

The Economic Situation in Belarus¹

Closer ties with Russia

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The signing of the treaty establishing the Community of Sovereign Republics (CSR) by Presidents Lukashenko of Belarus and Yeltsin of the Russian Federation marks the final stage in current Belarussian efforts to strengthen links with Russia. Belarus' original bid to achieve unification of the monetary systems of the two countries with the Russian rouble as the common base failed in the face of Russian opposition; and Russia is still not prepared to back the Belarussian rouble. Nonetheless, a common currency and, in some respects, a common public budget are among the long-term goals of the CSR. It remains to be seen whether, and at what cost, Belarus can push through these aims against Russia. There was a dramatic deterioration in the balance of payments situation in Belarus in the first four months of this year, with the trade deficit amounting to one fifth of GDP (of the same period). Economic policy-makers in Belarus are still attempting to combat the problems primarily by means of administrative intervention. Without decisive measures, however, especially with respect to exchange rate and interest rate policies, but also incomes policy, there is a danger of the situation getting out of control. Analyses are still made difficult by incomplete and sometimes inconsistent statistical reporting. Thus, considerable uncertainty remains about the state and the progress of the transition process.

Output, investment, prices

The process of contraction in the Belarussian economy continued in 1995, although the fall in output decelerated to some degree in comparison to the previous year (cf. table 1). According to official statistics GDP fell by 10% (1994: 13%). On the output side of nominal GDP the relative share of services rose on the previous year from 43 to 47%, whereas goods production fell from 47 to 44%. On the expenditure side the statistics show a decline in the relative share of private consumption from 57 to around 50%, while spending by the state and non-commercial organisations rose slightly (1994: 28%;

1995: 29%). "Gross accumulation of fixed assets", which is not the same as the gross fixed capital formation recorded in investment statistics, accounted for one quarter of GDP in 1995 (1994: 29%). The import surplus fell from 13 to 5% of GDP. This means that the above-average decline in private consumption and gross fixed capital formation was accompanied by an improved trade balance.

At 27% (1994: 11%), the decline recorded for investment was almost three times as high as the decrease in GDP, although the comparative value for the previous year, which was revised subsequent to its initial publication, is not very credible.¹ The public sector, not including agricultural cooperatives or state enterprises converted into joint-stock companies, accounted for 75% (1994: 69%) of total investment. There was an above-average decline of investment in agriculture (-37%), housing construction (-36%) and education (-54%). Industrial investment fell by 23%. Positive investment growth is recorded for communications (+90%), banking and insurance (+37%) and the retail trade and hotels and restaurants sector (+3%). Industry (1990: 24%; 1995: 29%) and housing construction (1990: 20%; 1995: 21%) account for the largest relative shares of total investment. Transportation (1990: 6%; 1995: 13%) and health (1990: 2%; 1995: 6%) increased their respective shares significantly, whereas investment in agriculture (1990: 29%; 1995: 9%) lost considerable ground as a share of the total.

Output trends by industrial sector were extremely heterogeneous in 1995 (cf. table 2). Given an average decline of 11.5% (1994: 17.1%) significant growth was recorded both in the fossil fuel (+10.1%) and in the chemical and petrochemical industries (+8.5%). However, the upswing in the fossil fuel industry is due exclusively to the refining in Belarus of Russian crude oil for Russian consumers, which accounted for 90% of output in Belarussian refineries. Output growth in the chemical sector was largely achieved through an increase in basic materials exports (especially fertilisers). A sharp drop in output (-22.4%) was recorded in the mechanical engineering sector, which was mainly caused by the renewed decline in investment and fewer exports to the CIS. The renewed massive fall in output in light industry (-32.9%) stems mainly from a lack of competitive strength both in the Belarussian and the CIS markets. The real appreciation of the Belarussian rouble in connection with efforts to stabilise the exchange rate had extremely negative repercussions for the endeavours of manufacturers of all types of finished goods to gain a foothold on OECD markets.

¹ The decline in investment for 1994 was originally put at 25%.

Table 1

Belarus: Selected Economic Indicators

Annual percentage change and share, respectively

	1990	1991	1992	1993	1994	1995
Gross domestic product	.	-1.2	-9.6	-11.0	-13.0	-10
Industrial output	2.1	-1.0	-9.4	-10.0	-17.1	-11.5
Agricultural output	-8.7	-4.9	-8.5	3.7	-14.1	-5
Gross fixed capital formation	9.0	4.0	-29.0	-15.0	-11	-27
Employment	-0.9	-2.5	-2.6	-1.3	-2.6	-4.8
Retail trade turnover, real	14.7	-8.1	-22.0	-14.4	-18	-25
Nominal private household income	17.7	94.4	759	1 256	1 865	535
Nominal wages	16	97	843	1 097	1 487	664
Consumer prices						
Annual average	4.5	80.7	971	1 190	2 221	709
December to December	1 960	244
Industrial producer prices						
Annual average	.	.	.	1 530	2 170	503
December to December	.	238	4 091	3 868	1 865	142
Unemployment rate an period's end	.	0.1	0.5	1.4	2.1	2.7

Source: Belarussian Ministry of Statistics and Analyses.

Agricultural output fell by 5% in 1995 (1994: -14%). The negative trend was limited to agricultural cooperatives and state-owned farms (-12%), while output growth was recorded for private part-time activities (+7%). There was a 2% increase in output for vegetable products and a 7% drop for animal products.

Inflation contracted substantially during the course of 1995 (cf. table 3), consumer prices rising by 244% between December 1994 and December 1995 (foodstuffs: +220%; other consumer goods: +259%; services: +477%), while the monthly rates of price increases have been fluctuating between 2.5 and 5% since May 1995 (January 1995: 39%). The slowdown in the rise of industrial producer prices was even more significant. In December 1995 producer prices were up 142% on the previous December's level; monthly inflation was maintained at under 3% throughout the final quarter of the year (January 1995: 44%).

Labour market

The number of persons in registered employment fell during 1995 by almost 5%, counting 4.2 million at the beginning of this year (1990: 5.1 million; January 1995: 4.4 million). The decline in employment was thus once again much lower than the fall in output. In 1995 employment decreased at above the average rate in construction (-11.4%), in industry (-8.5%) and in the retail trade and hotels and restaurants sector (-8.4%). By contrast, employment rose in the banking and insurance sector (+12.6%), in housing and local authorities (+8.6%), in public administration (+7.4%), health and social services (+2.9%) and education (+1.4%). At the end of December 1995 there were 131 000 persons registered unemployed and the unemployment rate had risen from 2.1% at the end of 1994 to 2.7%. However, there must be some doubt as to whether the official unemploy-

Table 2

Belarus: Industrial Output by Industrial Sector

Annual percentage change

	1990	1991	1992	1993	1994	1995
Industry, total ¹⁾	2.1	-1.0	-9.4	-10.0	-17.1	-11.5
Electricity industry	3.1	0.9	-3.1	-10.9	-11.3	-15.8
Fossil fuel industry	-2.3	-5.4	-42.9	-36.9	-45.2	10.1
Iron and steel industry	8.7	13.1	-13.7	-13.2	-12.5	-1.4
Engineering and metalworking	3.3	5.1	-7.4	2.8	-14.1	-22.4
Chemical and petrochemicals	-0.1	-6.7	-14.7	-12.3	-16.8	8.5
Wood, woodworking, paper and cellulose industry	2.4	6.9	-7.2	-3.4	-12.7	-11.7
Building materials industry	1.5	5.0	-10.6	-23.9	-28.8	-19.3
Light industry	0.3	1.0	0.7	1.7	-23.0	-32.9
Food industry	1.8	-9.4	-17.6	0.1	-5.5	-14.1

1) Excl. small firms, cooperatives, joint ventures and industrial subsidiaries of firms in other sectors.

Source: Belarussian Ministry of Statistics and Analyses.

ment figures actually correspond to reality. The Ministry of Labour has calculated an unemployment rate of 9% using the ILO method.²

Income trends and private households

Real incomes suffered a decline of 21.5% compared with 1994, whereas real wages (including benefits paid by firms) fell by only 6%. The share of total income earned through entrepreneurial activities, employment abroad and work for foreign organisations fell to half its 1994 level and to less than its 1993 level. It is possible that these decreases are a consequence of the abolition at the beginning of 1995 of the penal taxation imposed on firms paying in excess of the maximum permissible payroll. The penalty tax gave employers an incentive to pay wages in the form of benefits. In December 1995 outstanding wages amounted to approximately one fifth of the monthly wage bill. Some 35% of the population have a per capita income which is less than the official minimum subsistence level.³

The highest wages were paid in the banking sector, in the state administration and in the construction industry, while wages in the social sector and in agriculture remained substantially below average. The minimum wage was doubled in March and amounted to 11% of the official minimum subsistence level in December

² Cf. *Natsional'naya gazeta*, no. 9/1996. Unemployment is defined according to the ILO method as the difference between manpower potential and de facto employment.

³ The poverty line was fixed at 60% of the minimum per capita income of a four-person household.

1995. Pensions were adjusted to meet price trends on several occasions. The average pension amounted to 82% of the minimum subsistence level in December.

Despite the drop in real income consumption expenditure decreased as a share of cash income in 1995. By contrast the relative share of savings increased by six percentage points. These trends were accompanied in particular by an increase in the significance of foreign currency purchasing, which accounted for around 40% of savings in 1995 (cf. table 4). Clearly the population was concerned about stable investment options.

Table 3

Belarus: Monthly Price Trends, 1994 and 1995

Monthly percentage change

	Consumer prices		Industrial producer prices	
	1994	1995	1994	1995
January	40.7	39.2	24.3	44.4
February	18.7	33.7	17.3	13.2
March	10	20.0	12	9.6
April	29	14.5	37	7.6
May	29	3.4	32	2.4
June	20	2.5	22	1.2
July	27	5.2	18	2.4
August	53	3.0	42	5.1
September	26	5.2	42	5.2
October	26	3.4	42	2.1
November	41	3.7	28	2.6
December	31	3.9	26	2.2

Source: Belarussian Ministry of Statistics and Analyses.

Table 4
Belarus: Structure of Monetary Income and Expenditure in Private Households
in %

	1993	1994	1995
<i>Monetary income</i>	100.0	100.0	100.0
of which:			
Wages and salaries of dependent employees	62.8	54.7	64.3
Income from the sale of agricultural products	3.3	4.0	4.6
Pensions, grants, social transfers	15.0	13.4	16.6
Income from the financial system (loans, interest, insurance benefits)	3.8	2.3	2.1
Other income (entrepreneurial activity, wages and salaries from employment abroad or work for foreign organisations)	15.1	25.6	12.4
<i>Income disposal</i>		100.0	100.0
of which:			
Consumption expenditure		83.3	76.9
Payments to the financial system		5.8	6.9
Increase in savings deposits		2.3	4.2
Purchase of foreign currency		1.9	6.7
Purchase of securities		1.2	1.3
Other uses, increase in cash holdings ¹⁾		5.5	4.0

1) Not statistically recorded.

Source: Belarussian Ministry of Statistics and Analyses.

Public budgets

The restrictive financial policy stance adopted in 1994 was maintained in 1995. The consolidated government budget deficit was in the order of magnitude of 2.5% of GDP and thus slightly less than the previous year's level (cf. table 5). Given the persisting contraction of output and the related decline in the tax base, the restriction of the deficit is mainly a consequence of cut-backs in real spending. The deficit was financed through loans from the Belarussian central bank and international organisations; distribution of government bonds continued to play a negligible role.

Along with a slight decrease in tax and levy rates on the previous year, a notable change in the revenue structure emerged in 1995. The GDP share of revenue from profit taxation fell by over two percentage points on the previous year to 7%, and by as many as three percentage points compared to the first half of 1995. This was a consequence of the bad operating results of Belarussian firms and liquidity squeezes.⁴ However, the available data do not reveal to what extent revenue from enter-

prises has actually decreased. There was a sharp rise in 1995 in the revenue recorded under "other income", an item that conceals numerous special levies on firms. Because of the decline in revenue from profit taxation, value added tax (8.9% of GDP) became the most important source of income for the consolidated budget.

Expenditure by the consolidated budget as a share of GDP in 1995 was down one percentage point on 1994, while GDP itself continued to decline.⁵ The real curtailment of expenditure on the economy, including subsidies and investment spending, was maintained in 1995. At the same time expenditure on education, culture and social affairs as a share of GDP increased by two percentage points. Thus, the relative share of consumption

⁴ Cf. German Institute for Economic Research, Berlin, Institute for the World Economy at the University of Kiel and the Institute for Economic Research Halle, The Economic Situation in Belarus. Missing reforms endanger stabilisation. Seventh additional report, in: *Wochenbericht des DIW*, no. 44/1995.

⁵ Spending by the consolidated budget cannot be equated with government spending as a whole because fiscal policy activity has been financed to a significant extent by means of extra-budgetary funds.

Table 5

Belarus: Consolidated Government Budget

Selected public revenue and expenditure as % of GDP

	1992	1993	1994	1995	1996 Planned budget
<i>Total Revenue</i>	32.4	31.5	32.0	31.5	32.3
Value added tax	12.0	8.7	8.8	8.9	8.7
Excise duties	2.9	3.8	3.4	2.6	3.4
Profit taxes	8.3	9.4	9.5	7.1	6.7
Income tax	2.4	2.2	2.3	2.7	2.6
Chernobyl taxes	2.7	2.4	1.3	2.5	2.1
Duties etc.		2.3	2.9	2.0	3.0
Other revenue	4.1	2.7	3.8	5.7	5.8
<i>Total expenditure</i>	34.4	36.2	35.0	34.0	35.0
Economy	14.4	14.0	9.6	7.2	6.6
Education, culture, social affairs	10.5	11.0	12.6	14.5	17.1
Science	0.5	0.4	0.3	0.6	0.7
Costs of Chernobyl	4.3	3.5	2.4	2.7	2.6
Defence	1.7	1.5	1.5	1.5	1.4
Legal bodies	1.0	1.3	1.6	2.4	2.4
Administration	0.6	0.6	0.7	1.2	1.2
Internal debt servicing	0.7	0.4	0.2	0.2	0.5
Other revenue	0.6	3.5	6.1	3.7	2.5
<i>Deficit</i>	2.0	4.7	3.0	2.5	2.7

Source: Belarussian Ministry of Finance; calculations by the participating institutes.

expenditure continued to increase while public investment declined in real terms. The share of the item "other expenditure", which in the past included subsidised loans to enterprises, decreased in comparison to the previous year.

The budget for 1996 had not yet been passed in mid-March. The draft budget, which was drawn up under the assumption of a real growth in GDP of up to 1%, foresees an overall slight rise in income. Based on these assumptions regarding output trends a further decrease in revenue from profit taxation is expected, which will also be due to the planned introduction of tax relief for investment. An increase in income is mainly expected from the rise in foreign trade tariffs passed in the second half of 1995 and the higher excise taxes introduced in January 1996. According to this draft budget the quota of expenditure will rise by one percentage point in 1996. While expenditure on the economy is planned to decrease, a further increase in spending on education, culture and social affairs is foreseen. The intended deficit will lie below the 3% mark. A partial financing of the deficit by the central bank is also planned for 1996. However, in the future government bonds are to be placed to a greater extent on the capital market. Because demand for these securities has been negligible to date, an order requiring the use of surplus from extra-budgetary funds to buy government bonds is to be introduced,

that is, finances are to be redistributed within the public sector. Moreover, loans are again expected from international financial institutions (amounting to 0.5% of GDP) in order to finance the deficit in 1996. It is still unclear whether and how the negotiations between Russia and Belarus on aspects of a common budgetary policy will affect financial policy in Belarus.

Monetary, credit and exchange rate policy

The dangers threatening the process of monetary stabilisation were at least temporarily averted in 1995.⁶ The average quarterly rate of money supply (M3) growth decreased from over 100% in 1994 to less than 30% in 1995 (cf. table 6). In the course of this decline in M3 growth the monthly inflation rate fell in 1995 from figures close to hyperinflation at the beginning of the year to less than 5% since May. The growth of lending by the central bank and commercial banks was reduced by about the same amount as the growth of M3. At

⁶ Cf. German Institute for Economic Research ..., op. cit., p. 757. The data available on the Belarussian central bank's monetary and credit policy for the second half of 1995 are extremely incomplete; thus, a comparison over time is only possible within limits.

Table 6

Belarus: Money Supply and Credit Trends, 1992 to 1995

Yearly averages of quarterly rates of change on previous quarter in %

	1992	1993	1994	1995
Central bank loans ¹⁾	117	53	191	32
Cash	75	96	99	55
Bank loans ²⁾	107	64	114	25
M3	57	80	112	27

1) Domestic net provision of credit to government, banks and firms. — 2) Loans by the central bank and commercial banks to households and firms.

Sources: International Monetary Fund, Belarussian central bank; calculations by the participating institutes.

55%, cash emissions expanded to a much greater extent than the other aggregates.

The successes achieved as regards monetary stabilisation are still standing on very shaky foundations. The central bank – in contrast to the Russian central bank – has reduced refinancing rates quite drastically from 480% per annum at the beginning of 1995 to 66% since September.⁷ Thus only very slightly positive real rates of interest could be achieved in Belarus; the average real refinancing rate had already slipped into negative figures again by August (cf. figure 1).⁸ The goal of stability is endangered by the radical loosening up of the interest rate policy pursued and the considerable political influence exerted on the central bank. This is all the more the case since pressure on the central bank to expand lending is growing both because of the increase in the share of bad loans on the commercial banks' balance sheets and because of the increase in inter-enterprise debt. According to internal working papers of the central bank the share of overdue bank loans or loans that were extended after expiry of the repayment date had risen to 12.8% by the end of 1995. In March of 1995 only 2% of loans had been classified as overdue. And there is still cause for suspicion that not all unreliable loans have actually been included in this figure. Moreover, inter-enterprise debt increased in real terms by 13% in the first eight months of 1995 alone.

The central bank upheld a fixed exchange rate of 11 500 Belarussian roubles to the US-dollar between

⁷ The refinancing rate was reduced further to 55% after this article went to press.

⁸ The average refinancing rate is announced by the Belarussian central bank. This figure presumably also includes interest on subsidised loans.

April and December of 1995. At the end of January 1996 an exchange rate corridor of between 11 300 and 13 100 Belarussian roubles per US-dollar for the first half of the year was officially announced. Moreover, a range of currency control measures were introduced, such as an obligation on exporters to exchange earnings in foreign currency for Belarussian roubles and restrictions on import volumes.⁹ In view of a monetary policy that is incompatible with the exchange rate goal, these measures represent an effort to avert a balance of payments crisis.

The real appreciation of the Belarussian rouble against the US-dollar, which resulted from the fixed exchange rate, amounted to 64.5% for 1995 as a whole (cf. figure 2). Moreover, considerable real appreciation had already been achieved in the preceding years. Even though the exchange rate against the Russian rouble has not been fully fixed, it still remained relatively constant during 1995. This means the Belarussian rouble has depreciated in real terms since April 1995, so that the real exchange rate of March 1995 was reached again in December. Overall, however, a real appreciation against the Russian rouble of around 40% was recorded for the whole year. The consequences of defending the nominal exchange rate were a deterioration in the competitive position of Belarussian firms on world markets and the creation of incentives to substitute domestic products by imports.

Foreign economic relations

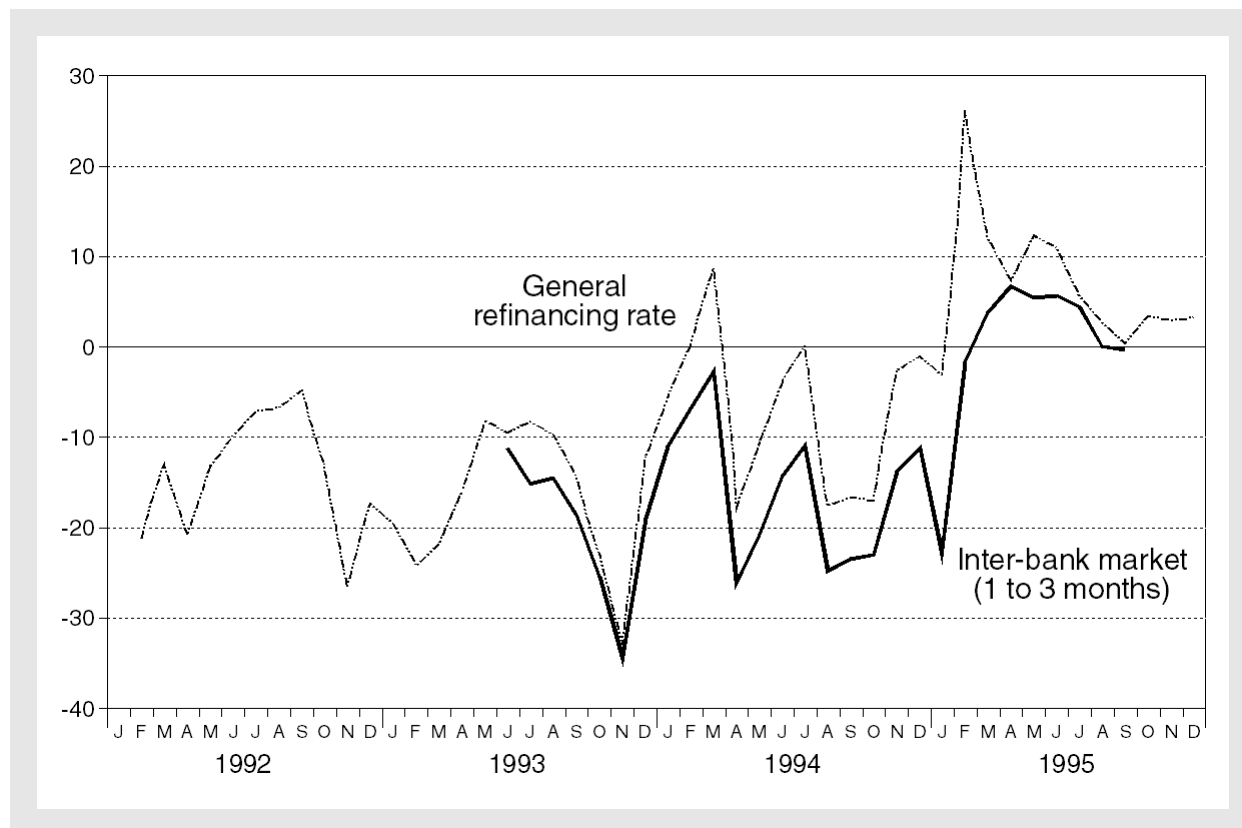
In 1995 the trade deficit declined in comparison to the previous year. According to initial estimates exports worth US-\$ 4.1 billion (US-\$ 3.1 billion in 1994) and imports worth US-\$ 4.6 billion (US-\$ 3.7 billion in 1994) were achieved. Russia was by far the largest trading partner, accounting for around 60% of exports and 70% of imports. Changes in the balance of trade in Belarus were thus primarily determined by the bilateral trade with Russia.

As regards trade with other countries, exportation of light industry products, such as textiles and clothing (contract processing) has increased significantly.¹⁰ Because domestic demand has declined particularly sharply in this sector, production for export must constitute a significant pillar of remaining employment. For some products exported to the European Union the maximum volumes fixed on the basis of the Multifiber

⁹ Cf. *Minsk Economic News*, no. 2/1996, p. 1 and no. 3/1996, p. 4.

¹⁰ *Nachrichten für Außenhandel*, 20 February 1996. Exports by member enterprises of the Federation of Light Industry – Bellegprom – thus rose from US-\$ 45 million in 1994 to US-\$ 224 million in 1995.

Figure 1
 Belarus: Monthly Real Interest Rates, 1992 to 1995¹⁾
 in %



1) Deflated using the producer price index.
 Sources: International Monetary Fund, Belarussian central bank; calculations by the participating institutes.

Agreement were actually achieved. However, much higher quotas have already been negotiated for 1996 so that, for the time being, there are now no barriers to a further increase in exports. On the supply side, however, the real appreciation of the Belarussian rouble during 1995 has diminished the return on exports. Because exports from light industry are largely contract products for foreign manufacturers or sales chains, an area where there is intense price competition between the various producer countries, this first attempt to diversify exports would be stifled, should the overvaluation of the Belarussian rouble be maintained.

The endeavours of the central bank to stabilise the nominal exchange rate have already led to retrogression as regards the liberalisation of foreign trade. In order to avoid a reduction in foreign currency reserves, as of December 1995 purchase of foreign currency is only permitted for "essential" imports (especially fuel, industrial basic goods, pharmaceutical products and some food-stuffs). This direct administrative intervention is to be replaced in early 1996 by a tax of 10% on foreign currency purchases for "non-essential" imports.¹¹ However,

this kind of discrimination will only create further problems for the tax system, because different import tariffs are already levied on different goods. The obligation to convert proceeds from exports into Belarussian roubles at the state currency exchange was recently raised from 50 to 100%.¹² Given the real overvaluation of the rouble and the not very transparent interventions of the central bank in the currency market, this measure will increase uncertainty concerning the profitability of exports and is thus an obstacle to the urgently required integration of Belarus into international commodity markets.

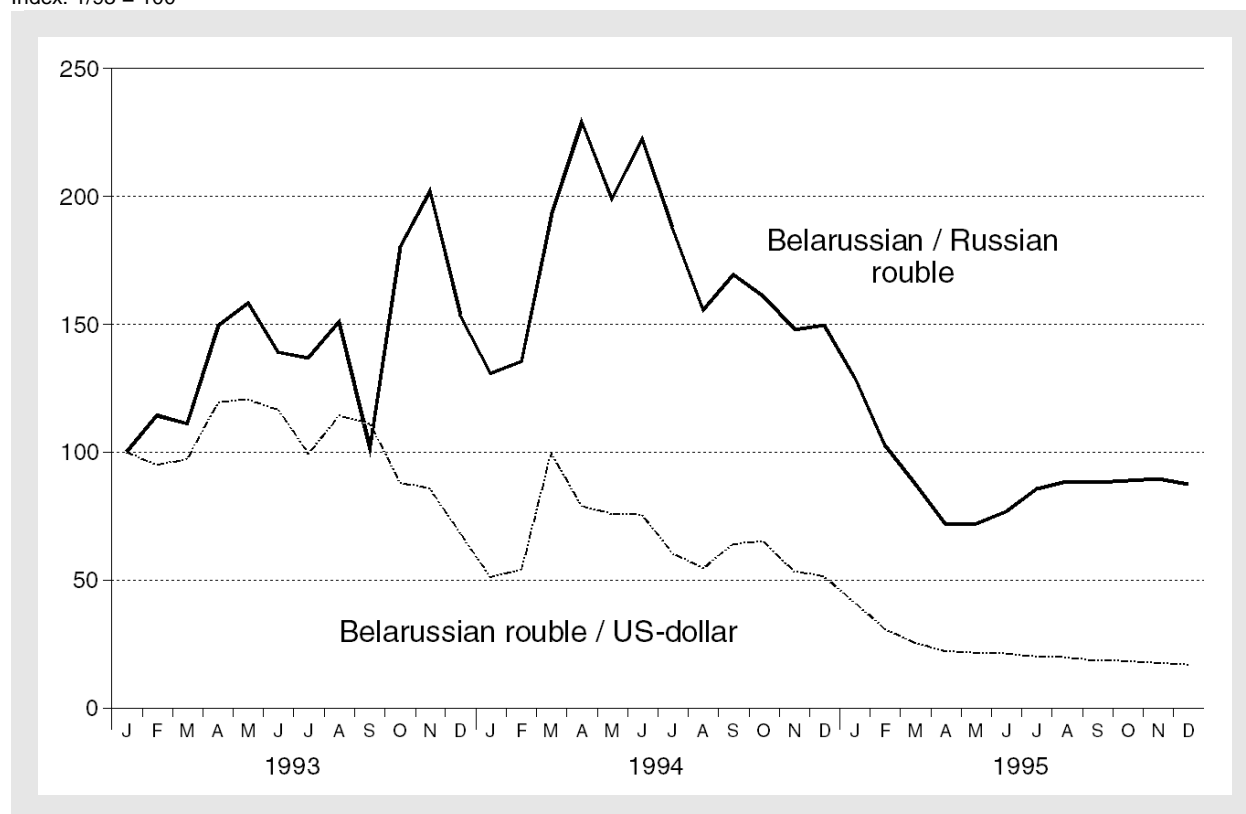
Because of the counter-movement in foreign trade policy and the overdue reforms in other areas too, the International Monetary Fund has only released a first tranche of US-\$ 70 million on the stand-by loan of US-\$ 300 million promised in 1995.¹³ This has contributed to the fact that the 1995 balance of trade deficit of over

¹¹ *Nachrichten für Außenhandel*, 20 February 1996.

¹² *Handelsblatt*, 20 February 1996.

¹³ *Economist*, 2 March 1996.

Figure 2
 Real Exchange Rate of Belarussian Rouble against the Russian Rouble and US-Dollar,
 1993 to 1995
 Index: 1/93 = 100



Sources: International Monetary Fund; calculations by the participating institutes.

US \$ 400 million was partially "financed" by means of an increase of approximately US-\$ 200 million in the backlog of payments to the Russian natural gas supplier Gazprom.¹⁴ Belarussian debts to Russia were cancelled as of 1 January 1996 by virtue of an agreement between the presidents of the two countries in February 1996. This applied in particular to arrears of almost US-\$ 800 million for energy supplies and inter-governmental loans amounting to almost US-\$ 500 million. In return Belarus forewent settlement of demands ensuing from the stationing of Russian troops in the country and from the transfer of nuclear weapons within the framework of disarmament.¹⁵ Even debt cancellation as comprehensive as this can, however, only contribute to a sustainable improvement in the economic situation if it is accompanied by credible structural reforms. This is the only way that the balance of trade deficit can be reduced in the long term to a magnitude that can be financed on the international capital market. Otherwise the above debt

relief will provide no more than a brief respite before a balance of payments crisis.

Systemic reforms

While it was possible to restore the parliamentary quorum after the elections in December 1995, the President of Belarus is still calling the existing constitution and the competence of the parliament into question. This is a considerable impediment to the further progression of the reforms.

No statistical data on the state of privatisation had been published by Belarus by the end of 1995. However, accounts in the press report that the slow pace of privatisation in the first half of the year¹⁶ decelerated further in the second half. Progress was only made in the privatisation of housing. Distribution of vouchers for the privatisation of enterprises proceeded slowly. On 1 Decem-

¹⁴ *Handelsblatt*, 22 February 1996.

¹⁵ *Itar-Tass*, 27 February 1996.

¹⁶ Cf. German Institute for Economic Research et al., op. cit.

ber 1995 only 54.5% of the citizens entitled to do so had applied for vouchers and the deadline for distribution was thus extended to mid-1996.

The privatisation programme for 1996 was passed – for the first time within the required deadline – on 30 December 1995. The programme foresees the privatisation of only 516 enterprises, that is, around 6.5% of state-owned enterprises. Because great weight is given in the programme to purely changing the legal form of enterprises, it is probable that the course pursued to date will be continued – that is, to convert enterprises into corporations, but rarely to actually privatise them.

The privatisation programme provides for acquisition of shares by external investors – including foreigners – in converted enterprises through increased equity capital. This includes the possibility of a debt-equity swap. The regulation also allows Russian creditors to convert their claims against Belarussian enterprises. Widespread participation of western foreigners is not to be expected because of the restrictive framework conditions. Thus important strategic investors who could introduce fresh capital as well as new impetuses for the required restructuring of the enterprises will be lacking.

In 1996, too, voucher distribution is to remain the primary method of privatisation. Although vouchers are non-transferable on principle, persons in possession of vouchers are entitled to transfer ownership to close relatives, to exchange them for shares in investment funds or to acquire corporate equity directly at privatisation auctions. In 1995 the vouchers were mainly used for direct acquisition of corporate equity. Deposits in investment funds were negligible after the funds had their licences withdrawn and had to suspend operations for a number of months.¹⁷ Because one cannot rule out a similar measure in the future, many owners will still consider placing vouchers with investment funds a risky option. The investment funds will thus, at least for the immediate future, not play a significant role in the privatisation process.

When those shares of a state enterprise that are not reserved for voucher privatisation are sold, the workforce can buy them at a discount of 20% of the nominal value. It appears, therefore, that even after the sale of enterprise shares the position of the workforce will not deteriorate to any great degree. This is also suggested by the regulation affording the privatisation agency the right to place conditions on external investors. The goal of increased capital inflow defined in the privatisation programme will only be inadequately met.

In addition to the slow pace of privatisation the regulations for market entry and exit have also not yet

helped to bolster competition. Last year it was possible to avoid declaring unprofitable enterprises bankrupt, although on 1 December 1995 as many as 18 Belarussian firms were classified as running at a loss. In addition, measures such as the registration freeze for new enterprises are impeding the development of the private sector. This affects the foundation of small and medium-sized enterprises in particular, which are hardly represented in Belarus as yet.

Outlook

The main feature of the economic process in Belarus in 1995 was increased integration with the Russian economy. Closer ties were not only advanced by the implementation of the agreements on customs union, but also by Russia waiving claims amounting to over US-\$ 1 billion. The depth of the links between the two countries is also reflected in clear parallels in the sectoral structure of real economic adjustment: both in Belarus and in Russia it is the sectors of industry in and around raw materials that are the first to emerge from the period of contraction. And it is thanks to Russian contracts more than anything else that production has recovered in these sectors in Belarus. At the same time light industry and other consumer-oriented branches are still far removed from stabilising production in both economies, also because these areas are suffering as a result of the real appreciation of their respective roubles against the US-dollar.

Belarus followed the Russian example of using an exchange rate target against the dollar as an instrument for monetary stabilisation. All in all, this parallel can be acknowledged as the first step towards de facto monetary union. In both cases real appreciation against the anchor currency was sustained. However, exchange rate policy in Belarus was much less compatible with monetary policy than in Russia. While the parallels between the exchange rate regimes of the two countries could be upheld to date, the Belarussian central bank was only able to defend its exchange rate target through substantial intervention in the foreign exchange markets. However, if the divergent interest rate policies of the two countries are not adjusted, de facto monetary union will be subject to extreme pressure in the medium term. In the short term these tensions have been reduced somewhat by debt relief on the part of Russia – Belarus was thus given breathing space as regards balance of payments policy. As in Russia budgetary policy is restrictive in Belarus and the maintenance of budgetary discipline will continue to be extremely difficult in 1996.

¹⁷ Of the 80 original funds only 38 funds had recommenced operations by the beginning of 1996.

As regards systemic reform, Belarus is still far removed from showing convincing evidence of transformation. Political obstacles continue to impede privatisation and much greater inadequacies in the establishment of property rights and other free-market indicators are apparent in Belarus than in Russia.

All in all the numerous similarities in the routes to transition of the two countries allow one to conclude that GDP and inflationary trends in Belarus are increasingly being determined by Russia. However, Belarus is lagging behind Russia so that different levels are apparent. A further decline in GDP can be expected for Belarus in 1996, which will, however, probably not be in excess of 5%. Annual inflation will be in the two-digit zone and only in the best possible case fall below the 50% mark.