Stolen decades: the unfulfilled expectations of the Belarusian economic miracle

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Abstract

The case of the Belarusian economy has puzzled many academic scholars for years. Belarus has often been referred to as a transition outlier, given its fast recovery in 1996 and spectacular growth prior to the global financial crisis without much transformation of its economy. Three decades after gaining its independence, the state control of the economy remains considerably high. Subsidized financing of state-owned enterprises allowed to preserve production capabilities over the first decade, to achieve some productivity gains in late 1990s-early 2000s, and to avoid social destabilisation. However, with a delay in structural reforms, this economic model, also heavily dependent on the Russian subsidies and foreign debt, has become fatigue, driving the economy into stagnation in the 2010s. The Covid-19, the 2020 post-presidential political crisis and Russia's war in Ukraine put further strains on the economy, calling for change. This chapter gives a brief overview of the Belarusian economic developments before the presidential elections to have a better understanding of how various rigidities of the Belarusian economic model have amplified the detrimental effect of the political unrest for the economy and the Belarusian society overall. It also discusses the anti-crisis and economic reforms Belarus will have to undergo.

Keywords: Belarusian economic model, political crisis, economic reforms

Introduction

Among all post-socialist economies that embarked on economic transition in the late 1980s-early 1990s, Belarus can typically be regarded as an outlier. Compared to its counterparts in Central Europe and the Baltic States (CEB) which on average went through a deeper and more prolonged output contraction in the 1990s after initiating the economic reforms (EBRD 2005), the Belarusian economy showed impressive economic growth in the late 1990s-early 2000s, having undergone hardly any economic transformation. As of 2000, a decade after the transition began in the region, a private sector in Belarus accounted for mere 20 per cent of GDP compared to 67 per cent on average across its neighbouring counterparts (EBRD 2005).

Following some patchy economic liberalisation in 1994-1995, whatever meagre reforms that had taken place, were reversed with the state assuming an increasing role in controlling the economy. A pervasive state intervention in Belarus manifested itself in the increased state ownership, price controls, state redistribution of financial resources to 'priority' sectors of the economy, production targets and so forth (Korosteleva and Lawson 2010). While some of these Soviet anachronisms were eliminated throughout the later decades, the practice of subsidising state-owned enterprises (SOEs), and other forms of state intervention in the economy have been preserved. Nevertheless, the economy grew on average by 8.1 per cent per capita over the period of 1996-2008 (World Bank WDI 2021a).

Has the Belarusian economic miracle continued to live up to its expectations beyond the Global Financial Crisis (GFC)? The rate of economic growth noticeably slowed down in Belarus post-GFC, but more so over the past decade compared to its CEB counterparts, which seem to have weathered better the turbulent times of transition and global financial crisis, steadily paving the way towards prosperity.

The structural rigidities of the economy, accumulated over the past few decades, including a dominant role of the state, a surge in the levels of external and public debt (predominately denominated in foreign currency) and continuing dependence on the Russian economy, have placed serious constraints on the future economic growth in Belarus. The mismanagement of the Covid-19 pandemic, adverse consequences of the 2020 political crisis, and Russia's war in Ukraine have further aggravated the economic situation in Belarus, contributing to the decline in economic growth, an increase in vulnerability of its banking sector and public debt position and a surge of inflation with the expectations of the Belarusian economy sliding into recession in 2022 and stagnation afterwards.

Consequently, this chapter reviews the case of Belarus's economic path of development after the breakup of the USSR, asking the following questions: (1) why Belarus followed a different path of transition compared to its CEB counterparts; (2) what implications this has had for its economic development three decades after transition began; and (3) how the recent events of the 2020 political crisis in Belarus and the Russia-Ukraine war in 2022 have acted as a waking up call for the society to initiate a long-awaited change to a liberal economic path of development. Belarus's economic fallout of the early 2020s appeals for urgent economic reforms, the speed and success of which depend highly on the resolution of the current geopolitical crisis in the region and the political crisis inside Belarus.

The next section provides an overview of the Belarusian transition over the past three decades to better understand some structural rigidities of the economy and their adverse effects on its growth. It proceeds with the discussion of the contemporary developments, focusing on the aftermath of the 2020 political crisis and further implications for its economic development. Section four provides a discussion of the reforms Belarus would need to undertake in the foreseeable future, followed by the conclusions.

Belarus's path of transition: an overview

Early-stage of transition: 1990-1995

The initial shock for all transition economies was the collapse of the administrative planned system which predetermined the transformational recession in socialist countries marked by initial fall in output (Campos & Coricelli 2002). The CEB countries, committed to market reforms and integration with the European Union, followed the conventional transition approach of pursuing the policies of liberalisation, deregulation and privatisation.

After the dissolution of the USSR, the Belarusian authorities were not ready for a radical reformation of the country. At the start of transition, the Belarusian economy remained heavily dominated by energy-intensive manufacturing and mining industries that determined its strategy to preserve economic links with Russia, its core supplier of energy, buyer of Belarusian goods and investor. Compared to the counterparts in the CEB region, such a policy allowed for a less profound recession in Belarus at the start of transition. However, an expansionary macroeconomic policy of the early 1990s triggered hyperinflation and declining living standards, largely determining the choice of the Belarusians to elect the populist Lukashenka in 1994. The beginning of Lukashenka's presidency, 1994-1995, was marked by some fragmented market reforms, reducing inflation, but at the cost of declining output and employment (Korosteleva 2004).

Afraid of losing his political popularity, Lukashenka reversed the reforms in 1996, setting the path for establishment of an authoritarian regime and turning economic policy into the tool of assuring the political viability of the dominant political elite (Korosteleva 2004; Korosteleva 2007b).

An illusion of the economic miracle: 1996-2004

Admitting a decrease in aggregate demand as one of the factors of output decline, the authorities stressed the importance of state stimulation of demand through policies of an unprecedented credit expansion, negative real interest rates, and administrative price control as central ones to achieving economic growth and minimising negative social costs of transition.

The mechanism of administrative resource allocation was not only realised through the directed preferential credits supplies to SOEs to keep them afloat, but also through such indirect instruments as relief from paying some taxes and customs duties by the 'strategic' sectors of the economy; licensing of certain economic activities that aimed to crowd out the potential competitors from the market; rationing access to cheap natural resources; multiple exchange rates; and price distortions. Overall, pervasive state intervention in economic regulation in Belarus created a type of state capitalism, combining state ownership and state control of the economy with the elements, attributed to crony capitalism, promoting rent seeking practices to the benefit of political elites (Korosteleva 2007b).

Public and quasi-public investment-led economic growth was further supported by direct and indirect subsidies from Russia and favourable external environment that boosted Belarusian exports in the late 1990s-early 2000s. Being a small open economy, Belarus highly depends on foreign trade. Since the establishment of the Customs Union between Russia and Belarus in 1995, Belarus received unlimited access to the Russian market and sizable loan subsides and energy discounts, estimated to reach between 11-19 per cent of the Belarusian GDP in the late 1990s-early 2000s (Silitski 2002; Aslund 2021)[1].

The policy of money-led stimulation of aggregate demand triggered the surge in households' consumption and investment. Subsidizing SOEs allowed to preserve their production capabilities in the medium run, gradually increasing the share of productivity as a driver of the economic growth in the late 1990s and early 2000s (Figure 1). Altogether, credit-stimulated economic growth jointly with the Russian in-kind subsidies ensured a fast recovery of the Belarusian economy with economic growth rate averaging at 7 per cent over the period of 1997-2004 – the phenomenon coined in the literature as the Belarusian economic miracle (Korosteleva and Lawson 2010).

{INSERT FIGURE 1 ABOUT HERE}

However, a loose monetary-credit policy accelerated inflation and led to inefficient allocation of resources, lowering productivity of accumulated capital and overall deterioration of Belarus's competitive position (Korosteleva and Lawson 2010; Kruk 2013).

A dual path of economic development: 2005-2019

Tensions with Russia, industrial modernisation and recession

The economic developments in the late 2000s were driven by the reduction in Russia's subsidies that urged the authorities to initiate some fragmentary structural reforms, including taking some steps towards modernisation of the industrial sector and private sector initiatives (including targeted privatisation), while continuing subsidizing SOEs.

Exports to Russia started to decline in 2005 reflecting a declining competitiveness of the Belarusian machinery and equipment products with Belarus losing its share in the Russian market to Chinese manufacturers. The export position was worsened further since 2007 because of political tensions with the Russian authorities who initiated a policy of gradual adjustment of the price of gas, supplied to Belarus, to market prices, starting with a doubling of the gas supply price in 2007.

This move had adverse consequences for the Belarusian economy, given relatively high energy intensity of Belarusian industries. Higher energy prices also harmed the competitiveness of export-oriented enterprises specialising in production of transport, equipment and electric goods, widening trade deficit. Finally, as a last straw in trade wars between Russia and Belarus was the introduction of a special duty on crude oil exports to Belarus in 2007-2009 to settle the long-lasting disputes between the two countries regarding sharing revenues from oil export duties in relation to the rest of the world that reduced energy subsidies to Belarus further (IMF, 2019a). The global economic crisis additionally reduced the Belarusian export growth in 2008-2009, widening a current account deficit (Table 1) and triggering the fall in GDP per capita growth from 10 per cent in 2008 to stagnation in 2009 (Figure 1), and along with the expansionary fiscal and monetary policy of the election 2010 year resulting in a severe currency crisis in the first half of 2011.

{INSERT TABLE 1 ABOUT HERE}

To address a decline in output growth after the global financial crisis, the authorities initiated some industrial modernisation during 2012-2015 via increase in investment directed towards SOEs, targeting an upgrading of their worn-out fixed assets, and enterprise restructuring.

The attempts of industrial modernisation largely failed which was also evidenced via a declining and negative contribution of total factor productivity to economic growth in the early 2010s (Figure 1). Large-scale privatisation and reforms directed towards increasing enterprise competitiveness remained stagnant (EBRD 2013). Foreign direct investments post-2011 remained low to ignite any foreign capital-led modernisation of the real sector (Table 1). Overall, as of 2013, Belarus presented itself as one of the least reformed economies with the progress of transition being stalled since the reversal of political and economic course in 1996 (EBRD 2013). A continuing credit expansionary support of inefficient SOEs threw the economy in the recession in 2015-2016, triggering also an increase in external debt relative to GDP as a result of the Belarusian rouble devaluation and a disproportionately large share of external debt denominated in foreign currency.

Private sector developments

Private sector development initiatives have largely begun with the creation of High-Technology Park (HTP) in Minsk in September 2005, entitling its residents to tax incentives and other benefits, introduced gradually over the past decade. The HTP creation effectively marked the establishment of the Information and Communication Technology (ICT) industry in Belarus, taking roots in the mid-late 1990s with the birth of such new technology firms like *EPAM Systems*, known these days as a world-leading software engineering & IT services company. The HTP has continued to grow, hosting new unicorn startups in the later years, including *VIBER*, a messaging app; *MSQRD*, social network service and video sharing mobile app, acquired by Facebook in 2016; *AIMatter*, a neural networks technology-based app for changing the background images, acquired in 2017 by Google, and so forth. The ICT sector's contribution to GDP has steadily increased over the past decade, reaching 5.5 per cent of GDP in 2018 and projected (prior the start of the political crisis in late 2020) to reach 10 per cent of GDP by 2023 (Foy 2020).

The private sector developments have continued with some business environment deregulation reforms over the period of 2008-2010, leading to the introduction of a one-day registration policy for individual entrepreneurs and simplification of liquidation procedures. A new entry of firms was expected to be facilitated further with the development of 'Great Stone China-Belarus' industrial and logistics park initiative launched in 2012, enactment of the decree on development of entrepreneurship in 2017, and with the steps taken to facilitate digital transformation of the economy in 2018.

While all these developments laid good foundations for the diversification of the Belarusian economy to be led by new technology firms, they were compromised by the political crisis following the Belarusian presidential elections in August 2020, and various structural rigidities inherited from the Soviet times and deepened under the Lukashenka's rule. Under the current regime with a preserved heavy state intervention in the economy, there has overall been little progress observed in new business entry in Belarus compared to its CEB counterparts (Figure 2).

{INSERT FIGURE 2 ABOUT HERE}

Belarus's relative innovation capacity, assessed via Global Innovation Index also remains the lowest among its neighbours overall and within the majority of its dimensions (Figure 3). Belarus underperforms particularly in terms of institutional quality where the most concerns raise government effectiveness, the quality of regulatory environment, and the rule of law; and within the business environment dimension of the institutional pillar – the cost of redundancy dismissal, and ease of resolving insolvency. Some other areas of concern include low Research and Development (R&D) capacity, not compatible with an economy pledged to become knowledge-based and technology-oriented; credit constraints underlying the underperformance of the market sophistication pillar; underdeveloped innovation linkages to enable an efficient technology transfer that remains the weakest link within the business sophistication pillar, and lack of intangible assets, such as trademarks, global brand names and so forth, constituting part of the creative pillar assessment.

{INSERT FIGURE 3 ABOUT HERE}

In sum, it is worth emphasizing that regardless inheriting fairly favourable initial economic conditions at the start of the transition, which jointly with the preservation of some links with Russia allowed the Belarusian economy to bounce back in the mid-1990s and to grow spectacularly in the late 1990s-early 2000s, structural rigidities of the economy, accumulated over the past few decades and summarized below, have placed serious constraints on future economic growth. These include the following:

1. A dominant state control over the economy via asset ownership; cumbersome regulation; and allocation of resources has become fatigue, throwing the economy into stagnation over the last decade. Although the share of the state in the economy has decreased over the past decades[2], the state preserves its dominant control over the banking sector with state banks owning more than half of all banking assets in the country, and their share in lending to the real sector of the economy accounts for 70 per cent (EBRD 2021). In their majority, SOEs remain inefficient in terms of their operation and dependent on state subsidies, constituting a burden for the economy as a whole (IMF 2019b). With a few exceptions, they are locked on regional CIS market, and their innovation in-house activity as judged by their R&D expenditure remains fairly marginal to have any substantial impact on raising their competitiveness globally.
2. External debt has increased over the past decade (Figure 4a), and it is primarily denominated in foreign currency (Figure 9b), making the economy vulnerable to any external shocks. International reserves in proportion to gross external debt have declined (Figure 4b). They are also predominantly comprised of illiquid assets.

{INSERT FIGURE 4a and 4b ABOUT HERE}

3. Belarusian economy remains highly dependent on the Russian economy in part of energy and financial subsidies (IMF 2019a). Russia also remains the largest trading and investment partner.

{INSERT FIGURE 5 ABOUT HERE}

Overall, the past decade of stolen reforms in Belarus has led to stagnation of the Belarusian economy (Figure 1) and slipping behind its neighbours to the West (Figure 6).

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Contemporary developments

Early 2020s and the oil price saga

Belarus entered into 2020 without agreement on supplies of Russian crude oil and no agreement on gas prices. The gas dispute was resolved, keeping the price at the level of 2019, but from January till March 2020 Russia stopped the supply of oil to Belarus.

The key reason for such a clash between Belarus and Russia at that time was the tax manoeuvre in the oil industry that Russia had conducted since 2015 which resulted in phasing out oil subsidies to Belarus. The idea was to gradually increase a tax on oil extraction while decreasing duties on exports of crude oil and petroleum products to stimulate Russia-based refineries to refine crude oil in Russia instead of exporting it. The second phase of tax manoeuvre was to take place between 2019 and 2023, meaning the steadily rising prices for Russian crude oil imported to Belarus, while the duties on exports of petroleum products retained in the Belarusian budget were to drop by 5 per centage points annually from 30 per cent to 0 per cent. It implied that Belarus would pay the market price for the Russian crude oil starting from 2024. According to the Research Centre of the Institute for Privatisation and Management (IPM 2019), the cumulative total losses for 2019-2024 were estimated at around 15 per cent of Belarus's GDP in 2019. Following the oil dispute, real GDP growth contracted in the first quarter of 2020 (Figure 7), marking the start of the third economic crisis of the last decade, after the ones in 2011 and 2015-16.

{INSERT FIGURE 7 ABOUT HERE}

The mismanagement of the Covid-19 outbreak as a first trigger of an uproar in Belarus

Just before the Russia-Belarus oil disputes were resolved, the Covid-19 pandemic erupted. Minsk chose a very controversial strategy of dealing with the pandemic. The authorities ignored the problem, not shutting down the production and encouraging social distancing, but rather sacrificing lives. Despite all the attempts of the Belarusian authorities to misrepresent the true statistics of deaths attributed to the Covid-19 pandemic, the real numbers were much higher, putting Belarus among the countries with the highest death rate resulting from the Covid-19 pandemic[3].

The state also decided not to support private businesses during the pandemic. Only the designated SOEs were able to receive any significant public support. Despite the chosen strategy, the economy was hit by the pandemic, leading to a drop in real GDP by 3.3 per cent year over year (yoy) growth in the 2nd quarter of 2020 (Figure 7).

The dark before the dawn: the 2020 political crisis, sanctions and gradual economic fallout

The next blow to the economy was the 2020 presidential elections. The brutal suppression of peaceful protests and massive violation of human rights triggered a sanctions response from the international community, toughened in May-June 2021 after the regime hijacking the plane with an opposition activist and migration crisis on the border of Belarus with the EU. Among those which were expected to have an economic impact were a set of trade, financial and aviation sanctions; blocking sanctions against selected entities; sanctions against wealthy business owners (so-called Lukashenko's 'wallets'); sectoral sanctions, targeting among others the largest Belarusian exporters of chemical and petrochemical products.

Regardless of the deepening of the political crisis, in 2021, the Belarusian economy surprised again with a fast recovery from the post-Covid recession and a surge in economic growth in the first two quarters of 2021 (Figure 7), attributed to net exports increase driven by the world prices upswing in raw materials and commodities markets (so called "exports miracle"). Nevertheless, in light of declining economic growth (Figure 7), growing inflation (Figure 8) and vulnerable public debt position (Figure 9and 9b), the Belarusian economy was to fall in recession in 2022 (World Bank 2021b). This will deepen further because of the above-mentioned structural rigidities of the economy and acceleration of the adverse impact of sectoral economic sanctions, broadened by the international community in response to Russia's invasion of Ukraine on 24 February 2022. Belarus is recognised by the world as the co-aggressor in this war, urging the international community to broaden the scope of sanctions on Belarus. As of April 2022, 40 Western countries, including the EU, US, UK, Canada, Switzerland and Norway, have severely restricted imports from Belarus, among others, of crude oil and petroleum products, potash and nitrogen fertilizers, iron and metal products, wood and wood products, cement and rubber products. In particular, the EU and US banned the supply of two thirds of the Belarusian exports to these countries (based on the value of exports for 2021). The US, Canada and the UK deprived Belarus of the most-favoured-nation (MFN) status, which will increase tariffs on Belarusian exports to these countries (e.g., in the case of Canada, this means 35 per cent duty on Belarusian goods). Due to the war, Belarus lost supplies to Ukraine, to which it directed almost 13.6 per cent of the exports in 2021. Exports to Russia will also fall significantly due to the deep recession. Thus, owing to the war and sanctions, Belarusian exports could be reduced by about 40 per cent, which is concerning given that Belarus is highly dependent on trade. In addition, the EU banned Belarusian automotive transportation providers from working in the EU. This war places serious constraints on the future economic performance of Belarus as a whole.

{INSERT FIGURES 8-9 ABOUT HERE}

Future development prospects and economic reforms[4]

Under the current geopolitical crisis, Belarus finds itself at a crossroads in history with its future development being highly dependent on the outcome of the Russian-Ukraine war in the first place. If the war prolongs for long, this will continue further precipitating the downfall of the Belarusian economy. The longer it lasts, the costly is a post-war recovery going to be for any parties involved in this conflict. Nevertheless, we expect an economic fallout, aggravated by the Western sanctions, to bring inevitable collapse of dictatorial regimes in Belarus and Russia.

Economic reforms to follow in Belarus should be the outcome of inclusive national dialogue, which would be impossible without free and democratic elections, and should reflect the values and aspirations of its people. While it has been debated for some time to what extent the Belarusians would like to see the state playing a reduced role in the economy, more recent survey data suggests that Belarusians view the private sector and entrepreneurship as sources of economic growth, and see the role of the state primarily as a provider of public goods such as healthcare and education (Rudkouski 2021; Thinktanks.by 2021). On average, Belarus's population is well-educated and creative, and it has high potential to unleash its entrepreneurial spirit to place Belarus on a new entrepreneurial path of economic development in which a significant role is played by new technology firms.

It is essential for a new government to communicate clearly to the society the vision of reforms, their timing and sequence, benefits and costs, chances and challenges prior launching the reforms, as failing to do this was one of the main mistakes of many reformers in post-socialist countries (Guriev 2019). Meaningful economic reforms are more likely to succeed if the judicial system is also reformed at the same time. The latter will be key to defending the foundations for economic growth – human rights, property rights protection and contract enforceability.

In general, Belarus's experience of economic transformation should be more smooth compared to its counterparts in the early 1990s. As a laggard in reforms, it can learn from the mistakes of other transition counterparts and adopt best practices. One of largest concerns anticipated in reforming the economy is a reform of the public sector. Belarus has much smaller share in the economy than three decades back, making public sector less challenging. Finally, a private sector, which accounts for nearly 50 per cent of the country employment, is dominated by relatively healthy and competitive firms that could help facilitate SOE restructuring, absorbing some job reallocations. However, the smoothness of reforms depends on the state of the economy after the Russian-Ukraine war and the attitude of Russia towards Belarusian democratisation and economic liberalisation (Hartwell et al. 2022). Further below we consider key aspects of economic reforms Belarus will have to undergo.

Macroeconomic stabilisation

In the first place, for a successful economic transformation, for Belarus it is essential to undergo macroeconomic stabilisation and institutional reforms that jointly will help addressing structural rigidities identified earlier. Declining economic growth, rising inflation, and mounting public debt all have adversely affected macroeconomic stability in Belarus. Drying up of international funding in the light of the imposed economic sanctions, an outflow of households' deposits in foreign currencies and growing non-performing loans (NPLs) of SOEs may trigger a severe banking crisis., The following actions must be considered to re-build macroeconomic stability: (1) establishing legal foundation of the National Bank (NBRB) institutional, functional, personal and financial independence to allow it achieving its objectives of maintaining low inflation and financial stability; (2) reforming the banking sector and tackling the problem of bad loans of SOEs; (3) fiscal policy support for structural reforms, targeted social protection and fiscal consolidation; (4) managing and sustaining public debt.

More specifically, maintaining the financial stability of the Belarusian economy depends on resolving the problem of debt problem of SOEs and preventing their consequences if the unresolved political crisis leads to a worsening of the economic situation in the country. Belarus might adopt the successful case of Slovak banking sector "cleaning" in 1999-2000 when, with support of international financial institutions, NPLs were transferred in instalments to a newly established specialised bank in exchange of the government bonds (Naūrodski & Šramko 2021). This would need to be supported by endowing the NBRB with the power of a mega-regulator, i.e. making it both regulation and supervision institution for the financial market; and introducing transparent and effective (both in terms of time and costs) legal bankruptcy procedure. In the long run Belarus should open the banking sector to foreign investors to facilitate privatisation of state-owned banks.

To support structural reforms, the authorities will need to reduce the cost of maintaining the state apparatus, to transit to medium-term fiscal management and to introduce fiscal rules with a view to ensuring due support for structural reforms while sustaining public debt. At the same time, authorities must phase in mechanisms for fiscal transparency and the accountability of the budgetary process, reduce tax evasions and close fiscal loopholes, such as numerous VAT and other tax reliefs as well as unreasonable benefits and preferences for individual entities established by the regime.

Belarus will need to refinance its public debt at a lower interest rate and for longer periods to reduce the debt burden on the budget and free up significant funds. Extending the loan terms with deferred repayment for the first few years of reforms will provide additional savings for the budget.

Economic liberalisation and private sector development

The private sector has developed rapidly in Belarus in recent years despite the high regulatory burden, unfair competition, and the risks of facing politically motivated criminal prosecutions. Ensuring competitive neutrality through the restructuring of state governance and SOEs and providing equal treatment for private and public sectors in regulation, public procurement, access to loans and other aspects is essential in facilitating private sector development further.

Among other things the focus should be placed on revising and liberalising existing regulations. Other measures should include decriminalizing further minor economic offences; reforming oversight bodies to minimize inspections and associated sanctions; introducing a moratorium on SMEs inspection for up to three years; reducing the fiscal burden on business and labour, including social security contributions via a shift towards consumption and wealth taxes; removing price controls and administrative market barriers.

Creating entrepreneurial and start-up infrastructure to support nascent high-tech businesses and entry of individual entrepreneurs could be tackled efficiently via promoting development of incubator parks; provision of consultancy and training grants; loan guarantee schemes for start-ups; R&D tax reliefs to encourage innovation; and facilitating a practice-based entrepreneurial and business education at higher education institutions. To ensure the provision of start-up funds, tapping into FinTech opportunities and developing venture capital infrastructure should be foreseen along with the reforms of the banking sector and revitalisation of the stock market.

It is essential to ensure integration of Belarus in the global value chains to enable its trade diversification and reducing dependence on the Russian market. The following steps should be taken in this direction: finalisation of the accession to WTO; adopting the partnership priorities between the EU and Belarus; reviewing numerous EU trade restrictions for Belarusian goods and services; developing and signing Comprehensive and Enhanced Partnership Agreement between the EU and Belarus that would also comply with Belarus' membership in the Eurasian Economic Union. With respect to the latter, it is worth considering the examples of the agreements signed between the EU and Armenia, when Armenia was already a member of the Eurasian Economic Union, or Deep and Comprehensive Free Trade Area, signed between the EU and Georgia, Moldova and Ukraine.

Finally, a programme to encourage return of businesses operated by Belarusian migrants overseas should be designed to prioritise, among other things, facilitating access to unexploited real estate under state control, and business relocation support programme.

Restructuring and privatisation of state-owned enterprises

The path to SOEs' restructuring should start from creating a single government body in charge of SOEs management and restructuring**.** Currently the de facto management of SOEs is scattered across sectoral ministries and the State Committee on Property, making an overall assessment of the sector impossible and related problems less visible. The next step should be to evaluate and classifying all SOEs through financial audit procedures to understand their viability and divide them into three groups: (i) viable and financially stable SOEs; (ii) SOEs in need of financial support but able to become solvent; and (iii) insolvent SOEs.

To restructure the largest and most significant SOEs (around 100 companies currently on the list of strategically important enterprises), individually tailored measures should be designed. Their privatisation should be postponed until they become more attractive for investors once proper incentives and corporate governance policies are implemented following their restructuring, and the administrative and tax burdens as well as the extent of cross-subsidization are reduced. As for small and medium-sized SOEs located in large cities, they could be either privatised or liquidated without further delay. In particular, this concerns SOEs in services sector like retail trade, transportation and warehousing, accommodation, food services, entertainment and recreation. Belarus already has a large enough private sector that could absorb and effectively use released assets and labour as a result of this restructuring.

Redefinition of the state's mission

The role of the state in the economy should be redefined. Instead of picking winners and combining regulation and ownership roles, it should focus on building inclusive institutions and providing public goods. The government can provide a supporting role for building up an entrepreneurial state via strategic and mission-oriented investment in tackling grand societal challenges and co-creating new markets which would otherwise be considered as too risky-undertakings for private firms (Mazzucato 2013). Establishing the rule of law, efficient judiciary, and functional political institutions are a prerequisite, and decentralization of major government functions would help build transparency, accountability and trust in these institutions.

Further reforms should focus on (1) reforming education with focus on nurturing creativity and entrepreneurial skills, and healthcare system with a focus on patient-centric approaches, while preserving the inclusivity of these public services; (2) decentralising decision-making, including by giving local authorities more powers and more flexibility on spending decisions. This is a reform that has delivered great results in other countries in the region (e.g., Poland, Slovakia and Ukraine); (3) promoting innovation through support for science and R&D tax relief schemes, as well as technology transfer development and innovation infrastructure; and (4) conducting productive development policies, including digitalization and investment in renewable energy. The latter will provide an additional source of economic growth and contribute to the diversification of energy sources and energy security. Facilitating a green transition through participation in the EU policy initiatives like European Green Deal will promote a sustainable and circular economy, reduce carbon emissions, and support for Belarusian exporters in becoming better prepared for trade and investment opportunities offered by the European markets.

Efficient social support policy

Reform of the social support system would be especially important to absorb the impacts of SOE restructuring, which should include introducing unemployment insurance and benefit schemes. This expansion of unemployment support must be accompanied by expansion of active labour market services, and retraining programmes. Targeted social assistance to the most vulnerable groups should be addressed via extending the longevity and increasing the minimum size of benefits.

The pension system reform should foresee the introduction of a fully funded component. Initial funding for a fully funded component could come from the proceeds of privatisation. However, further parametric reforms, including the gradual raising of the effective retirement age, may become necessary. Among other things, it is important to also address demographic challenges via redirecting childcare support away from benefits supporting long parental leave to supporting public (and private) childcare and offering Belarusian parents an option of combining childbearing with active labour market participation. Other actions to consider include supporting and promoting gender equality in the labour market, including through anti-discrimination legislation; introducing smart migration policies, focused on attracting the diaspora; reducing male mortality through a comprehensive set of policies that promote a healthy lifestyle.

Conclusion

Three decades on, Belarus remains the least transformed economy in the region with the state preserving the dominant control of the economy via bank asset ownership and allocation of the resources, employment provision and burdensome regulation. The chosen ‘status-quo’ strategy at the start of transition aimed at preserving economic links with Russia, public and quasi-public credit-led economic growth policy, jointly with Russia’s subsidies, helped avoid a sharp output contraction at the early transition, minimise social losses, making the economy boom over the decade prior the global financial crisis.

However, the model of state capitalism with prevalent rent-seeking practices to benefit the political elite, and delayed economic reforms have led to accumulation of a number of structural rigidities, driving the economy into stagnation post-2008. The Covid-19 pandemic, the 2020 post-presidential political crisis and Russia's invasion of Ukraine put further strains on the economy, calling for a change.

While back in the middle 1990s, Belarusians were not ready for market reforms, in their majority they have embraced them more willingly now by seeing clear benefits of private ownership and a healthy competitive environment. The role of the state should be re-focused on building inclusive institutions and providing for the public goods and effective social care support; promoting innovation via creating incentives for private R&D investments, technology transfer development and innovation infrastructure, tackling grand societal challenges and facilitating the emergence of new markets. The speed and success of the reforms to a large extent depend on the resolution of the Russian-Ukraine war and the ongoing political crisis in Belarus.

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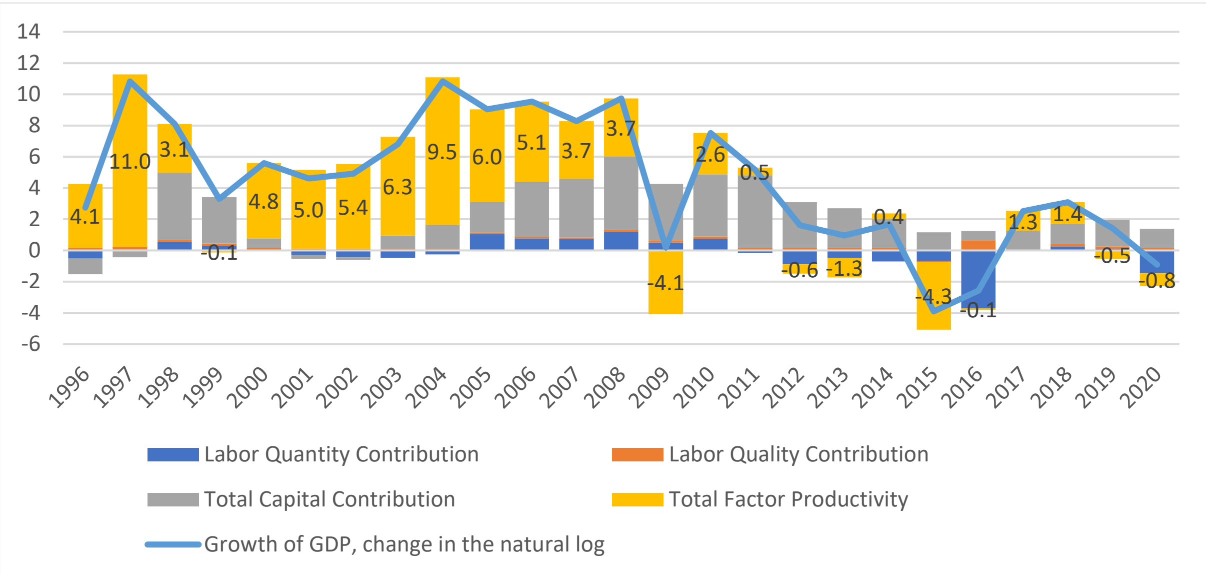
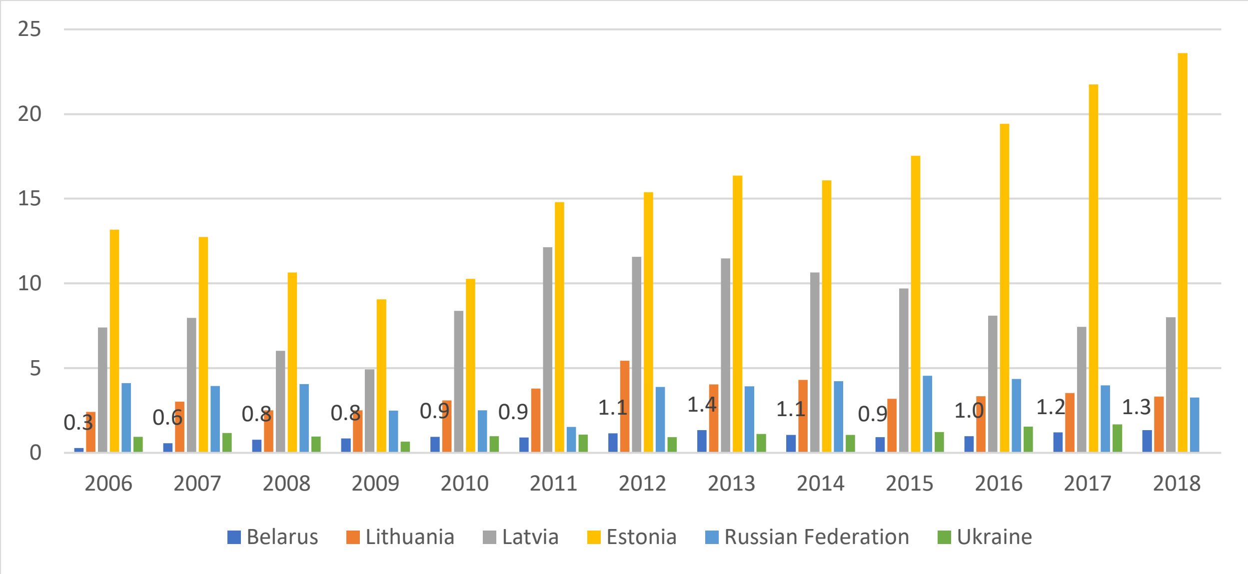
FIGURES & TABLES

Figure 1: Real GDP Growth Decomposition



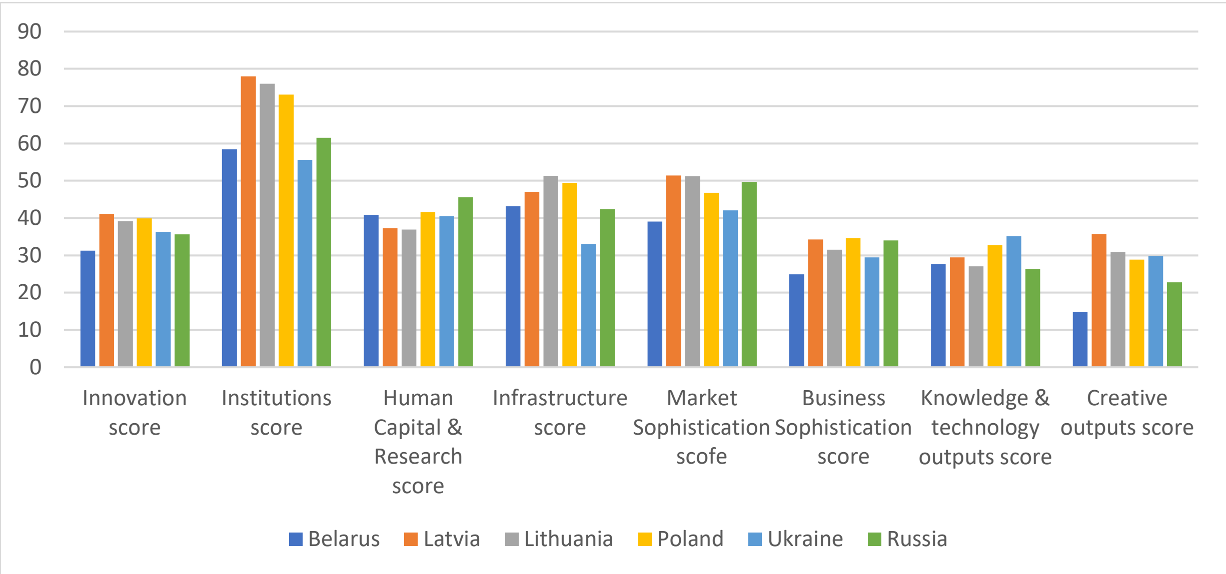
Source: Based on The Conference Board Total Economy Database™ (2021), available at http://www.conference-board.org/data/economydatabase/
Note: Total Factor Productivity (TFP) growth is a residual component of GDP growth not accounted for by capital accumulation, labour quality and quantity growth. It reflects efficient use of resources, including through innovation.

Figure 2: New business density (new registrations per 1,000 people ages 15-64)



Source: Word Bank WDI (2021a)

Figure 3: Innovation performance of Belarus, 2020



Source: WIPO (2020) The Global Innovation Index Report, available at https://www.globalinnovationindex.org

Figure 4a. Net external public sector & government debt

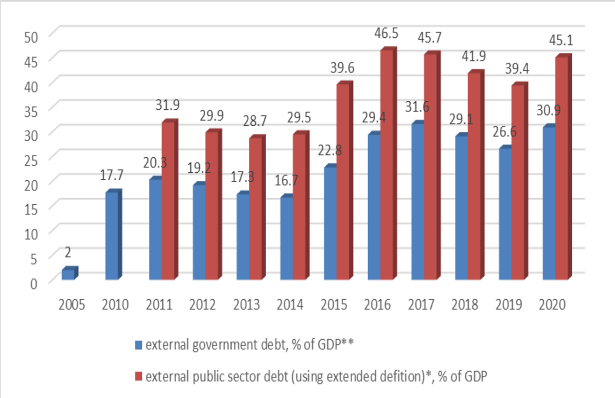
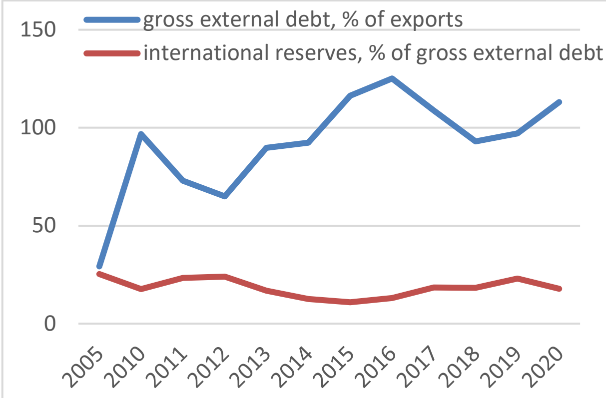
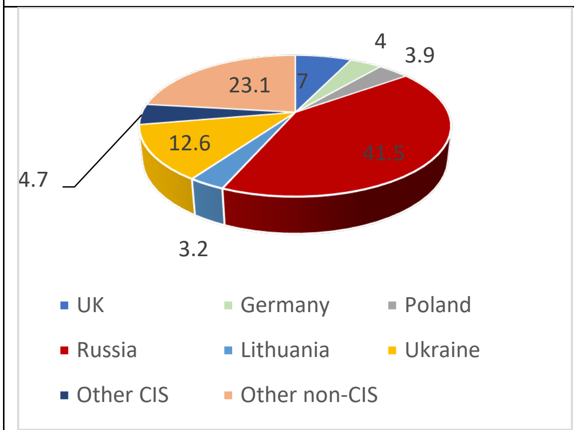
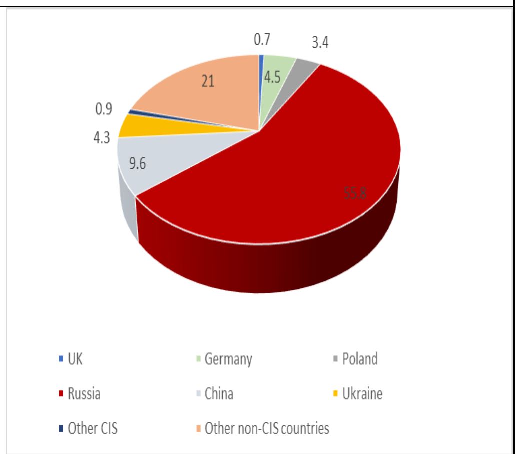


Figure 4b. Gross external debt in relation to export and international reserves



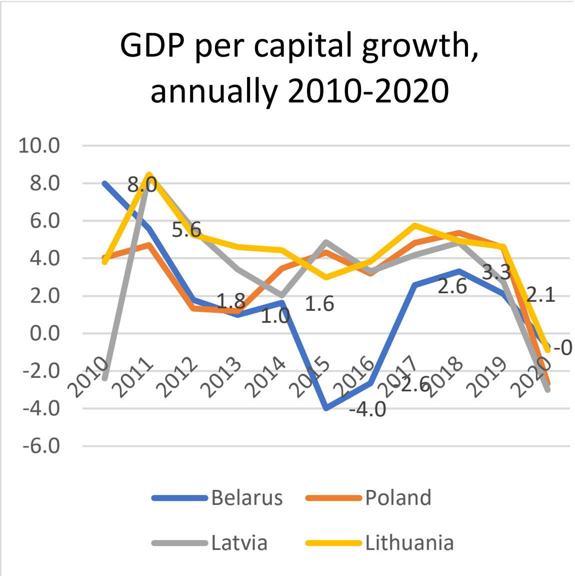
Source: National Bank of the Republic of Belarus (2021), available at https://www.nbrb.by/statistics/externaldebt.
*Note: the extended definition of external public debt includes also state-owned banks and enterprises.

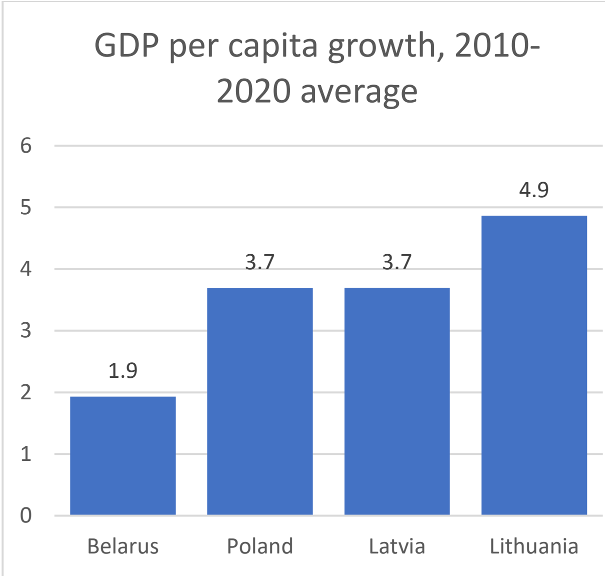
Figure 5: Belarusian foreign trade in goods composition by key partners, 2019

Export shares by key trading partners:	Import shares by key trading partners:
● Non-CIS countries – 41.1% ● CIS countries – 58.9%	● Non-CIS countries – 39% ● CIS countries – 61%
	

Source: Belstat (2020), available at https://www.belstat.gov.by/

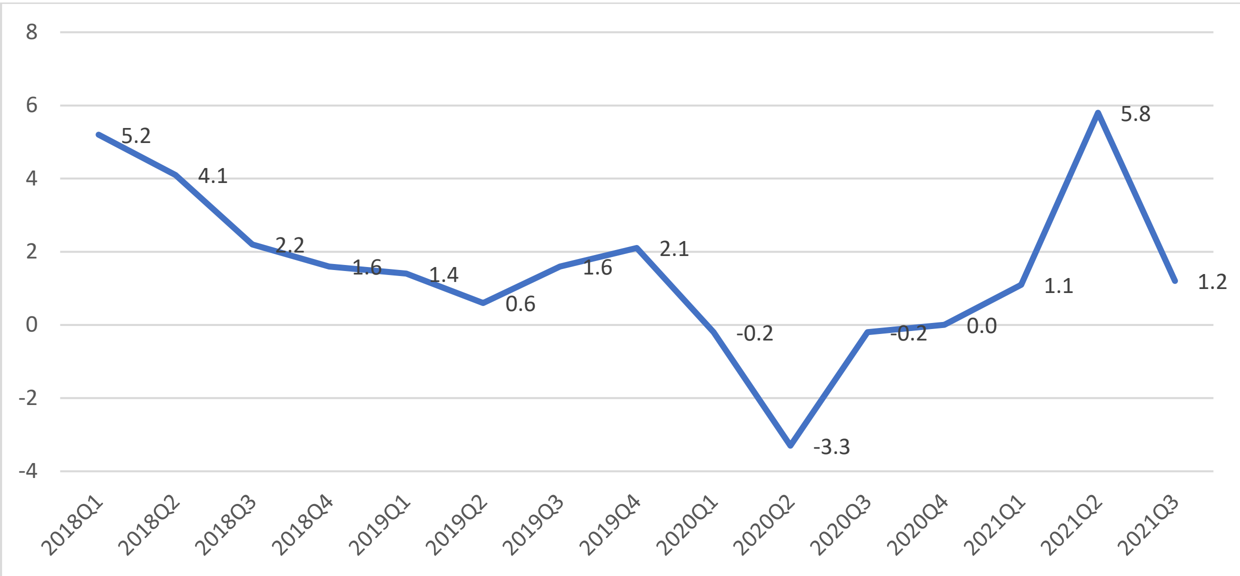
Figure 6: GDP per capita growth rates in Belarus comparing to neighbouring CEB countries, 2010-2020





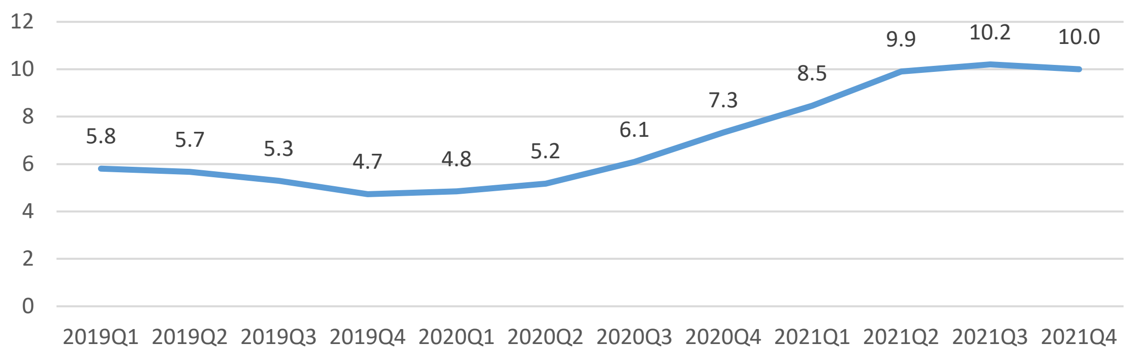
Source: World Bank WDI (2021a)

Figure 7: Real GDP growth rate, % yoy



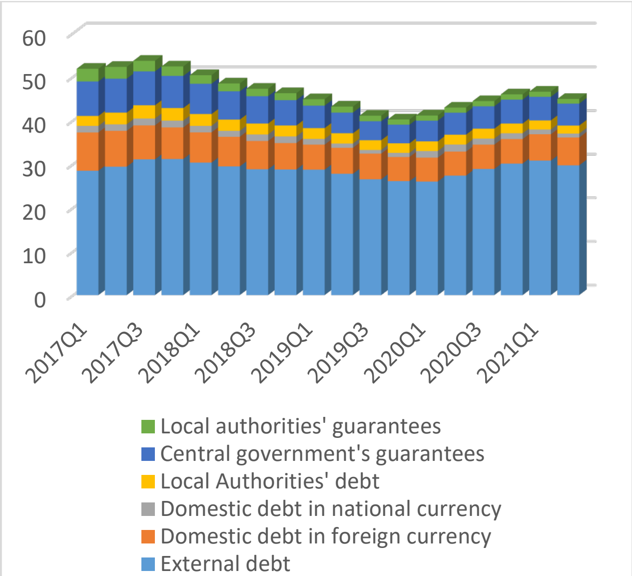
Source: NBRB (2021)

Figure 8: Inflation rate, % yoy



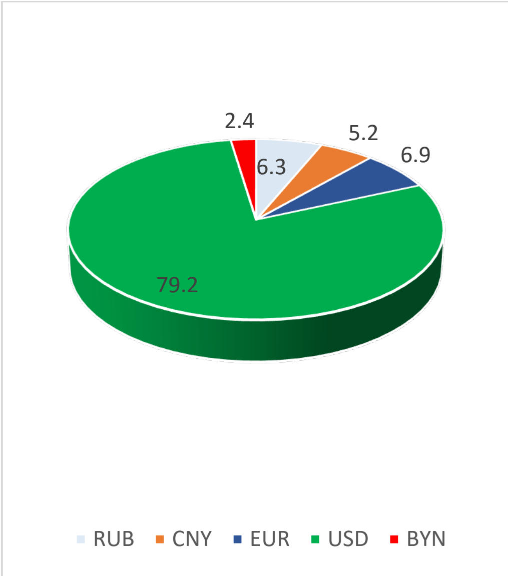
Source: Belstat (2021), available at https://www.belstat.gov.by/ofitsialnaya-statistika/ssrd-mvf_2/natsionalnaya-stranitsa-svodnyh-dannyh/indeks-potrebitelskih-tsen/indeksy-potrebitelskih-tsen-1999-100/

Figure 9a: Public debt, % of GDP



Source: BEROC, Economic Overview (Q2 2021), available at https://beroc.org/upload/iblock/3d4/3d425d54eeac6f757ad33c0b55109c69.pdf

Figure 9b: Public debt, composition by currencies



Source: Ministry of Finance (2020), available at https://www.minfin.gov.by/upload/gosdolg/publication/report_2020.pdf

Table 1: Key macroeconomics indicators, 1995-2020

Indicators	1995	2000	2005	2010	2015	2020
GDP per capita growth (annual %)	-10.1	6.3	10.1	7.98	-3.98	-0.7
GDP per capita, PPP (constant 2017 international $)	5805.3	8053.2	11940.2	17288.4	18307.5	19148.2
Final consumption expenditure (% of GDP)	79.6	76.4	72.8	71.7	67.8	68.4
Exports of goods and services (% of GDP)	49.7	69.2	59.8	51.4	58.0	61.9
General government final consumption expenditure (% of GDP)	20.5	19.5	20.8	16.0	14.9	16.9
Gross domestic savings (% of GDP)	20.4	23.6	27.2	28.3	32.2	31.6
Gross fixed capital formation (% of GDP)	24.7	25.2	26.5	38.8	28.6	24.8
Gross capital formation (% of GDP)	24.7	25.4	28.5	40.7	29.0	26.3
Industry (including construction), value added (% of GDP)	33.4	33.5	37.8	35.4	32.7	31.3
Research and development expenditure (% of GDP)	..	0.7	0.7	0.7	0.5	..
Income share held by lowest 20%	..	7.9	8.9	8.8	9.7	10*
Income share held by highest 20%	..	39.1	36.5	37.5	35.5	35.4*
Current account balance (% of GDP)	-3.4	-3.6	1.5	-14.5	-3.2	-0.4
Foreign direct investment, net inflows (% of GDP)	0.11	0.9	1.0	2.4	2.9	1.98*
Poverty headcount ratio at national poverty lines (% of population)	..	41.9	12.7	5.2	5.1	4.8
Total debt service (% of exports of goods, services and primary income)	3.4	5.5	3.96	5.9	14.9	11.3
External debt stocks (% of GNI)	12.6	20.7	17.6	50.6	70.9	73.7
Inflation, GDP deflator (annual %)	661.5	185.3	18.97	11.3	16.0	10.1

Source: World Bank World Development Indicators (2021) [accessed 17/11/2021].
Note: * shows the 2019 year figures

Notes

[1] According to Aslund (2021), Russia's subsidies amounted to USD $ 6 bln. per year in the early 2000s, which is based on the average estimate of the Belarusian GDP of USD $ 32 bln. over the period of 2000-2004 (WB WDI 2021), were reaching 19 per cent of GDP. The energy discounts were reduced post-2008 but according to the IMF (2019a), they still remained substantial.

[2] According to EBRD (2021) based on their Life in Transition Survey in 2016, employment in SOEs and public services (public administration, healthcare, education, etc.) remained the highest in the region, accounting for over 60 per cent of total employment. According to the data from IPM Research Center and Belstat (2021), employment in SOEs has declined to 30 per cent but jointly with public services, it accounts for 54.5 per cent of total employment.

[3] According to Karlinsky and Kobak (2021) by June 30, 2020 the excess mortality in Belarus during Covid-19 pandemic was 14.5 higher than the officially reported Covid-19 death count.

[4] This section is based on the Chatham House policy paper (Bornukova & Alachnovič 2021).