	2.3	8.8	0.4	19.9	3.7	13.3	2.4
Employment	-13.2	-2.8	-11.2	-2.4	-1.7	-0.2	-12.7	-1.2	-14.7	-1.1	-23.4	-1.6	0.4	0.1	-3.1	-0.6
Macro-productivity	9.9	1.9	-0.2	0.0	49.3	4.1	39.7	3.2	64.1	3.4	43.4	2.1	19.4	3.6	16.5	3.0
Belarus																
GDP	-33.9	²⁾ -9.8	²⁾ -41.7	-11.4	92.5	6.8	70.8	4.8	27.2	³⁾ 1.7	³⁾ -4.0	-0.1	41.5	7.2	35.0	5.9
Employment	-12.2	²⁾ -3.2	²⁾ -10.2	-2.8	-2.5	-0.3	-13.5	-1.3	-14.4	³⁾ -1.1	³⁾ -23.2	-1.7	-3.2	-0.6	-6.7	-1.3
Macro-productivity	-24.7	²⁾ -6.9	²⁾ -34.8	-8.8	97.4	7.0	87.8	6.1	48.6	³⁾ 2.9	³⁾ 28.0	1.6	46.2	7.9	43.2	7.3
Russia																
GDP	-34.7	²⁾ -10.1	²⁾ -42.5	-11.6	43.9	3.8	24.2	1.9	-4.7	³⁾ -0.3	³⁾ -35.9	-2.2	34.7	6.1	28.1	4.8
Employment	-13.1	²⁾ -3.5	²⁾ -11.1	-3.1	6.3	0.6	-4.7	-0.4	-7.6	³⁾ -0.6	³⁾ -16.4	-1.1	6.1	1.2	2.6	0.5
Macro-productivity	-24.8	²⁾ -6.9	²⁾ -34.9	-8.8	37.2	3.2	27.6	2.3	3.2	³⁾ 0.2	³⁾ -17.4	-1.0	26.9	4.9	23.9	4.3
Ukraine																
GDP	-47.7	²⁾ -14.9	²⁾ -55.5	-16.5	30.9	2.7	9.2	0.7	-31.5	³⁾ -2.7	³⁾ -62.7	-4.5	44.5	7.6	37.9	6.4
Employment	-3.5	²⁾ -0.9	²⁾ -1.5	-0.5	-14.3	-1.5	-25.3	-2.6	-17.3	³⁾ -1.3	³⁾ -26.0	-1.9	2.5	0.5	-1.0	-0.2
Macro-productivity	-45.8	²⁾ -14.2	²⁾ -55.8	-16.1	52.7	4.3	43.1	3.4	-17.2	³⁾ -1.3	³⁾ -37.9	-2.6	41.0	7.1	38.0	6.5
Moldova																
GDP	-52.2	²⁾ -16.9	²⁾ -60.0	-18.4	23.5	2.1	1.8	0.2	-41.0	³⁾ -3.7	³⁾ -72.2	-5.5	40.1	7.0	33.5	5.7
Employment	-19.2	²⁾ -5.2	²⁾ -17.2	-4.8	-18.5	-2.0	-29.6	-3.1	-34.2	³⁾ -2.9	³⁾ -42.9	-3.5	-10.0	-2.1	-13.5	-2.8
Macro-productivity	-40.9	²⁾ -12.3	²⁾ -50.9	-14.2	51.6	4.3	42.0	3.3	-10.3	³⁾ -0.8	³⁾ -31.0	-2.0	55.7	9.3	52.8	8.7
EU(15)																
GDP	7.8	1.5	-	-	21.7	2.0	-	-	31.2	1.8	-	-	6.6	1.3	-	-
Employment	-2.0	-0.4	-	-	11.0	1.1	-	-	8.8	0.5	-	-	3.5	0.7	-	-
Macro-productivity	10.1	1.9	-	-	9.6	0.9	-	-	20.6	1.3	-	-	3.0	0.6	-	-

Notes: 1) Central and east European new EU member states, comprising the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic and Slovenia. 2) 1991-1995. 3) 1991-2005.

Sources: wiiw Database incorporating national statistics, CISSTAT, wiiw calculations using AMECO.

Figure 1: Development of GDP and employment, 1991-2006
1995 = 100



Source: wiiw Database incorporating national statistics and CISSTAT.

The recent GDP and productivity growth in Belarus seems to be partly associated with rising investments. Gross fixed investments nearly doubled between 2000 and 2006 although they presumably have not reached the levels of the early 1990s yet. Also, overall investment levels – and especially the stocks of foreign direct investment – remain far below the ones in the NMS (see Table 1 above). However, the investment ratio (defined as the share of gross fixed investments in GDP) is not particularly low by international standards: about 30% in Belarus.

Apart from increased investment, the growth of GDP and labour productivity in Belarus has also been a reflection of the recovery of previously

lost output and improved capacity utilisation. In fact, detailed analysis shows that a major part of the recent growth in the NIS can be attributed to the growth in total factor productivity (TFP) which means that it is not directly attributable to either labour or capital. Instead, a mix of factors such as the increasing capacity utilisation, changes in the sectoral composition of output and terms of trade gains explains a large part of recent productivity improvements. After an exhaustion of these transitory factors rapid growth will not be sustained unless reforms are accelerated and investment spending goes up (Iradian, 2007). Similar conclusions were reached by the World Bank (World Bank, 2005).

While there are broad similarities in terms of the supply-side factors of the recent growth in the NIS, the demand-side factors have been largely different. Thus, in Belarus, with its investment ratio in the tune of 30%, the issue of under-investment appears to be less of a problem. No wonder, in Belarus the growth of GDP and labour productivity since 1995 has been by far the highest among the countries in question. The successful performance of this largely unreformed economy is at odds with the standard transition paradigm and constitutes a “puzzle” for many analysts (World Bank, 2005). Among possible explanations to this economic “miracle” is the ability of the authoritarian government to avoid chaos,⁵ as well as close and preferential relations with Russia securing relatively cheap energy supplies and market access for otherwise non-competitive exports. Probably even more important, the current growth appears to have been triggered by the specific policy mix pursued since the second half of the 1990s (Astrov, 2004). On the one hand, this policy is aimed at boosting aggregate demand by extending direct credits at strongly negative real interest rates, particularly in the construction sector. On the other hand, the government has been actively promoting Belarusian goods in the new export markets outside the collapsing Russian market and especially in developing countries (such as China or Peru) which could ‘accept the medium quality of Belarusian goods’ (Tarasov, 1994). Finally, starting from 1999, growth was additionally fuelled by the economic recovery in Russia – its by far most important trading

⁵ A limited number of large state-controlled enterprises produce more than 90% of GDP (Vassilevsky et al, 2006). For more details see also Usosky (2007).

partner. Nevertheless, during the last couple of years it became apparent that some of the growth factors may not be sustainable: Russia is raising its energy export prices, and the competitiveness of Belarusian exports appears to deteriorate (already in 2005, Belarusian exports to Russia dropped by more than 10%). The dangers intrinsic to the country's present development strategy which is largely based on the administrative allocation of resources and cheap Russian energy are increasingly recognised in Belarus.⁶

3. Structural changes

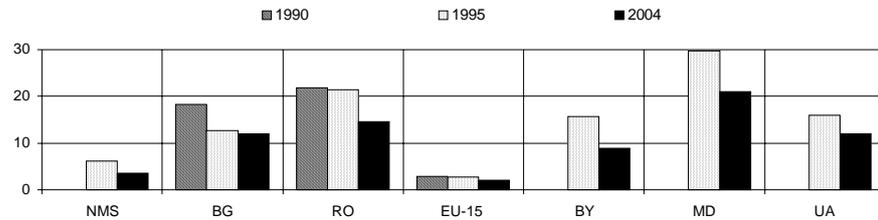
Belarus' output structures are characterised by the high (yet declining) shares of agriculture, the relative high and even increasing importance of industry and construction, as well as by the poorly developed services sector. In this respect, Belarus is similar to Bulgaria and Romania yet it differs not only from EU-15 but also from the other NMS (Figure 2a). Since neither Ukraine nor Moldova have reached their pretransformation output levels yet, their restructuring has been largely of a 'passive' nature, reflecting the different rates of contraction (and subsequent recovery) of individual economic sectors. Even in Belarus which by 2005 surpassed its pre-transition GDP level by nearly 30%, largely thanks to the expansion of industry, hardly any active restructuring has taken

⁶ See Vassilevsky et al., op. cit. – The energy price hikes imposed by Russia on Belarus as of January 2007 correspond to some 6% of the Belarusian GDP (Batory Foundation, 2007). However, according to some estimates, the higher transit fees for gas and the proceeds from the sale of 50% of Beltransgas to Gazprom should mitigate the shock to around 4% of GDP. Besides, the bulk of these losses essentially represent squeezing profits of the two oil refineries owned by Russians. This implies, in turn, that – unlike the impact on Gross *Domestic* Product – the impact on Gross *National* Product of Belarus is likely to be negligible, if any. The latest assessment of the IMF is much more pessimistic: it estimates that losses related to energy price hikes may amount to more than 10% of GDP over the period 2007-2012 (IMF assessment quoted in Vedomosti, September 3rd, 2007 – see <http://www.vedomosti.ru>).

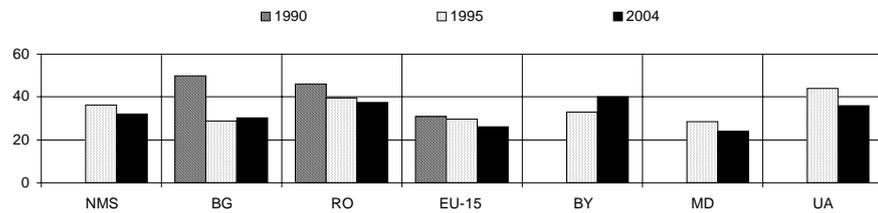
place.⁷ Nevertheless, the direction of structural change is "right" although the road towards a structure typical for a developed market economy is still long.

Figure 2a: Comparison of production structures in 1990, 1995 and 2004 (% of total gross value added)

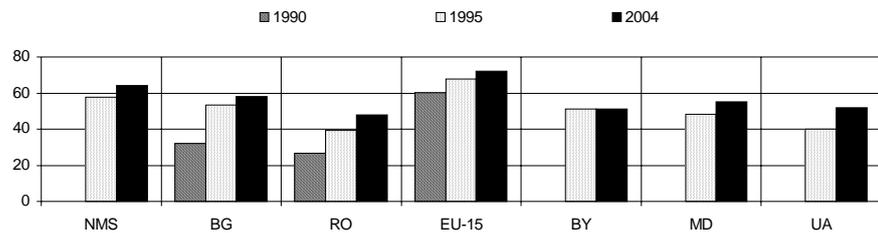
Agriculture and fishing



Industry and construction



Services

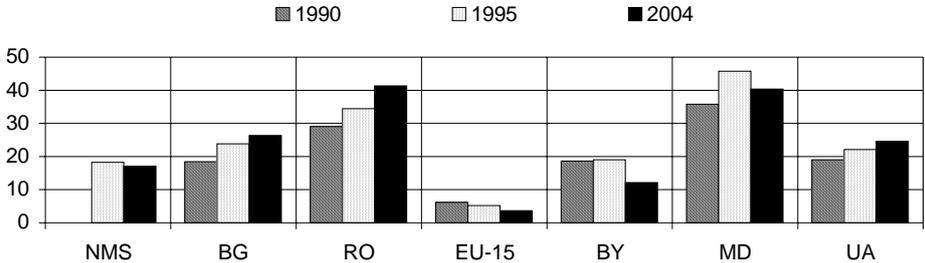


Sources: wiiw Database incorporating national statistics and CISSTAT; wiiw calculations using AMECO.

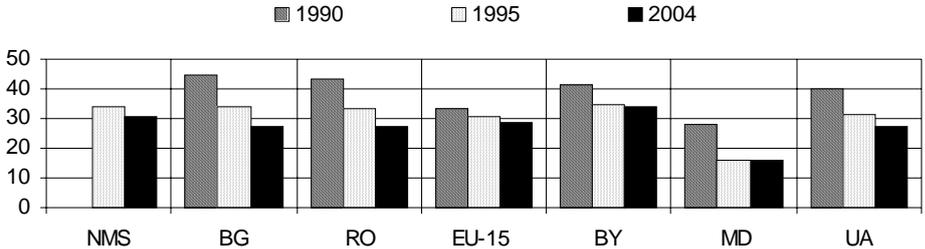
⁷ The major part of industrial growth in Belarus can be attributed to a limited number of enterprises established already during the Soviet times (partly with technology imported from the West) – see Vassilevsky et al. (2006), Usoski (2007).

Figure 2b: Comparison of employment structures in 1990, 1995 and 2004 (% of total)

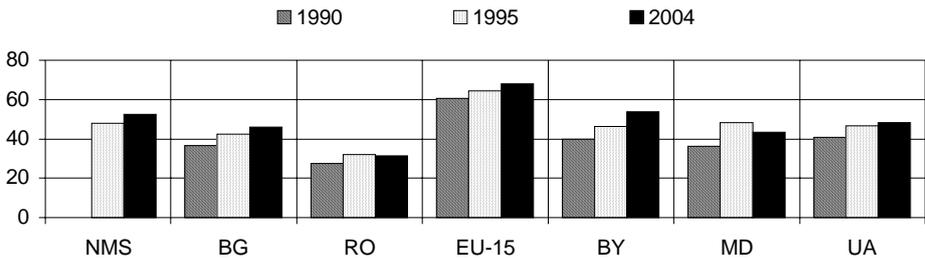
Agriculture and fishing



Industry and construction



Services



Sources: wiiw Database incorporating national statistics and CISSTAT; wiiw calculations using AMECO.

The evolution of employment structures leads to similar conclusions: the high employment shares in agriculture, the declining importance of industry and the rising shares of services employment (Figure 2b). Ukraine’s employment structures are similar to those of Romania and

Bulgaria; that of Belarus is closer to the NMS structure.⁸ The high shares of agricultural employment and the low shares of services are again an indication of structural weaknesses and underdevelopment – especially compared to EU-15. However, even in this respect these countries do not differ too much from Bulgaria and Romania.

Within industry, the importance of fuels and energy has been on the rise (largely due to price effects) while that of machine building has been declining – a sign of increasing specialization in manufactured products with relatively low value-added. Energy, fuels and metallurgy are the biggest industrial branches in terms of output shares in Belarus and Ukraine. These industries account for more than 50% of industrial output (CISSTAT, 2006). In this respect, Belarus differs again from the NMS since in the latter group of countries more advanced machinery and equipment account for a growing share of industrial output (and of exports – see below). Successful industrial restructuring in the NMS has been the result of a virtuous circle of reforms and FDI inflows (as well as integration with the EU) – both areas where Belarus and other NIS are substantially lagging behind.

Broadly speaking, the present Belarus' economy features the following structural problems:⁹

- extreme dependence on Russian supplies of raw materials and energy;
- clear-cut distinction between export-oriented and import-substituting segments of the manufacturing sector, with a further distinction in the export-oriented segment between industries exporting to the CIS and those exporting to the rest of the world;
- underdeveloped and heavily monopolized service sectors;
- inward-oriented agriculture with an inbuilt state system of social protection.

⁸ It should be reminded that these structural shifts occurred on the background of declining overall employment.

⁹ See Vassilevsky et al. (2007).

4. Foreign trade patterns and integration prospects

Starting with the early 1990s, a rapid trade expansion occurred in both NMS and the CIS.¹⁰ However, on the background of the overall trade growth, two new distinct trading blocs have emerged. According to the World Bank, the first – and bigger one – is “Euro-centric” and comprises the NMS, the “old” EU and Southeast Europe, while the second is “Russia-centric” and encompasses the 12 CIS countries (Broadman, 2005, *op. cit.*).¹¹ Our estimates show that between 1993 and 2005, the NMS exports increased by a factor of 5.4 and imports by a factor of 4.9 in Euro terms (Havlik, 2006b). Contrary to that, the dynamics of Ukrainian, Belarusian and especially Moldova’s foreign trade has been much lower.

However, in both the NMS and Belarus, the trade developments during the last 15 years have been accompanied by the regional shift in favour of the EU, albeit to a much greater extent in the case of the NMS. In 2004, after their EU accession, 70%-80% of the NMS trade represented intra-EU exchanges. Thus, the degree of EU trade integration, especially regarding NMS exports, is extremely high.¹² In case of Belarus (and, for that matter, the CIS countries in general), there has been a rising importance of the EU as an export market as well, especially so after the EU enlargement in May 2004. The major driving factor behind has been the vast impoverishment and the low purchasing power of the former Soviet markets and the undervaluation of their currencies, urging CIS producers to look for new export markets. Simultaneously, the role of the CIS as export destination for Belarus has been gradually declining. The impor-

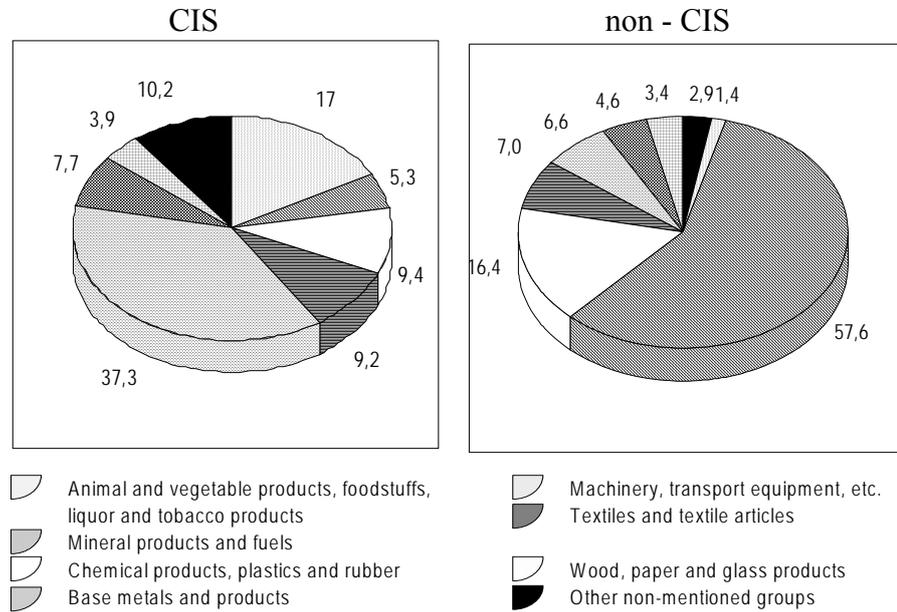
¹⁰ The recent World Bank study estimates that the NMS exports and imports volumes between 1993 and 2003 increased by the factors of 3.6 and 4.1, respectively. Notably, the CIS trade was much less dynamic (exports: 2.1, imports: 1.5 – see Broadman, 2005, p. 7).

¹¹ There are other differences between the performances of the NMS and the CIS. According to J. Stiglitz, transition in the CIS essentially failed (mainly because of the botched privatisation and the resulting asset stripping) whereas the NMS accomplished successful institutional transformation related to the EU accession process (Stiglitz, 2006).

¹² The EU shares in NMS imports are usually smaller since a bulk of inputs – especially energy – is imported from the CIS (see Havlik, 2006).

tance of the CIS as a source of imports is much bigger because of the already highlighted importance of the energy trade. The decline of the CIS shares in Belarus' imports has been less significant.

Figure 3: Commodity composition of Belarus' exports, year 2005



Source: wiiw based on CISSTAT.

Clearly, the importance of the CIS and especially Russian market is rather substantial for the “smaller” CIS republics, particularly for Belarus.¹³ Within the CIS, Russia and Kazakhstan as resource-rich countries enjoy large (and growing) foreign trade surpluses whereas Belarus, Moldova and, since 2005, also Ukraine run trade deficits – another manifestation of the role of energy trade.

¹³ The above is valid also for some other CIS republics (Georgia, Kyrgyzstan, Moldova and Turkmenistan, as well as for Tajikistan as regards imports) – see CIS-STAT 2006, pp. 120-121.

Needless to say, the CIS regional trade patterns depend very much on their commodity composition. Their export structures are typically characterized by a high concentration on a few commodities and persisting market dichotomy between the trade structure with the CIS and the rest of the world. In exports to the CIS, the Belarusian export structure is fairly diversified, with machinery and transport equipment accounting for nearly 40% of the total (Figure 3). However, as to exports to the rest of the world machinery and equipment is nearly absent, and the overwhelming part consists of mineral products, notably refined petroleum products based on crude oil imported from Russia. Overall, as regards trade with the CIS, Belarus tends to specialize on products with a higher value-added than in its trade with the rest of the world.

The relatively limited role of the EU and the low-profile pattern of Belarus' specialization in trade with the EU are both indicative of the meagre foreign direct investment inflows from the EU (see Table 1). In addition, certain products which could potentially be competitive in the EU market face considerable trade barriers (e.g. textiles, fertilizers and steel products – see Vassilevsky, 2007). Belarus does not have a free-trade agreement with the European Union. Any serious co-operation between Belarus and the EU has been blocked for political reasons. Thus – unlike in the case of the NMS, but also of Southeast Europe – the degree of economic integration between Belarus and the EU remains very low. Last but not least, the mutually restrictive visa regime adds to the complexity of relations.

Apart from political factors, one of the reasons for the sluggishness in the EU-Belarus trade integration are the still extensive economic links between this country and Russia. For instance, a free trade area between Belarus (as well as Ukraine and Moldova) and the EU (let alone a customs union) which does not include Russia would result in painful trade diversion effects. In particular, some of the more sophisticated manufactured items produced in Belarus (such as machinery and equipment, but also military production) would lose their principal export market. Meanwhile, Belarus' closer economic (re-)integration with Russia itself is also problematic, to a large extent for political reasons which reflect the legacy of the common past. While there is a CIS-wide free trade

agreement, a number of important commodities are exempted, and there are occasional bans on exports to Russia of selected (primarily agricultural) products. Both Ukraine and Belarus participate in the Common Economic Space agreed upon in 2003 (the other two participants being Russia and Kazakhstan) whose implementation is currently in progress. In many ways, Belarus is most integrated with Russia, as it participates in the Russia-Belarus Union State with a largely unified customs regime and a common labour market. However, just as in the case of other CIS countries, the issues of energy trade and energy transit appear to be an ever growing stumbling block for further integration. Given the recent Russian strategy of raising the previously beneficial prices for energy deliveries to Belarus, the latter may lose an important incentive for a closer trade integration with Russia.

A related issue is the necessary trade liberalization, especially in the context of the aspired WTO accession. As Vassilevsky et al. (2007) argue, accession to the WTO will not lead to any new problems for Belarus; it will merely set current problems in a new context. The main goal to be achieved through WTO membership extends far beyond the simple non-discrimination of Belarusian products on foreign markets. Liberalizing imports of certain items is very much in line with the need to revise the country's current trade specialization. The Belarusian economy needs a consistent policy of cutting back or closing down manufacturing activities that are unlikely to evolve into internationally competitive industries. At the same time, resources should be re-allocated to those sectors with good export prospects.

One of the main problems besetting the Belarusian economy is the marked degree of monopolization in most industries, which results from a lack of foreign competition on domestic markets. Liberalizing certain segments of the domestic market will reduce the domestic producers' market power. It will force them to abandon their monopolistic behaviour, thus paving the way for price cuts, quality improvements and increased effectiveness. "Importing competition" by liberalizing certain markets will also correspond to the long-term interests of national development.

On the other hand, an overly radical liberalization of domestic markets could worsen rather than improve current industrial structures, if it induces excessive and rapid deterioration of the domestic companies' finances. The losses and damages so inflicted might be so large as to appear irreversible since national producers will have no reserves for restructuring purposes. First and foremost, it will be precisely the high-tech and high value added industries that suffer most because those industries are least prepared for international competition. The outcome will be a replacement of those industries by other economic activities where cheap labour is the main factor governing international competitiveness.

According to Vassilevsky et al. (2007) domestic market liberalization in the context of WTO accession must: (i) allow for the financial viability of specific industries; and (ii) recognize that high value-added industries of strategic importance to the future development of Belarus need additional protection in forms compatible with WTO rules.

5. Main features of Belarus' economic policy, its achievements and shortcomings

Belarus' economic system may be characterized by the following key features:

“Volume-forming enterprises” (VFE)

116-117 state-owned or state-controlled enterprises producing more than 54% of industrial output; their taxes cover about 40% of public revenues and 25% of GDP. These are enterprises of the transport equipment industry (tractors, big trucks), chemicals (fertilizers), steel and refinery products.

Specific system of state planning

VFE are subject to direct governmental planning. For every year a list of plan indicators is set (by the Government or responsible ministry) for each of the VFE. Among these indicators are output, export, profit, average salary. Fulfilling the plan by indicators is continuously monitored and controlled by the Government (special statistics are prepared for this purpose). Top-managers of the VFE are appointed by the Government and take personal responsibility for fulfilling the fixed plan indicators.

“Branch departments” and sub-ordination mechanisms

Special public entities (ministries, trusts, committees) supervise VFE. Each of them is responsible to the Government for development of the respective industry. Subordinated firms are VFE of the respective industry and some other companies. Theoretically, they shall ensure that state-owned capital is used efficiently. In fact, they mainly ensure fulfilling the planned indicators.

Import substitution policy

Aimed at the broadly defined sector which includes a diversity of industries considered to have high value-added or to be of great social importance; conceals implicitly additional state support for enterprises in difficulties; prevents from establishing effective links with foreign suppliers of intermediates (even with the Russian ones); and leads to “overdiversification” of national industries instead of their integration into international clusters.

Among the *achievements* of the Belarus economic policy (“economic miracle”) one can list the following aspects:

- Preserving industrial potential, once inherited from the USSR.
- Maintaining high GDP growth without market reforms.
- Preventing structural changes associated with cutting back or closing down some industrial activities (enterprises).

However, these policies have also a number of serious *drawbacks*:

- Distorted planning and the lack of motivation.
Managers of VFE have motivation of public officers instead that of businessmen and focus primarily on the exaggerated social obligations of their enterprises instead of commercial efficiency. Reciprocal to that is permanent readiness of the state to support a volume-forming enterprise with special measures in case of financial difficulties.
- Export dependence on the Russian market.
- Crucial dependence on Russian energy supplies at preferential prices.
The history of “energy conflicts” with the Russian Federation (till the latest precedent at the beginning of 2007) illustrates this point quite well.
- Policy dilemmas.
Are adjustment costs under high energy prices really much higher than the long-run costs of “integration compromises” and lost opportunity costs for preserving the status-quo instead of market reforms?
- Inability to attract FDI and the lack of competitiveness on EU markets.
- Transformation from the current system (separated volume-forming enterprises organized by the industry principle) to the internationally integrated clusters on the FDI basis is urgently needed.

6. Conclusions

As demonstrated above, the recent economic developments of Belarus and other CIS countries, in particular Ukraine and Moldova, show a number of common features, but also some important differences. All these countries have been growing fast in the last few years, although the growth factors have been largely different. In Belarus it has been mainly demand stimulation, public investments and preferential trade relations with Russia in a largely unreformed economy. Notwithstanding all the differences, external factors in general and the high economic growth in

Russia in particular have played a crucial role. However, growth patterns may not be sustainable in the medium and long run. Risks emanate primarily from the sub-optimal state-dominated allocation of resources in Belarus. In addition, this growth has not been accompanied by structural changes of the scope observed in the NMS, at least so far (the share of industry in Belarus has even risen). Nevertheless, the rapid economic growth against the background of falling employment can be interpreted as an encouraging sign which gives evidence of impressive labour productivity gains going beyond the mere improvements in capacity utilisation. Despite some re-orientation of Belarus' foreign trade from the CIS towards the EU (particularly on the export side), the level of integration between Belarus and the EU remains low. This is partly due to the small volumes of foreign direct investment, partly due to the existing trade barriers, and partly due to political reasons. Besides, the patterns of Belarusian trade specialization vis-à-vis the CIS are more favourable than the ones with the EU, although the reverse side of this is a pronounced energy dependence on Russia on the still beneficial energy delivery terms. Although the economic (re-)integration prospects with Russia may be problematic, at least in the short and medium run the role of Russia will be nevertheless crucial for any future integration between Belarus and the EU, as the latter will ultimately depend on the integration steps between the EU and Russia itself.

Summarizing, the main conclusions and challenges for Belarus' economic policy can be listed as follows:

- High growth with extreme dependence on Russian energy and raw materials is not sustainable.
- Inward-oriented agriculture needs reforms.
- Current planning system leaves no chance to adjust to any global, regional or even domestic market challenges.
- Transformation of VFE into public-private partnership is urgently needed.
- Liberalization of certain segments of the internal market (especially services) is inevitable.
- Attracting FDI will require improvements of investment climate.

- Transitory arrangements with gradual reforms or a shock therapy (with or without Lukashenka).

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