



Ensuring Sustainable Economic Growth in Belarus

Summary

This paper discusses the main trends in economic growth in Belarus. It argues that the sustainability of several growth factors is in question over the mid-term. There are exogenous risks (decrease of commodities prices, Russian trade policy, and decrease or elimination of Russian energy subsidies to Belarus) and endogenous risks (income policy of the government and rigidity of its policy towards privatization). In order to reduce the risks for growth sustainability the government plans to implement several measures, in particular to balance its income policy by reducing the gap between labor productivity and real wage growth. But in order to ensure growth sustainability several additional steps will need to be taken. First, in order to improve the investment climate it is necessary to draw up a limited list of enterprises not subject to privatization and to allow foreign investors to buy the controlling shares of any company not on this list. Second, in order to attract capital into state enterprises, the government should soften the 'golden share' institute, i.e. it should limit the number of cases to which it will be applied to a clearly and unambiguously defined list, or – better yet – to eliminate this procedure altogether. Finally, it is necessary to make it easier to do business in Belarus. All these measures could contribute to transform the current short-term economic growth into long-term sustainable growth, which will increase the welfare of the Belarusian people.

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1. Introduction

In recent years Belarus showed quite fast economic growth: The GDP growth rate was 7% in 2003 and 11% in 2004, and the government has projected significant growth for the next 6 years (about 8% per annum). In this paper we are developing proposals to support this ambitious goal for economic growth, which the government has set. Our main question is how to convert the current rate of economic growth into long-term sustainable growth. In order to answer this question it is necessary to identify the main sources of the current economic growth and the growth determinants deriving from government policies and programs. This will then allow us to identify the major threats to sustained growth, and to propose suitable recommendations to overcome these threats.

The paper is organized as following. In the next part the main causes for the recent economic growth (from both the demand and the supply sides) are analyzed. The third section is devoted to whether the current economic growth can be sustained, i.e. an analysis of the major threats and risks to future growth. The fourth section describes the government plans for the next five years and analyzes their potential impact on economic growth. Both, the drawbacks of the planned policies and the measures aimed at ensuring economic growth sustainability are presented in this section. The final part of this paper contains conclusions and policy recommendations.

2. Determinants of recent economic growth

2.1. Aggregate demand

Economic growth accelerated since 2003: in 2003 GDP grew by 7%, in 2004 by 11%. Table 1 provides an overview of the main aggregate demand factors for 2002 to 2004.

Table 1. Contribution of aggregate demand components to GDP growth

	2002		2003		2004		2005 (forecast)	
	Growth rate ¹	Contribution ²	Growth rate	Contribution	Growth rate	Contribution	Growth rate	Contribution
<i>Final consumption expenditure</i> ³	8.2	6.8	5.7	4.9	10.3	8.7	9.4	7.9
Households	11.4	7.0	7.4	4.8	13.2	8.7	12.0	8.0
<i>Gross capital formation</i>	2.4	0.6	27.2	6.6	18.8	5.4	8.7	2.7
Gross fixed capital formation	6.7	1.6	22.0	5.3	18.9	5.1	14.0	4.1
Changes in inventories	-81.5	-1.0	623.2	1.3	17.0	0.2	-94.4	-1.4
<i>Net exports of goods and services</i>	-5.1	0.2	103.8	-4.4	74.6	-6.0	7.1	0.9
Exports ⁴	0.1	0.1	9.6	6.1	16.7	10.9	-0.1	0.0
Imports ⁴	-0.2	0.1	15.5	-10.5	23.1	-16.9	-1.2	0.9
<i>Statistical discrepancy</i>	--	-2.6	--	0.0	--	3.0	--	-3.4
Domestic demand⁴	6.9	7.4	10.4	11.4	12.5	14.1	9.2	10.5
Gross domestic product	5.0	5.0	7.0	7.0	11.0	11.0	8.0	8.0

¹ Growth rate in real terms, % yoy.

² Contribution to GDP increase, percentage points.

³ The consumption of the general government and of non-profit institutions serving households is not included because of the close-to-zero contribution to GDP growth.

⁴ Own estimates.

Source: Calculations based on the Ministry of Statistics and Analysis data. Forecast – IPM Research Center.

The main demand factors in 2004 were higher gross exports (10.9 percentage points of GDP increase), rising household consumption (8.7 percentage points), and higher fixed capital investment (5.1 percentage points).

(i) Gross exports

The contribution of net exports was negative in 2003 and 2004. Notwithstanding this negative contribution, one should not disregard the positive influence of gross exports on growth. Exports grew considerably, thus avoiding a further rise in the negative contribution of net exports to growth. For the rise in exports we identify 3 main reasons.

Firstly, the global economic recovery led to increased commodity demand (oil and metals), which in turn caused their prices to increase. As oil and metals are among Russia's main export goods, Russia increased its exports in real and in value terms. This increased Russia's domestic demand, including the demand for Belarusian goods, given the existence of a customs union between both countries. As a result, Belarusian exports to Russia grew by 13.9% in real terms in 2003 and by 15.1% in 2004.

Secondly, the external demand came also from non-CIS countries, focusing mainly on Belarusian refined oil and ferrous metals products. Belarusian exports to non-CIS countries grew by 6.6 and 13.1% in real terms in 2003 and 2004 respectively.

Thirdly, an additional external determinant of aggregate demand increase was the Russian trade policy towards non-CIS producers of milk, meat, and trucks. In 2003, Russia increased tariffs on several goods within these groups. This reduced the competitiveness of goods made in non-CIS countries compared to Belarusian ones. As a result, Belarus' export of food products and trucks to Russia increased significantly (Table 2).

Table 2. Impact of Russian protectionism on Belarusian exports

	Live animals and animal products			Vehicles and aircraft			Total exports		
	2002	2003	2004	2002	2003	2004	2002	2003	2004
Export, USD m	227.5	348.6	545.3	711.2	795.5	1110.1	8020.9	9945.6	13751.7
Growth rate, %	-8.0	53.2	56.4	-8.2	11.9	39.6	7.7	24.0	38.3

Source: Own calculations based on Ministry of Statistics and Analysis data.

(ii) Household consumption

The largest positive contribution from the domestic demand side came from household consumption (Table 1). The household consumption increase was due to rising real household incomes caused by wage and pension increases (in 2004, these sources of income grew by 17.0 and 17.5% in real terms respectively). There were two main determinants for wage growth: an administrative target to reach an average wage of USD 250 per month at the end of 2005, and productivity increases. The wage target stimulated salary increases in the governmental sector¹, while productivity increases allowed wage increases in other sectors of the economy.

(iii) Investment

Growing domestic and external demand contributed to increased investment activity in the country. An additional reason for faster investment growth was the high rate of housing construction. Thus, enterprises invested in fixed capital, while households invested in housing construction². As a result, investment in fixed capital and construction grew by 22.0% and 18.9% respectively in 2003 and 2004. This resulted in about half the domestic demand increase in 2003 and more than one third in 2004.

In summary, from the demand side economic growth was influenced by the following major factors: (1) a very favorable external environment, (2) an expansionary governmental income policy, and (3) the current Russian trade policy.

¹ The government was able to increase salaries because of higher-than-expected state revenues. In 2003 this was due to additional revenues from foreign trade, in 2004 due to higher than planned revenues from the profits tax, VAT, income tax and revenues of several budgetary funds, including the Social Security Fund. In turn, sound fiscal stance of the state was supported by the economic upturn: growth of exports and imports, profits, incomes, and enterprise revenues.

² The increased investment was partly financed by increased loans to the economy. Rising households incomes and enterprise revenues led not only to increases in consumption and investment, but also to savings growth, which allowed the volume of loans issued by the banking system to be increased.

2.2. Aggregate supply

Although the investment growth was quite fast (about 20% per annum), the production capacity (capital stock) increase was relatively low (1.8% in 2003 and 1.7% in 2004). Fixed assets growth was unevenly distributed among industries, or more precisely, among enterprises. Several large enterprises (the Belarusian Metallurgical Plant, the Mozyr and Novopolotsk oil refineries³, "Atlant"⁴, and the sugar refineries) substantially increased their production capacities (Table 3), as they faced rising demands for their goods. Other enterprises do not have enough resources to invest in fixed assets, or their production capacities are still significantly underutilized. They respond to increased demand for their goods by increasing their capacity utilization (Minsk automobile plant, Minsk tractor plant, Belaruskali, and a number of milk and meat producers).

Table 3. Production capacity utilization for selected industrial products

	Capacity utilization, %			Change in capacity utilization*	Increase of capacity, 2002–2004, %**	Increase of output, 2002–2004	
	2002	2003	2004			%	In % of capacity increase
Oil processing	55.0	53.1	52.8	-2.2	20.2	15.4	41.9
Steel	91.3	92.5	96.2	4.8	7.6	13.3	159.3
Accepted cast section	98.9	100.0	100.0	1.1	11.6	12.9	109.4
Rolled metal (finished)	100.0	97.2	100.0	0.0	13.8	13.8	100.0
Mineral fertilizers	89.6	97.4	98.7	9.1	3.0	13.4	407.3
Chemical threads and fibers	65.9	66.3	70.8	4.9	-8.7	-1.9	--
Trucks	72.4	80.0	91.4	19.0	1.9	28.6	1081.5
Tractors	49.2	53.9	68.8	19.6	0.1	39.9	32386.7
Refrigerators and deep freezers (Minsk)	100.0	100.0	100.0	0.0	11.4	11.4	100.0
Sugar from sugar-beet	100.0	95.0	100.0	0.0	76.9	76.9	100.0
Milk	49.6	54.5	57.5	8.0	-3.0	12.6	--
Meat	41.2	44.8	48.8	7.6	8.1	28.2	142.9

* 2002–2004, percentage points.

** Growth rates are calculated as changes in volume of capacity or production.

Source: Calculations based on the Ministry of Statistics and Analysis data.

Taking into account the fixed assets growth rate, the increased intensity of work (an employee worked 2.1% more in 2003 than in 2002 and 0.6% more in 2004 than in 2003 on average), and the decreased employment (by 0.9% in 2003 and by 0.1% in 2004), the labor productivity increased by 4.0% in 2003 and by 8.6% in 2004. But in almost all major industries the output increase exceeded the capacity increase (Table 3). This means that the increase of labor productivity is partly due to higher capacity utilization.

A special role in the output growth in Belarus is played by the Russian energy policy towards Belarus. The price of Russian gas for Belarus is lower than it is for European and CIS countries. According to IMF estimates, Belarus thus received a "subsidy" of 7.1% of GDP in 2004 (compared to the gas prices in effect for Germany) and of 1.1% of GDP (compared to Ukraine)⁵. Evidently, this subsidization means lower costs for Belarusian enterprises and artificially increases their competitiveness.

³ The capacity utilization in the Mozyr refinery at the beginning of 2005 was 72.9%, which is 31.4 percentage points higher than for the Novopolotsk refinery. Currently both enterprises process approximately equal amounts of oil, but the depth of oil processing at Mozyr is 82–84%, which is 10 percentage points higher than at Novopolotsk. Thus, capacity increases under a quite low utilization is due to increasing the depth of oil processing to the level of European refineries (which is 85–87%).

⁴ A closed joint-stock company: including the Minsk Refrigerator Plant and the Baranovichi Machine-tool Plant.

⁵ The first figure was calculated by taking the difference between the border gas prices in Germany and Belarus multiplied by the volume of gas supplied to Belarus from Russia; the border gas price in Germany was adjusted for the transport cost differential assuming a distance of 1,100 km between the Belarusian and German borders closest to Russia, and a transport cost of USD 0.46 per 1000 m³ per 100 km (IMF (2005) Republic of Belarus: Selected Issues, IMF Country Report No. 05/217).

The competitiveness of Belarusian enterprises on the domestic market also depends to a substantial extent on the government's protectionist measures. Belarusian retail trade enterprises are mandated to ensure that a certain part of their assortment of goods was produced in Belarus⁶. Thus, Belarusian enterprises are in a more favorable position compared to external competitors. The list of domestic goods was expanded in 2004, further restricting the competition on the domestic market. The new, expanded list even lists some of the producers of these goods⁷.

Thus, the main supply side determinants for output growth in recent years were increased capacity utilization, rising investments by major enterprises, and increased labor productivity. In addition, the Russian energy subsidies (relatively low gas prices) ensured relatively low costs for Belarusian enterprises, while protectionist measures by the government provided them with a certain share of the domestic market.

3. Is the current economic growth sustainable?

Belarus' recent economic growth is based (i) on a very favorable external environment and on increased utilization of the available production capacities, (ii) on the more or less monopolistic position of several Belarusian enterprises relative to certain market niches in Russia and/or CEE countries, and (iii) relatively low input prices (such as for wages and energy resources)⁸. Thus, whether this growth is vulnerable depends on the sustainability of its current determinants. Taking their nature into account, the sustainability of the current growth looks rather uncertain. There are several risks on the demand side (decreasing commodity prices, Russian trade policy, and new and more efficient competitors) and on the supply side (decreasing Russian energy subsidies, income policies, and decreasing investment growth).

3.1. Demand risks

(i) Commodity prices

One major risk on the demand side is the risk of lower commodity prices. Decreasing commodity prices can reduce the economic growth rate in Belarus for the following reasons. First, it can directly influence Belarusian enterprises. For instance, during the first half of 2005 world prices for ferrous metallurgy products decreased, while iron ore prices rose⁹. This reduced the profitability of ferrous metallurgy products and forced Belarusian enterprises in this industry to slow output increases. During 2Q05 ferrous metallurgy output only increased by 7% yoy, while during 1Q05 it rose by 47.9% yoy.

Second, lower commodity prices (primarily oil products, potash based fertilizers, and metals) mean lower revenues for Belarusian enterprises. In turn, this means slower

⁶ Regulation of the Ministry of Trade No.3 (January 24, 2003).

⁷ Regulation of the Ministry of Trade No.44 (October 29, 2004).

⁸ The Belarusian economic growth can be characterized as "recovery growth", i.e. as an economic recovery based on the utilization of inputs released by the transition process. There are two reasons for a recovery growth: (1) market reforms, privatization and restructuring of old state enterprises and emergence of a new private sector, and (2) increased input utilization in the old state sector based on a favorable conjuncture and/or on expansionary government policy. In the first case, the country's internal market environment becomes closer to the external one, which makes it easier for domestic enterprises to operate on external markets. In the second case, the domestic enterprises operate in a non-market framework within the country and in a market environment on the external markets. This implies potential problems for the enterprises should the favorable conjuncture disappear. For a detailed description of the concept of recovery growth see Gaigar, Y. (2005) Recovery Growth as a Stage of Post-Socialist Transition? *CASE Studies and Analysis* No. 292, and Dabrowski, M., Rohozynsky, O., Sinitsina, I. (2004) Post-Adaptation Growth Recovery in Poland and Russia – Similarities and Differences. *CASE Studies and Analysis* No. 280.

⁹ Based on the favorable price dynamics of 2003–2004, metallurgy companies increased their production of metal products, expecting higher demand. But the demand increase has been lower than expected, and world prices for metal products went down. At the same time, iron ore prices went up, because of the high demand for this input, which was based on the abovementioned expectations.

wage growth, reduced state expenditure increases, and lower investment demand (at least by the enterprises directly affected by prices decreases). The resulting slower domestic demand growth results in a decreased GDP growth rate. An additional consequence of commodity price decreases is a slower growth of external demand coming from Russia. Thus, lower commodity prices entail a lower external demand (and lower exports), and a slow down in domestic demand growth.

(ii) Russian trade policy and WTO

Another risk is related to the Russian trade policy. Currently, Belarus benefits from trade with Russia because of its customs union with that country. Abolition of this arrangement looks unlikely, except that once Russia joins the WTO, it will be required to eliminate or reduce certain trade barriers for WTO countries. This would make Belarusian goods less competitive on the Russian market. Hence, the Russian WTO accession will entail a lower demand for Belarusian goods in Russia and slower export growth (perhaps even a reduction of exports).

(iii) New competitors

There is also a risk of new competitors arriving on the international markets. The dynamics of the major export markets makes them attractive for foreign investors. However, attracting foreign direct investment into the biggest export-oriented industries of Belarus looks unlikely. Hence, new competitors can readily appear on these markets¹⁰. This again could mean a reduction of the external demand for Belarusian products, i.e. a certain deterioration of Belarusian exports.

3.2. Supply risks

(i) Energy prices

The international competitiveness of most Belarusian enterprises is input-based, i.e. it depends on the prices of inputs. Inputs of oil and gas are imported from Russia at preferential prices. Thus, the competitiveness of Belarusian products is greatly influenced by the existence of these energy "subsidies".

This situation entails the risk of decreasing the competitiveness of Belarusian goods should the Russian subsidies ever be reduced or eliminated. Russia plans to join the WTO in 2005–2006, and after its accession it will rise the gas prices it charges to CIS countries, including Belarus. This increase of the Russian energy prices will increase production costs, which threatens the profitability of many Belarusian enterprises, especially their competitiveness on external markets. Raising the gas price for Belarus to the level of the border gas price for Germany would increase the costs in the economy by 6–7% of GDP, while the total net profit within the economy in 2004 amounted to 9.1% of GDP. Such a reduction of profits will mean less investment activity and slowing output increases.

(ii) Income policy

Another important limitation for economic growth in Belarus is the current income policy of the government. The government has set several monthly wage targets: USD 100 by September 2001 (presidential elections), USD 250 by the end of 2005 (Program of Social and Economic Development for 2001–2005), and USD 500–540 by the end of 2010 (Program of Social and Economic Development for 2006–2010). However, labor productivity grew much slower. According to IMF estimates, labor

¹⁰ Several examples of Belarusian enterprises losing competitiveness vis-à-vis Russian or other foreign enterprises took place between 1998 and 2001, when Belarus lost markets for some food products (e.g. beer and packaged food products) and some light industry products (footwear and most clothing). These industries are quite small, and the government has been able to save for some of them a part of the domestic market through protectionist measures.

productivity rose only by one half to two-thirds of the wage increases between 1996 and 2004. Further wage increases would increase the cost of labor and decrease (potential) profits, thus reducing competitiveness and the investment potential.

The government increased salaries within the state sector, too. This entails a redistribution of state expenditures (for instance, from investment to infrastructure) and maintenance of the high current level of taxation. Evidently, high taxes reduce the incentives to invest in businesses within the country.

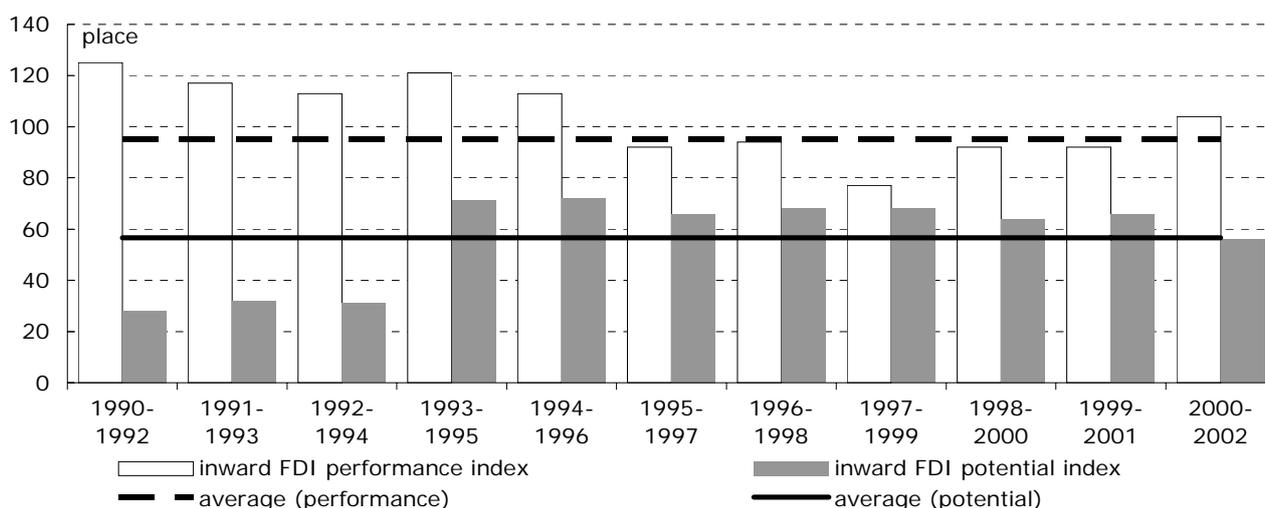
Thus, the current income policy of the government, though having a positive impact on consumer demand, can restrict the supply due to higher labor costs and lower investment.

(iii) Investment policy

An additional supply-side risk is the current investment policy of the government. At present, domestic resources are the main source of investment in Belarus. In recent years the main source for domestic investment was bank loans.

But the Belarusian financial sector is quite narrow (the monetization coefficient¹¹ was 16.7% at the end of 2004). It is also broadening more slowly than investment. Thus, domestic resources will be insufficient to increase investment over the long run.

Figure 1. Investment potential of Belarus and its utilization



Note. The data presents the place of Belarus among 140 countries of the world.
Source: UNCTAD (2004).

According to UNCTAD data, Belarus has a substantial potential for foreign investment. For 2000 to 2002 it was 56th among 140 countries. The inward FDI Potential Index is only slightly lower than that of Lithuania (52nd place), Latvia (49th), and Slovakia (47th), and substantially higher than that of Kazakhstan (78th) and Ukraine (94th). Nevertheless, Belarus uses only about 60% of its investment potential (Figure 1), i.e. the actual inflow of foreign direct investment is substantially lower than the potential inflow. Belarus' actual FDI performance ranks much worse (104th place). At the same time, Latvia, Lithuania and Ukraine (in 47th, 46th, and 89th place, respectively) attract FDI in accordance with their potential, while Slovakia and Kazakhstan (in 8th and 12th place) attract much more foreign investment than would be expected based on the FDI Potential Index.

Thus, the rather fast investment growth in recent years was based only on limited domestic resources and a slowdown can be expected unless the government changes

¹¹ Ratio of broad money supply (M3) to GDP.

its attitude towards foreign investment. Under-investment is a serious risk to the sustainability of economic growth in Belarus.

To summarize Part 3: We can conclude that the sustainability of economic growth in Belarus depends on exogenous and endogenous risks. The exogenous risks include a decrease in commodities prices, changes to the Russian trade policy (especially in light of Russia's WTO accession), and the decrease or elimination of Russian energy subsidies to Belarus. Belarus cannot influence on these risks directly, and their realization will cause a slow down of GDP growth. But the government could implement policies to reduce the negative effects of the exogenous risks. The endogenous risks include the government's income policy and the rigidity of its policy towards privatization and restructuring. Belarus could avoid these risks if it changed these policies from growth retarding to growth enhancing.

4. How to ensure sustainable economic growth in Belarus

4.1. Government plans

The Government has prepared a "Concept of the Program for Socio-Economic Development of the Republic of Belarus for 2006–2010" (hereafter: Concept 2006-2010), which proposes certain measures to ensure the planned GDP growth. We will only present those measures, which are related to the endogenous risks for sustainable growth discussed above.

(i) Income policy

The main improvement compared to the current situation is the plan to decrease the gap between labor productivity and real wage growth. For 2006–2010 the planned annual real wage growth is 9.2–10.1%, while the annual labor productivity growth is planned at 7.9–9.2%. Thus, the gap between these two indicators is expected not exceed 2.1 percentage points per year compared to the annual gap for 2001–2005 of approx. 6.9 percentage points¹². Evidently, this is a significant improvement of the income policy, which will reduce the burden of labor costs for enterprises.

(ii) Investment policy

According to Concept 2006–2010, the main investment source will be domestic resources: internal company resources, and household and bank loans. The main problem with this is the limited amount of domestic capital available in Belarus and, hence, the limited financing possibilities for the country.

The government also plans on significant investments by the state. One of the largest government investment programs is the State Program for Revival and Development of the Village. It envisages about USD 12 bn of government investment in the agricultural sector between 2005 and 2010 (Table 4).

Table 4. Expenditures of the State Program for Revival and Development of the Village

BYR bn	2005	2006	2007	2008	2009	2010	2005-2010
Total expenditures	10118.4	10543.7	11143.9	11581.5	12348.7	14082.9	69819.1
of which: state expenditures	3974.0	3968.9	4298.8	4633.4	5000.8	5394.1	27270.0

Note. State expenditures include the innovation funds. Assuming 2% devaluation between 2006 and 2010, the total amount of expenditures will be about USD 30 bn, including about USD 12 bn in state expenditures.

Source: State Program for Revival and Development of the Village for 2005–2010.

State investment in such spheres as agriculture is less desirable than private investment for two reasons. First, the government should invest in sectors with 'market

¹² The actual labor productivity growth matched the forecast of the Program for Socio-Economic Development for 2001–2005, while the actual real wage growth was higher by approx. 2.2% per annum. But despite the risk of higher than planned real wage growth without a matching increase in labor productivity, the 2006–2010 program is far more balanced in this respect than the 2001–2005 program.

failures' (e.g. education or infrastructure), where private investments are not enough to provide the required level of performance. Scarce fiscal resources must be distributed in the most efficient way. Second, higher state expenditures mean higher taxes, which reduces the investment incentives for taxpayers. Government investment in one specific sector reduces the investment activity in the whole economy. Thus, it is best to choose public investment projects carefully, and improve the investment activities in order to reduce the tax burden.

Finally, a change in the government's attitude towards privatization is not to be expected. In the Program for Socio-Economic Development of the Republic of Belarus for 2006–2010 the government declared that each case of creating a foreign or joint venture from a state enterprise should be considered individually. The government de-facto bans foreign investors from buying a controlling interest. Also, the very tight 'golden share' institute puts an obstacle in the way of fresh capital inflows into "old" enterprises. Thus, all major problems and risks of the bad investment climate continue.

In sum, the government plans to take some positive steps to ensure the sustainability of economic growth. Nevertheless, certain complementary measures are needed, as several risks for growth sustainability are not eliminated by the planned policies.

4.2. Complementary policies

(i) Investment climate

Two major institutional obstacles to a better investment climate go hand in hand: they are the de-facto ban on buying the controlling stock of Belarusian companies by foreign investors and the 'golden share' institute. Any foreign investor should be able to pursue his own policies (of course within legal bounds) without running the risk of governmental interference. He should also be subject to standardized and transparent privatization procedures, because an individual approach to privatization is non-transparent and contains risks for investors. Thus, in order to improve the investment climate, we propose the following:

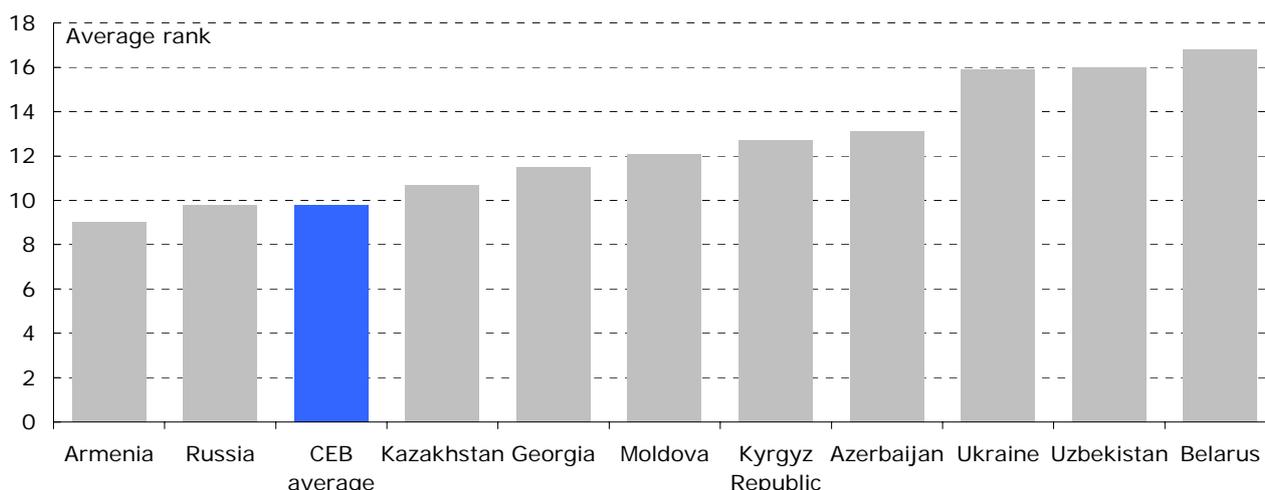
- 1) To draw up a limited list of enterprises not subject to privatization, and to allow foreign investors to buy the controlling stock of any company not on this list;
- 2) To soften the 'golden share' institute, i.e. to limit the number of cases to which it applies to a clearly and unambiguously defined list, or to eliminate this institution.

Improving the investment climate would allow Belarus to use its good investment potential, and to improve technologies and competitiveness. It would also reduce the risks inherent in energy price increases and the Russian trade policy, since Belarusian enterprises with foreign investment would have a better chance to increase their efficiencies and enter new markets. Some foreign companies might then even decide to invest in Belarusian companies rather than compete with them.

(ii) SME development

Another very important growth enhancing policy is SME development. It is needed to better utilize the resources released in the transition process and is one of the components of 'recovery growth'. The role of SME development is not fully realized in Belarus because the current favorable external environment allows the old state enterprises to increase their capacity utilization. Also, the country has a poor environment for SME development. According to the 'Ease of Doing Business' indicator (calculated by the World Bank), Belarus is the last among 25 transition economies (Figure 2).

Figure 2. Ease of doing business in CIS transition economies



Note. CEB (Central Europe and Baltic States) countries are the Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, the Slovak Republic, and Slovenia.

Source: Own calculations based on World Bank data (World Bank (2004) *Doing Business in 2005*).

The World Bank estimates that moving a country out of the group of 20% of countries with the biggest obstacles to doing business into the group of 20% with the most favorable business environment would give it an additional 2.2 percentage points of annual GDP growth. As Belarus is in the 20% group with most difficulties, any easing of doing business in the country would have a significant positive impact on economic growth. According to World Bank estimates, entry reform alone, i.e. reducing the time, the cost, and the number of procedures to register a business, would bring Belarus an additional 0.34% of annual GDP growth. In addition, promoting SME development would smooth the effects of negative external shocks and ease the restructuring of former state enterprises.

Thus, implementing these proposed complementary measures (improving the business climate and making it easier to do business) would contribute to the government's growth enhancing policies and further growth sustainability.

5. Conclusions and policy recommendations

Any economy sometimes faces a favorable and sometimes an unfavorable environment. During 2003 to 2005 the external environment was very favorable for Belarus, and economic growth accelerated.

Thus, Belarus should use the current good times to safeguard itself from likely downturns in the future. This could be done by investing and increasing the capital stock, and by improving the competitiveness of Belarusian enterprises. To do this, the government should create the right incentives for businesses, including foreign ones. In addition to measures already envisaged by the government, we propose to improve the investment climate by moving forward with privatization and making it transparent, by making it easier to do business in Belarus, and by promoting SME development. Only in that way can the current short-term economic growth be transformed into long-term sustainable growth, which will increase the welfare of the Belarusian people.

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Minsk, September 2005