2 An Ideal Economic Model for Belarus

by Uladzimer Kalupaieu
and Uladzimer Valetka

Below is a description and clarification of a market economy model that is alternative to the one currently in force in Belarus. The proposed model envisages tapping into the country's domestic potential and latent opportunities; it is underpinned by the principle of an open economy. It would enable FDI flows into the Belarusian economy and ensure its growth within the shortest possible time, thereby raising living standards.

Economic reform objective

The need for economic reform ensues from the fact that, with ongoing liberalization in international economic relations, closed economies i.e. those lacking modern technologies and management methods are fundamentally unable to compete with developed countries in domestic and international markets alike. With economic openness, conformity to patterns of international division of labor and high asset productivity as pre-conditions, high living standards may be a reality.

To achieve such living standards is the main objective for Belarusian economic reforms.

Fundamental economic model principles:

– economic efficiency, which cannot be attained without a free market and private ownership. One of the necessary conditions in this regard is a harmonious interaction between the government and market players, where the government contributes to enhancing efficiency of market operations by setting up an appropriate legal framework and market economy infrastructure.

– free competition; above all, this implies free market access for undertakings, guarantees for and protection of a level playing field for all market players. This leads to legalizing 'shadow' businesses and abolishing preferences enjoyed by 'law-abiding' state-owned enterprises.
– maximum openness, meaning not only transparency of limits to enterprise, but also openness in a broader context of traditions, business practice and the law, as technological progress is contingent on harmony in political and economic relations.

In addition, this model calls for undertaking an efficient social policy which should be purpose-specific to the maximum possible degree and tied to the degree of economic performance. In general terms, this implies the priority of generating the nation's wealth over its distribution.

In the proposed model, a market economy is primarily viewed as safeguarded economic freedom that manifests itself in:

– the right to increase personal wealth at one's discretion (freedom of consumption);
– the business owner's right to use their time, labor, funds and entrepreneurial skills at their discretion (freedom of business, freedom of choosing occupation and place of work, freedom to use property);
– the right of entrepreneurs to manufacture and sell goods at their own risk (freedom to manufacture and trade);
– the right of each buyer and seller of goods or services to achieve the desired purpose (freedom of competition).

These freedoms may only be limited in cases of breach of third sector's rights, constitutional provisions or legally established civilized rules of the game for engaging in business.

As expounded on in Sections 1–4 above, the legal framework in this economic model should contain provisions that foster choices and are related to the flow of goods, free movement of people, freedom to provide services and liberalization of capital flows.

One fundamental principle for this economic model is that economic freedom is an integral part of political freedom, and only in a developed democracy can one assess, formulate and modify business-related provisions and regulations that prove inefficient in business practice. Economic freedoms should also be combined with responsibilities: the government should be responsible for economic policy-making and stable market operation; the National Bank should ensure a stable currency, and private businesses ought to focus on results of their economic operations.

The essence of the described model is in multiple exercise of the fundamental business transaction – that of buying and selling to mutual benefit of the parties. For this purpose, it is necessary to enable the following:

Firstly, both the seller and the buyer should know what it is exactly that they possess and what they can acquire. This calls for specifying and protecting the ownership rights system by means of the law.

Secondly, there is a need for certain formalized transaction methods to be put into place that ensure performance of buy and sell contracts, and settlement of resulting disputes. For this, there should be contracts, laws, courts, a commercial code, etc.

Thirdly, it is necessary to keep account of what market participants transact, hence the need for a system of accounts and records allowing for monitoring asset and liability movements, corporate earnings, revenue, expenses and profit trends.

Fourthly, in order to avoid barter, which dampens manufacturing productivity and prevents adequate evaluation of changes in customer needs, market participants should have a stable currency acting as legal tender, accounting measure and means of accumulating wealth.

Putting the aforementioned conditions in place by government, combined with further development of market relations, will bring about a developed banking and financial system which will ensure the operation of businesses and insurance and advertising industries.

Thus, successful development of a market economy requires stable and efficient basic market components such as competition, the institution of ownership, small businesses, a banking sector with sufficient lending resources, flexible labor and capital markets, labor market movements, a stock market, pension and investment funds, etc.

A stable and transparent operation of these market infrastructure components and the enactment of unambiguous laws and regulations to govern economic activities will contribute to minimizing expenses related to conducting lawful business transactions (transaction expenditure).

The role of government

Regulations that govern the operation of market players will be developed with maximum participation of the Parliament and non-governmental organizations, rather than merely ministries and other governmental agencies that are not interested in increasing their current regulatory workload or being truly accountable for the documents they issue. To prevent the cost of setting up and running a legal framework that governs business operations from exceeding their actual economic effect, plans are designed to achieve maximum clarity and transparency of the legal framework and market institutions, and to clearly describe and specify government functions.

Peculiarities of reform

Many Belarusians believe that it is easier to endure financial hardship in a non-market economy than in a market one on the premise that 'we're all in this together'. The economic policy pursued by current government contributes much to tenacity of this conviction.

Belarusians will not be able to discard this stereotype without an economic revival and effective implantation of market institutions and principles in all their relevant aspects.

In contrast to the idea of market relations as stated before, the focus is on a broader interpretation of their social function, ensured both by normative elements (the constitution, general rights, laws, system of regulations) and informal methods of enforcing market rules.

Aside from limitations inherent in an economy (limited resources), legally set standards and limitations should establish a system of economic incentives and trends for efficient economic growth.

Entrepreneurship and the ability to learn are long-lasting personal qualities and Belarusians certainly have not lost them. Yet, decades of the Communist rule have distorted notions and standards characteristic of market behavior. In order to truly embed standards of market behavior, effective statutory mechanisms must be laid down to discourage disruption of market relations. This primarily calls for a judicial system reform with a view to restoring public trust in the law, confidence in its effective operation and enforcing accountability for one's acts. If a power, especially the judiciary, is not competent and independent, enacting good laws will help little if slack compliance undermines confidence in them.

The civil service reform is yet another prerequisite for economic transformations; it should be embarked on to warrant loyalty and stability of state machinery in implementing reforms and stabilization efforts. Measures should be taken to improve skills of government officials and reduce their numbers. Financial incentives to civil servants would be an important factor in increasing their liability for consistent implementation of economic policies and regulations.

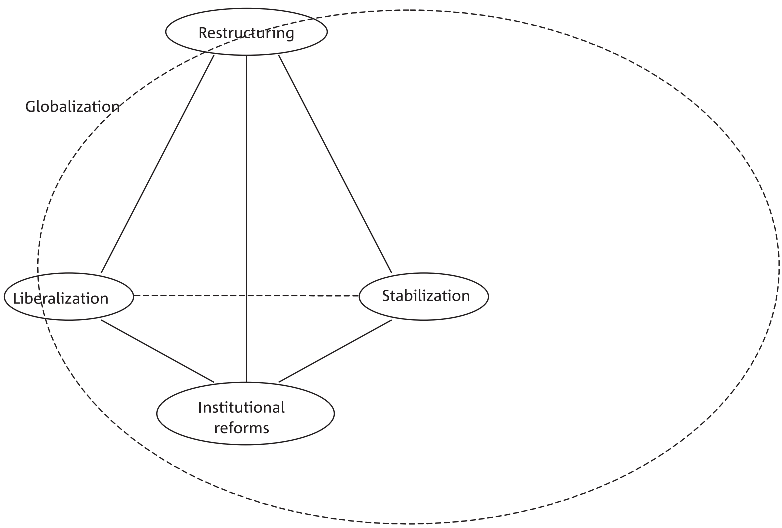
Consequently, undertakings would be issued with established rules of the game that would prevent profiteering at the customer's expense. Failure to comply would entail business closure.

The model's fundamental ideas and long-term advantages would be communicated to the general public via the media, schools and at training and retraining courses. The objective is to encourage business initiatives in people that run counter to expectations of better living standards being provided by the State, rather than individual work and entrepreneurial efforts. Initially, it is necessary to research possible ways of arguing with the general public to explain who benefits from the absence of market mechanisms and is interested in preserving low transaction costs. The government would vow accountability for reforms and publish a program with measures to alleviate their social consequences.

Reform program

Implementation of an economic model, once selected, entails the following reformist actions: 1) liberalization of economic relations; 2) institutional reforms and establishment of a system that complies with market economy principles; 3) macroeconomic stabilization; 4) structural transformation of the manufacturing sector and the economy at large. All elements of the transformation impact one another simultaneously, are influenced by other areas and aspects of reforms (so-called transformation tetrahedron).

Illustration. Market Reform Directions in a Globalized Environment



Effective structural transformations in the economy would only be possible as a result of successful implementation of other types of reforms. In addition, all transformation efforts are subject to controversial influence of globalization.

In all the aforementioned aspects, reforming implies relentless and consistent rapprochement to a liberal market economy through methodical continuation of previously started reforms.

Liberalization should include:

– ultimate abolition of remaining administrative centralized control of the economy, transition to planning at the level of undertakings, optimized operation of governmental agencies (e.g. currently, there exist seven concerns and three ministries governing the operation of 2,500 enterprises in the industrial sector alone);

– business deregulation, i.e. exercise of the principles underlying the freedom of establishment, level playing field, and competition among market participants regardless of ownership status;

– transition to deregulated pricing, including 'prices of goods of social import'; gradual increase of out-of-pocket payments for utilities and public transportation to match 100 percent of the cost, with parallel reduction of government spending for these sectors. Prices fixed by natural monopolies would be under public control. Public procurements would be allowed only if made at market prices;

– elimination of various State monopolies including utility services, transportation, energy supply, healthcare and education by means of privatization and free access of private operators to these sectors;

– foreign trade liberalization, abolition of import duty on foods, reduction of import duty on other goods from 10–12 percent to the average prevalent in EU member states and WTO (four to six percent); elimination of non-tariff foreign trade restrictions such as licensing, quotas, complicated procedures for certification, transportation, etc.; recognition of international standards and quality certificates;

– freedom of wealth formation and use of disposable income;

– expansion of the free market area by developing markets other than for goods and services: labor, real estate, capital, information, advertising, insurance and social services.

The objective for liberalization is to lay foundations for market self-regulation, itself the basis for fostering competition as the most efficient system of distributing resources, encourage efforts to improve the quality of goods and services and increase efficiency in the use of manufacturing assets, and turn effective demand into the single most important regulator of growth rate and output mix.

To ensure that market players enjoy economic freedoms for the consumer's benefit and do so in the most efficient way, it is necessary to reach macroeconomic stabilization along with institutional reforms in the economic system that sets out rules of the game.

Market institutions and infrastructure should develop along the following lines.

1. **Privatization** (reform of ownership relations) and establishment of an efficient system to protect owners' rights, effective creation of a land market and housing privatization.

The privatization concept. Regulation of ownership relations and establishing rules to be applied in State property restructuring and privatization is key at the time of market transformation. If restructuring does not bring about its logical effect, i.e. emergence of a competent owner, a reasonable economic policy is out of the question because any economic policy in that case would be detrimental to the economic interests of that kind of owners in effect. By seizing a market niche, such an owner is ready to reinvest their earnings and may be partnered with the government in industrial restructuring.

The emergence of a competent owner is currently impeded in Belarus by:

– procrastinated privatization, or sectoral agencies' efforts to slow down the ownership reform in enterprises within their remit, as privatization narrows the scope of undertakings under their control. Only 25 out of the initial 145 state-owned enterprises (17 percent) were restructured in 2001 against 44 percent in 2000, and 62 percent in 1999;
– flawed and unstable regulations that govern private enterprise;
– flawed regulations governing privatization (limited methods, no levers against state-owned enterprise managers' efforts to hamper privatization,

questionable asset valuation and property appraisal system, imposition of a heavy social/welfare burden on new owners);

– government intentions to use privatization proceeds merely to solve current financial and other problems, particular to bridge budget gaps or dispose of unprofitable plants.

However, privatization is the best method for economic recovery, as private investors are the ones most capable of analyzing market opportunities in the most adequate manner.

The following privatization rules could be proposed:

– viable medium-sized and large state-owned enterprises should be restructured and privatized under the supervision of a special agency accountable to the Parliament (for instance, the Privatization Department) and reporting to the relevant sectoral ministry;

– Uncompetitive, resource-intensive and environmentally hazardous enterprises should be shut down. This also applies to inefficient links in technological chains that may be substituted by foreign suppliers. This should be a gradual process the social consequences of which should be alleviated at every opportunity.

To privatize consistently, it is necessary to:

- prioritize the Privatization Law over all other acts governing privatization;
- abandon the approach to transforming state-owned firms into government-controlled joint stock companies whereby it is seen as special and ultimate form of denationalization; rather, it should be regarded as an interim privatization stage;
- ensure efficient application of the bankruptcy procedure to guarantee that the bankrupt enterprises and entities interested in keeping them afloat will be able to use all economically viable methods to continue manufacturing and other types of business;
- opt for 'cash' privatization on a competitive basis as the main privatization method; refrain from granting any privileges to employees of companies under privatization. In tune with the principles of market econo-

my and justice, it is necessary to ensure that '*mayomast*' (property) privatization coupons are used as a means for investment solely at auctions, along with the underlying funds, rather than exchanged for shares at par. In addition, it would be advisable to allow the use of '*mayomast*' coupons for privatizing housing stock by tenants.

- lift the ban on the sale of shares previously acquired by private individuals on preferential terms, abolish the golden share rights;
- simplify the privatization procedure. Existence of two separate agencies for restructuring and sectoral issues is by no means justifiable. Insofar as possible, the role of governmental agencies must be reduced as, by the sheer virtue of controlling entities, they are not interested in seeing them privatized. The right to the final decision to privatize should be delegated to the Privatization Department which could be established as a successor to the Department for State Property Management at Ministry of the Economy;
- ensure a level playing field in privatization rights for foreign and domestic players. Should the new owner guarantee capital expenditure on fixed assets, the asking price of the enterprise due for privatization could be reduced;
- allow potential new owners to use borrowed funds for privatization purposes;
- promote market valuation of enterprises under privatization by appraisers independent from potential buyers and the government. Enterprises with a market value close to zero should be sold for a token payment;
- reduce to three years the deadline for petitioning for contracts to be ruled void.

Efficiency of reforms aimed at stabilization largely depends on underlying financial support. That is why cash privatization proceeds should be collected in a special privatization fund that should be part of budget revenue. Proceeds from this fund and foreign loans would be used for social reforms, stabilization measures, and increasing foreign assets in the banking sector. At the same time, high debt would impede growth in privatized enterprises. In order to offset mutual debt between enterprises, the Privatization Department should develop a system for debt payment by enterprises with a more stable financial position, i.e. those where receivables exceed payables. Debt could also be settled from proceeds of the privatization fund, whose additional source of finance would come from asset sales of bankrupt enterprises.

Trade arrears in enterprises where payables exceed receivables could be neted by offering a stake in these indebted enterprises to commercial banks, should they find it beneficial. In exchange for loan payments due, the lending banks would be given shares. It would be advisable to restrict participation of government-controlled banks in these transactions.

2. **Land Reform**. The objective of land reform is to create conditions for farmers to choose forms and methods of land management, to be provided for by the Land Code. Private ownership of land would be introduced. In rural areas, land and other assets would be handed over to private owners with no compensation by means of distribution in the form of land and property shares. New owners would have the right to:

a) quit the collective or state farm, withdraw their land and property shares, start their own farms or joint agricultural undertakings;

b) delegate the right to manage their property to a newly elected management of an agricultural cooperative replacing the local collective farm, with the prospect of receiving a share in the profit generated by management of business,

c) lease out their land and property shares,

d) sell their shares.

Land Register (cadastre) appraisal of the country's land resources would be completed. Owners who possess land in excess of an established standard (one to three hectares) would pay property tax of no less than two percent of the land market value irrespective of land use.

Institutional measures

The government would regulate business activities, i.e. develop and enact regulations to establish rules of behavior and relationships among market participants in production, financial, external economic and other relations, for which it is necessary to adjust the civil, commercial, fiscal, budget and land codes. This would eventually lead to laying down business rules in tune with market economy principles, including the legal basis for protecting ownership, for bankruptcy, competition, antimonopoly activity, protection of rights of investors and contracting parties, insurance business, etc. All ownership rights should be firmly warranted by the law, safeguarded from breach and protected by the State.

The government would promote genuine competition in the economy at large, a natural stimulus for businesses to improving the quality of products, increase output, boost labor productivity, reduce primary costs and lower prices. Regulations concerning state competition policy should above all govern agreements concluded with a view to restricting market access and operation of state monopolies and state-owned enterprises that enjoy preferential treatment.

In this regard, the government would harmonize the 1990 Law 'On Enterprises in the Republic of Belarus' with international standards and enact regulations governing intellectual property rights.

An economic and legal environment would be established for the growth of market participants well adapted to market conditions and able to operate in a market environment efficiently. These include undertakings, research and development organizations, banks and investment funds, stock exchanges, brokerage houses, dealerships, employment centers, insurance companies, social security and pension funds, auditing and consulting companies, advertising agencies, etc. The government would facilitate market access for newly established undertakings, i.a. by way of a simple notification principle in registering small businesses.

Institutions and new rules would be established for implementing the State's social and economic policies at various levels of government (national, regional, and local). The main objective here would be to develop local government and self-management, delegate powers to this level along with funds necessary to solve local problems and satisfy major social and economic needs of local communities.

The government would establish and foster non-State bodies for regulating the economy and the market, such as trade unions, business community, consumer organizations, scientific associations, etc; develop international institutions, improve the system for staff training and retraining with a view to developing a sense of responsibility for personal career among labor market participants who would be capable of thinking strategically, operating in a global market environment and oriented towards innovation in production.

It should be borne in mind that liberalization measures geared to reform the economic system may be embarked on instantly, e.g. import duty could be abolished as soon as a law is enacted to this effect, whereas institutional transformations are a medium-term process at the least. To prepare and comprehensively examine institutional innovation, put it to effect, detect and remove shortcomings, establish efficient market institutions is a time-consuming effort. Reform of the real economy, i.e. restructuring of the manufacturing sector, is the lengthiest part of reforms. Changes should be instituted in parallel and according to a systematic program.

The length of transformation depends in equal measure on efficient establishment of market institutions and macroeconomic stabilization, to be conducted in parallel to launching the market institutions.

Stabilization

The following actions should be taken to stabilize the economy:

a) price reform;

b) currency reform and a sustainable monetary policy;

c) tax reform and a balanced fiscal policy;

d) a market-oriented income policy.

Ad a). Price reform

No government can fully satisfy consumer demand and please all consumers. Absence of an effective price system prevents consumer preferences from being identified. The goal of the price reform is to deregulate prices and limit administrative intervention in the economy. The government should retain control over electricity, gas, heating, public transport and telecommunications prices for some time. Prices will differ depending on consumer groups and the level of consumption. Electricity and heating rates to the residential segment will be higher than those for industrial consumers. Yet, simultaneously, subsidies to manufacturers will be replaced by household subsidies which will be phased out as incomes increase. In result of the reform, subsidized and market-based prices will gradually approximate the same level.

Ad b). Currency reform and monetary policy

A strong national currency is a pre-requisite for achieving economic growth and competitiveness, and for consolidating positions in the global marketplace. A government-forced growth of output via currency depreciation will not help to address the main issue of overcoming technological backwardness, boost productivity and set the stage for raising living standards.

Belarus is the only former Soviet republic lacking a truly sovereign national currency; in fact, preparations are underway for replacing it with a foreign currency. The country has no treasury to speak of since the annual inflation has been in excess of 30 percent ever since Belarus gained independence. The lending system is underdeveloped because of the ruble depreciation.

Since expectations concerning the inflation and depreciation of the ruble are high and set to continue, the main criterion for selecting a monetary policy should be its efficiency in achieving monetary stability.

This is possible by adopting a strict currency board regime. The National Bank should stop printing money. To make this regime effective, the currency board holds foreign currency reserves (or gold or some other liquid asset) at a fixed exchange rate equal to at least 100% of the domestic currency's value. The central bank may issue currency only for converting domestic into foreign currency. When buying foreign currency to support the ruble, the National Bank withdraws the corresponding amount from circulation. This will help to approximate domestic inflation and interest rates to those of the country whose currency the ruble is pegged to.

The currency board should be established by the law 'On Stable National Currency', which would ban government interference in monetary policies. This would prevent the government from demanding loans supporting the economy when monetary policies are tightened.

High inflation in Belarus is not attributable to monetary factors alone. It is also related to high manufacturing costs resulting from lack of competition, non-productive manufacturing technologies, excessive fixed asset depreciation, insolvency crisis and barter settlements.

The currency board system should be accompanied by a fiscal reform, tight budgetary constraints on undertakings and adoption of a balanced budget to prevent Belarusian goods from losing their price-related competitive edge.

There are two relatively stable currencies, the dollar and the euro, to which the Belarusian currency can be pegged. Although the US dollar dominated Belarus' foreign trade in the last decade, it is time for the National Bank to peg the ruble to the euro and conclude a currency board agreement with the European Central Bank.

Over the past few years, Belarus' economy has been slowly shifting from dollar-ization to euro-ization. Belarus' foreign trade is focusing on European markets: in 1997-2000, Europe accounted for 70 percent of Belarus' foreign trade with EU members, with candidate countries totaling as much as 30 percent.

With the start of real-term privatization and structural reforms, Belarus will be gradually involved in European political and economic integration. Trade with the EU will rise, while exchange with economically retarded CIS countries will be on the wane. The share of euro-denominated forex transactions will grow. The euro peg will become an effective mechanism for spurring Belarus' euro market and help to restore the Belarusian ruble as the currency of choice for households and businesses.

The potential of this monetary policy will be easier to fully realize as the financial system develops, and financials institutions, the currency and the stock exchange function more effectively.

Ad c). Tax reform and fiscal policies

The adjustment of public finance to market economy requirements should proceed in parallel with currency stabilization and tight budgetary constraints on undertakings. This is a crucial phase in stabilization as economic liberalization and market openness call for structural reforms and trigger off bankruptcies resulting in a sharp drop in inland revenue from the public sector. At the same time, the government will need to spend heavily on reforming the system for public governance, developing market infrastructure, supporting social service establishments, and providing unemployment benefits for redundant workers as the unemployment rate may hit 20 percent (1 million people) in the reform's first year. To avert a fiscal crisis which may be caused by declining output and tax revenue, the government will need to resort to cuts in spending, provide transparency in expenditure, phase out hidden subsidies such as arrears, barter transactions, subsidized household utility rates or cross-subsidies among various consumers groups designed to keep unprofitable operators afloat.

The fiscal reform should establish a mechanism for identifying and separating revenue and expenditure, ensuring budgeting transparency at all levels, impose legal budget deficit caps, and enhance the role of direct taxation in order to provide local budgets with greater financial independence.

To boost tax revenue, the government may expand the taxation base and sell state-owned enterprises. The government would have to stop supporting state-owned agro-industrial conglomerates (support there totaled 32 percent of GDP in 2002), and stop financing housing development with public money.

Unfinished housing construction and other projects with over three years in implementation and less than a 70-percent completion rate should be frozen. The government will need to cut numbers of army servicemen and expenditure on governmental institutions and the defense.

It would be advisable to deprive the government of the right to award undertakings with tax and customs duty exemptions. The parliament alone should have the right to approve exemptions when adopting the annual budget.

The reform should lead to fiscal decentralization and greater financial independence of local authorities. Utility companies should pay all taxes to local budgets. This would encourage local governments to adopting utility sector restructuring programs, expand the taxation base and develop local infrastructure.

The current tax system consists of 36 taxes collected by central and local budgets. The overall fiscal burden (incl. social security contributions) nears 50 percent.

The current fiscal system has the following drawbacks:

- it slows down economic growth;
- dampens the job creation potential among individuals and undertakings;
- does not encourage business owners to paying taxes and legalize their income; instead, it forces them into the shadow economy;
- creates conditions for unfair competition;
- impairs the competitive edge in business;
- slows down structural reforms;
- discourages foreign investors.

The tax reform and fiscal policies should be in line with the following principles:

- taxes should play an exclusively fiscal role, i.e. should guarantee collection of funds to finance public expenses. They should not be used as a means to adjust industrial output;
- neutrality and equitable treatment (all should pay taxes with no exception);
- the tax burden should not slow down economic growth;
- efficient administration (tax collection cost should be limited);
- simplicity and transparency (the purpose of taxes should be clear and the public should know how tax revenue is spent);
- single taxation (the same taxation base should not be taxed several times).

The government should reduce the overall tax burden and cut spending. The following taxes should remain in place after the tax reform:

- personal income tax;
- social tax;
- property tax;
- value-added tax (VAT) on goods and services;
- excise;
- customs duty.

It is necessary to adopt a pro-rata income tax to encourage business. During stabilization, it would be reasonable to set a higher property tax to achieve optimum distribution of tax revenue. As financial stability is achieved and emergence of the middle class is fostered, the government should seek to lower the property tax and customs duties, followed by reducing other taxes.

In particular, the standard VAT rate should be gradually reduced to 16–18 percent, while income tax rates should be cut to 10–15 percent. The overall tax burden on salaries should drop from 40 to 30 percent.

Early steps should include abandoning the 2.5-percent tax collected by local funds to support agricultural producers, and the 2-percent tax collected at the central level to support agricultural producers and agrarian sciences. A 1-percent cut in these taxes reduces the overall tax burden by 1.3–1.5 percent.

To make it easier for Belarusian companies to operate in international markets, inland revenue authorities should be prepared to cooperate with their opposite numbers in EU member states. In particular, lawmakers should bear in mind that indirect taxes (VAT and excise) and their collection principles are harmonized by various EU regulations. The same holds true for the direct capital gains tax.

Ad d). Income policies

To support financial stabilization, it is necessary to freeze wages and salaries so as to ease inflationary pressures (stop wages and prices from spiraling). The government should guarantee minimum income for vulnerable groups and make sure that its rise will be mirrored by an adequate rise in productivity. The government needs to set an acceptable rate of unemployment benefits to add transparency and predictability to the labor market. Unemployment benefits should be paid no longer than six months per year. It is necessary to stop payments of social benefits for those who do not need them. Wage increases should be related to greater productivity. To be able to earn additional income, households should have an opportunity to choose between keeping their savings in banks and entrusting them to institutional investors. Individuals should be guaranteed the right to divest shares regardless of the terms and conditions on which they were acquired.

Structural reform strategy

Stabilization, liberalization and the establishment of market institutions are preconditions for an effective structural economic reform, raising economic efficiency and living standards.

The real economy

Economic reform implies step-by-step implementation of the following objectives:

- financial and macroeconomic stabilization – curb inflation by pursuing sound monetary policies that rule out unsubstantiated money-printing practices and are conducive to monetization of the economy (insufficient liquidity in the real economy is an obstacle to a smooth self-adjustment of market mechanisms); offset overdue debt (the government pays the amounts due to companies from funds raised by selling property of bankrupt operators);
- create an environment for economic growth (competition and higher mobility of resources as enabled by various types of exchange), improve investment and depreciation policies, radical change in manufactured goods and services mix (restructuring), award public contracts via competitive procedures;
- integrate the national economy with the international labor market – join the WTO, phase out tariff restrictions, lift non-tariff restrictions, allow foreign companies to participate in tenders for public procurements, improve customs clearance procedures, and obtain an international credit rating;
- create a setting for sustainable development and adoption of environmental standards, develop the small business sector and the transport and tourism infrastructure, and diversify energy supplies;
- create scientific, technical and social preconditions for the economy's transition into the postindustrial (information) stage of development: train highly skilled employees, motivate researchers to integrating with

the manufacturing sector, raise the share of R&D spending from 0.9 percent of GDP today to 1.8–2 percent of GDP (the average R&D spending in EU countries).

State aid to enterprises should be based on the following principles:

- Financial support should be limited. The government along with other parties concerned may partially finance R&D, and R&D-intensive, environmental, and regional infrastructure development projects.
- State aid should be transparent and subject to close and permanent scrutiny.

Industrial policies

The main principle underlying industrial policies is to avoid putting the spanner in the works of market mechanisms. Therefore, the industrial policy concept should underscore its systemic nature and orientation towards fostering a general environment for economic growth.

Industrial policies should not be targeted at specific industries, undertakings or regions, but equally affect all market participants that constitute the economic, institutional, organizational and legal environment for their efficient operation. These policies will be pursued mainly at the macroeconomic level.

Their purpose will be to warrant a level playing field for all players, as assisted by financial stabilization and privatization.

Industrial policies should provide for organizational and financial assistance in restructuring enterprises that are fundamental for the economy of towns and cities.

Methods of pursuing industrial policies

Informational methods. The government must provide businesses with scientifically substantiated statistics on the business environment, including the global dimension, so that they may opt for better manufacturing, investment, innovation and trade solutions. The public should have access to economy, industry and regional surveys, forecasts, market research and consulting services.

Macroeconomic regulation methods should be aimed at maintaining financial stability, reducing the budget deficit and inflation and strengthening the national currency.

Resource methods pertain to the system of government contracts in the first place, and also to the formation of investment and export risk insurance funds, personnel training and retraining, and social security guarantees.

Institutional methods should adjust and improve the system as a whole. Use of institutional methods does not imply spending to support the system's constituent parts such as industries, undertakings and regions, but rather provide legal guarantees for labor relations.

The above-mentioned reforms (liberalization, institutionalization and stabilization) should provide an environment for restructuring the industries. The government should be equipped with a restructuring concept in order to limit line ministries' ability to lobby their interests by introducing additional taxes, extending soft loans, imposing import quotas etc. In this respect, it is necessary to point to an integral criterion of restructuring efficiency, this being a rise in manufacturing asset productivity, i.e. increase in the number of undertakings with above-average productivity or return on investments. The manufacturing asset productivity would be higher if products were competitive and in continuous demand in the domestic and foreign markets.

Obstacles to restructuring

There are three types of obstacles that should be overcome for a successful restructuring of the real economy. These are:

– Institutional constraints resulting from non-systemic reforms: lack of competition and well-developed fundamental market institutions such as owners, the SME sector, the banking sector with sufficient lending resources, flexible capital and labor force markets etc. The current ambiguous legal framework complicates business operation and decision-making at the micro-level, increases transaction costs and impairs competitiveness.
– Financial constraints manifest themselves in a shortage of investments and ineffective use of available capital. An open economy, stable legislation, and

a low tax burden would attract foreign direct investments and loans and induce the government, banks and undertakings to using their funds effectively.

– Technological constraints require rapid response to changes in prices of raw materials, energy resources and other cost factors, as well as the use of interindustry connections. Enterprises will need advanced technologies that would enable them to use the available raw materials (wood potassium salt etc.) more effectively. Due to absence of basic raw resources, Belarus should develop and pursue projects to procure raw materials abroad, in particular in Russia e.g. develop oil fields and other natural reserves, attract private capital and bolster partnerships in technological initiatives with other countries.

Restructuring principles

Key restructuring principles are openness, reliance on new and advanced technologies, resource conservation and environmental safety.

Openness is essential for Belarus' presence in economic globalization. Lower import duties are a key factor for raising living standards owing to lower prices of imported goods and overall economic modernization, if one is to rely on the premise that imported equipment is usually better. The open economy would encourage companies to manufacturing globally competitive goods. As domestic markets saturate, exports will rise (in Belarus, exports have been growing over the recent years due to lower domestic consumption and national currency depreciation.)

Specialization: inferior industrial efficiency calls for replacing inefficient technological elements (primarily domestic manufacturers) by foreign suppliers. At the same time, specialization in the manufacturing of certain parts and components would help to attract FDIs.

Reliance on new and advanced technologies is a key restructuring principle. It will help to consolidate competitive advantages of the economy. As a rule, technology-intensive industries are not usually associated with multiplication effects as they were not originally well connected with other branches. Therefore, technology-intensive industries should be the driving force for the economy, the main consumer of other industries' output, e.g. the construction industry. It is necessary to boost total technology-intensive share of GDP which shrank from 2.3 percent in 1990 to 0.8–0.9 percent at present.

Resource conservation and environmental safety: considering the limited supply of domestic raw materials, fuel and energy resources (not more than 30 percent of domestic demand), and high production costs in the manufacturing sector (74 percent in 2000), the restructuring strategy should be closely related to the resource-saving policy.

The relationship between the government's environmental and restructuring policies, launch of environmentally friendly technologies should reduce the share of resource-intensive industries in the country's total. At present, raw material, fuel and energy consumption in Belarus is twice as high as in developed countries. The experience of transition economies has pointed to a need for adopting a law to encourage efficient use of raw materials and energy.

Financial sector reform

The financial sector reform should be closely related to currency stabilization policies and will depend on successful reform of the real economy.

The purpose of the banking sector reform should be to increase its lending capacity. This cannot be done without a strong national currency and a financially stable banking system.

The following steps should be taken to reform the banking sector:

- ensure independence of the National Bank from the executive pursuant to a national currency law that has yet to be adopted. This step calls for changes to the Banking Code whereby the parliament will appoint National Bank governors and deliberate on central bank's audit reports. A law should be passed to prohibit the National Bank from printing money to finance budget deficit;
- open the way for private investments in six largest state-controlled banks that account for about 90 percent of the sector's total assets;

- balance household deposit and lending interest rate policies, as banks currently offer attractive interest rates for households and excessive loan interest rates to corporate cliens;
- forbid government forcing the banks to lend to certain sectors or enterprises, and ensure that the government settles bad debts resulting from compulsory lending to state-owned enterprises;
- abandon the current 50 percent limit on foreign capital presence in the banking system;
- have the country's banking system rated by international financial institutions;
- create a competitive environment in the banking sector to encourage banks to cut costs and fees, adopt international payment, auditing and reporting standards.

The reform should include efforts to encourage the development of stock and insurance markets on the basis of stable and transparent legislation harmonized with EU laws.

The following steps should be taken to develop the stock market:

- lift restrictions on professional dealers and brokers accessing the stock market, with simultaneous tightening of requirements for stock market dealers and brokers. To this end, the Securities Commission should be vested with greater powers;
- lift the 15-percent tax on personal income from securities and temporarily exempt corporate stock market dealers from taxing securities transactions;
- offer freedom of choice to individuals in divesting securities;
- broadly advertise public offerings of shares in profitable companies;
- prepare for integration with the European stock market.

Foreign trade policies

Consistent reforms will allow for bridging the GDP gap between Belarus and most EU countries. Belarus will continue to export commodities to CIS countries, but the proportion of exports to Europe and countries outside the CIS should rise from 35 percent to 60-65 percent. The exports of services should increase from 62 to 80 percent, combined with a rise in exports to former Soviet Union republics.

Belarus needs to join the WTO to see a removal of non-tariff barriers to exports of textiles, chemical products, potassium fertilizers and steel.

To re-orient exports westward, the country will need to reduce the ratio of cross-industry exchanges (trade in products of various industries) and encourage trading goods of the same industries to expand trade volumes and increase specialization. Intra-industry trade exceeds 70 percent of total trade, mainly among developed countries.

Export re-orientation will be fostered by modernization and technological advancement, involvement in multi-national R&D projects, acquisition of Belarusian companies by international corporations, and by the growing purchasing power of EU countries, which currently far exceeds the spending power in Russia and other CIS countries.

The reforms should allow for the country to achieve European standard of living and facilitate its convergence with the EU economies.

Reform of industries

In absence of large domestic investors, large-scale industries (petrochemical and machinery manufacturing) are likely to be controlled by foreign investors with the government retaining a stake. At the early stage of the reform, it is advisable to foster an environment for attracting domestic investments (including household savings) in sectors producing goods in large demand domestically and in external markets such as consumer goods, the woodworking industry and R&D-intensive sectors (integrated circuits, computer software, medical and environmental equipment, bio-technologies, production of new materials etc.). These industries should continuously pursue specialization as encouraged by increasing international intra-industry trade.

Medium-sized private businesses may take over some consumer and R&D industries with a short payback period that do not require major capital expenditure. An upturn in these industries, some of which are labor-intensive, would help to ease labor market tensions caused by the reform. Technological development, along with a rise in highly skilled labor force and growth of infrastructure, will cause high-tech exports to increase from current 3.7 percent to 10–15 percent. In a more distant future, competitive industries will help the country to discover new niches and gain the competitive edge on a global scale.

Agriculture

For the time being, Belarus' collective and state farms are not profit-driven; rather, they operate to support agricultural infrastructure.

Since rural population stands at 29 percent of the country's total, a reform of collective and state-owned farms should be accompanied by transfer of their social and welfare functions to local authorities. At an early stage, agricultural reform would boil down to denationalizing collective farm property and setting aside up to 30 percent of infertile soil from agricultural production (for forestation). Proceeds from the lease of land and other natural resources (property tax) should replace a considerable part of tax revenue. Unlike most other taxes, lease payments do not contain the production element and do not distort resource distribution. Lease proceeds would allow for the government to reduce agricultural subsidies to 5–10 percent, in line with WTO requirements. To employ excess labor force in rural areas, authorities will need to create jobs in non-agricultural sectors such as tourism, small businesses and hunting. Belarus will need to open its agricultural market to ensure sufficient food supplies and fully tap into the capacity of food processing plants.

As the land market develops and land becomes available to private owners and local governments, rural areas are more likely to attract investments both in non-agricultural sectors (restoration of historical monuments, tourism, transportation and leisure infrastructure development) and high agricultural technologies (production of renewable energy resources – ethyl alcohol, oils, GM-crops, creation of a gene pool).

Transportation, construction

Development of transport infrastructure and the construction industry spur economic growth, as the experience of EU expansion suggests.

The role of transit of goods and services would increase as Belarus' economy opens up. The need for improving the transit infrastructure urgently calls for intensifying the construction business. The country may see a rise in the population as a result of labor force migrations from Russia and other CIS countries.

However, these industries should give priority to local labor force and domestically manufactured products (building materials, trucks and construction equipment). The adoption of new building technologies will benefit housing renovation and utility sector upgrading projects.

The expansion of transport services network could create new jobs.

Fuel and power generation industry

The present state of Belarus' fuel and power generation industry highlights the need for saving fuel and electricity. The country's power generation facilities are in a critical condition: power generation units at the two largest hydropower plants are worn out, while most power plants using liquid fuel were built some 40 years ago. Belarus will need to replace 80 percent of its power generation plant and machinery before 2010. Most power plants are using expensive fuel like gas or oil.

Construction of a nuclear power plant does not seem to be the advisable option as the cost of nuclear power is high. Therefore, in the near term Belarus should increase electricity imports (which rose by 15.3 percent in 2001 to 8.3 billion kW/h, i.e. 25 percent of total power consumption). However, power plants should start replacing their worn-out equipment now. This will require private investments. In an open power and heat generation market, privatization of old facilities and greenfield investments should encourage competition.

Telecommunications

Despite some hardships, the telecommunications sector has been vigorously developing over the past few years. The number of telephone users rose by 80 percent between 1990 and 2002. Mobile telephony and Internet have been expanding, with the number of cellular subscribers rising to 600,000.

Reform priorities should include privatizing state-controlled companies and creating a competitive environment. Also, state-controlled media must be privatized.

* * *

The economic reform plan presented above seeks to achieve European living standards as fast as possible. The reform's main goal is to restore or set up effective market institutions that would help businesses in using their potential effectively, buy new technologies and know-how that enhance competitiveness on a global scale. All basic principles of this economic model, i.e. economic performance in market conditions, private ownership, free competition and an open domestic market, are designed to achieve that goal. Economic freedom will be mirrored by the government's responsibility for economic policies, markets and currency stability, and private companies' responsibility for their performance and earnings.

An effective, targeted social assistance that is commensurate with the nation's wealth is intended to cushion shocks of economic reform in the mid-term. Therefore, the government should seek to set the framework for boosting productivity, growth of small business, and inflow of foreign capital and technologies.

Market mechanisms should be established irrespective of economic and political support from the EU. However, close and mutually beneficial economic ties between Belarus and the enlarged EU would be conducive to the country's economic growth. While pursuing the above-mentioned reforms, the government should focus on developing the labor market, which implies prospects for employment opportunities and establishing a mechanism for effective use of individual energy and creative initiative.