

2 Belarus' Economic Status. Why Is Belarus' Economy In Urgent Need of Reform? by Vital Silitski⁴⁷

Current status

Since the 1990's, Belarus has lagged behind other CIS countries in economic reforms. The US-based Heritage Foundation dubbed Belarus' economy 'repressive'. In the early 1990s, the government attempted to carry out reforms, but stopped with Alyaksandr Lukashenka's effective election for president. He sought to retain total control of the economy by stifling the private sector. Repressive measures included nationalizing banks, imposing restrictions on private businesses, resurrecting the planned economy and fueling inflation to boost economic growth.

Structurally, Belarus has a Soviet-type economy. It lacks: a) a market-adjusted manufacturing structure resulting from independent choices of consumers, business and sources of capital. b) unregulated prices, and c) a well-developed labor market.

Institutionally, Belarus has a command economy dominated by the public sector with administrative allocation of financial and physical resources, price controls and unbalanced prices. In addition, the government relied heavily on 'bureaucratic deals', such as the oil-for-goods contracts with the Russian government. In result of such widespread practice, governmental agencies turned

⁴⁷ The author acknowledges the assistance of Paval Daneyka and Alyaksandr Hatouski in writing up this topic.

into intermediaries dealing in products of state-controlled enterprises. The latter have either lost their right to independently run their business, or deliberately handed business initiative over to the government.

The way the government makes economic decisions is high on economic populism. The government's priority is to see the economy advance and redistribute profits to the public sector's advantage by collecting a tax from private and foreign trade sectors. The policy ignores inflation and budget deficit risks, or takes no account of the external environment or response from contracting partners in business. In an effort to offer additional social security guarantees, Alyaksandr Lukashenka resorted to wage increases that were not supported by an adequate economic growth, aided instead by price and exchange controls, restriction on imports, and expansionary fiscal and monetary policies.

The 'economic miracle' or paradoxical growth in a command economy

Absence of reforms in the Belarusian economy has not led to its collapse, and the government's anti-market policy did not prevent it from growing in late 1990s. Despite macroeconomic instability, high inflation and depreciation of the ruble, the Belarusian economy has been growing since 1996. Against the background of recession continuing in Russia and other former Soviet republics, Belarus' economic recovery seemed to be a miracle.

Nevertheless, Belarus' true economic growth may be questioned, considering the controversies surrounding the credibility of official statistics. For example, the methods of calculating GDP growth, inflation and GDP deflators raise a lot of issues⁴⁸. Still, there was some economic growth in Belarus, but the nature of this growth needs thorough examination. It should be noted that capex on upgrade programs and new product development was negligible. Before the economic recovery, the private sector comprised merely small trade, service and woodworking companies. The fact that most enterprises were public did not make the environment more appealing to potential investors, or

⁴⁸ See details: А. Чубрик, *Экономика Беларуси: Статистический обзор*, Дасьледніцкі цэнтар бізнэс-школы ІПМ, аналітычны даклад № 5, Менск: верасень 2001 г.

prompt enterprises to invest in new plant and machinery and manufacture competitive products.

Table 1. Belarus' Economic Indicators (as share of prior year's indicator)

	1995	1996	1997	1998	1999	2000	2001	2002
Gross Domestic Product	89.6	102.8	111.4	108.4	103.4	105.8	104.7	104.7
Industrial output	88	104	119	112	110	108	106	104
Agricultural output	95	102	95	99,3	92	109	102	102
Capex on fixed assets	69	95	120	125	92	102	97	103
Cargo shipments	75	87	109	105	96	91	98	109
Retail sales	77	131	118	126	111	112	128	113
Producer's price indices	561	134	188	172	456	286	172	140
Consumer price indices	809	153	164	173	394	269	161	134
Exports to CIS countries	205	124	143	96	70	121	103	99,3
Exports to non-CIS countries	172	106	102	99,3	120	128	101	123
Imports from CIS countries	176	124	127	95	77	142	94	109
Imports from non-CIS countries	194	126	121	104	80	108	96	112

Source – CIS statistics committee

The industrial upturn was attributable to expansionary monetary policies, also used for funding the inefficient agricultural sector and government housing construction projects. Monetary expansion weakened the Belarusian ruble and led to a drop in prices in dollar terms and a rise in exports. Stocks of unsold goods were diminishing; factories operated at full capacity and recalled their employees from forced leave. However, soon it was obvious that it was a fall in the dollar equivalent of salaries and wages, calculated at the market exchange rate, which thwarted prices in dollar terms. People worked more but earned less.

To prevent living standards from declining sharply, the government resorted to price controls. The consumer purchasing power was growing, with wa-

ges decreasing in dollar terms. All these factors discouraged enterprises from producing better goods, and caused shortages in staple goods and agricultural stagnation.

Thus, a rapid yet temporary economic growth was fuelled by populist measures. The growth was too costly and unsustainable. The main objective of Lukashenka's experiment was to resurrect and maintain the Soviet economic model rather than carry out structural reforms in the late 1990s.

Once at its critical point, the dilapidated industrial asset base will be absolutely ineffective, while the external economic environment will develop in a manner disadvantageous to Belarus as neighboring countries, Russia primarily, will outstrip Belarus in terms of economic growth. This means that some day Lukashenka will have to pay a high price for his populist experiment.

The Lukashenka administration was forced to embark on efforts, however feeble, to reform the economy, including ways of limiting the growing money supply, cut State subsidies, unify the Belarusian ruble exchange rates and adopt a crawling exchange rate peg.

By contesting the need for market-oriented changes, the Belarusian authorities failed to lay a solid foundation for sustainable economic growth. Yet, in the short term, the policy was rather effective in terms of maintaining social stability and conserving the existing political situation with silent majority support among the general public. Moreover, by correcting their most absurd mistakes, the authorities managed to avoid a big macroeconomic disproportion that might have triggered off hyperinflation and a major economic crisis.

Living standards in an unreformed economy

Official statistics indicate improvements in living standards for Belarusians. According to the Ministry of Statistics and Analysis, real income more than doubled between 1995 and 2001. The figures also suggest that Belarusians enjoy the highest standards of living ever. Real incomes in 2002 were 30% above the 1990 level. Moreover, real income grew faster than GDP. One may logically assume that the consumption-to-GDP ratio was rising due to a decline in capex

and savings⁴⁹. Another possible explanation is that the official statistics have nothing to do with the real state of affairs in the country. Still, the truth is most likely to reside somewhere halfway between the two possibilities.

Official statistics on living standards and real income raise many questions, especially about the calculation methods used. Real income indicators depend directly on the computation of inflation, while the ministry's methods of determining the latter are rather questionable. There are also other questions. As per the same official statistics, for example, real income increased by 12 percent in January through March 2003. Yet, over the same period, real-term salaries dropped by 5 percent against December 2002 (The nominal salary was up by 3 percent, whereas consumer prices soared by 8.1 percent).

It would be interesting to compare the abstract statistics on real-term income growth with more realistic figures indicative of living standards, which offers a clearer picture for the general public. Let us consider food consumption. Belarusians spent more than half of their personal income on food. As seen in Table 2, the official statistics do not reflect any dramatic decline in food consumption, yet even in the most favorable year 2001, as reflected by official figures, Belarusians consumed much less than in 1990. Consumption was slightly above 1995 levels, but one should bear in mind that a high-calorie diet with high butter and sugar content is typical of countries with low living standards. It should be stressed also that the majority of consumed food was produced in private gardens and allotments. For example, in Minsk (the capital of two million), private holdings accounted for 53 percent of the output of consumed potatoes and 43 percent of vegetables in 2001. In other words, the standard of living does not decline much mostly as people supplement their income by additional work during days off, engaged in what is basically subsistence farming, hardly a proof of the Belarusian economic model's efficiency.

The poverty statistics (Table 3) may also offer a more realistic idea of how large personal incomes were. However absurd it may seem, between 1995 and

⁴⁹ Each official statistical indicator is calculated with the use of different deflators.

Table 2. Consumption of Staple Food Items

	1990	1995	1996	1997	1998	1999	2000	2001	2001 as % of 1990 level	2001 as % of 1990 level
Bread	127	121	122	122	118	115	110	105	82.6	86.7
Potatoes	171	182	188	182	173	170	174	172	100.5	94.5
Fruit	78	83	88	88	87	89	93	98	125.6	118.1
Vegetables and berries	38	38	39	37	35	24	25	65	65	
Sugar	49	32	32	34	37	34	34	41	83.6	128.1
Oil	8.6	6.5	6.8	7	6.6	8.3	8.7	10	116.2	153.8
Meat	76	58	60	60	62	62	59	59	77.63	101.7
Fish	19.6	7.3	8.7	8.7	6.1	6.2	9.5	11	56.1	150.7
Milk, liters	428	367	369	350	372	334	295	307	71.7	83.6
Eggs.	325	297	299	296	271	237	224	224	68.9	75.4

Source: the Ministry of Statistics and Analysis of Belarus, author's calculation.

2000 when, as the official statistics have it, real income soared by 70 percent, the proportion of low income households with below-subsistence levels increased instead of shrinking. The Gini index of inequality did not change much over the period.

Yet, the situation did improve in 2001, mainly as a result of short-term political measures (an increase in wages and old age pensions before the presidential elections in a move intended to bolster support for the incumbent president).

However absurd, in 1996 and 1998, at the time of a significant increase in personal incomes, the poverty level also rose. Moreover, for some reason, poverty was rapidly expanding in 1999, while the reported decrease in real income was negligible. In 2000, as claimed in official statistics, income rose by 50 percent against 1995, while the number of low income households sky-rocketed by a factor of three. It means that the official statistics on real income can hardly be a reliable criterion for estimating living standards in Belarus.

Table 3. Real Income, Poverty and Income Distribution in Belarus

	1995	1996	1997	1998	1999	2000	2001
Changes in real income (as percentage of prior year's indicator)	-27	17	6	19	-3	20	29
Households with per capita income below subsistence level (as percentage of prior year's indicator)	38.4	38.6	32.1	33	46.7	41.9	28.9
Gini index	26.1	25.4	25.8	28.3	26.9	27	27.8

Source: the Ministry of Statistics and Analysis of Belarus.

Living standards may be estimated by converting salaries and pensions into US dollars. The average monthly pay in November 2002 rose to \$107 after a slump from \$88 to \$36.4 in 1996–2000. However, over the same period, the US dollar equivalent of consumer prices increased twofold, consumer goods prices shat up by 77 percent, prices of consumer services and utilities sky-rocketed six- and 14-fold, respectively.

Moreover, official statistics hardly take into account the higher cost of education and healthcare services. Belarusians saw not only cheap goods but also free education and healthcare vanish. New price markets have emerged, including corrupted ones, but the government does not even intend to legalize them and thus provide real-term social security in the form of education loans or health insurance.

In this context, results of the opinion poll conducted by the Independent Institute of Social Economic and Political Studies (IISEPS) in April 2003 may seem interesting. Only 7 percent of those polled said they were better off lately, while 42 percent stated the opposite. 53 percent were concerned about rising prices of utilities and consumer services, 51 percent were concerned about rising prices of staple goods, 12 percent expressed concern over the introduction of tuition fees, and 24 percent worried about chargeable healthcare services⁵⁰.

⁵⁰ Source: IRISEPS, <http://www.iiseps.by/press1.html>, April 29, 2003.

It may be concluded that, firstly, there was no dramatic decline in living standards during Lukashenka's presidency; on the contrary, there was obvious improvement. Secondly, real income growth is certainly overstated in official statistics and may be questionable. Thirdly, the period of rapid economic growth, fueled mainly by political measures, is attributable to years 2000 and 2001, yet not sustained by the government. Finally, living standards did not drop dramatically as the people adapted to existing conditions. It merely goes to say that more people resorted to subsistence farming, but this did not help to improve quality of life or boost economic efficiency.

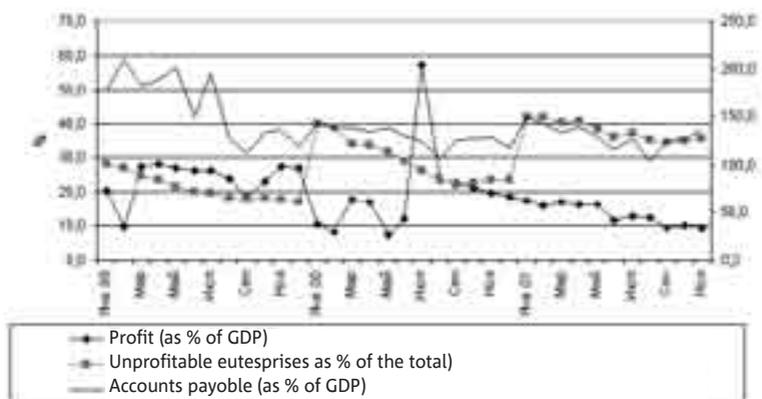
Real economy crisis

Are there any realistic prospects for a sustainable and dynamic economic development in Belarus? Is it possible to improve living standards within the existing economic system? Belarus' economic outlook is grim.

Unprofitable enterprises. The Belarusian government's economic experiment has brought about rapid erosion of profitability in the corporate sector. In the first quarter of 2003, the proportion of those in the red reached 48 percent. Most of these are bankrupt since their total debt exceeds asset value. Moreover, enterprises do not generate much profit from their output as their goods are not competitive at home or abroad. With profitability remaining low, enterprises are not in a position to finance upgrades. Most industrial operators seem hardly able to make it in the future, even if the government sticks to its current policy of supporting the public sector.

A number of factors have contributed to the financial crisis in the manufacturing sector. Some enterprises face difficulties as they had to follow governmental directives geared to increase the output, which was possible only by cutting capex on fixed assets and upgrade programs. Other enterprises fell victim to price controls. When the government was supporting the manufacturing sector with soft loans and redistribution of convertible currency resources, enterprises were not motivated towards making competitive products. As the industrial crisis deepened, the government adopted more sensible macroeconomic policies.

Diagram. Profit and Debt indicators of the Belarus' Economy



Source: The Ministry of Finance of Belarus

In fact, the governments' objective to achieve full employment has indeed brought about the crisis. Enterprises had to keep redundant labor force in employment or, in other words, to maintain low output and efficiency. During Lukashenka's presidency, the official unemployment rate dropped from 4 percent in 1995 to 2 percent in 2000. Yet, according to independent researchers, hidden unemployment was on the rise⁵¹. In 2000, just one in four unemployed persons was captured by the official system. As the financial crisis progresses, hidden unemployment was rising. In 2002, compensation arrears amounted to 20 percent of the payroll, and the debt was cleared only by the year's end. Yet, the arrears shot up again in April 2003 to reach 7.5 percent in result of the government's failure to reform the real economy.

⁵¹ In 1997, the government introduced new rules for granting unemployment benefits that discouraged the jobless from registering with employment centers (A. Соснов, *Государственная социальная политика: белорусский вариант* [в:] *Белорусская экономика: от рынка к плану, 1995–2000*, т. 1, р. 17).

In need of investments. Lack of capital expenditure aggravated the crisis in the real economy. As seen in Table 4, capex remains one of the most burning issues for the Belarusian economy. Capex in the manufacturing sector in 2002 was just over half of the 1989 volume, with the industrial output far exceeding peak levels of Soviet times, if official statistics are to be believed. In other words, the Belarusian economy is eating into its fixed assets.

Table 4. Investments in Belarus

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
Investment in GDP, %						18.4	15.6	18.6	22.6	20.6	19.8	17.8	16.6
In manufacturing						10.8	9.8	11.2	13.9	11.7	11.4	10.9	10.3
Non-manufacturing						7.6	5.8	7.4	8.7	8.9	8.4	6.9	6.3
Investment growth (1989=100)	109	113	80	68	61	42	40	48	60	55	56	54	56
In manufacturing	105	109	66	57	51	36	37	42	53	46	48	49	52
Non-manufacturing	116	121	112	94	83	56	48	62	76	77	77	68	68

Source: the Ministry of Statistics and Analysis, author's calculations.

In fact, the government provoked acute capex shortages in order to boost economic growth and maintain high consumption figures during populist campaigns. In 2001, the reported GDP growth was as low as 4 percent, whereas real wages increased by as much as 23 percent. The Lukashenka government's effort to achieve growth by all means made it much more difficult for investment-starved enterprises to replace their obsolete equipment, which has led to its further depreciation. Although Table 5 does not include equipment wear and tear figures, it should be noted that, in 2002, an average of 80 percent of plant and machinery was worn out.

The Belarusian government's populist investment policies, which included housing construction programs, the Minsk Ring Road, redevelopment of the Independence Square or National Library projects were a major cost to the taxpayer. In addition, the government allocated considerable funds for irrational import substitution programs.

Table 5. Equipment Depreciation in Various Industries

	1990	1995	2001
Average	39.8	56.5	61.4
Power generation	46	51.8	59.8
Fuel	68.2	58.8	66.4
Metallurgy	18.4	44	45.7
Petrochemical	58.6	67.5	69.9
Equipment manufacturing	45.3	56.3	63.7
Timber	50.2	49	59.6
Building materials	47.2	49.8	56.1
Light industry	38.8	54.3	57.1
Food processing	36.3	47.9	47.1

Source: the Ministry of Statistics and Analysis of Belarus.

Foreign direct investments are another problem⁵². Belarus ranks last among East European countries in terms of FDI per capita. Russian gas giant Gasprom's investment in the Yamal–Western Europe pipelines accounted for greater part of total foreign investments.

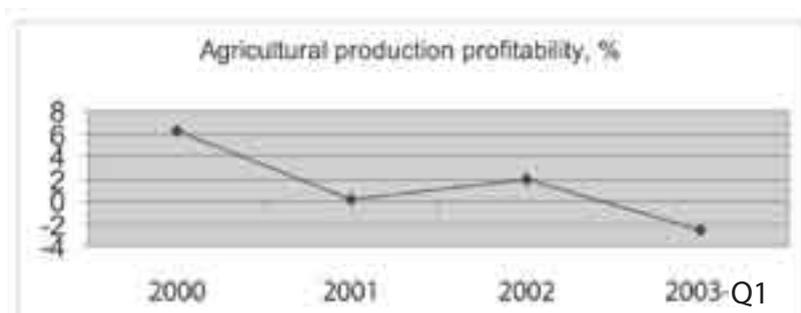
⁵² The government claimed that FDIs totaled \$700 million in 2002. The amount, however, includes loans of \$400 million and nearly \$200 million in proceeds from the sale of the government's stake in the Russian oil company Slavneft. Part of those monies was spent to pay off the country's debt for energy resources.

Table 6. Foreign Direct Investments in Belarus

	1993	1994	1995	1996	1997	1998	1999	2000	2001
Annual FDI growth, \$ mio	17	10	14	104	351	208	444	118	108
Cumulative increase, \$ mio	17	27	41	145	496	704	1148	1266	1374
FDI per capita, \$	1.7	2.7	4.1	14.5	49.6	70.4	114.8	127	137.4

Source: NBB, UNCTAD, author's calculations.

Agricultural decline. The Belarusian agriculture is in a problem situation, with profitability just over 2 percent (2.5 percent in Q1'2003). In order to support Belarusian agricultural producers, the government restricts imports, thus forcing Belarusian consumers to pay higher prices for domestically-produced food. The agricultural sector suffered heavy losses due to the government's populist intention to control prices in order to keep up the living standards of the urban population. Huge agricultural subsidies could not make up for the losses even in part. The agriculture is still paying the cost of this policy.



Source: the Ministry of Statistics and Analysis of Belarus.

Foreign trade deficit. In 2002, Belarus' deficit with Russia officially totaled \$822 million (ca. 7 percent of the GDP). A major disproportion in foreign trade balance illustrates problems in entering external and retaining domestic markets. Despite the talk of Belarus' great scientific potential, high-tech commodities accounted for just 4 percent of total exports, i.e. at a level similar to that in developing countries. Belarus' main exports to Western countries included raw materials, potassium salts, timber and products such as textiles, that do not require high technology input.

Belarus' exports to non-CIS countries doubled from 1998 to 2002, largely owing to effectively seizing an opportunity for processing more Russian oil and exporting it to Europe, and due to higher global oil prices.

Table 7. Foreign Trade of Belarus, 1995–2002

	1995	1996	1997	1998	1999	2000	2001	2002
Total	10367	12591	15990	15619	12583	15972	15626	17078
Exports	4803	5652	7301	7070	5909	7326	7448	8098
Imports	5564	6939	8689	8549	6674	8646	8178	8980
Balance	-761	-1287	-1388	-1479	-765	-1320	-730	-882
With CIS countries	6704	8334	11196	10714	7911	10469	10197	10677
Exports	3027	3764	5379	5160	3622	4399	4491	4461
Imports	3677	4570	5817	5554	4289	6070	5706	6216
Balance	-650	-806	-438	-394	-667	-1671	-1215	-1755
With non-CIS countries	3663	4257	4794	4905	4672	5503	5429	6401
Exports	1776	1888	1922	1910	2287	2927	2957	3637
Imports	1887	2369	2872	2995	2385	2576	2472	2764
Balance	-111	-481	-950	-1085	-98	351	485	873

Source: the Ministry of Statistics and Analysis of Belarus.

Foreign trade figures clearly explicitly show the results of political isolation and the government's failure to reform the economy. In 2002, foreign trade de-

ficit with Russia exceeded \$1.8 billion. The fact that Russia sold mainly energy resources to Belarus points to the Belarusian economy remaining energy-intensive and dependent on prices of natural resources in Russia. Attempts to find new external markets helped the country to reduce the trade deficit. Yet, with the prospect of EU enlargement, the likelihood of keeping the competitive edge of Belarusian products remaining in these markets is low, considering that a lion's share of Belarusian commodities is sold at dumping prices.

Problem areas of government control over the economy

Macroeconomic instability. As stated above, the economic policy implemented in Belarus throughout most of the last decade was not aimed at macroeconomic stability. Despite the reported 34-percent annual inflation for 2002 turning out to be at an all-time low for the independent country, Belarus experienced the highest depreciation of the national currency among the post-Soviet nations. However, attempts were made at a macroeconomic stabilization, but with each time that political stakes were getting high, the government pulled out of unpopular measures. The first realistic attempt was made in 1994 and 1995 following a 53.5-percent rise of consumer prices in August 1994. It was only then that Belarus started to put an independent monetary policy in place.

With the national currency established, the government began taking measures to prevent money supply from growing. Real-term interest rates reached a viable level, which was sufficient to keep monetary growth in the economy in check. An important component of the government's financial stabilization program consisted in fixing the ruble exchange rate to the US dollar at 11,500 rubles in March 1995. Since prices continue to rise, albeit at a relatively slow pace, and the National Bank sold convertible currencies to all willing buyers at a fixed rate, convertible currency demand lost its thrust and the foreign exchange market stabilized.

At the same time, against the background of a considerably slower price rise, contradictions emerged between the monetary policy of the time and the unreformed real economy. A fixed exchange rate in an inflationary environment spur-

red a growth of prices in US dollar terms. Due to the price factor, unreformed enterprises which manufactured obsolete, low quality products suffered from their competitive edge waning in effect. Late 1995 and early 1996 were the time of a major crisis for Belarus. Enterprises operated only two or three days a week, and hidden unemployment spread throughout the economy.

The government changed its economic priorities in 1996. Governmental agencies focused on supporting the real economy by trying to increase housing construction and agricultural output. Money-printing followed suit, and negative consequences were not long in coming. The CPI rose from 39.3 percent in 1996 to 63.1 percent in 1997, 181.7 percent in 1998, and 251.2 percent in 1999. Real-term interest rates turned negative again, and market forex rates escalated.

The task of keeping the lid on inflation was removed from the National Bank and delegated to the Ministry of Economy, which began to combat price hikes with administrative mechanisms available to it, such as capping markups, the industrial producer price index, prices for so-called 'consumer goods and services of general social import'. This resulted in consumer goods shortages, deteriorating quality, numerous price structure and financial flow deformations.

This state of affairs was further upsed by the fact that the National Bank's legal status prompted it to acting as a market player in the overall game of economic growth rather than safeguarding stability of the national currency. Due to its statutory reporting to the president and the Council of Ministers, the National Bank had to directly support a number of government programs for several years and extend low-interest loans to state-owned firms. Naturally, this led to general distrust in the country's banking sector, the assets of which in 2000 totaled slightly more than \$ 0.5 billion, i.e. the asset size of a Polish bank. In fact, banks served as an ancillary device in the life support system for the state-owned economic sector. A considerable rise in personal bank deposits was enabled only after real-term interest rates overshot the inflation rate again. It took several years for Belarusian authorities to accept the idea that there is immediate relationship between the rise in domestic lending and price hikes⁵³.

⁵³ The National Bank has and is continuing with a highly contradictory task for itself and other banks, i.e. increasing lending support in the economy and, simultaneously, restricting money supply,

In addition, due to the government's reluctance to curb climbing of forex rates, the National Bank effectively set its official rate plus those of commercial banks. In 1999, the official US dollar rate was three times below the then-black market rate, thus causing a severe convertible currency shortage in the country. For the necessary imports, such as energy resources, medicines, grain, sugar et al, the government required that the exporters sell a considerable part of their hard currency proceeds to the National Bank at the official exchange rate. Control was established over exports and imports. Thus, between 1996 and 1999, economic stabilization and liberalization were brought to a halt. The more the government interfered in the economy the more economic stability was lost, which only strengthened government pressure and exacerbated economic instability.

It was only at the end of 2000 that the government in fact recognized the unofficial ('black') market exchange rate as a the market's benchmark and gradually started raising the National Bank's official rate to match it. The government also restricted inflationary lending in financing agriculture sector and housing construction, and established strict money supply control. The National Bank's refinance rate was raised considerably, and real-term interest rates were jacked up above the inflation.

Macroeconomic stability prospects gained in viability in 2000 and 2001 in result of relative financial stabilization and waning inflation. However, the Belarusian economy proved to be unable to contain these processes even at this slow pace, as provided for in official economic programs. For instance, in the first quarter of 2003, consumer prices reportedly rose by more than 10 percent against an 18 to 24 percent forecast for the entire year. Moreover, the first six months of the year saw symptoms of loosening the macroeconomic discipline. The National Bank increased its direct lending to support the real economy. Given that, in April 2003, the president vested the government with an unrealistic task of reaching an eight-percent GDP growth per annum, prior years' inflationary methods are likely to be used again to boost the economy. Should this be the case, inflation will not take long to accelerate.

Monetarnaya Politika v Respublike Belarus (Monetary Policy in the Republic of Belarus), by I. Rusakevich, *The Belarusian Economy: From Market to Planning, 1995–2000*, Volume 1, p. 12.

Spurred by high inflation, the economy moved towards dollarization. Until recently, and especially before 2000, the Belarusian ruble was used by the people solely in routine daily transactions, with the trend lasting for several years. All larger transactions were made in convertible currencies, mostly the US dollar, or in Belarusian rubles with prices fixed in the dollar equivalent. Moreover, the Belarusian ruble was not much used for the purpose of saving. Personal bank deposits denominated in convertible currencies largely exceeded those in the Belarusian ruble. The situation changed notably only in 2001 and 2002, when a trend started for ruble-denominated bank deposit rates to be more appealing than foreign currency interest rates. However, there is a genuine threat that the Belarusian ruble's trend of the past two years to appreciate, where currency depreciation has been much slower than price rises, coupled with signs of the government's return to an inflationary monetary policy and the growing import surplus, may provoke a renewed steep decline of the Belarusian ruble in the immediate future.

Budget. Belarus' state system of finance is the main source of disequilibrium in the economy. The consolidated budget suffers from chronic deficit which is financed by inflationary methods. Table 8 illustrates a marked quasi-fiscal deficit which is several times above the externally reported figure of the 'official' deficit. In 2000 and 2001, owing to the National Bank's tighter monetary policy, quasi-fiscal transactions reduced in numbers. However, the practice of financing government expenditure from inflation-inducing revenue or, in plain terms, by reaching into people's pockets by spinning the money-printing press, has not been abandoned, yet.

Table 8. Official and Quasi-Fiscal Deficits

	1996	1997	1998	1999	2000
Official deficit	-1.9	-2.2	-2.4	-2.9	-0.6
Quasi-fiscal deficit	-3.4	-5.8	-5.0	-4.2	-0.9

Source: *Ekonomika Belarusi: Statistichesky Obzor (The Economy of Belarus: Statistical Review)*, by A. Chubryk, the Research Center for Privatization and Management Institute's Business School, Analytical Report No. 5, Minsk, September 2001.

The Belarusian government's fiscal policy has two distinguishing features. On the one hand, it is irrational in prioritizing government spending. This, above all, applies to social programs. With close to six million people entitled to various benefits, their average amount does not exceed a few dollars per capita. Consequently, government programs cannot cope with combating poverty. As seen in Table 9, the main path in income redistribution via the State and its social programs is 'from the poor to the rich', the only exception being subsidies to maintain low food prices that, at any rate, have been dramatically reduced lately.

Table 9. Distribution of Social Benefits to Households by Quintile Groups (Quintile groups ranked by the total amount of social benefits received)

Quintile group	Bottom	Second	Third	Fourth	Fifth
Food	2	3	1	4	5
Public transport	5	4	3	1	2
Public utilities	5	4	1	3	2
Drugs	5	4	2	3	1

Source: Choices for the Future, Belarus National Human Development Report 2000, p. 45.

The table ranks the quintile groups by amounts of social benefits received. For example, rating in 'Drugs' suggests that the highest consumption is attributed to the wealthiest and the lowest level to the poorest (the fifth quintile group).

On the other hand, this government's fiscal approach to all undertakings irrespective of their form of ownership results in a high level of taxation, approximately 40 percent of GDP. This, above all, stems from the large number of elevated taxes. There were a total of 39 various taxes at the national and local levels in 2001. That is why tax evasion has taken on mass scale; consequently, diligent taxpayers have to shoulder yet a heavier tax burden. In addition, the high level of taxation forces businesses into the shadow economy, which in certain sectors has already equaled the official economy in value terms.

Table 10. Share of the Shadow Economy by Sector, as a % of Official Levels*

Sector	Average percentage
Goods	55
Services	65
Construction	80
Trade	55
Transportation	66

* The percentage indicator shows the share of the shadow turnover in the sector against the official one. For instance, the construction sector's unofficial turnover totals 80 percent of figures captured in official statistics.

Source: *Usloviya dlya Chastnogo Biznesa v Belarusi (Conditions for Private Enterprise in Belarus)*, by P. Daneiko, *The Belarusian Economy: From Market to Planning, 1995–2000*, Privatization and Management Institute, Minsk, 2002.

Among other factors, this state of affairs is due to absence of a realistic approach in formulating and implementing the budgetary policy, as illustrated by frequent overestimates of the economic growth and budget revenue. The resulting budget gaps are mostly offset by new taxes and customs duties being launched, predatory customs methods and – a recent phenomenon – downright extortion of contributions from various social groups, from business owners to students.

The existence of special purpose undertakings that report to president's governmental agencies which in turn control the most lucrative financial and commodity flows, coupled with un-accountable presidential and off-budgetary funds – whereby the 'official' budget automatically loses a considerable part of lease proceeds – forces the government to tighten its budgetary and financial policy even further.

Methods of controlling the economy. Belarusian economic liberalization of the early 1990s was forced by pressure from the external environment and influen-

ced by examples of the neighboring countries. This may explain the government's indecision and half-hearted measures pursued in market-oriented reforms in Belarus. A large-scale price liberalization was in fact a knock-off effect of price liberalization in Russia with which Belarus shared the ruble zone at that time. However, despite declarations of moving towards free price formation in January 1992, prices for so-called 'goods of social import' such as bread, meat and dairy products, products for children, utilities and transportation – continued to be regulated. With economic ties severed with former USSR republics, foreign trade was liberalized at a relatively fast pace. At the same time, the Belarusian government was very reluctant in abandoning the centralized public procurements system for domestic market needs. Public procurements of industrial goods were eradicated in 1994, while the practice still continues in agricultural products and government control over the consumer/retail market. A large-scale economic liberalization promised by President Lukashenka in 2001 has in fact materialized only in the form of partial price liberalization. Between 1999 and 2003, the list of government-regulated prices was cut from 33 to eight items.

The government continues to throw stumbling blocks to the development of private enterprise. These include:

1. Lack of legal guarantees for private ownership and their relevant statutory regulation. However recognized – as officially asserted – private ownership does not enjoy true protection. Private and NGO property is subject to arbitrary confiscation by governmental agencies, as testified by the government's right to introduce its golden share in private companies and instances of its retro-active application, ordinances resulting in squeezing small-scale wholesale and retail operators from business with no compensation for the losses, President Lukashenka's decree allowing extrajudicial appropriation, orders to contribute property and funds as required by State needs, e.g. for sowing and harvesting campaigns, etc. This state of affairs discourages both domestic and foreign business communities from investing in the Belarusian economy.
2. Ambiguous, inconsistent, unpredictable and unstable regulations. For instance, there are about 280 laws, bylaws and ordinances that apply to

pricing. Fiscal and accounting regulations change several times in a year. This entails additional transaction expenses for conducting business. The situation is mainly due to the president's decision-making monopoly, as Lukashenka has usurped the right to issue edicts and decrees superior to laws passed by the legislature.

3. Excessive bureaucratization of the economy. The government continues to impose new barriers for starting-up private businesses. This may be illustrated by the need to obtain a license for ca. 180 types of business activities, and restrictions on private enterprise in sectors where the government endorses the interests of State monopolists.
4. Support for the predominant status of the state-owned sector. Statism in the Belarusian economy increasingly engenders crisis trends. Private business generates just over 20 percent of the country's GDP, i.e. the least among the region's transitional economies.

Denationalization and privatization peaked between 1991 and 1994, yet they were spontaneous and unorganized processes at the time. The government auctioned off enterprises or allowed for employees of a contractor-run enterprise to buy it out. Large enterprises were transformed into joint stock companies in which the government retained a stake, with the other shares distributed among the employees and put up for general sale.

Despite 1993 and 1994 being widely regarded as the golden age of Belarusian privatization, the years did not yield impressive results. A government program envisaged turning two-thirds of fixed assets in undertakings and organizations into non-State property in terms of value, including 10 percent in 1993. In reality, a paltry one percent of all State property was denationalized and privatized throughout year. In 1994, the government set out the ambitious target of privatizing 20 percent of all State property. However, after Alyaksandr Lukashenka's election for president that summer, the Belarusian authorities' approach to privatization changed radically. The Auditing Chamber started scrutinizing the rightness of privatization projects carried out in 1991 and 1992 according to standards established in 1994. Authorities started to annul municipal property auctions. By September 1994, about half of the targeted enterprises had been

withdrawn from the process of transformation into joint stock companies. Although Belarus' privatization did peak in 1994, only one-fourth of the targeted 20 percent of the fixed assets changed hands in result of the reform that year.

The following year, privatization was on the wane. In March 1995, the government revoked the licenses of all the 37 specialized investment funds set up to carry out coupon privatization. The president signed an edict titled 'On the Regulation of State Property Management', whereby all transactions involving State property exceeding 10,000 times the minimum monthly income required presidential endorsement. The State Property Ministry was thereby restricted in its powers. In the summer of 1995, due to the industrial sector's crisis, the trend was to re-nationalize. Employees of several joint stock companies who experienced pay delays petitioned the government to restore state ownership in their enterprises and provide them with support and preferential treatment. On January 1, 1998, the president proclaimed the State's right to the golden share that entitled the government to determining the corporate development strategy even with a minor public stake. The country's macroeconomic situation changed considerably. The government's inflation-inducing monetary policy and less rigorous tax and social security deductions from state-owned enterprises were conducive to preserving state-owned property status, which further abated the privatization process. A mere 94 enterprises changed their form of ownership in 2001, as compared to 177 in 2000, 307 in 1999, and 329 in 1998.

A total of 5,476 undertakings were reformed in terms of ownership between 1991 and 2001. Of this number, trade operators totaled 25.1 percent (1,372 entities), with 12.9 percent (707) in agricultural undertakings, 12.2 percent (670) in utilities, 10.4 percent (569) in industrial enterprises, 9.9 percent (536) in retail services, 4.9 percent (270) in public catering establishments, and two percent (112) in transport and communications.

In 2002, deceleration of inflation, increased fiscal pressure on businesses, rise in the real foreign exchange rate of the Belarusian ruble, increase in the dollar equivalent of monthly income, the resulting dampening of competitive strength, and greater numbers of unprofitable enterprises elicited renewed interest in ownership reforms, soliciting strategic investors and in privatization in

general. The government initiated joint stock company transformation of national petrochemical giants such as Azot and Khimvalakno in Hrodna, Palimir and Naftan in Navapolatsk, the Belshyna tire factory in Babruysk, the Horizont television factory and the Beltransgaz gas pipeline operator under pressure from Russia. However, the government is still reluctant to go ahead with privatization. In most cases, it offers small stakes for sale, intends to retain control over the enterprises by imposing numerous additional conditions for the prospective buyer. Some of these conditions seem absurd. For instance, Baltika, a leading Russian brewery, was told to build an ice-hockey arena 'for workers' when expressing interest in acquiring the Krynitsa brewery in Minsk. There is a realistic threat that if this approach to privatization continues, investors will be hard to come by in a few years, if at all, as the financial condition of enterprises due in for privatization deteriorates and their production facilities soon wear out.