

Belarus and the Advice of IFIs

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Belarus is a difficult case for the International Financial Institutions, the IFI

Ever since independence, the IFIs have been telling the Belarusian authorities that rapid and comprehensive reform was needed if Belarus was to grow and prosper. To a large extent, this advice was ignored, and Belarus remains well behind in all the indicators of transition. The state sector remains very large, the private sector plays a subordinate role, and administrative intervention in the economy remains widespread. And yet, despite this, Belarus's record of growth has been quite good, especially during the period 2000-2008 (see Figure 1). Belarus has also been able to avoid the disruptions to people's livelihoods and the sharp widening of income differentials that have occurred elsewhere. It is not surprising if the authorities have not been convinced by the arguments of the IFIs.

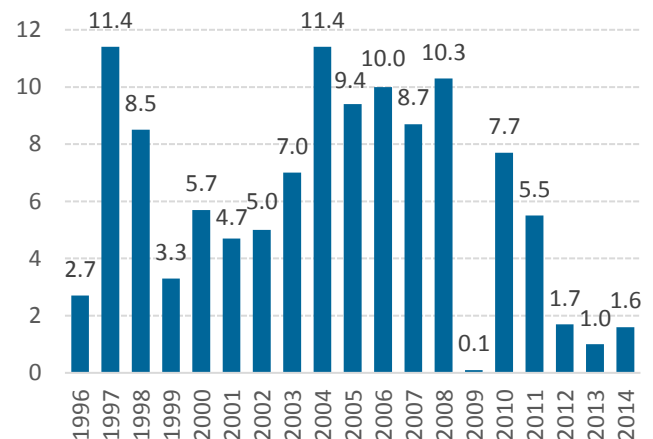
The IFIs in question, the World Bank, the EBRD and the IMF have been a useful source of money for various investment projects in Belarus or to cover balance of payments deficits. This assistance came with policy conditionality, and various reform measures have been introduced as a condition for disbursements. But it is a commonplace in the IFIs that "conditionality has to be owned" if reforms are to work -- that the authorities have to believe in what they are doing. And that has not been the case in Belarus, which has a record of reversing reforms once they were not needed to unlock IFI disbursements. And if the authorities have not believed that the reforms were needed to sustain growth, this is hardly surprising.

How did Belarus maintain such strong growth while rejecting the reform path advocated by the IFIs? It probably reflected the mobilization of domestic resources that administered economies can do quite effectively, and allocating this to investment. It also reflected the easy external borrowing conditions of the early years of this century. And then there were some special factors, such as the ability to obtain energy and other resources from Russia at cheap prices, and even to export some at higher prices. Belarus has been able to borrow from Russia and has benefitted from a flow of remittances.

But Belarus was hit by the global crisis of 2008-2009, and then by further balance of payments crises in 2011 and 2014. Since 2008, growth has been mediocre, despite efforts to mobilize resources internally and externally, and to raise productivity by administrative fiat. Of course the IFIs say that the only solution is reform, but they were saying that for almost two decades before this downturn. But, they might well be right now. It really does look as though the growth model has run out of steam. Russia is also going through a very difficult period economically, so little help can be expected from that source. This time it really is probably different. But it would be unrealistic to expect Belarusian policy makers to be easily convinced that the alternative, reform strategy suddenly looks like the answer.

Nevertheless, the country needs assistance. The assistance of the IFIs is largely conditional. So what should the IFIs be recommending?

Figure 1. Belarus, GDP, constant prices, % change



Source: Dąbrowski (2016).

Growth will need a sustained increase in economy-wide productivity

The preferred approach of the Belarusian government to raising productivity has been to invest in technologically advanced equipment and to require firms to produce plans to raise productivity. It is reflected in a strong preference for green field investment by foreign firms and the use of Special Economic Zones. But the success of Special Economic Zones world-wide is quite limited, especially in their ability to produce productivity-raising

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linkages with the rest of the economy. And in Belarus, while there have been some successful investments in this form, the amount has been small and the names of the same few companies are mentioned time and time again.

Kruk and Bornukova (2014) showed that Belarusian growth from 2000 to 2008 was extensive, without a sustained increase in factor productivity. Indeed, government administrative action in itself may have lowered productivity. Kruk (2014) also shows that growth was based on embodied technological progress (*grosso modo*, new machines), rather than natural productivity growth (the more efficient use of resources).

A sustained increase in productivity across the economy must come from a myriad of small-scale decisions by those directly involved in production. And while there are policy measures that can facilitate these decisions, such as enhancing the availability of credit, stronger drivers are the positive incentives of financial success and the negative incentive of fear of loss. Neither of these works particularly well in the administered part of the economy. So if these drivers of productivity growth are to be harnessed, there must be more people in Belarus with a direct stake in the successful outcome of their activity, people whose livelihoods depend on getting these decisions right.

These people also need to operate in an environment where they have options: to acquire the resources to expand production, to shed or sell resources they do not need, to enter into longer-term contracts with suppliers or customers. This calls for an expansion of private ownership, better legal protection of property, the free functioning of markets for the inputs that people need, and a stable framework for operation. More people need to have assets that they are prepared to defend, and to resist the changes in regulations or market interruptions that have characterized policy-making.

In particular, the privatization and commercialization of agricultural land would allow rural owners to invest more effectively in their farms, knowing that they would benefit from increased productivity and suffer the loss of value from inaction. Devolving the responsibility for agriculture would help deal with the serious problem of losses in the collective farms. While there are constitutional constraints on land ownership, there are ways to work around this.

For small and medium-size business, constraints on hiring and firing need to be lifted, and on the acquisition of property for productive purposes. Control over supply of inputs by local authorities should be lifted. If privatization of large enterprises is ruled out -- and the experience of the pilot privatization schemes indicates that the authorities have not been committed to such privatization

– other schemes for the involvement of foreign capital can be considered. But this would have to come with the ability to control resources and to have adequate legal recourse in the case of contract disputes.

Foreign trade has huge potential to help raise productivity levels, particularly in a small country like Belarus. An open trading environment creates the two drivers for increasing productivity. First is the much larger market for which firms cater. The idea goes back at least to Adam Smith that larger markets permit the lowering of unit production costs. The second is the discipline that a larger and more competitive market entails. A true assessment of the reduction of trade barriers has to see advantages not just in the expansion of the market for domestic firms, but also the advantages of increased competition to force firms to raise standards, or to cede their place to imported products, while moving resources to areas of comparative advantage. Of course, for these forces to work firms must be able to react to changed conditions.

There is much misunderstanding of how international trade works in the modern world. The traditional picture of a country exchanging raw materials and its finished products with those of other countries no longer defines international trade, and in particular its more dynamic elements. Production is now unbundled, and two thirds of international trade is now in intermediate goods. Trade contributes to productivity growth less by specialization in products of comparative advantage but by participation in global value chains. Finished products may contain elements that have crossed several borders in the course of production. What would be needed for Belarus to participate in such a system?

If firms located in Belarus are to form part of such systems, there must be openness to the outside, with a harmonization of standards, predictability in controls, and reliability in legal norms. These are things that benefit both the external partner and domestic firms. By participating in the Eurasian Economic Community, Belarus is committed to adapt its standards to those prevailing on that market. Unfortunately, for the time being, these standards fall short of those under which the bulk of world trade is conducted. In that respect, Ukraine's ultimate choice of harmonizing its regulations with those of the European Union is likely to be more successful. But WTO membership provides some of the elements that strengthen certainty in international trade, requiring the adoption of standards for customs procedures, government procurement, subsidies and anti-dumping action, transparency in regulation, and providing effective dispute settlement procedures. Belarusian business should be less concerned with the lowering of the level of protection that WTO membership offers, and more with the support that WTO enforcement mechanisms would give

to the stable administration of rules within Belarus. Among the central WTO principles is national treatment, that once goods and services enter the country's customs territory, they should be treated on the same basis as domestic goods and services.¹

IFIs should support irreversible reforms

To return to the question of which reforms should the IFIs support. The list of desirable reforms is long, but the problem is that unless they are the reforms the authorities want, they are likely to be implemented half-heartedly and reversed. My proposal is to focus on reforms that will help to raise productivity, but are more difficult to reverse, since they create a constituency that would fight any reversal. Action that would put more of the productive resources of the economy into private hands, by privatizing agricultural land and distributing municipal and surplus state property would help. Action to permit the flexible use of such resources and developing markets in production inputs would give more meaning to ownership and make reforms more difficult to reverse. And WTO membership, as well as creating a larger market and exposing Belarusian business to more competition, would help ensure that rules were implemented consistently by the state. Adopting external constraints can help ensure that desirable change become permanent.

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¹ For discussion of some of the current obstacles to business in Belarus, see Liuhto (2014).