INVESTMENT AND TRADE POLICY OF THE REPUBLIC OF BELARUS

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Globalisation creates a situation where the conflicts in certain regions directly affect the global state of affairs. From this perspective, developments in the 21st Century will be largely influenced by processes taking shape in the whole world. Multi-ethnic and multi-confessional Belarus has avoided the religious and ethnic conflicts so characteristic of many post-Soviet countries. Organised government management and law-enforcement systems have allowed us to ensure an adequate level of security for our society and people.

The strategy of economic development, priorities and the stages of reformation of the economy of Belarus are based on the so-called “Belarusan model” of development, which is a socially orientated market economy stipulated by the Constitution and with regard to the place and the role of our state in the world community. Reformation of the Belarusan economy started in 1991 after the dissolution of the USSR. The current stage of reformation and development started in 1994-1995 and is connected with cardinal changes in the economic policy of the state carried out before. Belarus looked for its own way of development in the years of crisis, one based on a sound pragmatic and practical understanding of world experience, taking into account particular internal problems and the general situation in the world.

How should one build a programme of economic development? To ensure financial stabilisation at the cost of a drastic tightening of monetary and credit policy which would limit purchasing power (i.e. wait for economic growth in the future), or to undertake positive economic dynamics and to ensure financial normalisation of the economy?

As a rule, we receive advice and recommendations in one direction - to remove everything from the road and to observe the reconstruction of a market economy. For this purpose, it is necessary to undertake decisive reform steps: total privatisation without any restrictions, ensuring total liberalisation of prices and foreign economic activity, and the introduction of bankruptcy proceedings. But nobody tells us how the state should maintain state budget payments to pensioners and the unemployed when production is falling.

The experience of world economic development affirms that the economic systems which achieved the greatest prosperity are models where market mechanisms have been complemented by an active state policy. No country in modern history has overcome crisis and depression setting all its hopes upon the "miraculous power of the market" alone. In this respect, we have come to the conclusion that "one should not give complete control over the matter of transfer to the market itself" and "it is useless trying to take advantage of an institution which has not yet been created".

General Summary and Outlook of the Economy of the Republic of Belarus

GDP Growth and Output

The rate of real GDP growth in Q2 1999 was 3.2% having increased from 1.1% in Q1. The rate of growth during H1 1999 is lower than GDP growth recorded during 1998. The slow- down in growth rate has occurred since August 1998 and was caused by the Russian crisis, as Belarus is still heavily dependent on trade with Russia. GDP growth during 1997 and 1998 was due mainly to growth in consumption, and the decline in consumption during the first half of 1999 has also been the major factor behind the decline in GDP growth.

The BET index of real industrial production showed an increase of 1.8% during Q2 1999, which included a fall in production in April followed by a recovery in May and June. The sectors that showed the largest increases in production during Q2 were construction and food processing, both of which were seasonal increases. The sectors that showed the greatest decreases in output during Q2 were electrical energy (which is a seasonal decline) and iron and steel production. None of the nine major industry sectors in Belarus is showing signs of long-term growth, and as yet there are no new sectors that appear to be growing. This is consistent with the lack of restructuring and development of the private sector. Restructuring of industry leading to new growth sectors is vital to Belarus, and new sectors are only likely to emerge from newly privatised and/or start-up firms.

Although there was a seasonal increase in agricultural output during Q2, the long-term decline in agricultural productivity continued during the quarter. This is also consistent with a lack of restructuring and state domination in the agricultural sector. The agricultural sector still receives quasi-fiscal subsidies (i.e. subsidised loans) through the banking system.

Prices and Inflation

The CPI grew by 25.3% during Q2, compared with 48.6% during Q1 1999. The rate of increase in inflation is sharply reduced from the peak levels experienced during Q4 1998, although the level of inflation is still substantially higher than that achieved during 1997 and the first half of 1998. The producer inflation index (IPPI) rose by 17.3% during Q2 compared with a rise of 76.3% during Q1 1999.

The increase in nominal wages during Q2, due mainly to the increase in the minimum wage, is certain to increase inflationary pressures in the near future, as these increases in wages are unlikely to be matched by productivity increases. Inflation is still the price that Belarus is paying for the policy of directed and subsidised credits, mainly to the agricultural and construction sectors. Money creation, due both to government borrowing and to financing a quasi-fiscal deficit, is still a major issue in determining inflation.

Administrative measures have been increasingly used in an attempt to control inflation, although these measures are evidently not succeeding. Inflation will only be significantly reduced by a coordinated move to allow prices to be determined by market forces. This will have to be combined with measures to liberalise markets and trade. Liberalisation will unavoidably bring to the surface existing inflationary pressures, which have been administratively repressed but not eliminated, but will not otherwise create new inflation. From the new market balance, the containment of inflation will, of course, require a greater monetary discipline than has been exercised until now by the NBB.

Fiscal and Monetary Developments

The government's measured fiscal position remains sound, with the budget effectively balanced during Q2 1999. This indicates a good record on tax collection. The fact that there is little domestic and external debt is a very positive factor for Belarus, especially compared to other transition economies such as Ukraine and Russia. However, government expenditures continue to be understated because of the quasi-fiscal subsidies to the agricultural and construction sectors (as noted above) which have been effected through the banking sector since 1996.

The sources of government revenues remain inherently weak, whilst pressure on government expenditure continues to increase. The long-term decline in the contribution of direct taxes (especially taxes on profits) continues, and government revenues are increasingly derived from indirect taxation. There is limited scope for further rises in indirect taxation without further sustained economic growth. Policies aimed at promoting growth and wealth creation in the private sector would lead to an increased proportion of government revenues being derived from direct taxes, which would be more sustainable in the long-term.

Pressures on government spending continue to increase due to the increasing size of the dependent population. The continuing decline in productivity in the agricultural sector and the lack of sustainable growth in industrial sectors inhibits the Republic's ability to provide for its dependent population. There is likely to be considerable pressure on government spending on social security needs in the near future.

Government borrowing and claims on the banks, caused mainly by the quasi-fiscal deficit, have continued to increase the money supply during Q2 1999, although the rate of growth is lower than in the previous year. The apparent growth in foreign assets denominated in BRB is attributable exclusively to the BRB devaluation. The reduced levels of seigniorage and inflation tax may be due to a tightening of monetary policy during Q2. However, there is no evidence of any significant reduction in monetary emissions, and whilst the policy of support to inefficient industries and agriculture through directed credit emissions continues, any such reduction will be unlikely.

There are indications that the NBB plans to allocate credit resources mostly at market rates during 1999, and subsidies for directed credits will now be provided via the state budget. This movement away from quasi-fiscal subsidies is to be welcomed if it is to be implemented. However, more fundamental and coordinated policy measures aimed at liberalisation, restructuring of industry and promoting growth in new sectors are vital for Belarus if it is to achieve genuine growth, and thus reduce the perceived need to subsidise failing industries.

Balance of Payments and Trade

Data for Q1 1999 shows a trade deficit of 1.9% GDP. This deficit is the lowest since Q3 1995, although volumes of both exports and imports during the quarter were particularly low compared with the previous period in 1998. The current account recorded a surplus in Q1 of 0.9% GDP, due mainly to the reduction in trade volumes. Reserves are low, and there is an extreme shortage of foreign capital entering the Republic, as there is foreign direct investment, and little from external transfers, borrowing or development aid.

There was a sharp deterioration in exports to and imports from Russia, due mainly to the Russian crisis, although the reduction in exports was substantially greater than the reduction in imports. Exports to non-CIS countries increased by 32.7% during Q1 1999. This increased trade with non-CIS countries (especially Germany) is to be welcomed. The level of exports in services declined during Q1 1999, although this is a sector which could provide significant export opportunities for Belarus in the future, particularly in transport services.

The share of trade in barter, especially to CIS countries continued to increase during Q1 1999, reaching 36.8% of exports and 36.2% of imports. Barter trade during Q2 is likely to have been at similar levels. Barter trade is an issue of increasing concern to the authorities, and a number of regulatory measures have been taken to reduce the level of barter trade. However, rather than increased regulatory measures, the barter trade problem is far more likely to be alleviated by market-based reforms. Further liberalisation measures and encouragement of growth in trade in the private sector are necessary to increase the diversification of trade with non-CIS countries, and reduce the dependence on barter trade.

The intention of the NBB to move towards a unified exchange rate is to be welcomed if this is implemented, although currently a number of cash and non-cash exchange rates still operate in the Republic.

Privatisation and Restructuring

The contribution of the private sector to the economy is the lowest of all transition economies. There has been an increase in the number of Republican and Communal properties privatised during Q2 1999, and this is to be encouraged. However, the rate of growth of privatisation is not enough to lead to any significant degree of restructuring (e.g. development of new markets and industry sectors, new product innovations and processes, management techniques).

Measures to preserve state influence in privatised firms still remain. Such measures increase the costs of administration and level of risk for private firms, and are thus not likely to improve either performance or profitability in the private sector. This will therefore continue to restrict the ability of the private sector to contribute to the state budget in terms of profits and incomes taxes. Growth of the contribution of the private sector has been one of the primary indicators of transition to a market economy for the former centrally planned economies. Until Belarus adopts policy measures that encourage growth of the private sector, progress in transition, and thus long-term economic growth, will remain limited.

Foreign Direct Investment of the Republic of Belarus

The Level of FDI in Belarus

The level of FDI that Belarus has attracted since 1993 is shown in Table 1. This shows cumulative FDI, the number of companies with foreign ownership[1] that are registered and operating, and the level of production of goods and services produced by these firms. Table 1 also shows the number of employed in foreign-investing firms and the level of exports and imports that foreign owned firms have generated.

As can be seen from Table 1, the contribution to GDP of foreign owned firms has increased from 0.3% GDP in 1993 to 4.3% in 1998, including an exceptional increase to 7% GDP in 1997. This increase has occurred in spite of the poor investment climate attributed to Belarus. The level of employment in foreign-investing firms has increased steadily from 18,041 in 1993 to 58,147 in 1998. A total of 99.3% of employees in foreign-investing firms in 1998 were Belarusian citizens. This represented 1.3% of total registered employment in the economy.

Table 1 - Main Indicators of FDI in Belarus, 1993-1998

	1993	1994	1995	1996	1997	1998
FDI cumulative ($USm)	30.9	46.6	70.0	99.3	171.4	237.1
Number or registered companies	1,447	2,070	2,645	2,856	1,903	2,272
of which functioning	411	676	881	1,371	1,235	1,416
Volume of production goods and services (BRB bln)	29.3	701.1	3,045.1	6,256.5	24,518.2	28,167.8
as % of GDP	0.3	4.0	2.6	3.4	7.0	4.3
Number of employed	18,041	22,930	26,618	38,522	49,469	58,147
of which Belarusian citizens	17,965	22,770	26,618	37,531	49,118	57,742
as % of registered employees in economy	0.4	0.5	0.6	0.9	1.2	1.3
Exports, $USm	35.7	60.1	193.6	335.4	466.1	565.0
as % of exports	1.8	2.4	4.0	5.8	6.3	8.0
Imports, $USm	68.9	89.0	133.8	319.1	622.4	809.6
as % of imports	2.8	3.0	2.4	4.6	7.1	9.5

(Source: BET Staff Calculations on data provided by Minstat[2])

Foreign-investing firms have also added significantly to the level of foreign trade. The proportion of total exports derived from the activities of foreign-investing firms increased from 1.8% in 1993 to 8.0% in 1998. The proportion of total imports derived from the activities of foreign-investing firms increased from 2.8% to 9.5% during the same period. Belarus is experiencing the early stages of growth in FDI, and as the experience of other transition economies has shown, the effect of the trade balance at this stage is negative (i.e. their imports have exceeded their exports). This is because foreign-investing firms need to import capital goods in order to develop a production facility that may in future lead to an increase in exports. An initial negative effect on the balance of trade may thus be seen as an investment for the future.

Additionally, some foreign-investing firms (e.g. Coca-Cola, McDonalds) may be orienting production for the domestic market. In cases where foreign-investing firms produce and sell on domestic markets goods which were previously imported, this also contributed to an improved balance of trade. The increase in foreign trade may also lead to a variety and quality of goods, which may advance the restructuring process by promoting competition and leading to improved quality from local producers. The restructuring effects of foreign-investing firms, including increased productivity, new management practices, increased product range, and the "spill-over" effects that these have an other firms represent important micro-economic effects of FDI, which must be considered along with the macro-economic data shown in Table 1.

The effect of FDI on employment, and on exports and imports is common with other transition states. In Hungary, foreign-investing firms represented 36.1% of total employment in 1996 and in Czech Republic the number was 13.1%. The level of exports from Estonia rose significantly since 1995, associated with an increase in FDI.

In the Czech Republic, virtually all FDI until 1995 came into the country as a result of the privatisation programme. In Hungary, Croatia and Bulgaria, the majority of the early FDI (up till 1997) was due to these countries' respective privatisation programmes. In Belarus, the majority of the capital employed in FDI has come from major investors, with very little FDI derived from the privatisation programme. Policy on privatisation programmes has been influential in attracting FDI to transition economies, and there is considerable future potential for this, as many firms that could be privatised remain in state hands. This is an obvious source of FDI in Belarus. However, privatisation programmes without associated market reforms are not unlikely to attract significant FDI. Non-privatisation related FDI has been more associated with the progress in transition and subsequent economic growth.

Distribution of FDI by Sector

As can be seen from Tables 2 and 3, the majority of companies with FDI are concentrated in tertiary and secondary sectors. The tertiary sector, which accounted for 63.7% of the total number of foreign investing firms in 1998, includes primarily non-manufacturing sectors such as transport, storage, and telecommunications, electricity and water distribution, wholesale and distributive trade, real estate, tourism and finance. Belarus records a large number of companies in the wholesale and distributive trades sectors and in transport, storage, telecommunications, real estate, rental activities and business activities. These branches accounted for 86.8% of total tertiary sector, and 55.4% of the total number of foreign-investing firms.

The secondary sector accounted for 34.6% of the total number of foreign investing firms in 1998. In this sector, the most attractive branches are wood, paper, publishing and printing, food, beverages, tobacco, textiles, leather and clothing. These branches accounted for 65.9% of total secondary sector in 1998, or 22.8% of total number of foreign-investing firms. The number of foreign investing firms in the primary sector (including agriculture and mining) comprised only 1.6% of total in 1998.

The significant of tertiary sector activities, as a proportion of total FDI is apparent across the Eastern Europe and the CIS Region. Although the majority of FDI in terms of value is in manufacturing, the sector with the greatest number of foreign-investing firms is the tertiary sector (see next section for size of foreign-investing firms). Belarus is thus no different in this respect, and the investment in trade and transport related services reflect Belarus' position as a

Table 2 - FDI Distribution by Sector/Industry
(Number of Firms)

	1996	1997	1998
Primary sector			
Agriculture, hunting, forestry and fishing	48	31	33
Mining, quarrying and petroleum	3	3	3
Food, beverage and tobacco	130	128	167
Textiles, leather arid clothing	125	03	103
Wood, paper, publishing and printing	308	205	249
Chemicals, chemical products and coke and petroleum products	65	55	70
Non-metallic mineral products (cement and building materials)	43	19	25
Basic metals and metal products	42	33	43
Machinery and equipment	165	70	76
Electrical machinery and apparatus	49	37	41
Automotive	15	9	12
Unspecified secondary	4	1	1
Tertiary sector			
Electricity and water distribution	0	1	1
Construction	115	63	80
Wholesale trade and distributive trade	956	849	973
Hotels and restaurants (tourism)	38	23	27
Transport, storage and telecommunications	124	114	170
Finance (banking and insurance)	13	8	8
Real estate, rental activities and business services	267	109	115
Public administration, health and social services	109	62	75
Unspecified	237	0	0

(Source: BET Staff calculations on data provided by Minstat).

Table 3 - FDI Distribution by Sector/Industry
(as % of total Foreign Investing Firms)

Sector/Industry	1996	1997	1998
Primary sector	1.8	1.8	1.6
Secondary sector	33.1	33.6	34.6
Tertiary sector	56.8	64.5	63.7
Unspecified	8.3	0.1	0.0

(Source: BET Staff calculations on data provident by Minstat).

natural trading post between East Central Europe and Russia. A number of multinational firms have invested in Hungary recently, and evidence from Hungary suggests that recent multinational investment has been into manufacturing. This is undoubtedly due to the perceived progress in transition that Hungary has made to a market economy, as the investment in manufacturing involves a high and long-term commitment in investment in resources which takes place on the territory of the host country. The concentration of foreign investing firms in Hungary in the early 1990s suggests that foreign investing firms tread carefully in new markets. Hungary was the main recipient of FDI during the early stages of transition mainly because it was perceived by foreign investors as the country with the lowest level of perceived risk as a foothold in the emerging post-centrally planned markets.

Size of Firms involved in FDI

There is considerable evidence across the East European and CIS Regions that early FDI includes a significant number of relatively small-scale investments, which will thus involve lower levels of sunk cost. Figures for distribution of FDI in Belarus are also consistent with the figures for sectors distribution, and are consistent with the fact that a significant proportion of early FDI is in smaller scale business. In Belarus, in 1998, only five firms recorded a statutory capital of over US$10m. These included JV Coca Cola - Amatil Belarussia (US$59.9m), JV Dynamo-programme (US$14.7m), JV Frebor (US$14.4m), JV Rautaruukki Belcolor (US$13.7m), and JV Civil Project (US$10.5m). Approximately 60 companies recorded a statutory capital declared by the foreign partner from US$1m to US$10m. The remainder (i.e. all but 65 of the 1,416 foreign-investing firms operating in Belarus, referred to in Table 1), recorded a statutory capital of less than US$1m.

Table 4 - FDI Distribution (as % of Total)

	Employment	Statutory Fund	Number of companies
Industry	58.4	64.1	34.8
Agriculture and Forestry	0.3	0.5	1.5
Transport Communications	8.2	4.8	7.5
Construction	2.4	1.6	3.5
Trade and Catering	23.7	19.3	44.0
Others	6.6	9.8	8.8

(Source: BET Staff calculations on data provided by Minstat).

Table 4 displays FDI distribution by employment, Statutory Fund and by number of companies. As can be seen from the table, industry has the largest share of employment and the largest proportion of Statutory Funds, but trade and catering has the largest number of firms. Transport and communication is a sector that employs 8.2% of those employed by foreign-investing firms, but only 4.8% of the Statutory Fund, implying that the investment in this sector is low (i.e. low capital start-up). This is consistent with patterns across the CIS, that those firms that are involved in manufacturing tend to be the largest and require the greatest capital input. However, these do not represent the majority of firms, which tend to be small-scale enterprises, typically involved in labour intensive activities in the tertiary (service) sector.

Table 5 - FDI Distribution
(as % of Total in "Industry" Group)

	Employment	Statutory Fund	Number
Chemical and petrochemical	5.4	6.4	5.7
Mechanical engineering	12.1	24.2	11.6
Timber, pulp and paper	19.2	8.2	16.7
Light industry	30.9	13.5	32.2
Food	19.1	35.1	19.9
Others	13.4	12.7	13.9

(Source: BET Staff calculations on data provided by Minstat).

Table 5 shows the FDI distribution within the "Industry" Group in Belarus. The majority of FDI is in mechanical engineering, timber, pulp and paper, light and food industries. These four sectors represent 81.2% of total employment, 81% of total statutory fund and 80.4% of total number of companies with foreign investment.

Free Economic Zones on the Territory of the Republic of Belarus

The four free economic zones (FEZ) in Belarus are created with the purpose of securing favourable conditions for the acceleration of economic development of Belarus, the attraction of foreign investments, the promotion of manufactures based on new and high technologies, the securing of new employment, and the development of trade and economic relations with other countries.

The FEZ residents shall be subject to following tax privileges and preferences:

- support of republican and local authority;
- low land rent rates;

- reducing rates of tax on profits and income (15%) and VAT (10%), as compared 30% and 20% in the Republic;
- exemption during the first five years from taxation of profits made from the realisation of services and goods of their own production;
- enterprises with priority activities pay profits and income tax at the reduced rate for one year;
- residents who export not less than 70% of their own products pay profits and income tax at the reduced rate or are exempt from it for five years;
- VAT and excises are not collected from goods imported into the zone;
- exemption during the first five years from taxation of dividends;
- income tax of citizens, ecology tax, state and social insurance taxes, excises are paid at the same basis as on the other territory of Belarus;
- customs duties are not levied and measures of economic policy are not taken if the goods are imported into the FEZ. Own produce of the residents of FEZ, if delivered out off it, is free of customs duties and not subject to quotas and licensing.

Concluding Comment

Having achieved independence, Belarus has chosen its own model of economic development, which adequately reflects its national conditions and capacities. This is the model of a socially oriented market economy. Our objective is not simply the implementation of reforms for their own sake, but the achievement of a more effective economy. Good economic performance is essential for safeguarding social stability. The development of democratic institutions is an integral part of sustainable development. Mindful of that, the policy of the government of Belarus is based on a pragmatic and practical understanding of both world experience and of our own internal problems.

Notes

1 Firms which have received FDI are referred to in this paper as “foreign-investing firms”, this term includes firms that are wholly and partially foreign-investing, and joint ventures where at leat one of the partners is a foreign company.

2 The Ministry of Statistics.