

The Economic Situation in the Republic of Belarus

Economic decline manifests itself

by the German Institute for Economic Research, Berlin (DIW), the Institute for the World Economy at the University of Kiel (IfW) and the Institute for Economic Research Halle (IWH)

The Republic of Belarus has for many years been struggling with the effects of its inappropriate economic policies. It was only by virtue of covert financial support from Russia that this policy could be maintained. The crisis in Russia has now further exacerbated the problems in Belarus. Yet President Lukashenko until quite recently continued unflinchingly, indeed even more vocally, to hold up his approach as an example to Russia, while at the same time pursuing his longer-term efforts to achieve political union with Russia. So far, however, the corresponding treaties have remained without real impact.

Output, investment and prices

The economic decline in Belarus expected by the Institutes¹ has, in principle, already begun. However, the figures provided by the official statistical authorities reflect this trend to only a very limited degree.² A rate of real GDP growth significantly in excess of 10% was reported for the first half of 1998. As the year progressed, the official growth figure declined, but the value given for the year as a whole was still extraordinarily high, at 8.3% (cf. table 1). Growth of as much as 4.5% was recorded even for the fourth quarter. An absolute decline in GDP was reported for the first time for the period January to February 1999 (-0.7%); a figure of 1.0% was given for the first quarter of 1999 as a whole.

This trend, which at first sight can in no way be considered catastrophic, to some extent reflects the fact that GDP and its components are calculated using prices that do not square with the realities of a small open economy. It is therefore hardly surprising that President Lukashenko has protested against using the hard-currency equivalent as a yard-stick in measuring, say, Belarusian wages over time; he has described freely determined

exchange rates as 'deceptive'.³ And indeed, exchange rates may deviate substantially from reality. This may be the case particularly in the wake of rapid inflows and outflows of foreign capital, as in the context of the Asian crisis. Yet Belarus has never experienced a comparable degree of capital inflow, and this was not only because of the failure to liberalise capital transactions. What has occurred, however, is that, following very strong growth of the money supply, understandable fears about inflation arose, and corresponding attempts were made to sell of Belarusian rouble where possible. Even tough capital controls were never able to prevent capital flight.⁴

Consequently, the official growth figures are distorted upwards by price and exchange-rate controls. It is not possible to determine with reasonable certainty the quantitative extent to which Belarusian growth successes need to be adjusted downwards. On the expenditure side of GDP, the deterioration in the economic situation is manifesting itself in the rapid decline in the official growth rates. In the first half of 1998, real retail trade turnover was still more than 40% above the level recorded in the same period the previous year; for 1998 as a whole, the rate of growth was only just over 20%. Investment trends point in the same direction. In the first half of 1998, the real rate of growth of gross fixed capital formation was almost 30%, whereas for the year as a whole it was just 16%. This slow-down reflects falling rates of investment growth in industry and housing construction (cf. table 2); together these two sectors account for 55% of total investment. It is only in agriculture that investment is on a marked expansionary trend. It must be remembered in this context, however, that agricultural investment had previously fallen drastically as a proportion of the total, from 29% in 1990 to a low of 5% in the first quarter of 1998.

Neither government consumption nor changes in inventories has exerted an identifiable growth effect according to the data available. Government consumption (see the section on government finances) has, if anything, exerted a restrictive impact on GDP growth, with a slight decline in the budget deficit. It must be emphasised, however, that state activity in Belarus mainly takes the form of central bank lending, controlled by the President's Office, to industrial and agricultural enterprises, and thus bypasses the government budget. Foreign trade is of major importance for GDP trends. For

³ In a discussion on Russian television, quoted by Radio Free Europe-Radio Liberty (RFE-RL), on 10 December 1998.

⁴ It is not possible to determine the extent of capital flight with any accuracy. According to Belarusian estimates, by mid-1998 assets totalling up to US-\$ 4 billion had been transferred abroad or were being held within the country in the form of foreign currency outside the banking system.

¹ Cf. 'The economic situation in the Republic of Belarus', *Economic Bulletin*, vol. 35, no. 12, December 1998.

² Unless otherwise indicated, the following data are taken from publications by the Belarusian Ministry of Statistics and Analyses (Minstat).

Table 1

Selected Economic Indicators, 1990 to 1998

Changes on the previous year or share, in %

	1990	1991	1992	1993	1994	1995	1996	1997	1998
GDP ¹	.	-1	-10	-8	-13	-10	3	11	8.3
Industrial production ¹	2.1	-1.0	-9.4	-10.0	-17.1	-11.7	3.5	18.8	11.0
Agricultural output ¹	-8.7	-4.9	-8.5	3.7	-14.4	-4.7	2.4	-4.9	-0.4
Fixed capital formation ¹	9	4	-29	-15	-11	-31	-5	20	16.0
Volume of goods transport ²	-3	-6	-25	-30	-36	-26	-19	7	6.0
Dependent employment	1	-3	-3	-1	-3	-6	-1	0	0.5
Retail trade turnover ¹	15	-8	-22	-14	-10	-23	31	18	21.0
Nominal monetary income of private households	18	94	754	1 393	2 008	497	80	74	108
Nominal wages	16	101	838	1 107	1 504	669	61	88	104
Real wages	14	4	-12	-7	-31	-5	5	14	18
Consumer prices									
Annual average	5	94	971	1 190	2 221	709	53	64	73
December to December	.	.	.	1 997	1 960	244	39	63	182
Industrial producer prices									
Annual average	.	165	531	1 787	1 916	499	32	89	70
December to December	.	238	4 091	3 868	1 857	140	29	90	196
Unemployment rate at end of period	.	0.1	0.5	1.4	2.1	2.7	3.9	2.8	2.3

1 Real. — 2 By weight.

Sources: Minstat: Respublika Belarus' v tsifrakh, Minsk 1997, p. 5. 57 and 169; Minstat: Statisticheskiy byulleten', no. 12/1998.

many years Belarus' links to Russia were a life-line for its economy, especially the economic concessions granted by Russia in the form of the provision of energy supplies on credit or against payment in kind. However, Russia's willingness to import products from Belarus has recently declined dramatically. Exports to Poland have also declined, as has the until recently substantial revenue earned from transport services (transit of goods to Russia).

The origin side of GDP also reflects the problems now afflicting the macroeconomy. Official growth figures have declined markedly (cf. table 3). An absolute decline was recorded in the official statistics only for agricultural output (-0.4%), however, and within the industrial sector for electricity (-7.5%). To some extent the results in agriculture were influenced by the weather. Yet weather conditions have only exacerbated the fundamental problems that exist in the agricultural sector, problems which have now been recognised by the authorities. President Lukashenko called it a 'crime' to continue to subsidise loss-making agricultural enterprises.⁵ It seems that the shortage of animal feed has recently worsened further, so that a renewed decline in animal stocks is to be expected.

The flattening-out of output growth affected all of the industrial branches for which the official statistics

provide data. Growth rates in 1998 were only around half those recorded in the previous year, with a particularly marked slow-down in the second half of 1998. Electricity generation contracted sharply, accompanied by an increase in electricity imports by one third; this is the largest increase among all the import categories identified in the statistics.⁶ So far it has only been possible to maintain industrial output because Russia has continued to import traditional Belarusian products (lorries, tyres etc.) in the form of barter trade, at prices that have been knocked down to an unknown, but probably considerable, extent. The Russian market, the main external market for Belarusian goods, can no longer absorb such quantities, however. Moreover, the comparatively minor exports to non-CIS countries, mostly with a high primary-good content (e.g. iron and steel, phosphate fertiliser, wood and wooden products) have clearly come up against their limits. Last but not least, most export companies are struggling to avoid operating at a loss.

Price trends in 1998 were initially largely determined by a presidential decree limiting inflation to a maximum of 2% per month (27% p.a.); see table 4. As was to be expected, this requirement conflicted fundamentally with the extremely expansionary monetary policy stance. Initially, panic buying by the domestic popula-

⁵ At a meeting with agricultural enterprise directors; quoted by RFE-RL on 14 January 1999.

⁶ This consists of - unpaid - supplies of electricity from Lithuania. The corresponding debts amounted to US-\$ 100 at the start of 1999; cf. Reuters, 22 February 1999.

Table 2

Investment at Constant Prices, 1990 to 1998

Changes on the previous year or share, in %

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Investment, total	9	4	-29	-15	-11	-31	-5	20	16
Producing sector	5	4	-40	-13	-10	-29	2	14	10
Industry	2	6	-29	-11	12	-36	0	19	12
Agriculture	8	-5	-51	-31	-46	-34	-16	1	38
Construction industry	2	27	-54	-12	-20	-47	-32	23	42
Transport	3	39	-27	7	-24	0	0	23	-4
Communication	0	-17	-58	37	-5	100	81	-20	-21
Trade and catering	12	-8	-43	-3	81	-62	19	15	37
Material provision and sales	38	-27	-38	48	-24	-15	27	71	19
Non-producing sector	16	4	-7	-16	-12	-33	-14	29	25
Housing	13	10	-11	-19	-10	-44	-5	42	27
Municipal services	20	18	-1	-8	-27	-19	-12	8	21
Health affairs, sports, social security	8	27	23	-22	-12	-16	-30	28	13
Education	-9	-3	-4	-12	-13	-58	-1	26	14
Culture and art	-6	6	-37	-13	-25	-29	-24	21	96
Science	6	-41	-65	-15	-24	-23	-65	150	6
Financial sector, banks, insurances	.	.	.	.	138	28	-41	-27	35

Sources: Minstat: Statisticheskiy byulleten', no. 12/1996, p. 159, 164 ff; no 12/1997, p. 162, 166; no 12/1998, p. 144 ff.

tion led to rationing and attempts to prevent exports to the Russian Federation, where food prices were around five times the level in Belarus; increasingly this policy proved untenable, however. President Lukashenko criticised his Prime Minister, Ling, following the doubling of the price of vodka. However, he soon began arguing that

price increases were necessary in order to protect producers who wanted to produce in such a way as to cover their costs. At the same time, he demanded that no further sudden price increases should be allowed, even if this posed problems for the country; all the statements were made on Belarusian television.

Table 3

Industrial Production 1990 to 1998

Changes on the previous year in %

	1990	1991	1992	1993	1994	1995	1996	1997	1998
Total industry ¹	2	-1	-9	-10	-17	-12	4	19	11
Electricity	3	1	-3	-11	-11	-16	-2	6	-6
Fossil fuel industry	-2	-5	-43	-37	-45	11	-5	-1	1
Iron and steel	9	13	-14	-14	-13	-1	23	35	15
Engineering and basic metal industries	3	5	-7	3	-14	-20	2	26	13
Chemical and petrochemical industry	0	-7	-15	-12	-17	9	7	19	6
Wood, wood working, paper and cellulose industry	2	7	-7	-3	-13	-10	14	35	21
Construction materials	2	5	-11	-24	-29	-21	-4	26	14
Light industry	0	1	1	2	-23	-34	12	27	22
Food industry	2	-9	-18	0	-6	-13	6	21	19

¹ Excl. small enterprises, cooperations, joint-ventures and industrial extra enterprises of other branches.

Sources: Minstat: Statisticheskiy byulleten', no. 12/1997, p. 108 ff.; no 12/1998, p. 32 ff.

Table 4

Monthly Development of Prices, 1994 to 1998

Changes on the previous month in %

	Consumer prices						Industrial producer prices					
	1994	1995	1996	1997	1998	1999	1994	1995	1996	1997	1998	1999
January	40.7	39.2	5.6	13.3	3.9	16.6	24.3	44.4	4.0	18.5	3.7	28.0
February	18.7	33.7	4.0	6.6	3.1	13.7	17.4	13.2	0.3	15.4	3.7	18.1
March	10.2	20.0	2.0	2.3	3.3	.	11.9	9.5	1.1	5.3	2.7	15.0
April	28.6	14.5	1.5	4.3	3.8	.	37.0	7.5	1.6	7.0	2.3	.
May	28.7	3.4	0.6	5.0	3.4	.	32.4	1.7	0.4	5.9	3.0	.
June	19.5	2.5	2.3	4.5	2.7	.	22.0	1.3	2.1	2.5	3.5	.
July	26.6	5.2	2.0	1.4	2.8	.	17.5	2.4	1.7	2.3	4.9	.
August	53.4	3.0	1.3	1.0	3.8	.	42.5	5.2	3.5	1.4	6.3	.
September	25.5	5.2	1.8	5.0	17.6	.	41.1	5.0	2.1	2.3	10.7	.
October	25.7	3.4	1.3	3.2	21.0	.	41.6	2.1	1.6	2.4	12.4	.
November	40.5	3.7	3.9	1.8	25.0	.	28.4	2.7	2.2	2.4	22.4	.
December	31.3	3.9	7.4	2.3	21.7	.	26.4	2.2	5.5	2.6	44.5	.

Sources: Minstat: Statisticheskiy byulleten', no. 12/1996, p. 1193 and 217, p. 205 and 229; no 12/1998, p. 185 and 209; press releases.

Whether recent promises have a chance of success will depend primarily on whether monetary and exchange-rate policy are set in a compatible way. For years now, Belarusian economic policy has been under the illusion that it could expand the money supply substantially without being forced to adjust the exchange rate in time. Not for the first time, it has been announced that a single exchange rate is to be set, without it having been made clear at what level.⁷ Surveys suggest that the population does not expect a fall in the rapid rates of growth of consumer goods prices (182% in 1998 as a whole). Rather, it is widely assumed that the extremely high inflation rates recorded in autumn 1998 – in the last quarter of that year inflation averaged significantly more than 20% per month – will be maintained. The rise in industrial producer prices last year was of a similar order of magnitude to that of consumer prices, although the acceleration of inflation began after a certain time lag; in December 1998 the monthly rate was 44.5% on the previous month.

Labour market

The high rates of economic growth recorded by the official statistics have again been reflected in the level of employment. In December 1998 employment was 95 400

⁷ August 1999 is now being given as the date of introduction.

higher than a year earlier. The unemployment rate fell to just 2.3%, compared with last year's figure of 2.8%; this is the lowest figure by far of all the former centrally planned economies. The highest rates of employment growth were recorded in trade, hotel and catering (10.7%), banking (8%) and construction (7.2%). Job losses occurred, however, in science (-6.5%), agriculture (-4.9%) and wholesale trade (-3.6%).

At the end of December 1998, officially registered unemployment was 105,900, i.e. 20,300 less than in December 1997. Long-term unemployment (more than one year) declined as a proportion of total unemployment, from 24.5% in 1997 to 18.7% in 1998. However, the official statistics report only those persons officially registered as unemployed as a percentage of the workforce; if the ILO methodology⁸ were used, unemployment would, as in Russia, almost certainly be far higher.

As in the previous year, only 39% of the unemployed were in receipt of unemployment benefit. The availability of benefit offers those without work little incentive to register as unemployed; in December 1998 the benefit level represented just 6.5% of the average wage and 12% of minimum subsistence income.⁹ Around half of the unemployed were aged 29 or less, two thirds were women.

⁸ The International Labour Organisation (ILO) calculates the unemployed as the difference between employment and the economically active population.

⁹ Cf. *Belarus Economic Trends*, October-December 1998, Minsk 1999.

Short-time working for economic reasons, a form of hidden unemployment, fell in the first 11 months of 1998 by 3% compared with the same period the previous year, affecting 4.4% of those in employment. In addition, 4.9% of employees were on compulsory holiday (-30%). Around 40% of those forced to take holiday were not entitled to pay.

The number of vacancies reported to the employment offices remained virtually constant. The number of registered unemployed per recorded vacancy fell, however, from 4.3 unemployed persons in December 1997 to 3.5 in December 1998. Firms are most likely to register jobs as vacant if they require no qualifications or only semi-skilled labour.

Private household income

For 1998, too, the official statistics record substantial real rates of growth of money income and wages. These high growth rates must be seen as fictitious, however, as government intervention on the markets has repeatedly led to supply shortages, which have worsened in the wake of the crisis in Russia. In statistical terms private household money income rose by 19% (1997: 6%) and wages by 17.8% (1997: 14%). Whereas real money income increased year-on-year at a double-digit rate from February, and particularly from September 1998, in spite of high inflation, monthly real wage trends actually declined in some months (compared with the previous month).

In mid-1998 wages accounted for 58.6% of total private household income, although the figure for the year as a whole declined to 53.2%, whereas the proportion of total income derived from self-employment, property and other sources increased from 23% to 29.6%. On the expenditure side, consumer spending increased to 79.4% of total expenditure by private households, whereas savings fell to 11%. This suggests that people increasingly sought to buy real assets as inflation rose. However, such behaviour cannot be squared with the alleged trend of retail trade turnover, which exhibited virtually the same rate of growth as real money income (cf. table 1): particularly given the increased illegal export of goods to Russia, the Ukraine and Lithuania, of which the government has made frequent complaint, the growth of money income ought to be much higher than that of retail trade sales.

There has been practically no change in the extent of wage differentiation. As before, the highest wages were paid in banking (208% of the average), the public administration (132%) and in construction (130%); the lowest in social services (53.3%) and agriculture

(58.9%). The average wage represented 213% of minimum subsistence income, while the minimum wage was 13% a mere of the minimum subsistence level (1997: 15%).

Outstanding wage payments, at 6% of the previous month's wage in December 1998, were relatively minor, and in particular were far less serious than the figures observed in Russia. Outstanding wage payments are a particularly serious problem in agriculture, which accounts for 85% of wage arrears (industry: 7%).

Pensions were raised on more than one occasion during the course of the year. Even so, the social situation facing pensioners remained difficult. In 1998 the average old-age pension represented just 95% of minimum subsistence income. Almost 60% of pensioners received a pension below subsistence level. In spite of the real growth of average incomes, poverty remains widespread and social standards low. As in the previous year, around one third of the population was living on an income below subsistence level.¹⁰ Alongside pensioners, families with several children are particularly at risk of poverty. In the third quarter of 1998, half of the households with five or more members and 40% of those aged less than 17 had a (statistical) income below the poverty line.¹¹ Partial indexation of wages and pensions is planned for 1999: incomes below the minimum subsistence level are to be adjusted upwards in line with inflation; incomes above this level but below the so-called 'minimal consumer budget' are to be adjusted by just 80% of the inflation rate.

Government finances

Substantial quasi-fiscal activities reduce the value, as an indicator, of the data presented by the Belarusian finance ministry on the state of government finances. Such activities include not only state-controlled lending at preferential conditions, but also the massive direct interventions in the price mechanism. The underlying aim is to increase state influence on the economy, without simultaneously increasing the pressure on the budget. The extent to which pressure on the budget is eased by such activities can be illustrated using the example of price controls. A price is set by law for, say, selected foodstuffs. Normally this would require a price subsidy, paid out of the budget. But because no payment is in fact made, there is a corresponding deterioration in the financial situation of the relevant enterprises, whose

¹⁰ Cf. *Belarus Economic Trends*, loc. cit.

¹¹ *Ibid.*

losses are usually offset by managed lending by the central bank.

As a result, the official deficit for 1998 of 1.1% of GDP (cf. table 5), which itself was financed in large measure by preferential loans, constitutes the lower limit of the actual fiscal position. It is estimated that the savings on interest payments granted to state-owned enterprises in the form of preferential lending terms amounted to at least 3.5% of GDP in 1998.¹² Due not least to the negative real rate of interest on government loans and the devaluation of the real volume of credit through inflation, the domestic debt of all government budgets amounted to only around 3% of GDP at the end of 1998. Such low debt ratios are typical of inflationary economies; after all, inflation can be seen as income redistribution in favour of debtors. It is in keeping with this picture of high inflation and the financing of government claims by printing money that the importance of the inflation tax again increased in Belarus.

Since the 1998 fiscal year all expenditure by, and revenues of, the extra-budgetary funds (excluding the social security funds) have been recorded in a single consolidated budget. This change in methodology is responsible for the marked increase in revenue to the consolidated budget compared with the previous year. Adjusting for these revenue inflows, which are tied to specific spending items and together represent 5.7% of GDP, taxation and social insurance receipts fell as a proportion of GDP (1997: 32.2%; 1998: 30.5%). This masks a sudden turnaround in the second half of 1998; prior to this, revenues to the consolidated budget, adjusted for the effect of the extra-budgetary funds, had risen by around three percentage points to over 35% of GDP. The turnaround can be explained with reference neither to changes in taxation laws nor to an increase in outstanding tax dues.¹³ Instead, this trend can be seen as an indicator that many firms are operating at a loss, against the background of output rises stimulated by government activity and administratively set prices. Further support for this view comes from the fact that the revenue from taxes on profits, which was in any case decidedly small in the light of official claims about economic prosperity, declined further.

¹² This estimate was made on the basis of figures taken from the International Financial Statistics on credit allocation; cf. International Monetary Fund, CD-ROM, Washington D.C., March 1999. An average nominal rate of interest of 2% was assumed on loans to state-owned economic entities. On the borrowing terms see *Belarus Economic Trends*, loc. cit.

¹³ The problem of tax arrears, which amounted to around 0.5% of GDP in 1998, is far less serious in Belarus than in the Russian Federation; cf. *Belarus Economic Trends*, loc. cit.

Spending by the consolidated budget – adjusted for that by the extra-budgetary funds, which are financed on a pay-as-you-go basis – amounted to just under 32% of GDP at the end of 1998, marking a sharp fall on the previous year. Given that most of the cuts came under the heading of 'other spending', it is not possible to draw conclusions on a possible structural shift on the spending side. Government spending continues to focus on financing the economy – and hence on subsidies – and on social security. Spending by the extra-budgetary funds declined during the first nine months of 1998 compared with the corresponding period the previous year;¹⁴ an exception is the agricultural fund, which paid out additional sums in support of loss-making agricultural enterprises, and thus increased in importance in terms of spending compared with 1998.

The national budget for the current year was passed in February 1999. It is based on an assumed rate of economic growth of 4-6% and an inflation rate of between 80 and 100%. These assumptions must be considered excessively optimistic, however. According to the budget law, government revenue will total 36.7% of GDP, public spending 38.5%. Given that Belarus would only be able to gain access to international financial resources if it were to make a major change in economic policy, the budget deficit will once again be financed from domestic sources, primarily central bank loans. Also planned is a reform of taxation law, the main points of which are a reduction in profits tax by five percentage points and a harmonisation of income tax between Belarus and the Russian Federation. At the same time the tax base for the special consumer taxes is to be broadened.¹⁵

Monetary and exchange-rate policy

In 1998, as in previous years, monetary policy was instrumentalised in order to finance quasi-fiscal activities by the government. In this, central bank lending to the commercial banks was more important than direct lending by the central bank to finance the budget deficit. More than three-quarters of loans to commercial banks were subject to commitments to pass on the funds to selected sectors, in particular agriculture, the food industry and construction. This form of lending represented a total volume of 3.8% of GDP.¹⁶ Interest rates varied between zero and 24%; they were thus at most only half

¹⁴ Ibid.

¹⁵ Ibid.

¹⁶ Ibid.

Table 5

Selected Revenue and Spending Items from the Consolidated Budget, 1992 to 1998

	1992	1993	1994	1995	1996	1997	1998
Revenue (structure in %)							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
VAT	37.1	27.6	27.4	28.0	28.1	29.8	25.7
Excise duties	8.9	12.1	10.6	7.9	12.5	13.0	11.0
Profits taxes	25.8	29.7	30.7	21.6	14.5	14.6	12.4
Income taxes	7.4	7.1	7.3	9.3	10.5	.	.
Chernobyl tax	8.4	7.7	4.9	8.0	.	.	.
Petroleum tax	2.4	2.6	2.2	1.7	0.5	.	.
Housing tax	0.6	0.9	1.3	2.5	1.9	.	.
Tariffs etc. ¹	1.6	6.9	9.2	5.7	6.7	8.1	6.4
Extra budgetary funds	.	.	.	.	.	.	7.7
Other revenue	7.8	5.4	6.4	15.4	.	.	.
Spending (structure in %)							
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0
Economy	41.9	38.7	27.5	21.9	19.9	16.1	15.8
Education, culture, social spending	30.6	30.3	35.9	42.8	48.7	42.7	38.3
Science	1.4	1.2	0.9	1.7	.	1.5	1.3
Chernobyl	12.6	9.7	6.9	7.7	.	.	.
Defence	4.8	4.2	4.3	4.4	.	4.7	2.9
Legal organs	3.0	3.5	4.5	7.1	2.4	6.2	5.4
Administration	1.8	1.7	1.9	3.5	1.1	3.2	2.9
Foreign economic activities	.	.	.	.	.	0.9	0.8
Debt servicing	2.0	1.2	0.6	0.6	.	1.9	2.1
Other spending items	1.8	9.6	17.6	10.2	27.9	22.9	30.3
Deficit in % of total spending	-5.7	-13.1	-8.7	-8.5	-6.7	-6.3	-2.9
Revenue (% share of GDP)							
Total	32.3	37.0	36.8	30.0	27.5	32.2	36.2
VAT	12.0	10.2	10.1	8.4	7.7	9.6	9.3
Excise duties	2.9	4.5	3.9	2.4	3.4	4.2	4.0
Profits taxes	8.3	10.8	10.9	6.4	4.0	4.7	4.5
Income taxes	2.4	2.7	2.7	2.8	2.9	3.2	3.8
Chernobyl tax	2.7	2.8	1.8	2.4	.	.	.
Petroleum tax	0.8	1.0	0.8	0.5	0.1	.	.
Housing tax	0.2	0.3	0.5	0.7	0.5	.	.
Tariffs etc. ¹	0.5	2.6	3.4	1.7	1.8	2.6	2.3
Extra budgetary funds	.	.	.	.	.	.	2.8
Other revenue	2.5	2.0	2.3	4.6	.	.	.
Spending (% share of GDP)							
Total	34.3	42.3	39.9	32.3	30.2	34.4	37.3
Economy	14.3	16.3	11.0	7.1	6.0	5.5	5.9
Education, culture, social spending	10.5	12.8	14.3	13.9	14.7	14.7	14.3
Science	0.5	0.5	0.4	0.5	.	0.5	0.5
Chernobyl	4.3	4.1	2.8	2.5	.	.	.
Defence	1.7	1.8	1.7	1.4	.	1.6	1.1
Legal organs	1.0	1.5	1.8	2.3	0.7	2.1	2.0
Administration	0.6	0.7	0.8	1.1	0.3	1.1	1.1
Foreign economic activities	.	.	.	.	.	0.3	0.3
Debt servicing	0.7	0.5	0.2	0.2	.	0.7	0.8
Other spending items	0.6	4.0	7.0	3.3	.	7.9	11.3
Deficit in % of GDP	-2.0	-5.6	-3.6	-2.8	-2.0	-2.2	-1.1

1 1st half year. Including non-budgetary funds, excluding social insurance funds.

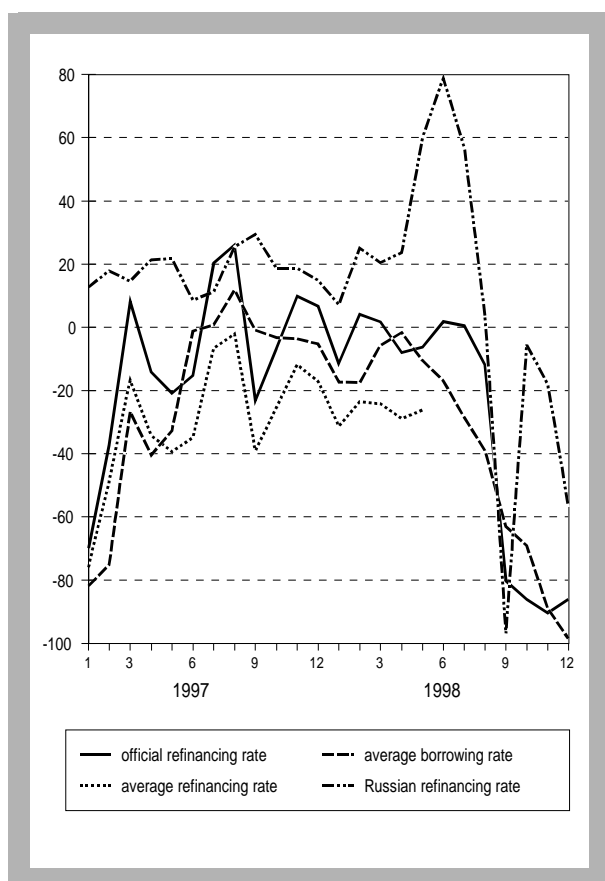
Sources: Minstat: Respublika Belarus' v tsifrakh, Minsk 1997, p. 175 ff.; Minstat: Statisticheskiy byulleten', no. 7/1997, p. 81 ff.; calculations by the Institutes.

the official refinancing rate, which itself, particularly in the second half of the year, was far below the current inflation rate (cf. figure 1).

In view of the predominance of preferential loans, monetary policy once again exerted a massive destabilising effect. The growth of both the monetary base and M3 accelerated markedly once again in 1998 (cf. table 6). The increase in inflation was correspondingly dramatic. Despite comprehensive price controls, in the fourth quarter of 1998 the monthly inflation rate, as measured by the consumer price index, rose to over 20%.

The acceleration of inflation reflected, on the one hand, the inflationary pressure that had built up through lending on preferential terms. On the other hand, the financial and economic crisis in Russia has seriously raised the pressure for adjustment and contributed to the acceleration of money supply growth.

Figure 1
Real Interest Rates, 1997 to 1998
Annual rates in %



Nominal interest rates were deflated using the change in the consumer price index during the previous 12 months.

Sources: Russian European Centre for Economic Policy (1998). Russian Economic Trends. Monthly Update July. Moscow; Belarus Economic Trends. Monthly Update (various issues). Minsk; calculations by the Institutes.

Whereas, during the first half of the year, the rates of growth of the monetary aggregates had not exceeded those of the previous year, they increased markedly in the fourth quarter. In the case of the monetary base, the increase primarily reflected the fact that in the fourth quarter the central bank increased its lending to the commercial banks by more than half. The growth of M3 largely reflects the devaluation of the Belarusian rouble and the higher value consequently placed on foreign-currency accounts.

On the asset side of the central bank balance sheet, in 1998 cash in circulation doubled on the previous year. Here too, the increase was particularly pronounced in the fourth quarter of 1998. The accelerated growth of the monetary base was reflected particularly in an increase in the excess reserves of the commercial banks in the second half of the year, reducing the money multiplier. In the absence of this increase, the destabilising effects of the quasi-fiscal activities and the additional lending to the commercial banks would have made an even more marked impact.

In view of the signs of crisis, the government approached the International Monetary Fund (IMF) for financial support in the form of a US-\$ 100 million loan, within the framework of the so-called 'Compensatory and Contingent Financing Facility' (see the section on the balance of payments). In order to meet the conditions set by the IMF for granting such a loan, Belarus would have had to make substantial corrections to its monetary and exchange-rate policy in the first quarter of 1999. Above all else, in the area of monetary policy the emission of additional money and the subsidisation of interest payments for privileged sectors would have had to be reduced.

According to its own figures, in January 1999 the central bank did not emit any additional money.¹⁷ In December and January it raised its official refinancing rate symbolically in two steps, from 38 to 60%. At the same time the volume of subsidised loans to agriculture earmarked for the spring of 1999 was halved compared with previous plans, and the average rate of interest on the loans was increased to 45%.¹⁸ Yet even this higher rate of interest is still significantly below the rate of inflation. Moreover, in the past the planned ceilings on subsidised lending to privileged sectors have regularly been exceeded by far. As early as April, subsidised loans to the agricultural sector totalling 20 trillion Belarusian rouble were announced, a figure equivalent to an expansion of the money supply by around 30%.¹⁹

¹⁷ RFE-RL, 9 February 1999

¹⁸ Cf. *Belarus Economic Trends*, loc. cit.

¹⁹ Based on the monetary base at the end of 1998; RFE-RL, 9 April 1999.

Table 6

Growth of the Monetary Aggregates, 1995 to 1998

From end of one period to end of next, in %

	1995	1996	1997	1998	1997		1998	
					1st half	2nd half	1st half	2nd half
Monetary base	286	78	108	163	25	21	18	60
M3 ¹	158	52	111	276	21	16	29	121
memo item:								
Consumer prices	244	39	63	182	8	7	25	84
Producer prices	140	29	90	196	6	8	23	99

¹ Including accounts denominated in foreign currency.

Sources: Belarus Economic Trends, Quarterly Review, October to December 1998, Minsk 1999; calculations by the Institutes.

In the wake of the Russian crisis, the decline in the external value of the Belarusian currency, which had begun back in the first half of 1998, has accelerated further. Between August and October 1998 alone, the Belarusian rouble lost 70% of its value against the US dollar on the Moscow interbank market. The gap between the market rate and the official central bank rate, which fell far more slowly, reached almost 80% in October.

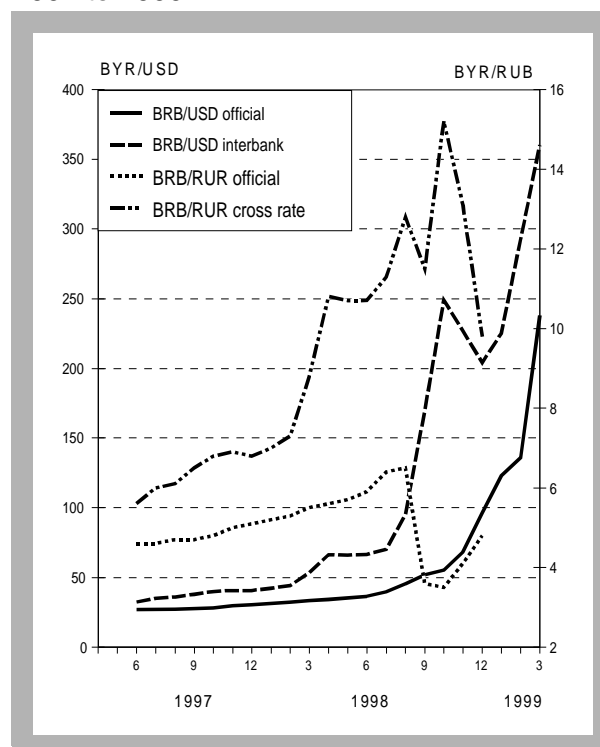
Faced with the increasing disequilibrium on the foreign-exchange markets, the central bank devalued the official rate by more than 50% in the fourth quarter, from 53,300 to 107,000 rouble per dollar (cf. figure 2). In spite of this massive devaluation, the official central bank rate still differs markedly from the rate on the Moscow interbank market (204,000 rouble per dollar), which itself deviates substantially from the black market rate (400,000 rouble per dollar).

In an attempt to qualify for an IMF loan, since the start of 1999 Belarus has made certain changes to its exchange-rate policy.²⁰ The official rate was devalued further, to reach 136,000 rouble per dollar by February, and the obligation on exchange bureaux to pass on hard currency to the central bank was reduced from 95 to 30%. Dealings in foreign currency on the interbank market were also partially liberalised. Following a brief stabilisation of the currency in the wake of these measures, the decline in its value continued; at the start of April the official central bank rate was 238,000 rouble, the black market rate reaching as low as 457,000 rouble.²¹

The real exchange rate, i.e. allowing for differences in national inflation rates, against the dollar shadowed the changes in the nominal exchange-rate (in each case on the interbank market) relatively closely. It depreciated markedly, particularly in the wake of the Russian

crisis (cf. figure 3). Although a slight appreciation subsequently occurred, starting in November 1998, along with the nominal exchange rate, a real depreciation of 80% was recorded for the year as a whole. Exchange-rate trends were very different, however, with respect to the Russian rouble, the currency of Belarus' most important

Figure 2
Nominal Exchange Rates of the Belarusian Rouble to the US-Dollar and Russian Rouble, 1997 to 1999

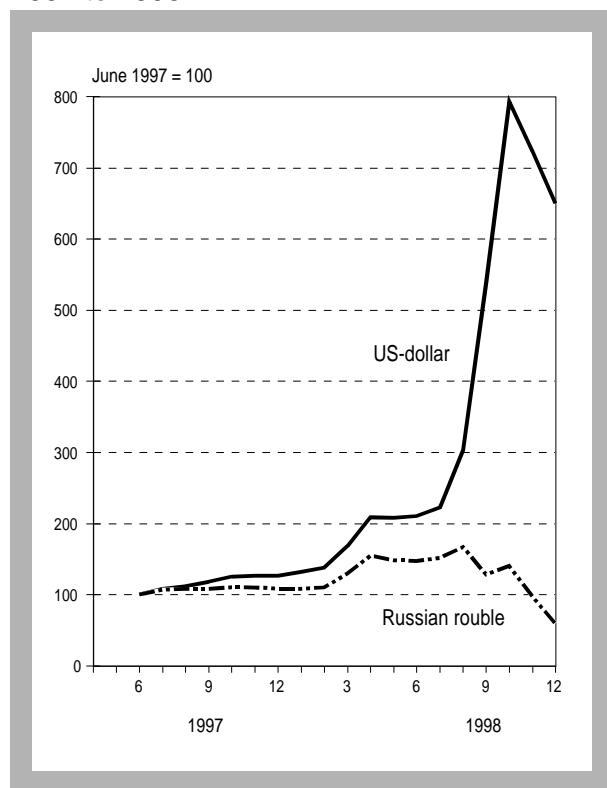


Sources: Russian European Centre for Economic Policy. Russian Economic Trends. Monthly Update March. Moscow 1999; Belarus Economic Trends. Quarterly Review, October to December 1998. Minsk. 1999; calculations by the Institutes.

²⁰ RFE-RL, 9 February 1999; cf. *Belarus Economic Trends*, loc. cit.

²¹ RFE-RL, 7 April 1999.

Figure 3
Real Exchange Rates of the Belarusian Rouble to the US-Dollar and Russian Rouble, 1997 to 1998



Nominal interest rates were deflated using the change in the consumer price index. Sources: Russian European Centre for Economic Policy, Russian Economic Trends, Monthly Update March, Moscow 1999; Belarus Economic Trends, Monthly Update November 1998, Minsk 1999; Rietumu Banka (1999). Exchange rates. Website <http://www.rieturu.lv/english/Exchange-Rates/exchange-rates.htm>; calculations by the Institutes.

trading partner; here the real depreciation in the first half of the year was far less pronounced, and was more than offset by the appreciation in the fourth quarter. The same is broadly true of the real exchange rate vis-à-vis the Ukraine. As a result, the effective exchange-rate, i.e. the exchange rate weighted on the basis of trade shares, appreciated in 1998.²² This means that during the period under consideration exchange-rate trends have again led to a deterioration in the price competitiveness of Belarusian exports.

Balance of payments

Since mid-1998 the economic and financial crisis in Russia has seriously exacerbated the existing problems in

²² Cf. *Belarus Economic Trends*, loc. cit.

the Belarusian balance of payments (cf. table 7). Compared with the previous year, the current account deficit rose from 6 to 6.8% of GDP. Russia remained by far the most important trading partner of Belarus, accounting for almost two-thirds of goods exports and more than 50% of import. Accordingly, Belarusian exports as a whole fell significantly following the onset of crisis in Russia. In the fourth quarter of 1998 they were almost 20% down on the previous year's figure. Exports to Poland, too, the most important western importing country, fell by almost 25% between 1997 and 1998 (annual averages). Thus the temporary export recovery in the second quarter was reversed. At the same time, in the second half of 1998 and the first quarter of 1999 imports fell to an even greater extent, thus reducing the impact of the decline in exports on the balance of trade deficit.

Against the background of the deterioration in the balance of payments situation and the decline in foreign-currency reserves, the importance of barter trade has clearly continued to increase. Its share of total trade with non-CIS countries exceeded 10% for the first time in 1998. In trade with Russia, more than 40% of transactions were on the basis of barter trade. The figure was even higher in the case of gas imports. Belarus has clearly failed to honour an agreement reached in the spring of 1998, under which 26% of Russian gas supplies were to be paid for in cash.²³ In fact only around 8% of supplies were paid for in cash. The debts arising from unpaid energy supplies are currently the subject of negotiations with the Russian government. For 1999 Belarus is seeking an agreement under which 20% of Russian gas supplies would be paid for in cash. At the start of 1999 Gazprom evidently reduced energy supplies to Belarus, in order to exert pressure for the payment of outstanding dues totalling US-\$ 250 million; in mid-March, however, supplies were returned to the previous level.²⁴ No information has been made available on the background to this decision.

The extent of Belarus' balance-of-payments problems can be seen from the fact that its gross foreign-currency reserves again declined, as had also occurred last year. Following a sharp decline at the start of the year, in the second half of 1998 the reserves were only sufficient to cover one tenth of the country's monthly imports of goods and services.²⁵ Alongside the increase in the current account deficit on the previous year (see above), this is due to the fact that the surplus on the capital account probably fell by around 40% in 1998. In the previous year Belarus had recorded a capital-account

²³ RFE-RL, 15 January 1999.

²⁴ RFE-RL, 18 March 1999.

²⁵ Cf. *Belarus Economic Trends*, loc. cit.

Table 7

Balance of Payments, 1995 to 1998

US-\$ millions

	1996	1997	1997 i-III	1998 I-III	1997				1998			
					I	II	III	IV	I	II	III	IV ¹
Foreign trade	-1149	-1335	-949	-1151	-497	-224	-229	-387	-486	-372	-293	-287
Exports	5790	7383	5238	5328	1457	1794	1986	2145	1773	1894	1662	1753
Imports	-6939	-8718	-6186	-6479	-1954	-2018	-2215	-2532	-2259	-2265	-1954	-2039
Non-factor services	572	554	405	332	142	142	122	149	116	144	72	106
Revenue	908	919	650	660	196	217	238	269	224	234	202	191
Spending	-336	-365	-245	-328	-54	-75	-116	-120	-108	-90	-130	-85
Factor services	-31	-85	-45	-54	-19	-15	-12	-39	-13	-25	-16	-20
Revenue	74	31	24	17	3	10	12	7	4	2	11	2
Spending	-105	-116	-69	-70	-21	-25	-23	-47	-17	-27	-27	-24
Transfers	91	78	64	75	16	27	21	15	15	43	17	24
Balance on current account	-516	-788	-525	-797	-357	-71	-97	-262	-368	-209	-220	-179
Capital transfers	101	133	82	113	33	23	27	51	46	32	34	16
Net direct investment	73	198	119	87	54	50	16	79	25	40	22	18
Revenue	0	-2	-2	-1.7	-0	-0	-2	-0	-0	-1	-0	.
Spending	73	200	121	88	54	50	18	79	25	41	22	.
Portfolio investment	-15	-20	-14	22	2	4	-19	-6	-11	10	23	-8
Revenue	-18	-62	-40	21	-4	-19	-17	-22	-11	11	21	.
Spending	3	42	26	2	6	23	-3	16	0	-1	2	.
Other investment	289	383	-26	98	95	-16	-105	408	29	-11	80	86
Revenue	-132	25	-133	101	12	-91	-55	159	-50	10	141	.
Spending	420	358	108	-3	82	76	-50	250	79	-21	-61	.
Balance on capital account	347	561	80	207	150	38	-108	481	43	39	125	112
Statistical discrepancies (balancing item)	-146	157	384	166	144	7	233	-227	-46	146	66	12
Balance	-214	64	22	-312	-30	-3	55	42	-325	9	5	-39
Financing	214	-64	-22	312	30	3	-55	-42	325	-9	-5	.
Reserve assets	-79	77	73	91	47	32	-6	4	95	5	-9	.
IMF, World Bank etc.	0	0	0	-16	0	0	0	0	-8	0	-8	.
Debt restructuring	293	-140	-95	236	-16	-29	-49	-46	238	-14	12	.

¹ Figures of the fourth quarter 1998 not always comparable.

Sources: International Monetary Fund (IMF). International Financial Statistics on CD-ROM, Washington, D.C., March 1999; calculations by the Institutes.

surplus of almost US-\$ 600 million, of which 'other credits' – a term that primarily conceals commercial loans – accounted for around 70%. In 1998 the inflow of capital was higher than in the previous year during the first three quarters, but, according to official data, was significantly lower than in previous year in the fourth quarter. It seems that a particularly sharp decline in commercial credit occurred. The net outcome was a substantial deficit, met primarily through so-called 'exceptional financing', i.e. by rescheduling liabilities and accumulating payment arrears.

In December 1998 negotiations began between the Belarus government and the IMF on a special loan within the framework of the so-called 'Compensatory and Contingent Financing Facility'. This programme was set up to supplement adjustment programmes

approved by the IMF, in support of countries that encounter balance-of-payments difficulties as a result of serious external shocks. Although Belarus pointed to the economic crisis in Russia in justification of support, it has so far refused to present an adjustment programme for IMF approval. To this extent the preconditions for granting a loan within the framework of this facility have not been met. Among other things, the persistently overvalued official exchange rate is damaging the tradable-goods sector, and exchange controls are exerting a similar effect to a tax on exports. Moreover, the unstable macroeconomic environment and the failure to reform restrictive legislation are harming not only domestic investment in Belarus, but, in particular, the inflow of foreign direct investment.

Table 8

Number of Converted and Privatised Enterprises, 1991 to 1998

	1991	1992	1993	1994	1995	1996	1997	1998	Total
Privatised and converted enterprises	61	190	245	641	467	518	572	418	3112
Privatised by:									
Sale of leased property to tenant	34	47	57	152	35	58	76	53	512
Sale of property to workforce	13	87	24	12	1	0	0	0	137
Direct sale, auction	11	52	93	260	172	208	223	187	1206
Other sales	.	.	.	.	.	34	95	89	218
Conversion into joint-stock company	3	4	71	217	259	218	178	89	1039
of which:									
Property of the Republic	19	32	140	184	53	131	192	140	891
Privatised by:									
Sale of leased property to tenant	9	20	44	28	1	5	1	11	119
Sale of property to workforce	6	8	10	1	0	0	0	0	25
Direct sale, auction	1	1	18	3	0	0	0	0	23
Other sales	.	.	.	.	.	34	95	89	218
Conversion into joint-stock company	3	3	68	152	52	92	96	40	506
Property of local authorities	42	158	105	457	414	387	380	278	2221
Privatised by:									
Sale of property to tenant	25	27	13	124	34	53	75	42	393
Sale of property to workforce	7	79	14	11	1	0	0	0	112
Direct sale, auction	10	51	75	257	172	208	223	187	1183
Other sales	0	1	3	65	207	126	82	49	533

Sources: Belorusskiy rynek, no 31/1996, p. 14, no 5/1997, p. 7, no 29/1997, p. 21, no 5/1999, p. 15; calculations by the Institutes.

Market reforms

Further setbacks were observed in the area of market reforms in Belarus. Rising output in 1998 was again the result of constraints caused by comprehensive administrative intervention in the economy. Output growth and references to the difficulties facing other CIS countries were used by the government as arguments justifying its policy approach.

Compared with other transition countries, Belarus is seriously lagging behind in privatising state-owned enterprises. Of the 4423 state-owned enterprises earmarked for privatisation, only one fifth were actually incorporated into the privatisation programme.²⁶ Moreover, the overwhelming majority (506 of 891) of the firms, most of them large enterprises, were merely converted into state joint-stock companies (cf. table 8). At local government level, on the other hand, as many as 40% of

the 4 114 companies originally put up for privatisation have been sold, most of them small trade outlets and service enterprises. However, in 1998 the number of newly privatised and merely converted local-government enterprises once again declined. As a result, the so-called 'small privatisation', which has already been completed in other transition countries, will in no way have been concluded by the middle of 1999, as envisaged in the amended version of the privatisation law of January 1999. On top of this comes the fact that the President has obtained more decision-making rights within the framework of the so-called voucher privatisation; among other things he determines the proportion of state assets available for transfer free of charge. So far voucher privatisation has proceeded very slowly, because of a limited offer of shares; by the spring of 1998 the population was able to exchange only one-third of its vouchers for shares. Voucher privatisation is expected to stagnate in the coming months. Although it is planned to convert a large number of companies into state joint-stock companies in 1999, concrete proposals for actual sales have not

²⁶ Cf. *Belarus Economic Trends*, loc. cit.

Table 9

Mixed and Foreign Enterprises 1991 to 1997

	1991 ¹	1992	1993	1994	1995	1996	1997
Number of registered enterprises	283	832	1 447	2 070	2 645	2 856	1 903
of which commercially active	102	209	411	676	881	1 371	1 235
Production in % of GDP	0.8	1.5 ¹⁾	3.0	0.4	2.5	3.4	7.9
Employee in % of whole employee	0.2	0.2	0.4	0.5	0.6	0.9	1.1

¹ Only mixed enterprises.

Sources: Belorusskiy ekonomiceskiy zhurnal. Statisticheskie materialy. No 3, p. 122 ff., Minsk 1998; Kooperationsbüro Osteuropa (KOST) (edit.). Wirtschaftslage und Reformprozesse in Mittel- und Osteuropa – Sammelband Berlin, 1998.

been made. Moreover, a list has been presented of 695 state-owned companies that are to be excluded from privatisation, in order, it is argued, to protect the national interest. This indicates that, at best, privatisation will continue to be a merely formal exercise.

In the course of 1998 the number of loss-making firms in the state sector increased, as did their total net debt.²⁷ The subsidisation of the agricultural sector, in which less than 1% of cultivated land is worked by entirely private enterprises, continued. There have been various announcements since the autumn of 1998 to the effect that lending to unprofitable agricultural enterprises was to be reduced or stopped,²⁸ and in the spring of 1999 40 state-owned firms belonging to various branches were to begin restructuring. It must be doubted, however, whether such plans will in fact be implemented, given the adjustment effect they imply, including job losses and plant closures. In the past, at least, no active measures to restructure enterprises have been observed.

The purely formal nature of privatisation is also illustrated by government attempts to maintain or even increase its influence even on privatised companies. For instance, the state is entitled to introduce a so-called 'golden share' in companies, even after their successful privatisation; this gives it a right of veto in important company decisions. So far the demand by the IMF that the 'golden share' legislation be rescinded has been ignored. In firms partly owned by foreign investors, the introduction of a 'golden share' is supposed to be subject to the approval of the foreign investor. However, given the generally inadequate legal parameters and the one-off measures implemented by the government (for instance the re-registration of companies implemented in 1996 to 1998), foreign investors have so far been very reluctant to invest in Belarus. In terms of both GDP and

total employment, foreign-owned firms and joint ventures are of only marginal importance (cf. table 9). The unfavourable legal framework is also hampering the development of small companies, where only around 5% of the workforce are employed.

Further restrictions on price determination were imposed in 1998. To the extent that the price controls were effective, they have led to shortages and rationing; tougher export controls were introduced in reaction to illegal exports to Russia. The proposed new price determination law, which envisages substantial government intervention, has not yet been adopted. Even so, price determination is being interfered with by means of ad hoc measures.

The target indicators of planned economic development in 1999, set out in a presidential decree of 15 January 1999, do not include a target for consumer price inflation. This exclusion is an indication of uncertainty within the political leadership: any lack of success in dampening down inflation cannot be so easily quantified without an explicit target, rendering the government's inappropriate price policy less susceptible to attack.

On 25 December 1998 the Union Treaty between Belarus and Russia signed on 2 April 1997 was supplemented by a joint declaration, a treaty on equal rights of citizens in both countries, and an agreement on establishing equal conditions for economic actors. According to the declaration, Russia and Belarus will remain sovereign states with their own presidents. Joint union organs are planned, however. As in the past, the integration of the two countries is to proceed in stages. In the economic sphere, legal parameters are to be harmonised, a single customs area established, and taxation laws brought into line, all during the first half of 1999. In addition, preparations are to begin for the introduction of a single currency. It is extremely doubtful, however, whether such far-reaching integration of the two countries will actually materialise. The measures foreseen under the existing Union Treaty have so far been implemented

²⁷ Cf. *Belarus Economic Trends*, loc. cit. pp. 92f. and 164.

²⁸ Cf. *Minsk Economic News*, no. 6/1999.

only very hesitantly, if at all.²⁹ Another argument against rapid integration is the major difference between the two countries, especially in regulatory policies. Given the disorientation concerning market reforms currently prevailing in Russia, there is, however, a real danger of the reform process stagnating or even being reversed there. At the same time, in Belarus there are no signs of the anti-reformist course being changed.

Summary

For some years now the Republic of Belarus has pursued an economic policy strategy that appears to exert a certain attraction on Russian policy. The Belarusian concept is based, at heart, on the attempt to raise output quickly with the help of direct grants to enterprises, financed by the central bank. This is associated with extremely rapid growth of the money supply. Central to the negative economic trend in Belarus is the substantial overvaluation of the official exchange rate. In an attempt to counter the numerous negative repercussions of this policy, the regime is being forced to adopt ever more wide-ranging administrative interventions in economic processes. The economic outcome is such, however, that recently even President Lukashenko posed the rhetorical question 'why is our people getting poorer from month to month..., when our industry and agriculture are developing so dynamically?'.³⁰ The political leadership sees the answer in the financial crisis in Russia and a poor harvest in Belarus due to unfavourable weather conditions. Its own economic policy concept is still considered to be correct, indeed is even held up as a model for Russia. However, in the course of 1998 there was an unmistakable decline in the official rates of the GDP growth and of its aggregates. Inflation soared to more than 180%. The negative economic trend is expected to deteriorate further in 1999; GDP is forecast to contract by the order of 5%, and inflation will remain in triple figures.

²⁹ For this reason President Lukashenko recently voiced his supposition that Russia was not seriously interested in creating a unified state. RFE-RL, 8 April 1999.

³⁰ Belarusian television, quoted from RFE-RL, 12 November 1998.