



MINISTRY FOR FOREIGN
AFFAIRS OF FINLAND



Belarus

BELARUS: The Human Development Implications of Trade Policy



BELARUS:

The Human Development Implications of Trade Policy

United Nations Development Programme

2011

Belarus: the human development implications of foreign trade policy

I.E. Tochitskaya (Candidate of Sciences, Economics), D.E. Kruk

Peer reviewers: Jacek Cukrowski, Ph.D, Team Leader , Aid for Trade Initiative, UNDP Regional Office in Bratislava, UNDP Regional Bureau for Europe and the CIS; Ludmila Istomina, Candidate of Sciences (Economics), Programme Analyst, UNDP Office in Belarus.

Belarus: the human development implications of trade policy/I.E. Tochitskaya, D.E. Kruk. – Minsk: UN/UNDP Office in Belarus, 2010 – 100 p.

Belarus: the human development implications of trade policy

All rights reserved. No part of this publication may be reproduced, stored in a retrieval system or transmitted, in any form or by any means, electronic, mechanical, photocopying, recording or otherwise, without prior permission of UNDP Office in Belarus.

This is an independent publication commissioned by UNDP. The views expressed in this publication are those of the author(s) and do not necessarily represent those of the United Nations, including UNDP, or their Member States.

Copyright © UNDP Belarus 2011

All rights reserved

This publication forms a part of the UNDP project "Wider Europe: Aid for Trade for Central Asia, South Caucasus and Western CIS". It examines the macroeconomic context and foreign trade policy of Belarus in 2000-2008, and the interrelationship between trade and human development, based on examples from the food and light industries, some of the most sensitive sectors of the economy. It also provides an action matrix and ideas for international technical assistance projects to facilitate international trade. This report is geared for decision-makers, national experts, researchers, and general audiences.

An electronic version of the report is available at the web site: <http://europeandcis.undp.org>

Acknowledgments

The report “Belarus: the human development implications of trade policy” forms part of a complex regional UNDP’s regional Aid for Trade project “Wider Europe: Aid for Trade for Central Asia, South Caucasus and Western CIS” financed in the context of Finland’s Wider Europe Initiative.

It focuses on the identification of capacity gaps and technical assistance needs both at the national and sub-regional level in Central Asia, South Caucasus and Western CIS and supports economic development in the areas located along the selected transport corridors, helping small entrepreneurs to gain from new trade opportunities.

We extend special thanks to the Government of Finland, whose generous contributions in the context of the Wider Europe: Aid for Trade for Central Asia, South Caucasus and Western CIS initiative made this publication possible.

Work on the report was coordinated by Jacek Cukrowski, Team Leader, Aid for Trade initiative of the UNDP Regional Office in Bratislava, UNDP Regional Bureau for Europe and the CIS; and carried out in close collaboration with Ludmila Istomina, Programme Analyst, UNDP Office in Belarus.

A steering group was formed to facilitate the preparation of the report, which included civil servants from the Ministry of Foreign Affairs, Ministry of the Economy, Bellegprom Group, Belgospischeprom Group, State Customs Committee, National Statistical Committee, Belarus Chamber of Commerce and Trade, National Centre for Marketing and Marketing Research. The comments and insights from members of the group have contributed greatly to the analysis and recommendations contained in this Report.

The authors would like to thank the following individuals for their invaluable comments, feedback and other contributions that assisted in the preparation of this report: Alexandra Shevtsova, Chief Economist, Department of Foreign Trade Statistics, Trade Statistics Division of the National Statistical Committee of Belarus; Dmitry Doroshevich, Second Secretary, Division of Customs and Tariffs and Negotiations with the WTO, Department of Foreign Economic Activity of the Ministry of Foreign Affairs; Elena Andreeva, Deputy Chief, Department of Trade and Marketing, Foreign Trade Division of Bellegprom Group; and employees of the Belarus Chamber of Commerce and Trade.

List of Acronyms

- GDP – Gross Domestic Product
- WTO – World Trade Organisation
- GATS – General Agreement on Trade in Services
- GATT – General Agreement on Tariffs and Trade
- EurAsEC – Eurasian Economic Community
- EU – European Union
- ITC – Information and Communication Technologies
- TPI – Trade Performance Index
- IMF – International Monetary Fund
- NAIP – National Agency for Investments and Privatisation
- FDI – Foreign Direct Investments
- PPP – Purchasing Power Parity
- MFN – Most Favoured Nation Regime
- RTA – Regional Trade Agreements
- CIS – Community of Independent States
- USSR – Union of Soviet Socialist Republics
- FEZ – Free Economic Zones
- TN VED – Commodity Classification for Foreign Economic Activity
- UNCTAD – United Nations Conference on Trade and Development

Content

08. Introduction

09. 1. Macroeconomic background

09. 1.1. Economic growth factors

09. 1.1.1. Starting conditions

09. 1.1.2. 1996-1998: growth from the old production base

13. 1.1.3. 1999-2002: changing terms of trade and the search for new growth points

17. 1.1.4. 2003–2008: benefiting from improvements in the external environment to accelerate growth

21. 1.2. Employment, poverty and household expenditure

26. 1.3. Attracting foreign direct investments

31. 1.4. Effects of the global financial crisis on the Belarusian economy

36. 2. Foreign trade policy

36. 2.1. Belarus' foreign trade performance

45. 2.2. Foreign trade policy

50. 2.3. Integration in the world economy and accession to WTO

55. 2.4. Participation in regional trade agreements

59. 2.5. Impact of the world financial crisis on Belarusian foreign trade

64. 3. Trade and human development: a sectoral analysis

64. 3.1. Exploring the interrelationships between trade and human development

66. 3.2. Light industry

66. 3.2.1. Background and overview

69. 3.2.2. Foreign trade performance

71. 3.2.3. Competitiveness and export potential

72. 3.2.4. Impact of accession to WTO and EURASEC Customs Union on trade and human development in light industry

75. 3.3. Food industry

75. 3.3.1. Background and overview

78. 3.3.2. Food industry development – context-specific factors

80. 3.3.3. Potential for increasing exports

82. 3.3.4. Human development implications of WTO and EURASEC Customs Union accession for the food industry

85. 4. Conclusions and Action Matrix

87. Action matrix

90. 5. Ideas for international technical assistance projects

90. 5.1. Expanding trade and export potential of light industry in the Republic of Belarus

92. 5.2. Improving training and expertise of researchers and technicians working in the food industry and creating a network of certification laboratories to test food products for compliance with the EU food safety regulations

93. 5.3. Creating an Internet portal of the State Customs Committee of Belarus for electronic submission of notices of exports or imports

95. Bibliography

Introduction

As known from economic theory, participation in foreign trade promotes efficient resource allocation, thus contributing to economic growth. Economic growth, in turn, is closely related to human development. The nature of this interrelationship is an important characteristic of growth quality, and shows whether such growth creates or removes barriers to human development. Because foreign trade promotes human development by contributing to economic growth, the indirect role of foreign trade in poverty reduction, wealth generation and equitable income distribution is therefore quite obvious. By promoting economic growth, foreign trade may also generate additional public revenue, which can be spent on education and health, resulting in even higher levels of human development. However, this causal chain – foreign trade leading to higher levels of human development through economic growth – is not the only one possible. Depending on the structure of the economy, employment trends and other contextual factors, each country may display additional linkages between trade and human development.

Belarus has one of the highest ratios of exports and imports to GDP in Central and Eastern Europe. Foreign trade has long determined its macroeconomic performance by accelerating or constraining economic growth. During the last fifteen years, the Belarusian economy has experienced significant change, affecting the key determinants of growth and, consequently the

structure of foreign trade, its role in the national economy, and impact on human development. Furthermore, the Belarusian economy has been hit by the world recession, further impacting the economic significance of foreign trade for Belarus. Given the nature and scope of these changes, examining the role and implications of foreign trade for human development in Belarus is highly relevant.

The aim of this report is to identify the challenges to foreign trade in Belarus from a human development perspective. The report highlights the linkages between foreign trade and human development and defines the avenues for foreign trade development that are the most conducive to human development.

The first chapter presents the macroeconomic background and defines the periods and determinants of economic growth that have affected the interrelationships between foreign trade and human development. The second chapter examines the current trends in foreign trade and trade policies in Belarus. It formulates criteria to determine the sectors of the national economy that are the most essential for foreign trade and human development. The third chapter presents a sectoral analysis of foreign trade effects on two of these sectors – light and food industries. Finally, the fourth chapter presents the main conclusions and practical recommendations on promotion of foreign trade in individual sectors for better human development performance.

1. Macroeconomic background

1.1. Economic growth factors

1.1.1. Starting conditions

Similar to most transitional economies, Belarus experienced a long transformational recession in the mid-1990s that had a deep impact on its economic and social indicators. The start of the recession period in 1991 was caused by drastic changes in the external environment and the first efforts of launching market-oriented economic reforms. The recession lasted five years, during which the gross domestic product declined by 34.8% to 65.2% of the 1990 level in 1995. The scale of the recession appears relatively small by comparison with Central and East European states that were not a part of the USSR (which experienced declines of 32% to 47%). However, it is fairly large relative to other post-Soviet states, where the depth of the recession ranged from 32% to 39%.

The depth of the transformational recession is not the only indicator of economic and social decline in the early 1990s. This was also a period of high inflation caused by monetary and systemic factors. Hyper-inflation distorted the economic incentives, depressed household incomes and increased income inequality. Income distribution, however, remained equitable by international standards. The Gini coefficient was 0.261 in 1995, and the ratio of incomes of the richest 10% to the poorest 10% was at 5.5. On the other hand, these indicators represented significant change from the Soviet period.

In 1991, the removal of price controls was an initial push to relative prices reconsideration, which contributed to increase in price level. A new relative price structure was emerging,

more consistent with the market principles. The absence of a national currency at the initial stages of the reform exacerbated this trend, destabilising money circulation and contributed to dollarization of the national economy. When the national currency was introduced, Belarus initially had a very limited choice of monetary policy instruments. As a consequence, it was not until 1995-1996 that hyper-inflation was overcome and relative monetary stabilization was achieved.

During the transformational recession of 1991-1995, the main focus of the reform effort was on building the market infrastructure of the sovereign state (e.g. introducing the national currency, establishing the national credit and finance systems, etc.). Command and control mechanisms were preserved to a significant extent. Structural reform measures -- such as large-scale privatisation of state property, price reform, establishment of labour and capital markets -- were implemented only to a limited extent.

GDP resumed a positive dynamic in 1996. A period of sustained economic growth began, which has continued until the present day. However, the factors and mechanisms, and consequently, the quality of growth, has varied throughout this period. Based on the above criteria, this time period can be divided into several stages. The first stage lasted from 1996 to 1998, the second from 1999 to 2002, the third from 2003 to 2008, and the fourth from 2009 to the present¹.

1.1.2. 1996-1998: growth from the old production base

The first stage of the sustained growth period relied on the use of the production base inherited from the Soviet era. It was

marked by relative improvements in the external environment for the national economy.

¹ For a detailed discussion of this period, see Section 1.4.

Relative to other post-Soviet states, Belarus had several advantages in the starting conditions for the market transition. First, from 1971 to 1991, the cost of fixed capital increased by 4.1 times, far above the USSR average of 3.4 times (Easterly, Fischer (1995))². Furthermore, much of the fixed capital was modernized in the 1980s. Belarus thus had at its disposal a fairly large capital base for industrial production (Chubrik (2005))³, with low rates of depreciation and obsolescence. In 1990, industry value added represented 37.9% of the GDP, putting Belarus in second place by this indicator in the former USSR. Strong export orientation was another key characteristic of the Belarusian economy that determined its development in the 1990s. In 1990, the share of exports in the GDP was at 50%, including 5.5% to countries outside the former Socialist bloc (De Melo et al. (1997))⁴. Finally, Belarus also benefited from its competitive advantages in the quality of labour and human capital. For example, 32% of the workforce in 1990 had higher or upper-secondary education, a ratio considered fairly high by comparison with other transitional economies. Other workforce characteristics, such as structure by employment grade, age and gender, were similar to those of advanced market economies, easing the market transition for Belarus.

Economic growth in 1996–1998 was also affected by improvements in the terms of trade. The existing output base was oriented towards production of export goods, making the national economy dependent on demand in the export markets. The structure and size of the domestic demand was markedly different from the structure of domestic production. Therefore, reorienting production towards domestic demand was ruled out by definition. Utilisation of the production base was thus fully dependent on stable external demand. Relative to the final years of the USSR, the demand for Belarusian products fell sharply in 1992–1994, both as a result of the economic recession in most of Belarus' export markets and due to changes in the terms on which intermediary goods were supplied to Belarus. The rapid growth of external demand since 1995 could be attributed to

policy measures – such as the creation of the customs union with Russia (which improved competitiveness of Belarusian goods in the Russian market) and to gradual macroeconomic stabilisation in the importing countries, including Russia. As a result, annual growth rates in export volume in 1995–1997 averaged 46.1% year-on-year, and exports to Russia grew by 61.7% per annum. (In 1992–1994, exports to Russia decreased, on average, by 15.5% per annum).

Partial monetary stabilisation was also an important background factor for successful pursuit of growth from the existing production base. Imbalances in the finance and currency markets, combined with weak and accommodative monetary policies during the transformational recession period created imbalances in the real sector and distorted firm and household behaviour. As a result, the money and capital markets were unable to perform their economic functions, slowing progress towards macroeconomic stabilisation. Interaction between firms and households improved when inflation decreased from four-digit levels in 1993 and 1994 (consumer prices grew by roughly 20 times per year in 1993 and 1994) to 50–60% per annum in 1996–1997.

In summary, economic and institutional policies in the mid-1990s were determined by three main considerations. First, the economy had preserved a large amount of productive assets, most of which could be utilized under market conditions, subject to significant external demand. Second, improvements had taken place in the terms of trade, and the economic policies that were being implemented favoured growth in external demand for Belarusian products. Third, the government had maintained a significant degree of direct control over the economy (including by keeping a large proportion of the real sector in state ownership), and finance. As a result, it maintained the capability to intervene in resource allocation, which eased the transition to the period of economic recovery. Guided by these three considerations, government policies helped overcome the transformational recession without a radical restructuring of the economy. Instead, the government sought to

² Easterly W., Fischer S. (1995). The Soviet Economic Decline, World Bank Economic Review, 9, 3.

³ Chubrik A. (2005). A decade of growth in Belarus – factors and future prospects, *Ecowest*, 4, 3, pp. 454–474.

⁴ De Melo M., Denizer C., Gelb A., and Tenev. S. (1997). Circumstance and Choice: The Role of Initial Conditions and Policies in Transition Economies, World Bank Policy Research Working Paper, 1866.

promote the engagement of the old production base in a new economic environment, which was different from the other transitional economies,

The policies framed by this approach had acquired a systematic character. By 1996- 1998, Belarus had built a unique growth model in comparison to other transitional economies. It was based on three main drivers of growth: (1) utilisation of productive assets inherited from the USSR that had low rates of depreciation and obsolescence; (2) high quality of work force and human capital (3) improved terms of trade and availability of effective tools for promotion of Belarusian exports to foreign markets.

The economic model adopted in 1996-1998 helped to achieve a relatively favourable macroeconomic dynamic for Belarus (Table 1.1).

Annual economic growth averaged at 7.5%. Real monetary incomes grew by a substantial 73.6% per annum, approaching the 1990 level by 1998.

An examination of the quality of growth through the lens of human development indicators does not present a straightforward picture. Most absolute indicators that describe the development of education, health and culture had deteriorated, albeit to a lesser extent than in the other CIS states. For example, the number of preschool institutions, general secondary schools and public libraries decreased significantly in 1995-1998. This was accompanied, on the other hand, by improvements in a range of relative indicators, such as preschool enrollment ratio, enrollment in upper-secondary and higher education, capacity of outpatient clinics, and number of doctors and nurses per 10,000 population.

*Table 1.1.
Key macroeconomic indicators in 1996-1998*

	1996	1997	1998	1998, as % of 1995 (1995=100)
GDP, % annual increase	2.8	11.4	8.4	24.2
GDP, billions of US Dollars	12.0	10.9	5.5	52.0
Exports of goods, billions of US Dollars	5.7	7.3	7.1	47.2
Exports of goods to Russia as % of total exports of goods	53,5	65,5	65,2	
Imports of goods, billions of US Dollars	6.9	8.7	85	53.7
Fixed capital assets, % annual increase	0.3	0.4	0.6	1.3
Industrial output, % annual increase	3.5	18.8	12,4	38,2
Agricultural output, % annual increase	2,4	-4,9	-0.7	-3.3
Industrial output as % of GDP	29.1	29.9	29.0	--
Agricultural output, as % of GDP	14.4	12.7	11.5	--
Real household incomes, % annual increase	13.5	21.6	25.8	47;6
Employment, % annual increase	-1.0	0.1	1.1	0.2
Labour productivity, % annual increase	-0.06	13.3	2.5	16.1
Inflation, %	52.7	63.8	73.0	432.8
Real exchange rate of the national currency to the US Dollar, % annual increase *	6.2	-24.0	-55.0	-63.7
Real exchange rate of the national currency to the Russian Rouble, % annual increase *	-20.1	-12.3	-43.9	-60.6

Note:
real exchange rate was computed from the consumer price index based on the mean annual exchange rate and consumer price index.

Source:
Belstat, Bureau of Labour Statistics (BLS), RosStat, own calculations based on data from Belstat, BLS, RosStat.

In this context, it would be particularly relevant to emphasise one key aspect of the relationship between foreign trade, economic growth and human development. As previously indicated, economic growth was driven largely by high external demand, and had a positive impact on human development. In addition, foreign trade impacted human development directly through another important causal mechanism. Notably, measures to promote Belarusian goods in Russian markets boosted employment, and consequently, the incomes of those working in the respective industries. Much of the social infrastructure (outpatient clinics, kindergartens, summer camps, etc.) had remained on the balance sheets of the large industrial enterprises. Higher

export revenue gave them the resources to maintain these facilities, which also had positive implications for human development. The rising share of industry in gross value added was a good indicator of this trend at the macro level. (Table 1.1). Furthermore, the industries that contributed the most to employment also increased their share in the GDP (Table 1.2). However, some industries – such as machinery/metal working and light industries – were experiencing gradual declines in employment while maintaining high rates of output growth. One possible explanation is that, in the face of tough competition in the export markets, these industries were seeking to maximize their competitive advantages, including by cutting labour costs.

Table 1.2.
Industry performance indicators, 1996-1998

	Average staffing number, 1995 (thousands)	Average staffing number, 1998 (thousands)	Share of industrial output, 1995	Share of industrial output 1998 г.	Mean annual growth of production 1996-1998
Manufacturing industries, including	1176	1147	100	100	11.4
Power generation	40	43	13.8	9.0	-1.3
Fuel industry	16	16	4.3	3.4	-1.9
Iron and steel	12	15	2.4	3.2	24.2
Chemical and petrochemical industry	91	99	14.3	13.5	11.3
Machine building and metal working	490	427	23.3	25.7	13.8
Wood. Lumber, pulp	101	117	5.3	6.2	23.2
Construction materials manufacture	69	67	5.1	4.7	11.7
Light industry	184	168	8.0	9.2	20.1
Food industry	107	124	17.0	18.3	15.0

Source: BelStat.

Although the chosen growth model had produced positive outcomes by comparison with other countries in transition, it could hardly be described as sustainable. First, the role of exports in growth promotion was overly emphasised. Considering that high external demand was essential if the existing production capacity was to be fully utilised, the government applied a

wide range of measures to support the main exporters. This included pursuit of monetary and exchange rate policies that maintained the price competitiveness of Belarusian exporters. The rate of devaluation tended to exceed inflation, which weakened the Belarusian rouble in real terms relative to the currencies of Belarus' main trade partners. By 1998, the real exchange rate

of the Belarusian rouble to the Russian rouble had decreased by 60.6% from the 1995 level (Table 1.1). Thus, despite rapid economic growth, the balancing of foreign trade was in a great extent achieved at the cost of real devaluation of the Belarusian rouble. This indicated that low wages were still the leading factor in maintaining competitiveness of Belarusian goods in foreign

markets. At the macro level, this situation had eliminated incentives for employers to increase productivity through improved efficiency. Enterprises saw no need to reduce costs, including by investing in new technologies and technological innovations, as seen from relatively low gross fixed capital formation contribution into GDP growth (Table 1.3).

Table 1.3.
Contribution of aggregate demand components to economic growth

	1996-1998	1999-2002	2003-2008	2009
GDP	7.5	4.7	9.5	0.2
Final consumption expenditure, including	5.1	5.7	7.0	0.0
Household consumption	3.9	4.8	7.0	0.2
Gross savings.	2.5	0.0	7.4	-0.2
Gross fixed capital formation	2.2	0.1	6.5	2.9
Net exports	0.4	0.1	-6.8	1.5

Note:
Data presented in percentage points of GDP growth. The growth of GDP and contribution of the demand components represent annual average increases for the given period.

Source:
Own computations based on data from BelStat.

The ultimate result of these developments was the unfolding of the spiral of inflation and devaluation, which further distorted the functioning of the market mechanisms. Price stability was gradually disintegrating, and becoming hostage to export promotion. From 1996 to 1998, the rate of average annual inflation increased from 52.7%, to 73.0% per annum. The rapid devaluation of

the Russian rouble in 1998 dealt a final blow to the Belarusian growth model. Facing this challenge and trying to keep on the existing growth model, Belarus implemented a rapid devaluation of the national currency relative to the Russian rouble, as Russia accounted for over 50% of Belarusian exports at the time.. This decision was the de-facto start of the transition to a new economic growth model.

1.1.3. 1999-2002: changing terms of trade and the search for new growth points

In general, the policies pursued in 1999-2002 can be described as an attempt to preserve the growth model of the previous period under new conditions of foreign trade. Reduction in the external demand for Belarusian products was the most important change. Export revenue and external demand were severely impacted by the Russian financial crisis and

its rapid growth ended . Hence, the volume of Belarusian exports remained comparable in absolute terms to 1997-1998, and did not exceed this level until 2002. The external demand shock affected the export volume, but also the structure of exports. As a result, Belarus' export basket in 1999-2002 was different from 1996-1998 (Table 1.4).

Table 1.4.
Commodity structure of Belarusian exports

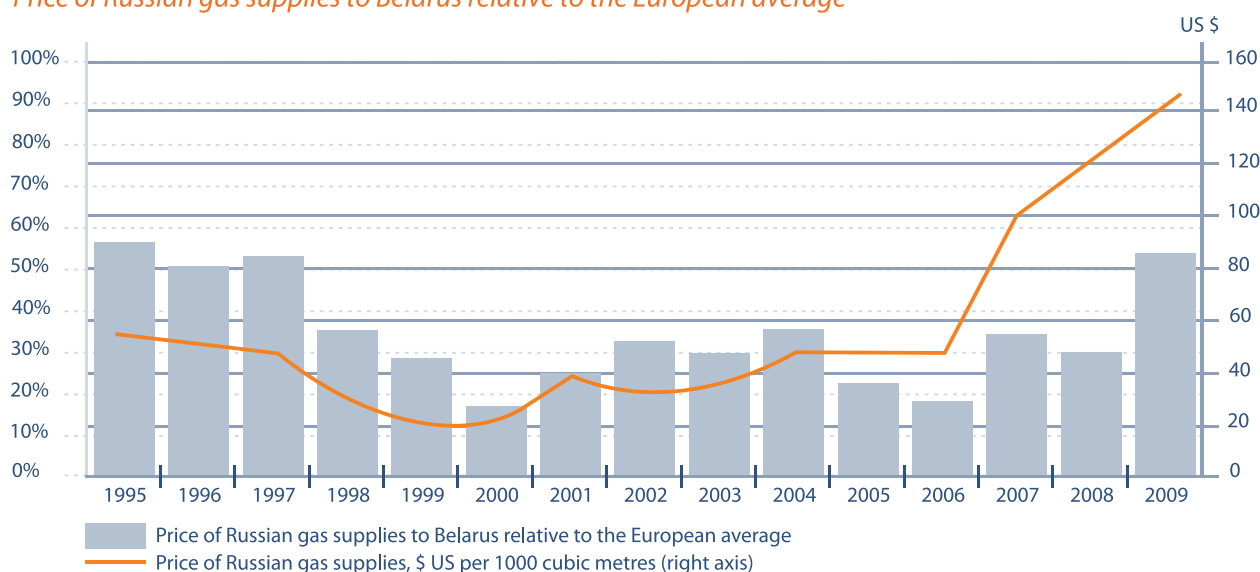
	1998		2000		2002	
	US \$, millions	%	US \$, millions	%	US \$, millions	%
Exports, total	7069.7	100	7326.4	100	8020.9	100
Machinery and transport equipment	2134	30.2	1848	25.2	2077	25.9
Mineral products	594	8.4	1482	20.2	1680	20.9
Ferrous, coloured metals and products thereof	646	9.1	530	7.2	663	8.3
Chemical products	1550	21.9	1454	19.8	1419	17.7
Wood, paper and pulp	275	3.9	314	4.3	340	4.2
Textiles and textile articles	551	7.8	469	6.4	491	6.1
Food products	617	8.7	503	6.9	635	7.9
Other	704	10.0	726	10.0	717	9.0

Source: BelStat.

Because the Belarusian growth model relied mainly on favourable market conditions, the Belarusian government was actively looking for alternative sources of growth as these conditions had deteriorated. It was able to negotiate a low price for gas from Russia in both absolute and relative terms, a key achievement for reducing

production costs (Figure 1.1). The low price of gas was initially justified by Belarus' participation in the Yamal to Europe pipeline project and the conclusion in 1999 of the customs union agreement between Russia and Belarus. Relatively cheap gas supplies provided an important competitive advantage for Belarusian exports.

Figure 1.1.
Price of Russian gas supplies to Belarus relative to the European average



Source:
Own computations based on data from BelStat and International Financial Statistics

Negative external shocks. Exacerbated by fixed capital depreciation and underinvestment, the negative external shocks deteriorated financial performance of the real sector (Table 1.5). Profit margins began to fall rapidly, challenging the foundations of the growth model based on utilisation of the old production base. This development, coupled with the growth in the proportion of loss-making enterprises in the main industries, led to changes in the structure of production and exports.

Revisions were also made to the existing growth model, which contributed to changes in the output structure. In the new growth strategy, a selected number of industries were designated by the government as prospective areas of growth, and were given priority in the allocation of financial and investment resources.

These changes led to above-average growth in a select number of industries. The fuel industry was the case in point. The fuel industry was benefiting from the low price of Russian oil supplies that were covered by the Customs Union Agreement, and therefore were not subject to the Russian export duty. Also, Belarusian oil refineries had a number of technological advantages over competitors in Russia, which attracted Russian suppliers of crude oil on processing terms. The ensuing increase in profitability provided the oil refineries with enough liquidity to purchase their own oil. The rise of the fuel industry was fully consistent with the new “growth area” model, because it generated growth in the downstream industries, along with the export revenue. (Tables 1.5).

Table 1.5.
Profit margin on sales of industrial goods and services and trends in industrial output

	Profit margin from sale of goods and services, %				Share of industrial output, %	
	1999	2000	2001	2002	1998	2002
Manufacturing industries, including	17.1	15.8	10.9	10.5	100	100
Power engineering	3.9	2.2	6.0	3.0	9.0	7.1
Fuel industry	46.3	64.0	33.8	34.5	3.4	15.8
Iron and steel	13.5	22.5	5.6	17.8	3.2	3.1
Chemical industry	27.1	25.8	12.8	12.7	13.5	11.9
Petrochemical industry	10.0	0.6	4.0	-4.4		
Machine building and metal working	17.9	14.4	12.2	11.5	25.7	22.2
Wood, lumber, paper and pulp industry	17.7	11.4	8.7	10.5	6.2	5.1
Manufacture of construction materials	8.1	5.2	4.6	7.3	4.7	3.7
Light industry	22.6	14.3	6.1	4.6	9.2	6.9
Food industry	13.4	9.2	8.1	5.5	18.3	18.3

Source:
BelStat, World Bank computations based on data from BelStat.

The rise of the fuel industry was accompanied by the decline of several basic industries with large numbers of enterprises and significant shares of total employment. Petrochemical, light and mechanical engineering/metal working industries

were the most affected. In the new growth model, enterprise access to loans and investment resources was dependent on the financial outlooks for their respective industries. In the new conditions, the need for capital investments was

experienced by all industries, as the average rate of fixed capital depreciation had approached 60%. In 1999-2002, however, substantial variations emerged among industries in the actual amount of investments. For example, asset replacement ratios in the relatively high-profit iron and steel and fuel industries were above the national average, while the mechanical engineering/metal working, light and petrochemical industries had much lower asset replacement ratios. As a result, multiple industries were facing prospects of diminishing competitiveness and profitability, more limited access to loans, and, consequently, lower investments.

Unlike the previous growth model, implemented in 1996-1998, the new growth model was based on the "areas of growth" concept. In addition to the fuel industry, construction was designated as a second "growth area". Growth within the sector was encouraged mainly by priority access to finance. State banks provided most of these resources through quasi-fiscal transactions. Legislation on low-interest housing loans contributed greatly to growth in the construction industry in both absolute and relative terms (i.e. in the share of construction in total industry value added). One positive social effect of this policy was an increase in housing supply. From a long-term growth perspective, however, it had a negative side effect by destabilizing the money market and diminishing the efficiency of resource allocation in the economy.

Monetary imbalances were among the most typical distortions accumulated in pursuit of a

growth strategy in select industries designated as top priorities. While promoting short-term growth of aggregate production, these imbalances also led to high rates of inflation and devaluation, created inefficiencies in resource allocation and had disorienting effects on economic agents.

The main drivers of economic growth in 1999-2002 can be summarized as follows:

- Cheap supplies of Russian gas, resulting in relatively low costs of production;
- Favourable conditions at individual external commodity markets;
- Economic and investment stimuli to select industries as a part of the growth area concept;
- Export promotion through currency devaluation and monetary incentives.

The latter two factors are of a short-term nature, affecting output, rather than the institutional structure and potential GDP. The quality of growth during the period under review is thus in doubt. First, despite positive GDP dynamics, the presence of three-digit inflation raised questions about the sustainability of this growth. Second, the competitiveness of Belarusian products did not improve, as evidenced by the negative current account position and the need for special interventions to promote exports. Third, the growth was not accompanied by sustainable increases in fixed capital investments, suggesting a low return on investments.

Table 1.6.
Key macroeconomic performance indicators in 1999-2002

	1999	2000	2001	2002
GDP, % annual increase	3.3	5.8	4.7	5.0
GDP, US \$, billions	5.6	9.0	12.5	14.7
Exports of goods, billions of US Dollars	5.9	7.3	7.5	8.0
Exports of goods to Russia as, % of total goods exports	54.5	50.6	53.1	49.6
Imports of goods, billions of US Dollars	6.7	8.6	8.3	9.1
Total production assets, % annual increase	-0.2	0.2	-0.4	1.1
Industrial output, % annual increase	10.3	7.8	5.9	4.5

	1999	2000	2001	2002
Agricultural output, % annual increase	-8.3	9.3	1.8	0.7
Industrial output, as % of GDP	27.6	26.5	26.1	25.4
Agricultural output, as % of GDP	12.2	11.6	9.7	9.5
Real personal incomes, % annual increase	-2.5	14.1	28.1	4.1
Employment, % annual increase	0.6	-0.02	-0.5	-0.8
Labour productivity, % annual increase	3.9	9.6	5.9	3.8
Average annual inflation, %	293.7	168.6	61.1	42.6
Real exchange rate of the national currency to the US Dollar, % annual increase	-9.4	38.2	15.9	8.6
Real exchange rate of the national currency to the Russian Rouble, % annual increase	8.6	60.1	4.2	1.6

Source:
BelStat, Own computations based on data from BelStat.

1.1.4. 2003–2008: benefiting from improvements in the external environment to accelerate growth

The price of gas continued to remain a key factor affecting economic performance in 2003–2008. In absolute terms, the price of gas changed very little until 2007, but had declined significantly relative to the price charged from European customers. Belarus was able to secure this advantage by entering an agreement with Russia in 2002 on expanding cooperation on gas. Under the terms of the agreement, Belarus was obliged to convert the joint stock company Beltransgaz into a joint venture with Gazprom in exchange for Russia's obligation to apply the equal revenue principle in determining price of gas for Belarus. The low price of gas at a time of rapidly increasing world prices helped Belarusian enterprises keep the energy costs under control without spending too much on energy efficiency. The low price of gas was thus an additional source of competitive advantage in foreign markets.

Favourable conditions in international markets became another growth factor in 2003–2008. The rising world prices of energy inputs and primary goods were an important opportunity in this respect. As shown above, the fuel industry was becoming a "growth area" in the economy, and was benefiting from this opportunity to expand and technologically improve its production base. Simultaneously, Russian crude oil to Belarus continued to be exempt from the Russian export duty. Belarusian oil refineries also had the benefit of a favourable geographical position. All of these factors created significant advantages for the Belarusian oil industry over Russian competitors. As the world price of oil was increasing rapidly, the Belarusian fuel industry was expanding production, and consequently, the exports of oil products, while maintaining high profitability. (Table 1.7).

Table 1.7.
Fuel industry performance in 2003–2008

	2003	2004	2005	2006	2007	2008
Industrial output, % annual increase	7.0	18.8	8.9	23.1	-0.2	11.1
Fuel industry output, as % of total industrial output	16.7	18.9	21.7	21.8	20.4	21.3

	2003	2004	2005	2006	2007	2008
Profit margin, %	29.8	30.8	29.9	29.3	7.8	13.1
Costs per 1000 roubles of output, % annual increase	1.1	-5.0	-0.3	5.7	19.0	-5.7
Crude oil refining, millions of tons	15.8	18.4	19.8	21.3	21.3	21.3

Source: BelStat.

Petroleum products contributed a large proportion of the growth in physical exports, exports in value, export revenue (Table 1.8). This increase was creating significant positive downstream effects. Improved performance of the fuel industry generated the resources for increasing output in the related industries. From a long-term perspective, the increase in the prices of primary

inputs improved profitability, and increased domestic consumer spending and potential GDP.

The positive price shock that increased the price and physical volumes of petroleum exports was accompanied by improvements in external market conditions that benefited exporters from other sectors (Table 1.8).

Table 1.8.
Exports in value and physical exports of selected goods and commodities

	Petroleum products	Milk and dairy products	Ferrous metals	Potassium fertiliser	Tractors	Cargo vehicles	Exports, total
Physical exports, % annual increase							
2003	7.0	58.4	-2.7	14.6	22.1	12.2	10.8
2004	22.7	44.3	6.0	11.5	22.7	3.2	15.2
2005	4.0	26.1	8.9	0.8	20.0	7.9	-1.2
2006	9.8	12.0	11.9	-7.6	22.1	0.0	8.3
2007	1.8	-0.4	1.7	9.9	31.4	2.0	5.2
2008*	7.4	-11.5	-2.8	0.3	15.0	-5.0	12.4
Export prices, % annual increase							
2003	23.9	5.6	40.3	1.0	-7.2	-0.9	11.9
2004	37.0	11.1	46.1	25.9	11.9	39.4	20.2
2005	41.5	4.9	-6.8	33.5	5.0	6.7	17.4
2006	26.4	11.3	10.9	8.5	10.9	16.4	14.0
2007	11.3	57.2	33.8	21.0	14.9	31.3	16.9
2008*	67.0	64.4	35.7	149.5	21.9	31.1	43.6

Note:

Data for 2008 refer to January-June to show the effect of the economic recession on foreign trade.

Source:

Own computations based on data from Belstat.

As seen from the table, export growth was mainly the result of increases in the prices of export goods. Physical exports grew much less. This trend was particularly obvious in the Russian market, where Belarus was exporting a large share of its

capital and consumer goods. As the demand for Belarusian export goods in Russia was increasing, they were becoming less competitive in this market. This statement is best supported by the changes in Belarus' share in Russia's imports of select commodities (see Table 1.9).

Table 1.9.
Size of the Russian commodity markets and the share of Belarusian exporters in these markets

		2000	2001	2002	2003	2004	2005	2006	2007	2008
Milk and dairy products (04)	1*	100.0	162.5	173.9	254.8	308.9	403.1	374.5	504.3	637.3
	2**	30.7	27.9	25.9	28.5	34.1	33.2	39.6	40.9	40.0
Ferrous metals (72)	1*	100.0	102.7	80.6	143.0	227.1	311.6	438.1	700.2	779.8
	2**	8.2	7.4	10.7	13.3	12.2	8.0	6.0	6.7	7.1
Ferrous metal manufactures (73)	1*	100.0	121.9	124.6	157.4	218.2	297.2	412.2	613.5	682.4
	2**	11.2	11.1	11.9	12.2	11.7	8.3	7.2	6.2	7.0
Equipment and mechanical appliances (84)	1*	100.0	133.3	160.5	197.0	261.0	366.9	510.5	758.4	1072.8
	2**	8.8	7.6	7.0	7.1	6.7	4.3	3.9	3.6	3.0
Electrical machinery, audio and video equipment (85)	1*	100.0	1582	196.2	228.9	345.6	517.1	774.6	1153.6	1463.5
	2**	10.6	7.7	6.4	6.6	5.8	3.4	2.9	2.6	2.1
Land transport vehicles, parts, equipment (87)	1*	100.0	173.4	212.2	361.6	675.3	1016.8	1683.9	3021.7	4335.7
	2**	40.0	28.7	23.1	16.4	12.8	8.3	6.6	5.1	4.1

Note:
Data for 2008 refer to January-June to show the effect of the economic recession on foreign trade.

Source:
Own computations based on data from Belstat.

Income growth and rising competition were causing Belarusian exporters to lose their shares in the Russian markets. However, the situation of Belarusian exporters was affected only to a limited degree, because the size of the Russian markets was also increasing. The prospects of maintaining high rates of economic growth were nevertheless becoming increasingly dependent on preferential market access for Belarusian exporters. Starting in 2006, Belarus began to benefit from preferential access to the Russian public procurement system, following enactment of a Russian law

that enabled foreign producers to compete on equal terms with domestic firms for award of public procurement contracts. By the end of 2006, however, Russia introduced restrictions on access to public procurement tenders for Belarusian exporters citing lack of mutuality in the treatment of Russian producers in Belarus. Under a bilateral agreement of March 2007, both parties undertook to eliminate discriminatory measures in access to public procurement tenders. Belarus actively benefited from this opportunity until the onset of the global economic recession⁵. Diminished

⁵ Statistical data on the contribution of public procurement to the increase of exports are not available. However, according to statements by Russian officials, Russian public procurement may have contributed around 20% of the increase in physical exports of investment goods in 2007-2008.

competitiveness of Belarusian goods in the Russian markets, however, resulted in gradual decline in Russia's share of Belarusian exports throughout the period under review (Table 1.10).

The key factors of growth in 2003-2008 can be summarized as follows:

- Low price of gas imports from Russia;
- Favourable conditions in the world markets of raw goods;
- Rising demand in the Russian commodity markets and preferential access of Belarusian producers to the Russian market.

Favourable market conditions, and rising foreign currency revenues stabilised the

national currency markets and enabled a monetary policy used the US dollar exchange rate as nominal anchor. The demand for money was balanced, and the national financial system was strengthened. Multiple distortions in the money and capital markets were eliminated, and numerous imbalances in the national economy were removed as a result. In light of these improvements, the government was limiting the use of command and control mechanisms⁶. The combined effect of these trends was to accelerate the growth of potential GDP and to facilitate macroeconomic stabilisation in Belarus. Hence, macroeconomic performance indicators appeared favourable relative to the previous years and to the neighbouring states (Table 1.10).

Table 1.10.
Macroeconomic performance trends in 2003-2008

	2003	2004	2005	2006	2007	2008
GDP, % annual increase	7.0	11.4	9.4	10.0	8.6	10.2
GDP, billions of US Dollars	17.8	23.1	30.2	37.0	45.3	60.8
Exports of goods, billions of US Dollars	9.9	13.8	16.0	19.7	24.3	32.6
Exports to Russia, as % of total exports of goods	49.1	47.1	35.8	34.7	36.6	32.4
Imports of goods, US \$, billions	11.6	16.5	16.7	22.3	28.7	39.4
Total production assets, % annual increase	1.8	1.5	2.0	2.5	2.1	3.0
Industrial output, % annual increase	7.1	15.9	10.5	11.4	8.7	11.5
Agricultural output, % annual increase	6.6	12.6	1.7	6.0	4.4	8.6
Industrial output, as % of GDP	26.1	28.0	28.4	28.2	27.1	28.0
Agricultural output, as % of GDP	8.0	8.3	7.9	7.9	7.5	7.9
Construction output, as % of GDP	6.1	6.5	6.9	8.0	8.5	9.3
Real personal incomes, % annual increase	3.9	9.8	18.4	17.8	13.2	11.8
Employment, % annual increase	-0.9	-0.5	0.8	1.3	1.1	2.0
Labour productivity, % annual increase	1.6	13.0	10.1	8.3	6.6	9.8
Mean annual inflation, %	28.4	18.1	10.3	7.0	8.4	14.8
Real exchange rate of the national currency to the US Dollar, % annual increase	9.1	9.2	7.0	4.1	5.3	11.1
Real exchange rate of the national currency to the Russian Rouble, % annual increase	-3.9	-5.2	-3.4	-6.0	-6.6	-2.0
Current accounts balance, as % of GDP	-2.4	-5.2	1.7	-4.1	-6.6	-8.0
Gross external debt, as % of GDP	23.7	21.4	17.9	18.6	28.4	24.6

Source:
BelStat, Own computations based on data from BelStat.

As shown above, the drivers of economic growth in Belarus varied in time, but were always dependent on conditions in the export markets. To large extent, this was the consequence of the strategic choice of the growth model in the mid-1990s. Domestic drivers of growth were Belarus' human capital (or quality of the work force), and the positive impact of macroeconomic stabilization on allocation efficiency. However, excessive reliance on short- and medium-term growth factors resulted in a range of structural imbalances, which resulted in diminished

competitiveness of a wide range of Belarusian products in foreign markets. Furthermore, policies to promote domestic demand were also encouraging growth in imports. Together, these trends generated chronic current accounts deficits throughout the 2003-2008 period. In summary, the Belarusian growth model in 2003-2008 resulted in rapid income growth, but created a range of internal imbalances, and was highly sensitive to external shocks. This raised doubts about the long-term sustainability of this growth strategy.

1.2. Employment, poverty and household expenditure

According to official data, employment declined by 9.8% in 1990-2009. This decline did not affect the rate of unemployment, but increased the economic inactivity rate. These changes were inconsistent with the economic growth figures and the ongoing demographic trends, but may be attributed to the fact that many private entrepreneurs and microenterprise employees are recorded in statistics as economically inactive, despite being de-facto employed. High work

migration from Belarus (mostly to the Russian Federation), also explains a significant amount of this apparent discrepancy.

Due to limitations of national employment statistics, official data need to be supplemented by assessments of economically active population in the context of sample household surveys. Household surveys data show significantly higher levels of economic activity and employment.

Table 1.11.
Trends in employment

	Economically active population, thousands		Employment, thousands		Unemployment, thousands		Unemployment rate, %	
	Registration data, at midyear	Household income survey, end of year	Registration data, at midyear	Household income survey, end of year	Registration data, at midyear	Household income survey, end of year	Registration data, at midyear	Household income survey, end of year
1995	4524	5104	4409	4642	115	462	2.5	9.0
1996	4537	4979	4365	4547	172	432	3.8	8.7
1997	4528	5148	4370	4755	158	394	3.5	7.6
1998	4528	5172	4417	4801	111	372	2.4	7.2
1999	4542	5106	4442	4772	100	334	2.2	6.5
2000	4540	4959	4444	4623	96	336	2.1	6.8
2001	4524	4988	4442	4619	102	370	2.2	7.4
2002	4506	5162	4387	4751	119	411	2.7	8.0
2003	4488	5179	4347	4774	141	405	3.1	7.8
2004	4438	5130	4326	4797	112	333	2.5	6.5

	Economically active population, thousands		Employment, thousands		Unemployment, thousands		Unemployment rate, %	
	Registration data, at midyear	Household income survey, end of year	Registration data, at midyear	Household income survey, end of year	Registration data, at midyear	Household income survey, end of year	Registration data, at midyear	Household income survey, end of year
2005	4491	5204	4414	4903	77	301	1.7	5.8
2006	4534	5324	4470	5104	64	220	1.4	4.1
2007	4567	5358	4518	5131	49	228	1.1	4.2
2008	4654	5416	4610	5253	44	162	0.9	3.0
2009	4686	-	4644	-	42	-	0.9	-

Source:

BelStat, computations based on household survey data by Chubrik, et al. (2009). *Social Protection and Social Inclusion in Belarus, Report for the European Commission, Directorate General for Employment, Social Affairs and Equal Opportunities.*

Household surveys also show higher rates of unemployment throughout the period of economic growth. Furthermore, the survey data suggest that the rate of unemployment increased in 2000-2002 by a significant 1.5 percentage points. This is additional evidence of the ambivalent nature of the economic growth in 1999-2002. Conversely, growth in 2003-2008 was accompanied by an increase in employment and reduction of unemployment.

Changes in the structure of employment were consistent with the shifts in the industrial structure of the GDP. As manufacturing industries have been the main contributor to growth, they also contributed the largest share of total employment. The share of construction in total employment also increased, consistent with its rising share in the GDP in the mid-2000s.

Table 1.12.
Employment structure by industry, %

	1995	2000	2005	2007	2008	2009
Total employment, thousands	4409.6	4443.6	4414.1	4518.3	4610.5	4643.9
Employment by industry (%)						
Manufacturing industries	27.6	27.6	26.9	26.7	26.5	25.7
Agriculture	19.1	14.1	10.8	10.1	9.8	9.8
Forestry	0.6	0.7	0.7	0.7	0.7	0.7
Construction	6.9	7.0	7.8	8.3	8.6	9.1
Transport	5.7	5.8	6.0	6.1	6.3	6.2
Communications	1.3	1.4	1.5	1.4	1.4	1.4
Trade and public catering, supplies, marketing, procurement	10.7	12.0	13.5	14.1	14.4	14.6
Housing and utilities	3.4	4.2	4.6	4.6	4.5	4.5
Health care, sports, social protection	6.5	7.3	7.4	7.3	7.2	7.2
Education	9.5	10.4	10.4	10.0	9.8	9.6
Art and culture	1.6	1.8	1.9	1.9	2.0	2.0
Science and science support	1.0	1.0	0.9	0.8	0.8	0.8

Source: BelStat.

Significant changes were recorded in 1995 - 2009 in the structure of employment in manufacturing industries (Table 1.13). Although the growth was driven by

industrial production, this did not translate to significant increases in employment, with the exception of several industries with low labour intensity.

*Table 1.13.
Mean annual employment in manufacturing industries (thousands)*

	1995	2000	2005	2007	2008	2009
Manufacturing industries, including:	1176.2	1150.2	1062.0	1083.8	1104.2	1068.0
Electric power generation	40.0	43.4	40.9	42.7	43.7	48.7
Fuel industry	15.9	16.0	15.8	15.2	15.7	15.6
Iron and steel	11.8	16.5	17.4	18.2	17.4	17.8
Chemical and petrochemical industry	91.3	104.1	102.3	106.9	108.8	107.1
Machine building and metal working	490.4	426.1	385.8	396.2	397.8	379.6
Wood, timber, paper and pulp industry	101.4	122.5	122.2	117.4	120.9	113.8
Manufacture of building materials	69.2	58.5	53.6	60.3	63.6	59.0
Light industry	183.7	162.8	131.2	126.9	129.3	123.5
Food industry	107.1	128.0	130.8	137.9	140.4	140.4

Source: BelStat.

The socioeconomic changes of the last two decades also affected household incomes. During the transformational recession in 1991-1995, incomes declined by 48.7%, and prices grew by over 25 thousand times, resulting in near-complete loss of personal savings. These developments led to rapid increases in the poverty rate⁷. In 1995, 38.4% of the population was poor. The poverty rate peaked in 1996 at 38.6%. Thus, poverty and poverty reduction became a major challenge for economic policy.

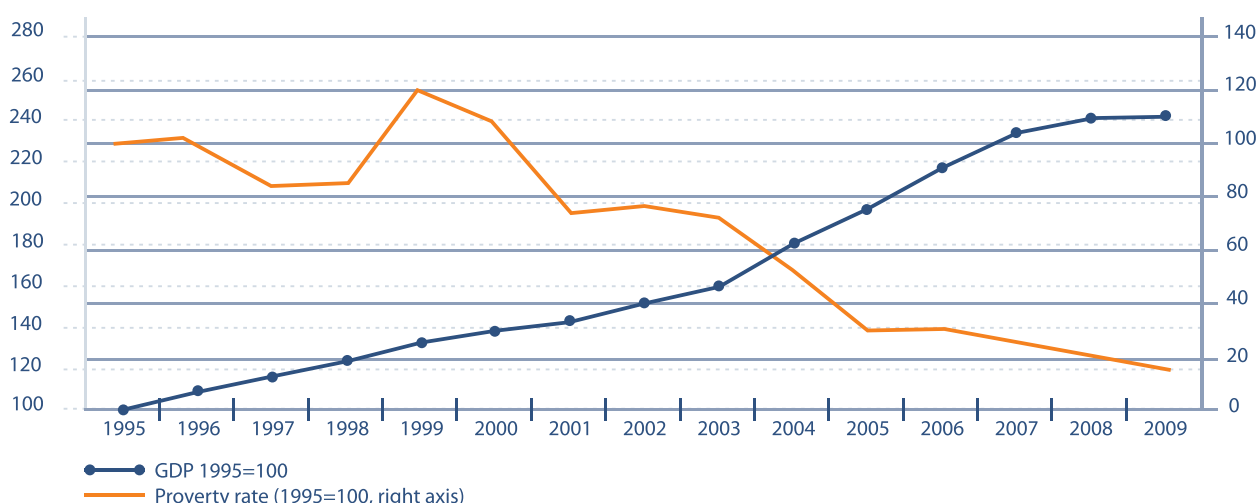
Based on its effect on the poverty, economic growth in Belarus could be defined as pro-

poor (Figure 1.2). During the growth period, the share of the population living below the minimum subsistence level decreased from 38.4% to 5.4%. Alternative poverty indicators (e.g., those utilised in the World Bank poverty review (World Bank (2004))⁸ reveal a similar dynamic. The only exceptional years to this trend were 1998 and 1999, when record inflation and devaluation may have affected income distribution. In absolute terms, however, the socioeconomic dynamic of 2000-2009 makes it possible to define Belarusian economic growth as pro-poor.

⁷ The poverty measure used here and elsewhere in the text is based on the comparison of incomes with the national poverty line. Due to colatility of the real exchange rate of the Belarusian Rouble to the US Dollar over the last fifteen years, the absolute poverty line, expressed in PPP US dollars, did not always provide an accurate measure of poverty. The cost of a certain amount of calories can be utilised as an alternative poverty line. The World Bank used this poverty line in the 2004 poverty assessment for Belarus (World Bank (2004)). The minimum per capital amount of calories on which this study was based was 2400 calories (including 2700 calories per adult).

⁸ World Bank (2004). Belarus: Poverty Assessment, World Bank Report No. 27431-BY, Europe and Central Asia Region Human Development Sector Unit.

Figure 1.2.
Economic growth and the poverty rate



Source: Belstat

Alternatively, the impact of growth on poverty can be evaluated based on the premise that it should result in the most rapid increases in the incomes of the most poor. Assessment of the quality of growth on this criterion would not

be as straightforward. As seen from Table 1.14, economic growth increased the incomes of the middle-income groups relative to the subsistence level, but was also accompanied by rising income inequality, as measured by the Gini coefficient.

Table 1.14.
Change in income levels and distribution, 1996-2008

	1996	1997	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008
Mean per capita income in real terms, % annual increase	0.3	10.1	17.4	7.8	8.1	21.0	9.3	4.6	14.4	19.9	14.2	15.8	11.9
Ratio of mean per capita income to the minimum consumer budget	0.75	0.78	0.75	0.69	0.75	0.85	0.87	0.90	1.02	1.19	1.31	1.46	1.63
Ratio of mean per capita income to the minimum subsistence budget	1.26	1.30	1.25	1.05	1.19	1.40	1.41	1.44	1.63	1.86	2.02	2.26	2.53
Real wage, % annual increase	5.1	14.3	18.0	7.3	12.0	29.6	7.9	3.2	17.4	20.9	17.3	10.0	9.0
Gini Index	0.254	0.258	0.283	0.269	0.270	0.278	0.272	0.254	0.254	0.256	0.262	0.274	0.274

Source:

BelStat, computations based on household survey data in Chubrik et. al. (2009). *Social Protection and Social Inclusion in Belarus, Report for the European Commission, Directorate General for Employment, Social Affairs and Equal Opportunities.*

Again, the end of the 1990s was an exception to the general trend, which could most likely be attributed to high inflation. Because the

consumer basket varies with income, the effect of consumer price growth on different income also varied. As shown by Chubrik

(2007)⁹, devaluation has a differential impact on income distribution, and the poorest tend to be the hardest hit by the effects of precipitous devaluation of the national currency. He concludes that Belarusian economic growth in 1996-2000 can be characterized as pro-poor with some difficulty, if one were to utilise the share of the poorest in the total income as the criterion of pro-poor growth. According to Chubrik, the benefits of economic growth were being distributed more towards the middle-income households than towards the poor, as the middle-income groups were the most likely power base for Belarusian economic policies (Chubrik (2007)).

In 2005, changes in the income inequality dynamic began to emerge. Income distribution,

as measured by the Gini coefficient, had increased. Apparently, the economic growth in recent years has continued to benefit the middle-income groups, and a growing proportion of the national wealth has been going to more wealthy households.

The rise in household income, accompanied by relative stability in income distribution, led to changes in the structure of consumer demand, which lasted until the onset of the world financial crisis in 2008 (Table 1.15). The share of expenditures on food had decreased, a trend typical during periods of relative affluence. Some of the biggest increases were recorded in the share of household expenditure on housing and utilities, as the cost of the relevant services had been growing above the rate of inflation.

Table 1.15.
Household consumer expenditures (%)

	2001	2002	2003	2004	2005	2006	2007	2008
Food	48.9	45.9	42.1	40.6	39.5	37.3	36.1	36.7
Meals outside the home	1.6	1.7	1.9	1.8	2.0	2.0	2.1	2.3
Alcohol	12.8	12.4	10.5	10.1	9.3	9.5	10.1	8.7
Tobacco	1.3	1.2	1.4	1.5	1.4	1.3	1.3	1.3
Clothing, footwear, fabrics	9.9	8.8	8.4	8.8	8.6	8.5	8.4	7.7
Personal hygiene items	1.7	1.9	2.0	2.0	2.0	1.9	1.9	2.1
Health	2.5	2.7	2.9	2.7	2.5	2.6	2.8	3.0
Housing and utilities	4.3	6.5	10.2	9.4	8.5	8.2	6.8	7.2
Furniture	0.8	0.9	0.9	1.0	1.5	1.9	2.3	1.9
Household and leisure goods	3.3	3.3	3.4	4.3	4.6	5.0	5.7	5.3
Preschool education	0.2	0.3	0.3	0.2	0.2	0.2	0.2	0.3

⁹ Chubrik A. (2007). Economic growth and household incomes – who benefits? // Growth for all? New challenges for the Belarusian economy - K. Gaiduk, I. Pelipas, A. Chubrik (eds.) - SPb.: Nevsky Prostor, pp. 48-78.

	2001	2002	2003	2004	2005	2006	2007	2008
Educational services	1.1	1.2	1.4	1.4	1.5	1.3	1.4	1.5
Culture, recreation and sport	1.4	1.5	1.8	2.2	2.7	3.0	2.5	2.4
Public transport	2.1	2.5	2.8	3.1	2.9	2.9	2.8	2.9
Car maintenance	3.0	2.8	3.0	3.0	3.1	3.2	3.7	4.2
Communications	1.4	1.7	2.2	2.5	3.3	3,7	4.4	4.4
Other goods and services	3.6	4.7	4.6	5.3	6.5	7,6	7.5	8.1
Total consumer expenditures	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note.

All data are presented as percentage of the total. Expenditures on alcohol are based on retail sales data (household surveys understate these expenditures by several times). The difference between the alcohol expenditures computed from retail sales and reported in the household survey was added to the total expenditures.

Source:

Computations based on household survey data in Chubrik, et. al. (2009). *Social Protection and Social Inclusion in Belarus, Report for the European Commission, Directorate General for Employment, Social Affairs and Equal Opportunities.*

The share of household consumer expenditures also grew in items such as education, health, household goods and services, recreation, sport and consumer

durables. As suggested by these figures, the economic growth of 2003-2008 had expanded opportunities for households to achieve higher levels of human development.

1.3 Attracting foreign direct investments

In the modern world, foreign direct investment is an important strategy for maximising competitiveness of the national economy, accelerating economic growth, and integrating the local firms in the global economy. The inflow of foreign investments can create new jobs, and facilitate adoption and diffusion of advanced technologies. Firms with foreign direct investments tend to be more efficient, as shown by a range of empirical studies covering industrialised and developing countries.¹⁰ Competition for investments has intensified in the last two decades, creating new challenges for Belarus and calling for specific policies to maximise the benefits of Belarus' geographical location and make it more attractive for investments.

Belarus is interested in attracting FDI, and is taking steps to improve its investment climate. It expects to benefit from the new technologies and managerial approaches that come with the FDI, promote their diffusion, and facilitate integration in the world economy.

Belarus has enacted an investment code, and implemented a national programme on attracting investments for 2002-2010, supplemented by annual investment programmes that incorporate current changes in the economy. In 2006, the National Investment Agency was reinstated to implement the one-stop principle in implementing administrative formalities and provide practical assistance to investors. The

¹⁰ Lipsey (2004). Home- and Host-Country Effects of Foreign Direct Investment. In: Baldwin R. and Winters A. (Eds.). *Challenges to Globalization*. Chicago: University of Chicago Press.

agency was renamed the National Agency for Investments and Privatisation, removed from the authority of the Ministry of Economy and made directly to the government of Belarus by a Presidential Edict of 25 May 2010. The decree established a ten-member advisory council to exercise oversight over the Agency, consisting of officials from the Presidential Administration, the Ministry of Economy, Ministry of Finance, Ministry of State Property, and other government agencies, and headed by the Prime Minister. The Agency will have a mandate to attract investors, implement government policies on investments and privatisation, monitor investment projects, and facilitate formation of a favourable investment image for Belarus.

The government projection for FDIs in 2010 is \$5.6 billion, including \$2.8 in revenue from the sale of strategic assets (e.g. corporatisation and, possibly, sale of BelarusKaliy to a Chinese firm). As the global financial crisis and recession had a negative impact on investment resources and investor plans, these projections may prove to be unrealistic. However, the government's decision to initiate legislation that removed the state monopoly in a range of markets is a sign of its intent to proceed with privatisation, including with the purpose of attracting foreign direct investments.

Recently, several measures were implemented to improve the investment image of Belarus. Firms with foreign direct investments were permitted to apply discretionary depreciation rates; they were given the freedom price of own products and were exempted from import taxes and the profit tax (on condition that the share of FDI in the firm's authorized capital exceeds 30%). Firms with foreign direct investments are not subject to mandatory targets (e.g. for employment or export revenue). They enjoy the right to lease the land under production premises for 99 years, and may be given the right to purchase such land if their production is deemed strategically important. Belarusian law establishes a five-year delay of entry into force of any legislation that deteriorates the situation of a firm with foreign direct investments. There are not requirements for firms with FDIs to comply with foreign revenue repatriation rules. Although capital foreign currency transactions are subject to licensing requirements, they are less stringent for non-resident firms. However,

despite all of these advantages, Belarus' position in the Doing Business 2010 ranking on the investor protection criterion deteriorated from 105th to 109th place.

By the amount of foreign direct investments, Belarus is still behind most countries in the region, despite all the efforts to attract investments. Cumulative per capita FDIs are 9.6 times below Lithuania's, 1.8 times below Ukraine's, 4.8 times below Russia's, and 8 times below Poland's. Under the government's privatisation programme, 924 enterprises were scheduled for sale to investors in 2008-2010, including 206 in 2008, 306 in 2009, and 412 in 2010. It was hoped that these sales would help accelerate the inflow of investments, but the privatisation targets for 2008 and 2009 were not met.

The Belarusian economy has few extractive industries that can attract investors elsewhere in the CIS regardless of the investment climate or market conditions. Other potential barriers to investments include slow progress of the economic reform and a high share of state ownership. Investors are also discouraged by a number of legal requirements and regulations, such as the golden share rule. The latter was abolished in 2008.

In these conditions, the inflow of foreign investments was mostly determined by large privatization sales. Some of the most attractive assets included oil and gas pipeline systems and facilities, and enterprises that completed the full production cycles based on Russian fuel and primary goods. Some of the most notable examples of such investment projects included the construction of the Yamal to Europe gas pipeline, and the sale to Gazprom in 2007-2010 of a 50% stake in Beltransgaz for \$625 million. The Yamal-to-Europe pipeline project accounted for the bulk of foreign direct investments in the early 2000s

Significant growth of foreign direct investments from 2005 was mostly the result of large privatization sales. Relative to 2005, FDI volume has grown six-fold, the share of FDIs in the GDP increased from 7% to 17,3%, and the ratio of FDIs to total domestic investments rose from 3.8% to 12.1%. In 2009, the Belarusian economy received \$1860.5 million in foreign direct investments, down by 13.8% from 2008 r (Table 1.16).

Table 1.16.
Foreign direct investments in Belarus, millions of US Dollars

	2005	2006	2007	2008	2009
FDI (receipts)	305	354	1772	2152	1861
Including as % of gross domestic investments	3.8	3.2	12.9	10.[?]9	12.1
Accumulated FDIs	2382.8	2734.3	4508,2	6670	8457
Including as % of the GDP	7.0	7.4	10.0	11.1	17.3

Source:
World Investment Report 2010, National Bank of Belarus, own computations.

As seen from Table 1.17, the bulk of FDIs (74.7% in 2009, and 80.3% in 2008) were equity investments, while reinvested profits represented 22%, and loans from foreign co-owners 3.3%. Equity investments related to privatization sales thus contributed most of the increases in FDIs in 2007-2009.

The sale of the government share in the Belarusian mobile phone operator Velcom, and the receipt of the first instalment of the payment from Gazprom for the 50% stake in Beltransgaz formed the majority of FDIs in 2007. Under the terms of the agreement, the payments were to be made in four stages between 2007 and 2010.

In 2008, most of the FDIs were represented by the second stage of the payment from Gazprom for the shares of Beltransgaz (\$625 million), and the revenues from the sale of 80% of the government's share in the equity of the mobile phone operator «Best» to Turkcell (\$600 million). Together, these transactions represented 78.5% of FDI equity inflows.

In 2009, 78.2% of FDI inflows were provided by the receipt of \$625 million from Gazprom as payment for the shares in Beltransgaz, and Russian equity investments in Belarusian banks (\$460.9 million). In sum, the national investment regime had relatively little effect on FDI inflows in Belarus in 2007-2009.

Table 1.17.
FDI receipts by type, millions of US Dollars

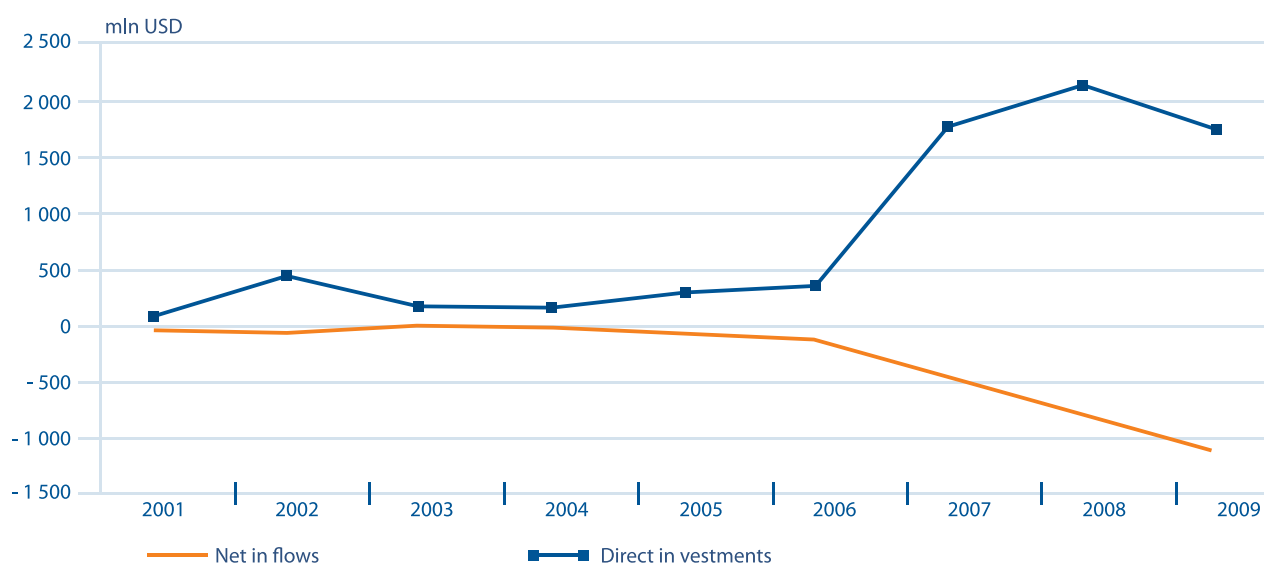
	2004	2005	2006	2007	2008	2009
FDIs	169.7	305.0	354.0	1772.2	2152	1860.5
Equity investments Including in bank equity	125.9 12.4	281.1 2.2	304.9 7.1	1425.5 86.7	1726.4 384.8	1388.9 539.1
Reinvested earnings	23.9	32.5	58.4	185.2	261.1	409.7
Loans from foreign co-owners	19.9	-8.7	-9.3	161.5	164.4	61.9

Source:
National Bank of Belarus.

The effect of the above transactions on the Belarusian economy was not straightforward. On the one hand, these investment deals had brought into Belarus the needed foreign currency and advanced technologies. On the other hand, they may accelerate the outflow of resources from the national economy in the long

term through repatriation of profits and other incomes on investments. A clear relationship has emerged in recent years between FDI inflows and the subsequent deterioration of the current accounts balance as a result of funds outflows through the income on investments account (Figure.1.3).

Figure 1.3.
Income on investments, FDI



Source: National Bank

The 2007-2009 period saw an increase in equity investments in Belarusian banks. This was mainly the result of an earlier strategic decision to increase bank capitalization by attracting direct investments. FDI equity investments in Belarusian banks exceeded \$1 billion in the last three years, representing 17.7% of total FDIs.

Equity investments, however, represent only a proportion of FDIs (58% in 2009, 49% in 2008, and 59% in 2007)¹¹. The remainder of the FDIs come in the form of reinvested earnings and inter-company loans. Thus, sustained inflow of HDIs has not been achieved, and Belarus' competitive advantages have not translated into higher amounts of investments. In our opinion, this outcome is mostly the result of slow progress of economic reform, high state ownership of assets, and high degree of state intervention in the economy.

Another challenge for Belarus is to find "appropriate" investors, whose arrival would

create positive spillover effects, promote concentration of output in high value-added sectors, increase product competitiveness and ultimately, facilitate exports, a key prerequisite to the development of Belarus' open-type economy.

It should also be noted that Belarus' investment inflow is significantly below its potential. Although FDIs have increased in volume in both absolute and per capita terms, and are coming at a faster rate, Belarus has one of the region's lowest FDI effectiveness index, an indicator that relates FDI volume to the size of the economy¹².

It is also of interest to examine the impact of FDI inflow on exporting capability, technology transfer and productivity. Internationally, FDIs tend to have a positive effect on exports. In China, for example, firms with FDIs have been able to increase exports considerably, and now contribute almost 50% of the export volume.

¹¹ A large part of these investments was contributed by a single privatization deal with Gazprom

¹² The relevance for Belarus of cooperative links between SMEs and TNCs is underlined in UNCTAD's Belarus Investment Policy Review (UNCTAD (2009) Investment Policy Review: Republic of Belarus) <http://www.unctad.org/Templates/webflyer.asp?docid=12340&intItemID=5166&lang=1&mode=dowloads>.

Table 1.18.
Economic performance of enterprises with FDIs

	2004	2005	2008	2009
Firms with FDIs at December, including	3457	3545	4880	5176
Joint ventures	1841	1903	2704	2819
Foreign ventures	1616	1642	2176	2357
Exports, US \$, millions, including by	2582	3334	10074.1	4734.0
Joint ventures	1656	1707	6416.4	2752.7
Foreign ventures	926	1627	3657.7	1981.3
Imports, US \$, millions, including by	3705	4879	13680.1	12110.1
Joint ventures	1926	2037	7306.4	7404.1
Foreign ventures	1779	2842	6373.7	4706.0

Source: BelStat.

In Belarus, exports by firms with FDIs increased by almost three times since 2005, despite a decline by 2.1 times in 2008-2009 as a result of the world economic crisis. The contribution of firms with FDIs to total exports grew from 20.9% in 2005 to 30.9% in 2008, and declined to 22.2% in 2009. However, firms with FDIs are also putting upward pressure on imports. In 2004-2008, the share of foreign and joint ventures in total imports grew from 22.5% to 34.7%, and reached 42.4% in 2009.

For a complete assessment of the impact of FDIs on local firms, one should examine the degree to which firms with FDIs are facilitating the creation in Belarus of a new export base and improvement in overall productivity. A survey of 2000 industrial enterprises found that firms with FDIs are generally more productive than local firms¹³, achieving greater total factor productivity by utilizing advanced technologies and management practices. In addition, firms with FDIs are less labour and more capital intensive, utilising 20% less labour and 10% more capital per unit of production. It should be noted, however, that foreign investors tend to favour higher productive sectors of the economy. On the other hand, firms with FDIs were found to

have no tangible effect on productivity in local enterprises. One possible explanation is that a significant proportion of equity FDIs had been made by Russian investors, and the technological level and managerial practices in Belarus and Russia are fairly similar.

The limited impact of foreign investments on industrial enterprise performance can also be explained by the low proportion of FDIs in most industries. Furthermore, FDI effects on local firms depend on their ability to learn and absorb the practices of other firms, the level of technological advancement in the economy, the quality of the human capital, the state of the finance system, and the quality of the institutions (e.g. the legal framework, protection of property rights, etc.), in addition to other factors that determine a country's ability to attract and benefit from foreign investments. It is important to note that enterprises with foreign ownership seldom compete, and thus have limited incentives to increase productivity and contribute to increasing the efficiency of the Belarusian economy. Export-oriented firms with FDIs are no more productive than similar firms serving the domestic market. The reason is that

¹³ Kolesnikova I., Tochitskaya I. (2008). FDIs and technology transfer in Belarus. A3 07/2008. IPM Research Centre.

that firms with FDIs mostly specialise in making unsophisticated products with low value added.

Belarus should promote the inflow of FDIs to a level that would maximise spillover effects and create competition. Policies on FDIs should emphasise the following objectives: (1) transfer of technologies and best business practices; (2) maximising spillover effects; (3) creating a new platform for exports. FDIs should be attracted to high value added industries, and local firms should be encouraged to develop their absorptive capabilities¹⁴. There is also a need to strengthen the finance system, the legal framework, and the mechanisms to protect property rights. Work should continue on improving the quality of the workforce and other factors conducive to investments.

As shown by international experience, policies on FDIs should be coordinated with industry and innovation policies. Only then could foreign direct investments be made to serve the long-term development needs of Belarus, by promoting competitiveness and integration of local firms in the world economy.

Free economic zones (FEZ) have provided a mechanism for attracting investments. At present, Belarus has six free economic zones ("Minsk", "Brest", "Gomel-Raton", "Vitebsk", "Mogilev", "Grodno-Invest") and one high technologies park. They were established to increase the exporting capacity, support technological innovation, and promote import

substitution. However, the actual specialisation of exporters that operate in the FEZs are plastic packaging (9.9% of all exports from the FEZs), canned fish (7.1%), furniture and furniture parts (6.8%), synthetic fibre (5.8%), sausage and canned meat (5.6%), polyacetals and polythioethers (4.8%), and hosiery (4.4%). The main export markets are in Russia and the CIS. Non-CIS exports are small, representing only 11% of the total non-CIS exports. Many firms established in the zones have unfavourable efficiency indicators, as evidence by high proportions of loss-making firms - 20.2%, including 27.4% in FEZ "Brest", 27.3% in FEZ "Vitebsk", 27.3%, 26% in FEZ "Minsk", 13% in FEZ "Grodno-Invest", and 11.1% in FEZ "Gomel-Raton". Thus, the existing free economic zones are contributing little to creating a new export platform for Belarus.

It would seem appropriate to reconsider the need for so many free economic zones, given the small size of Belarus. First, the free economic zones may create the so-called "roundtripping effect", known from the Chinese experience, when capital is invested outside the country only to be returned as foreign investment in order to claim the investor privileges granted to FEZ resident companies. Second, establishment of free economic zones should support the goals of and priorities of the industry policy. Third, national economic policy should create a more business-friendly environment for all firms: privileged treatment of FEZ residents alone cannot achieve greater competitiveness.

1.4. Effects of the global financial crisis on the Belarusian economy

The Government of Belarus attempted to maintain high rates of economic growth despite the rapid contraction of external demand in the second half of 2008. To this end, it resorted to external borrowing in an attempt to overcome the negative demand shock. As a result, gross external debt rose from 24.9% to 45.0% in 2009 alone, approaching a threshold deemed critical for a transition economy (Reinhart, Rogoff (2010))¹⁵. Most of this increase in external debt

was created by government borrowing. We believe that this high external debt burden can be viewed as a significant potential threat to economic growth.

Other anti-recession measures also involved serious potential risks, including the risks of weakening financial discipline, macroeconomic destabilisation, and worsening institutional environment. In this respect, the policy to promote domestic demand is

¹⁴ The need to increase absorptive capacity of domestic firms is underlined in UNtAD's Belarus Investment Policy Review. (UNCTAD (2009) Investment Policy Review: Republic of Belarus) <http://www.unctad.org/Templates/webflyer.asp?docid=12340&intlItemID=5166&lang=1&mode=downloads>.

¹⁵ Reinhart C., Rogoff K. (2010). Growth in a Time of Debt, American Economic Review, American Economic Association, Vol. 100(2), pp. 573-78.

a typical example. The government cited absence of internal imbalances in the finance sector as the main argument in favour of this policy. It believed that, since such imbalances had been avoided, there was no basis for economic recession in Belarus. Demand promotion measures were most consistently implemented from October-December 2008 to July 2009, and succeeded in increasing all components of domestic demand. Starting from mid-2009, these policies were somewhat weakened.

Much of the economic growth in the crisis years was due to the sustained level of capital investments. This component of domestic demand is known to be the most sensitive to external shock and, consequently, highly volatile. In Belarus, capital investments had a different dynamic. Rather than reacting to the global recession, it continued to increase in volume, and showed a considerable degree of inertia. This outcome was fully attributable to government interventions. To the government, this was an opportunity to boost production in a range of industries, and particularly in construction. It was hoped that investment goods would become a new area of growth, and create beneficial effects for other industries.

This approach was most consistently applied to the construction industry. The government utilised a full range of fiscal and monetary incentives. It showed clear preference for monetary interventions, as it was bound by the terms of the loan agreement with the IMF, which imposed an obligation to enforce tight fiscal discipline. However, fiscal and monetary measures were interrelated and mutually complimentary¹⁶. In this respect, policies to promote growth in housing construction became an innovation of sorts for Belarus (Kurk, Tochitskaya, Chimanovich (2009)).

The government also promoted investments in manufacturing industries. In this, it relied on two distinct policies. One was setting investment targets for state-owned enterprises, which were mandated to continue their pre-crisis investment programmes. To do so, some enterprises incurred significant losses and even became unprofitable. Directive lending was the second policy – the government was forcing banks to maintain a high supply of credit resources. Growth of capital investments throughout 2009 was almost fully financed by bank loans (Table 1.19)

*Table 1.19.
Increase of capital investments by source of funding*

	% annual increase			Contribution to GDP growth, percentage points		
	2008	2009	%change	2008	2009	Difference
Fixed capital investments	23.5	4.7	-18.8	23.5	4.7	-18.8
Consolidated budget	23.2	-10.6	-33.8	6.1	-2.8	-8.9
Enterprise equity	20.5	-0.2	-20.7	8.4	-0.1	-8.5
Third party borrowings	34.5	-30.0	-64.5	0.3	-0.3	-0.6
Foreign borrowings (excluding bank loans)	105.1	25.7	-79.4	0.9	0.4	-0.5

¹⁶ Kurk D., Tochitskaya I., Chimanovich G. (2009). Impact of the global economic recession on the Belarusian economy, IPM research centre working paper, WP/09/03.

	% annual increase			Contribution to GDP growth, percentage points		
	2008	2009	%change	2008	2009	Difference
Bank loans	31.0	29.4	-1.6	6.1	6.1	0.0
Loans from foreign banks	-43.7	2.8	46.5	-0.6	0.0	0.6
Loans from local banks	38.1	30.5	-7.6	6.3	5.7	-0.7
Personal savings	13.8	20.5	6.7	1.1	1.5	0.4
Extrabudgetary funds	-22.6	-9.0	13.6	-0.1	0.0	0.1
Other sources	14.1	-1.9	-16.0	0.4	-0.1	-0.5

Source:
Own computations based on data from BelStat.

In manufacturing industries, investments were expected to result in rapid technological upgrading of the production base, and make Belarusian firms more competitive in future. The costs of this investment policy at the micro and macro levels – such as poor financial performance, depletion of liquid assets, and upward pressure on imports – were viewed as temporary problems, and a fair price for the expected gains.

Given the emphasis on domestic demand promotion, government policies on household incomes were sending mixed signals. On the one hand, the government was obliged to implement fiscal restrictions and constrain wage growth¹⁷ to control the demand for imports. These policies were had been agreed with the IMF and outlined in the signed memorandum of understanding with the Fund, and were expected to reduce pressure on the Belarusian currency market. In practice, implementation of these measures left a lot of room for flexibility. Belarus was able to vary a range of expenditure items within the 2009 deficit-free budget to increase aggregate demand in selected markets. In addition to reaching targets for production, Belarusian

enterprises were forced to implement pre-crisis targets for wage increases. Many enterprises complied at the cost of reduced competitiveness. At the macro-level, this was evidenced by sharp increases in unit labour costs during the crisis years.

The reduction in real wages, however inevitable, had a relatively limited effect on real personal incomes. The relationship between real wages and incomes, and real wages and household consumption weakened somewhat in 2009. The latter relationship is characteristic of how households adjust their spending in times of crisis. Normally, household propensity to save increases during recession. On the one hand, the resulting decrease in household consumption acts as a constraint to GDP growth. On the other hand, increased household propensity to save also can eliminate serious macroeconomic imbalances. For example, by spending less on imported goods, households can help reduce the current accounts deficit, and increase the amount of resources available for domestic investments. As seen from the household income and expenditure statistics, the behaviour of Belarusian households seem to be ambiguous (Table 1.20).

¹⁷ In November 2008, the government announced a planned 25% increase in Grade 1 tariff rate, which determines wages throughout the economy, including in the private sector. The increase was later cancelled, and the tariff rate was increased by only 5%, upon demand from the IMF.

Table 1.20.
Trends in household expenditure in 2008-2009

	2008				2009			
	I	II	III	IV	I	II	III	IV
Goods and services	81.3	82.7	85.1	87	74.6	77.7	83.5	80.6
Taxes, duties, and other mandatory payments	16.5	17.1	17.6	19.9	18.2	19.2	19.2	18.7
Savings	6.3	5.5	3.9	0.0	9.5	5.0	2.7	5.7
Change in loan debt	-4	-6.8	-7.5	-5.9	-5.2	-3.0	-3.3	-4.3
Incomes less expenditures (+/-)	-0.1	1.5	0.9	-1.0	2.9	1.1	-2.1	-0.7
Household incomes, total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: BelStat.

Remarkably, the share of household consumer expenditure decreased only moderately, and this downward trend was not consistent throughout the recession period. For example, there was a spike in household propensity to consume in the fourth quarter of 2008, accompanied by a similar decline in propensity to save. This dynamic was most likely determined by changes in consumer expectations and the accumulated imbalances in the finance sector. Household savings and consumption dynamics in 2009 show no clear adjustment trend. In turn, this produced a relatively favourable dynamic of household consumption relative to GDP.

In sum, economic recession in 2009 was avoided mainly through policies to promote domestic demand. However, these same policies, implemented at a time of changing conditions in foreign markets (e.g. worsening of oil delivery terms, and rising price of gas), were creating new qualitative imbalances in the national economy. The global recession had affected Belarus' current macroeconomic performance, but also the prospects of sustainable growth in the future.

The world economic crisis affected potential GDP in the following ways:

1. By relaxing credit and market discipline outside the banking and finance sectors;
2. By reducing the efficiency of financial intermediaries, as a result of increased imbalances in the banking sector;
3. By giving rise to trends that may undermine macroeconomic stability (e.g. growth of external debt to a dangerous level, rising debt burden, worsening financial performance of banks);
4. Weak institutional environment are preventing efficiency gains at the macro level¹⁸;

By reducing the potential for economic growth¹⁹, the crisis created a new challenge for the Belarusian economy – the search for alternative sources of sustainable growth.

Likewise, the economic crisis has affected Belarus' human development levels. Contraction of external demand reduced employment in industries that were the most dependent on the export markets. This impact was partially mitigated by administrative interventions. For example, a de-facto prohibition was introduced on personnel cuts in state-owned

¹⁸ For more detail, see. Kurk D., Tochitskaya I., Chimanovich G. (2009). Impact of the global economic recession on the Belarusian economy, IPM research centre working paper, WP/09/03.

¹⁹ For more detail, see Kruk D. (2010). Impact of the global recession on long-term economic growth prospects in Belarus, in National competitiveness of Belarus, I. Pelipas (ed.), Minsk.: «BelPrint», pp. 159-199.

enterprises affected by adverse conditions in the foreign markets. As a result, a decline in total employment was avoided. In fact, employment had increased by 0.7% in 2009 relative to 2008. However, working time losses also increased significantly as employers had begun to cut hours. In 2009, this reduction affected 10.1% of employees, up from 3.9% in 2008, and total time losses amounted to 5.4 million man-hours, as compared to 1.2 million work-hours in 2008.

In response to the world crisis, the government imposed a freeze on the base wage rate in 2009 to slow the growth of nominal and real incomes. As a result, real incomes grew by only 2.7% in 2009, as compared to 11.8% in 2008. Year-on year increases in real wages were 0.1% in 2009 and 9.0% in 2008. On a positive note, the drop in real incomes was successfully avoided. Government income policies were also focused on protecting

the poorest. This led to a more equal distribution of national wealth, as measured by the Gini coefficient and the ratio of incomes of the richest 10% to the poorest 10%. In 2009, the Gini coefficient had declined to 0.268 from 0.274 in 2008, and the 10% income ratio decreased from 5.9 in 2008 to 5.6 in 2009.

Although the income and employment trends were relatively favourable, the world recession is still having a negative effect on human development. The crisis has deteriorated the state of public finance, and Belarus has again encountered the problem of budget deficit, after several years of deficit-free budgets. This may increase the pressure to reduce expenditure on needs related to human development, such as education, health care, and social protection. The slowing of economic growth may also create new challenges for the social sectors.

2. Foreign trade policy

2.1. Belarus' foreign trade performance

As a small open-type economy, Belarus has traditionally had a high ratio of exports, imports and foreign trade to the GDP, exceeding most of the CIS, and central and Eastern Europe. Belarus' high dependence on foreign trade – inherited from the Soviet times – is explained by the predominant role of manufacturing industries in the economy, the small size of the domestic market, and the need to import primary and investment goods. In 1989 – just before the break-up of the Soviet Union – Belarus exported over one-half of its GDP, including 5% to countries outside the Socialist bloc. On average, exports represented 57.3% of the GDP in 2000–2009, and imports 66.9% (Table 2.1). Although the share of foreign trade in the GDP declined somewhat in 2005–2009, the degree of openness to foreign trade remained the highest

in the region. By its ratio of foreign trade, Belarus was ahead of Lithuania (112.5%), Poland (71.9%), Russia (47.5%), and Ukraine (84.5%). From 2005 to the onset of the global economic recession in 2008, Belarus was exporting over 90% of its output of machine tools, around 90% of its refrigerator equipment and tractors, over 80% of cargo vehicles and potassium fertilizers, and around a third of its dairy products²⁰.

The ratio of foreign trade to the GDP continued to grow throughout 2000–2009, reflecting the strengthening of the Belarusian rouble relative to the US dollar. By 2008, it had reached 65.8%, nearly twice as high as in 2000. The subsequent decline in 2009 was attributable to the global economic recession.

Table 2.1.
Openness to foreign trade -- foreign trade to GDP ratio for Belarus in 2000–2009

	2000	2002	2003	2004	2005	2006	2008	2009
Exports as % of GDP	58.7	55.1	56.0	59.6	52.9	53.4	53.5	43.5
Imports as % of GDP	68.2	62.6	65.1	71.3	55.3	60.5	64.8	58.4
Foreign trade as % of GDP	126.9	117.7	121.1	130.9	108.2	113.9	118.3	101.9
Exports as % of GDP, PPP US dollars	15.2	14.5	16.4	19.8	20.5	23.0	27.3	19.0
Imports as % of GDP, PPP US dollars	17.6	16.4	19.1	23.6	21.4	26.0	33.0	25.5
Foreign trade as % of GDP, PPP US dollars	32.8	30.9	35.5	43.4	41.9	48.9	65.8	44.5

Note:
GDP figures for 2001 and 2002 are expressed in US dollars at the market rate (Source – IPM Research Centre), which differed from the official rate. GDP data for 2009 are expressed in PPP US dollars – World Bank estimate.

Source:
Own computations based on COMTRADE (exports, imports and trade), BelStat u National Bank (GDP) u WEI database (GDP in PPP US dollars).

High openness of the Belarusian economy had a clearly positive effect on growth, contributing on average 5.4% percentage points of the increase in the GDP in 2000–2008. However, it also made the

Belarusian economy sensitive to external shocks, as evidenced by the effects of the Russian financial crisis of 1998 and the global economic recession in 2008–2009. In 1999, the price volume of Belarusian

²⁰ Belarus: foreign trade and competitiveness data. Economic policy notes. World Bank policy note № 2. 25 June 2010. World Bank.

exports decreased by 16.4% below the previous year's level, and imports by 21.9%). The effect of the global economic recession was even deeper. From 2008 to 2009, exports had decreased by 34.6%, and imports by 27.5%. In contrast to 1998-1999, Belarus is experiencing a decrease in non-CIS trade.

In 2000-2008, Belarus had one of the fastest export and import growth rates. Exports from Belarus grew by 22.5% per annum, as compared to 19.8% from Lithuania, 22.1% from Poland, 20.1% from Ukraine, 20.8% from Russia. Up until

2007, exports was growing at roughly the same rate as the GDP (Table 2.2). The only exception to this trend was 2005, when the transition to the new principles of VAT collection in Belarus' trade with Russia led to a decline in the exports and imports volume. The effect of this transition weakened in subsequent years, as the growth in exports was more the result of higher prices. As a result, the export dynamic became highly sensitive to price fluctuations (particularly of petroleum products and potassium fertilisers) and changes in the market conditions.

Table 2.2.
Trends in real GDP, exports and imports, 2000-2009 (%)

	2002	2003	2004	2005	2006	2007	2008	2009
GDP	5.0	7.0	11.4	9.4	10.0	8.6	10.2	0.2
Exports, value	7.7	24.0	38.5	16.0	23.5	23.0	34.2	-34.6
Physical exports	8.8	10.8	15.2	-1.2	8.3	5.2	1.5	-11.5
Export price index	-0.1	11.9	20.2	17.4	14.0	16.9	32.2	-26.2
Imports, value	9.7	27.1	42.7	1.3	33.8	28.4	37.2	-27.5
Physical imports	12.2	13.6	21.4	-3.1	21.7	7.2	14.3	-12.6
Import price index	-2.2	11.9	17.6	4.5	9.9	19.8	20.0	-17

Source: BelStat.

Imports rose as fast as the GDP, but grew more rapidly than exports. As Belarus was increasing production of export goods to meet growing consumer demand, it was importing larger amounts of primary and intermediate goods. As a result,

imports consistently exceeded exports, leading to rising foreign trade deficit (Figure 2.1). The trade deficit with Russia was partially offset by the positive trade balance with non-CIS countries, including by 40.6% in 2007, 37% in 2008, and 22.2% in 2009.

Figure 2.1.
Foreign trade balance in 2000-2009 (millions of US dollars)

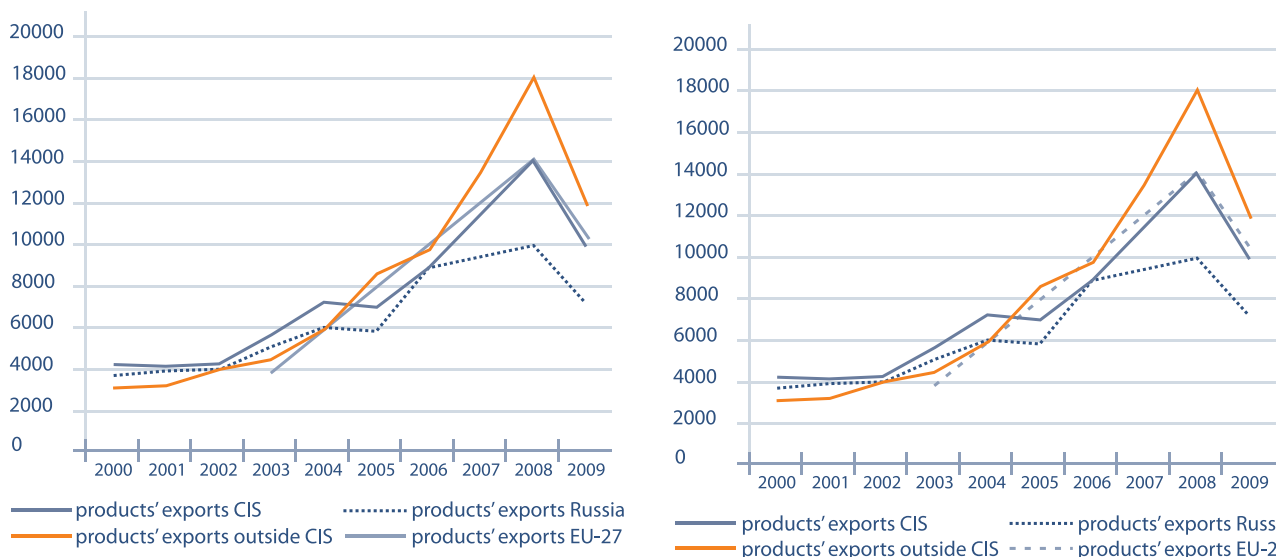


Source: BelStat

This dynamic can be explained by the rapid rise in the exports of petroleum products outside the CIS, including to the EU-27, accompanied by a much slower increase in the exports of manufactured goods to Russia (Figure 2.2).

Imports had the opposite dynamic – rising deliveries from the CIS, and especially of primary and energy inputs from Russia exceeded deliveries to Belarus from outside the CIS and the EU-27.

Figure 2.2.
Exports and imports to Belarus in 2000-2009 by geographic region (millions of US dollars)



Source: BelStat

In 2000, an upward trend emerged in the share of exports from Belarus to non-CIS markets. The change was very slow up until 2005, when Russia remained the leading trade partner for Belarus, and, unlike most other post-Soviet states, was still exporting mainly to the CIS. However, positive demand shocks in the world markets for petroleum products, ferrous metals and potassium fertilizers led major in the geographic structure of Belarusian exports. The share of Russia declined to 31.5% in 2009, while the proportion of exports to non-CIS

states increased to 56.3%, mainly as a result of a 43.7% in the deliveries of petroleum products to the EU (Table 2.3.). Excluding oil, petroleum products and mineral fertilizers, the share of the EU in Belarusian export had changed little in 2000-2009, registering a slight increase from an average of 18.7% in 2001-2005 to 19.2% in 2005-2008. Other neighbouring states, by comparison, had much higher shares of exports to the EU, including 76.7% in Poland, 62.6% in Lithuania, 37.4% in Russia, and 25.2% in Ukraine²¹.

Table 2.3.
Geographic structure of Belarus merchandise exports and imports (%)

	2000	2003	2004	2005	2006	2007	2008	2009
Exports								
CIS	60.0	54.6	53.1	44.2	43.6	46.2	44.1	43.7

²¹ Belarus: foreign trade and competitiveness data. Economic policy notes. World Bank policy note № 2. 25 June 2010. World Bank.

	2000	2003	2004	2005	2006	2007	2008	2009
Including Russia	50.6	49.1	47.1	35.8	34.7	36.6	32.4	31.5
Non-CIS, Including	40.0	45.4	46.9	55.8	56.4	53.8	55.9	56.3
EU	28.5	36.4	36.8	44.6	46.1	43.7	43.5	43.7
Imports								
CIS	70.2	69.6	72.1	66.7	64.9	66.3	65.9	63.8
Including Russia	64.8	65.8	68.1	60.6	58.6	60.0	59.7	58.5
Non-CIS, Including	29.8	30.4	27.9	33.3	35.1	33.7	34.1	36.2
EU	21.4	21.9	19.8	21.6	22.5	21.8	21.7	22.9

Source:
Own computations based on data from BelStat.

Ukraine is another leading trade partner for Belarus in the CIS, representing 12.7% of the total CIS exports in 2000, and 18.2% in 2009. Russia, however, was the indisputable leader by the share of imports to Belarus (92.3% in 2000 and 91.8% in 2009), partially reflecting its role as the main supplier of energy inputs.

Outside the CIS, the Netherlands, Latvia, Germany, Poland and the United Kingdom were the largest export markets for Belarus in 2008-2009. The share of the Netherlands in non-CIS exports increased from 2% in 2000 to 30.7% in 2009 (representing 17.3% of the total exports). Germany, a major supplier of investment goods to Belarus, represented the largest proportion of import, followed by China and Poland. The biggest increase in the share of non-CIS imports was from China (from 1.8% in 2000 to 10.4% in 2009). As a result, China has become the second biggest trade partner of Belarus outside the CIS.

The changes in the geographic structure, and the decrease in Russia's share of the total exports from Belarus increased Belarus' foreign trade diversification index²². In 2000-2008, it grew from 2,283 to 2,631, a level comparable with the

EU countries such as Germany and the UK, and higher than in Hungary, Poland, and the Czech Republic.

Commodity composition of exports

In terms of commodity composition, the structure of Belarusian exports changed little in 2000- 2009. The export structure continued to be dominated by machinery and transport equipment, as the CIS countries continued to give preference to the relatively inexpensive investment goods from Belarus in modernizing their production base. The commodity composition of exports, however, had become more diversified, mainly as an almost twofold increase in the proportion of food and agricultural products.

Significant changes had taken place in the commodity composition of non-CIS exports. The share of transport equipment decreased from 4.4 % to 3.8%, while the proportion of petroleum and petroleum products rose to 55.6%. Potassium fertilizer was another important export commodity. In 2009, the combined share of petroleum, petroleum products and potassium fertiliser in the total exports was 66.8%, and

²² To measure geographic concentration /diversification of trade, we utilized the Absolute Entropy Index. The Index was computed with the following formula: $I_{xi} = \sum b_{ij} \ln(1/b_{ij})$, where b_{ij} is the proportion of export/import from country i to country j, and $\ln(1/b_{ij})$ is the weight. A higher index indicates a higher level of export diversification. For a more detailed description of the methodology, see Laaser и Schrader (2002).

the share of these three commodities and non-precious metals was 73.7%.

To find out whether Belarus' export structure was shifting from Russia towards the non-CIS markets, the commodity composition of exports was recalculated excluding petroleum and petroleum products (Table 2.4). As seen from the Table, the share of machinery in total non-CIS export declined from 5.6% to 4.1% (despite the rising share of this commodity group in world exports), textiles from 11% to 3%, and wood manufactures from 6.9% to 3.9%. This was accompanied by increases in the shares of the following commodities: overland transport equipment (from 6.6% to 8.6%), non-precious

metals (from 13.1% to 15.4%), chemicals (from 37.5% to 49%, mainly as a result of higher exports of potassium fertilisers). As suggested by these data, the decline in the share of the CIS, including Russia, in the total exports, and the increase in the share of the non-CIS states, was not caused by a reorientation of commodity exports from one set of markets to another, but was mainly the result of increased exports of petroleum products and the more favourable conditions in the world markets of primary goods. Some traditional exports – such as textiles (excluding chemical fibre and threads) – had not only decreased as a proportion of the total export, but also in terms of price volume (by 25.4%).

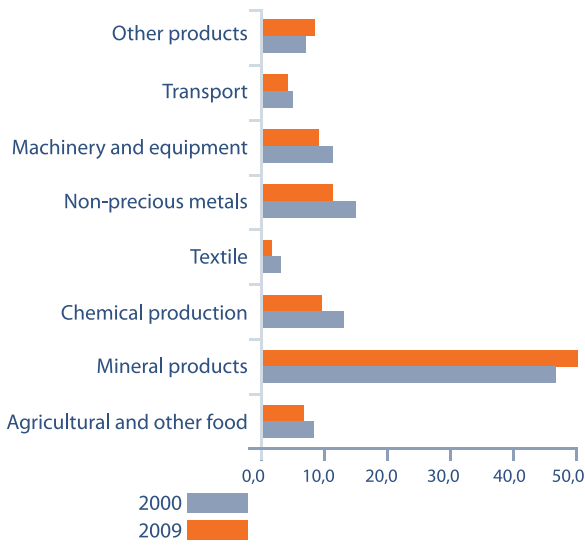
Table 2.4.
Commodity composition of export from Belarus (%)

Export components	2000				2008				2009			
	Including oil and pipelines		Excluding oil and pipelines		Including oil and pipelines		Excluding oil and pipelines		Including oil and pipelines		Excluding oil and pipelines	
	CIS	Non-CIS	CIS	Non-CIS	CIS	Non-CIS	CIS	Non-CIS	CIS	Non-CIS	CIS	Non-CIS
Agricultural and other food products	9.6	2.8	10.7	4.1	14.6	0.7	16.2	1.7	21.8	2.1	24.7	4.8
Minerals	10.8	34.5	0.6	1.9	11.3	58.1	1.4	5.3	13.0	57.3	1.5	3.9
Including crude and petroleum products	10.2	33.2	0.0	0.0	10.0	55.7	0.0	0.0	11.7	55.6	0	0
Chemicals and chemical products	16.4	25.1	18.2	37.5	11.2	25.1	12.5	56.7	13.7	21.8	15.5	49.0
Including potassium fertiliser	0.1	13.9	0.1	20.8	1.0	17.6	1.1	39.8	0.1	11.3	0.1	25.3
Textiles	5.8t	7.3	6.4	11.0	4.2	1.1	4.6	2.5	4.9	1.3	5.5	3.0
Non-precious metals	6.2	8.8	6.9	13.1	9.1	6.9	10.1	15.6	6.9	6.8	7.8	15.4
Wood and products thereof	4.1	4.6	4.5	6.9	3.2	1.7	3.5	3.8	2.9	1.8	3.3	3.9
Machinery	15.5	3.8	17.3	5.6	17.0	1.2	18.9	2.8	15.9	1.8	18.0	4.1
Transport equipment	18.8	4.4	20.9	6.6	19.3	2.5	21.5	5.6	10.6	3.8	12	8.6
Other products	12.8	8.7	14.5	13.3	10.1	2.7	11.3	6.0	10.3	3.3	11.7	7.3
Export of goods	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source:
own computations from Belstat data

Similar changes were taking place in the commodity composition of imports. The share of petroleum and petroleum products in total CIS imports rose to 45.8%, bringing the proportion of mineral products and non-precious metals to 72.8% of the total imports from the CIS. Conversely, imports of investment goods and chemicals had declined as a proportion of the total imports.

Figure 2.3.
Commodity composition of CIS imports, %



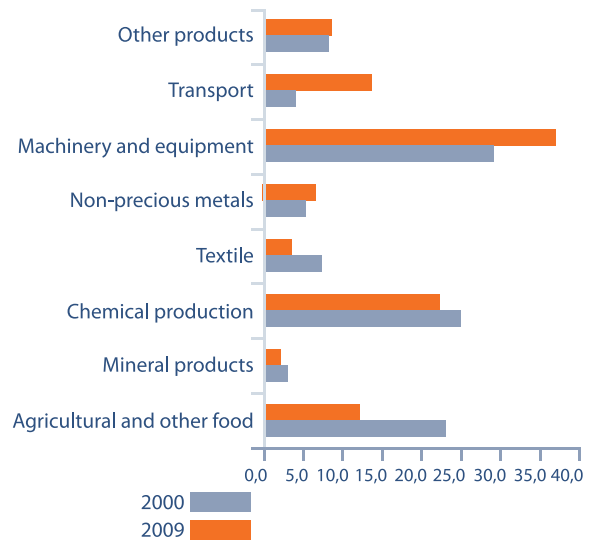
Source: BelStat

It would be useful to examine the factor intensity of exports, i.e., the key factors of production in the output of the traded goods. Five categories of exports/imports commodities can be identified based on the factor intensity criterion: primary goods, labour intensive/low-tech goods, capital intensive/medium-technology goods, and high-technology goods²³. As the data from Table 2.5 suggest, Belarus' export specialisation, particularly outside the CIS, has shifted towards primary goods, while the proportion of capital-intensive and high-technology goods had decreased. Similarly, the proportion of labour-intensive export goods, such as textile items, has declined.

The changes in the structure of exports to the CIS were in the opposite direction – the proportion of capital-intensive goods was increasing, mainly

Imports of machinery and transport equipment grew as a proportion of total imports from 24.4% to 32.2% and from 7.5% to 12.7%, respectively. Much of the increase in the imports of transport equipment, however, was represented by passenger cars. These two categories of imports constituted around a half of all non-CIS imports, indicating a strong investment focus of imports from outside the CIS. By contrast, the imports of chemicals, non-precious metals and other major commodities had decreased.

Figure 2.4.
Commodity composition non-CIS imports, %

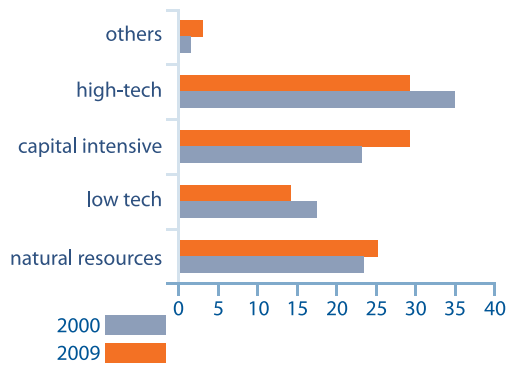


of car tires, ferrous metals, tractors, tractor-trailers and cargo vehicles. However, similar to non-CIS exports, deliveries of other skilled-labour intensive products to the CIS -- notably, of machinery, transport equipment, machine parts and mechanisms, photographic and optical instruments, measuring and medical equipment and parts – had decreased, mainly as a result of their diminished competitiveness in the Russian market.

The high proportion of primary-resource intensive exports is a sign of unfavourable trends in the export structure. Because these export commodities are produced by industries with limited growth potential, their high share in the export volume is a constraint to job creation and productivity growth.

²³ Analysis was performed using World Bank methodology. The grouping is based on the Standard International Trade Classification (SITC).

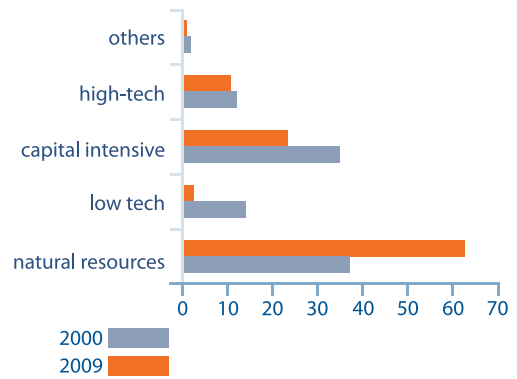
Figure 2.5.
Commodity structure of CIS exports by factor intensity (%)



Source:
Own computations based on data from UN COMTRADE.

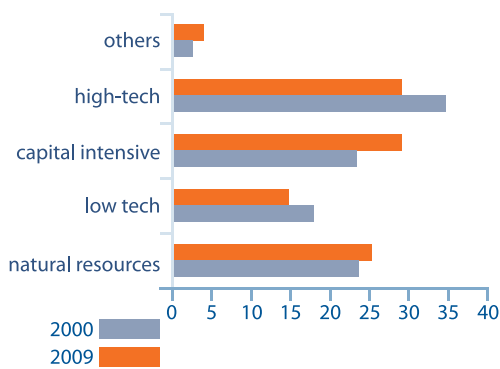
Imports from the CIS were marked by significant growth in the proportion of primary imports and a decline in the share of high-technology and capital-intensive goods (Figure 2.7). Conversely, imports from outside the CIS were marked by increases in the share of capital intensive goods, notably of alcohol beverages and tobacco products, dyes and tanning agents, detergents, rubber and caoutchouc and transport equipment. The rising imports

Figure 2.6.
Commodity structure of non-CIS exports by factor intensity (%)



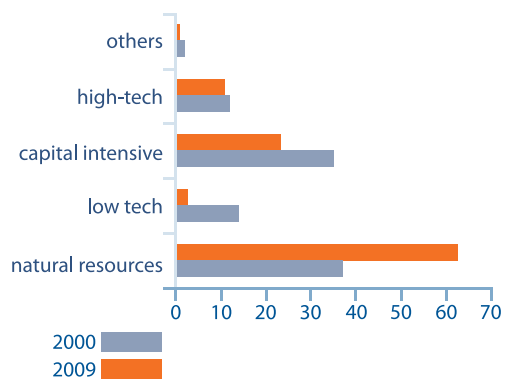
of investment goods from outside the CIS is positive a sign of the ongoing modernization of the production base²⁴. However, several neighbouring states not only increased the proportion of investment goods in total imports, but also achieved a higher share of such goods. In Russia, for example, it had reached 39%, indicating rising competition for Belarusian exports of investment goods from outside the CIS.

Figure 2.7.
CIS imports by factor intensity (%)



Source:
own computations based on UN COMTRADE data.

Figure 2.8.
Non-CIS imports by factor intensity (%)



²⁴This commodity group also includes chemical products, notably, organic and inorganic compounds, pharmaceuticals, plastics and products thereof, office machinery and equipment.

The commodity composition of Belarusian exports has become less diversified in the last decade. It is generally believed that the specialisation of the export basket is determined by a range of factors, including availability and productivity of factors of production, and the competitive advantages of individual industries and firms. More developed economies tend to have a more diversified (and,

consequently, less specialised) export basket. As indicated by the ratio of the number of export goods to the total number of SITC lines, the Belarusian trade basket became less diversified in 1998-2008²⁵, while the neighbouring countries – such as Lithuania, Latvia, Poland and Ukraine – had diversified their exports (Table 2.5.). In 2008, Belarus had the least diversified export structure in the region.

Table 2.5.
*Export diversification ratio (%)**

	1999	2005	2008
Belarus	75.4	67.1	63.2
Bulgaria	72.3	80.2	80.0
Czech Republic	92.7	91.3	89.4
Estonia	76.4	75.1	75.1
Hungary	69.6	80.8	67.0
Latvia	65.5	72.2	74.1
Lithuania	77.8	82.0	81.3
Poland	67.3	91.4	89.4
Russia	88.1	86.5	83.4
Slovak Republic	84.3	67.4	65.4
Slovenia	82.4	83.7	83.5
Ukraine	75.1	77.6	80.2

* SITC 5 digits, 2852 items.

Source:
own computations based on UN COMTRADE data.

Belarusian exports to Russia and Ukraine, the main markets for industrial goods, became remarkably less diversified, similar to exports to the EU (Table 2.6). This was at least partially the result of diminished competitiveness of Belarusian goods in foreign markets. The growth in exports to the Netherlands and the UK, making them Belarus' main trade partners outside the CIS, was not the result of a wider export nomenclature, but reflected the growth in the deliveries of petroleum

products. For example, exports of energy goods to the Netherlands grew by 1723 times, reaching 98.5% of the total exports. The exports of clothing items, by contrast, decreased by 25% to 0.3% of the total exports, down from 40.5% in 1999. Likewise, the proportion of energy exports to the UK reached 95.5%, the exports of ferrous metals grew by 32 times to 2% of the total exports, while the exports of clothing items had decreased by one-half.

²⁵ No computations were made for 2009, as some countries had not provided statistics to UN COMTRADE for 2009 at the time of writing.

Table 2.6.
Export diversification by the main Belarus' trade partners

	1999	2005	2008	2009
Russia	68.5	61.9	56.3	54.2
EU-27	46.8	43.9	42.6	n.a.
China	1.7	3.8	4.7	4.9
India	1.7	1.8	2.3	3.2
Brazil	0.1	0.5	0.5	0.4
Ukraine	31.8	26.7	28.1	26.3
Poland	15.7	16.1	18.5	17.8
UK	3.3	5.3	4.9	4.8
Netherlands	5.1	7.9	6.6	5.9

* SITC 5 digits, 2852 items.

Source:
own computations based on UN COMTRADE data.

A higher commodity concentration of Belarusian exports to Russian and non-CIS markets is also

evidenced by the rising Herfindahl-Hirschman index.

Table 2.7.
Export market concentration (Herfindahl-Hirschman index)

	1998	2000	2002	2005	2006	2007	2008	2009
Russia	541.3	557.8	523.0	568.1	596.6	619.4	625.6	550.0
Non-CIS	681.9	1734.1	1826.5	2938.3	3358.1	3066.7	3169.5	3068.
Total	482.9	692.4	696.7	1356.9	1574.3	1399.3	1598.7	1545.4

Source:
own computations based on UN COMTRADE data.

The trends in the Herfindahl-Hirschman index reflect narrowing of the export nomenclature, weakening of the competitive position in the export position, and growing reliance of exports on a small number of traded goods – mostly of petroleum products²⁶. Whereas Herfindahl-Hirschman index of Belarus' exports to the Russian market is fairly low, it has been rising

rapidly for exports outside the CIS, from 681.9 in 1999 to 3169.5 in 2008, acknowledging the fact that trade with non-CIS countries was becoming increasingly dependent on a few commodities. In 2009, the commodity concentration of exports deteriorated still further, mainly as a result of the global economic recession. It should also be stressed that the high concentration of exports

²⁶ In the Index is below 700 in Poland, 1000 in Hungary and 600 in the Czech Republic.

also means its great vulnerability to changes in the world markets of a limited number of goods

(in case of Belarus, these goods are mineral oil, potash and ferrous metals).

2.2. Foreign trade policy

Similar to most other countries, foreign trade in Belarus is regulated by a set of standard legal, executive and oversight interventions to maintain the balance of foreign trade, promote progressive change in the structure of exports and imports and attract foreign direct investments. Specific policy instruments for foreign trade regulation include export and import tariffs and non-tariff restrictions.

According to data from the World Trade Indicators Database of the World Bank (Table 2.8), the level of tariff protection (or the weighted average tariff) in Belarus was below the world average, but significantly above the

average level for the Europe/Central Asia region and for the EC -27. Of the CIS countries, only Russia had a higher weighted average tariff than Belarus (Table 2.9). Higher tariffs, however were applied only to 36% of imports from outside the CIS, as trade with the CIS and Russia, Belarus' main trade partner, was not subject to tariffs. In addition, all imports from developing countries are taxed at the rate of 75% of Most Favoured Nation tariff under the Generalised System of Preferences. It should also be remembered that calculation of the most favoured nation tariff always carries a margin of error, as combined and specific import tax (charged on 17.5% of the tariff lines in Belarus).

Table 2.8.
Tariff protection level in Belarus

2006-2009	Belarus	Europe and Central Asia	EU27	World average
MFN – applied tariff (AV + AVE)				
MFN – applied tariff (AV + AVE), simple average (%)	10.77	6.72	5.46	9.54
MFN – applied tariff (AV + AVE), dispersion (%)	1.02	1.79	1.97	1.80
MFN – applied tariff (AV + AVE), weighted average (%)	8.04	5.86	3.15	8.53
Tariff peaks				
Share of tariff lines with domestic peaks (value above 3 times the simple average tariff) (%)	1.78	8.38	9.79	6.11
Share of tariff lines with international peaks (applied tariff rates that exceed 15 percent) (%)	18.15	10.25	11.10	21.73

Note.

* AV – ad valorem tariff, AVE – specific tariff in ad valorem equivalent.

Source:

World Trade Indicators, the World Bank.

By comparison with Europe and Central Asia, the Belarusian tariff schedule is more regular and has lower deviation from the average nominal tariff (1.02%, as compared to 1.79%

in Europe and Central Asia and 1.97% in the EU-27), and a lower proportion of tariff peaks, i.e., greater than three times the average nominal tariff.

Table 2.9.
Applied MFN tariffs in the CIS and Georgia

	Applied MFN Tariff (AV + AVE) – simple average, %	Applied MFN Tariff (AV+AVE) – weighted average, %
Period	2006-09, last available data	2006-09, last available data
Uzbekistan	15.4	11.1
Belarus	10.77	8.04
Russia	10.75	12.34
Azerbaijan	9.01	5.06
Tajikistan	7.89	6.90
Kazakhstan	6.16	5.06
Moldova	4.70	3.58
Kyrgyzstan	4.66	3.89
Ukraine	4.56	2.62
Armenia	3.02	3.79
Georgia**	1.32	1.63

Note:

* World Trade Indicators have no data for Turkmenistan.

** Georgia exited the CIS in August 2009, but the data refer to the period when it was still a CIS member. We include the data for Georgia for comparison.

Source:

World Trade Indicators, the World Bank.

Similar to other countries, Belarus applies non-tariff barriers to protect domestic producers, including quotas, licenses, anti-dumping and countervailing duties, technical and sanitary regulations and the award of the special importer status. The size of non-tariff barriers can be measured by the frequency ratio²⁷, calculated as the proportion of HS tariff lines affected by NTBs²⁸. According to our calculations, the frequency ratio for Belarus lies within the 10-12% range. The World Bank utilised a broader approach, considering a range of additional

factors -- such the effect of price controls, anti-monopoly interventions and policy support for agricultural producers²⁹ -- and arrived at a higher value of the frequency ratio. Because the frequency ratio has been calculated for every country, the frequency ratio for Belarus (0.29, or 29%) is lower than in Russia (0.39), similar to many industrialized nations such as the United States (0.27), the United Kingdom (0.29) and France (0.29), but higher than in most neighbouring states, including Lithuania (0.17), Latvia (0.18), Poland (0.14), and Ukraine (0.17).

²⁷ For a description of the methodology, see Deardorf A and R. Stern (1997), "Measurement of Non-Tariff Barriers", OECD Economics Department Working Paper No.179, Paris, OECD.

²⁸ I.e. the proportion of the tariff lines affected by nontariff restrictions.

²⁹ Hiau Looi Kee, Alessandro Nicita, Marcelo Olarreaga (2006). Estimating Trade Restrictiveness Indices. World Bank Policy Research Working Paper 3840.

However, Belarus ranks below most other CIS states by a majority of foreign trade liberalisation measures, including the World Bank's Tariff Trade Restrictive Index, and the EBRD Index of Forex and Trade Liberalisation. (Table 2.10). As confirmed by the experience of Southeast Asia, trade restrictive policies protect the domestic

producers in a range of key industries, such as engineering, light and food industries. The effectiveness of such policies, however, should be closely monitored, as excessive emphasis on protectionism can restrict competition and reduces social welfare, as higher import duties result in higher prices of consumer goods.

Table 2.10.

Country foreign trade policy, institutional environment and trade facilitation rankings

	Foreign trade policy	Institutional environment	Trade facilitation
	Tariff Trade Restrictive Index (applied MFN tariff – all tariff lines)	Ease of doing business rank	Logistical performance index rank -
Period	2006-09 (last available)	2006-09 (last available)	2006-09 (last available)
Kazakhstan	7	63	63
Moldova	11	94	104
Kyrgyzstan	15	41	93
Ukraine	52	142	104
Azerbaijan	62	38	90
Russia	70	120	94
Belarus	87	58	110
Armenia	..	43	114
Turkmenistan	116
Uzbekistan	..	150	69
Georgia	..	11	94
Latvia	25	27	37
Lithuania	25	26	45
Poland	25	72	29

Source:
World Trade Indicators, the World Bank

Foreign trade policy is closely linked to the institutional environment. The government of Belarus and the Presidential Administration adopted in January 2009 a list of priority interventions to liberalise

the conditions for economic activity for 2009. These included measures to improve the business climate and remove excessive administrative barriers, including by simplifying procedures for business

registration, standardisation, certification, licensing, sanitary and fire safety regulations. As a result, Belarus rose to 58th place in the World Bank's 2010 Ease of Doing Business ranking, from 115th place in 2008, and ranked in fourth place among the world's top ten most improved business reformers.

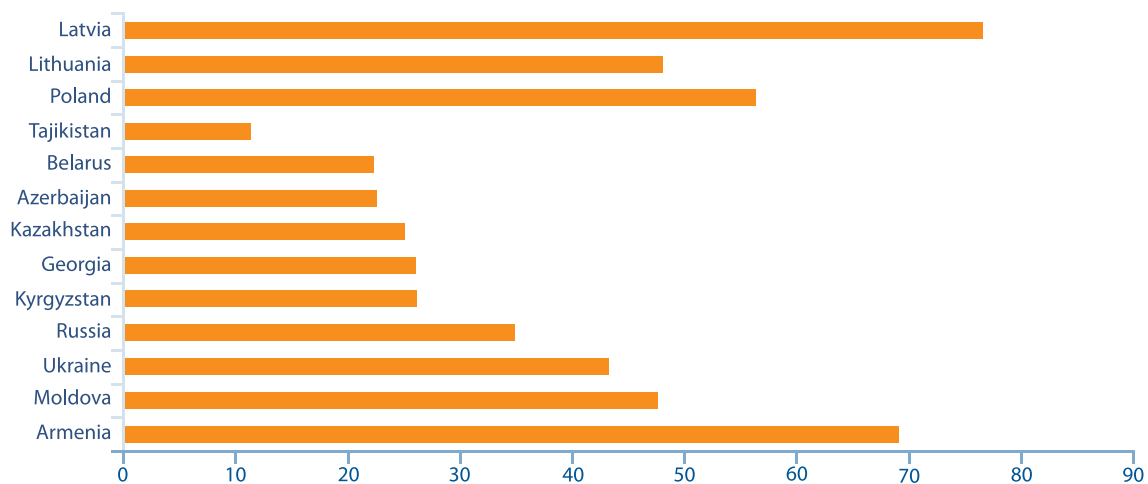
Belarus moved down to 64th place in the Doing Business 2011 ranking, as a result of a revision by the World Bank and the IMF of the list of indicators and the removal of employing workers data from the calculation of the ranking. Belarus ended up in 64th place in the 2010 ranking, after the Ease of Doing Business was recalculated using the new standard methodology.

By the five-year doing business change score, a new measure introduced by the 2011 Doing Business Report, Belarus was in third place among the world's top ten economies that the 10 economies that made the largest strides in making their regulatory environment more favourable over five years. For example, Belarus moved to 7th place in the global starting a business ranking.

Remarkably, however, Belarus continues to have a low ranking by the World Bank's trade facilitation measures (Table 2.10), suggesting the presence of significant constraints to the growth of foreign trade and FDI inflows. Belarus' rank on the logistics performance index, which reflects perceptions of a country's logistics in seven key dimensions, changed from 74th to 110th place. This tendency will no doubt be reversed by current policies to reduce and simplify administrative procedures related to shipments and transport oversight. The planned construction of transport logistics, wholesale logistics and multi-functional centres, prescribed by the Logistics Development Programme up until 2015, will also be beneficial in this regard.

Belarus also has a low rank by the World Bank's measures of trade finance, a key determinant of competitiveness of Belarusian goods in foreign markets. Belarus is in 85th place by the Export Credit-Ensured Exposures indicator. In Belarus, export credits represent 22.4% of exports (as compared to 43.4% in Ukraine, 76.6% in Latvia and 56.2% in Poland), putting it in the global 153rd place by the export credits to exports ratio.

Figure 2.9. Country foreign trade finance ranking, 2006-2009

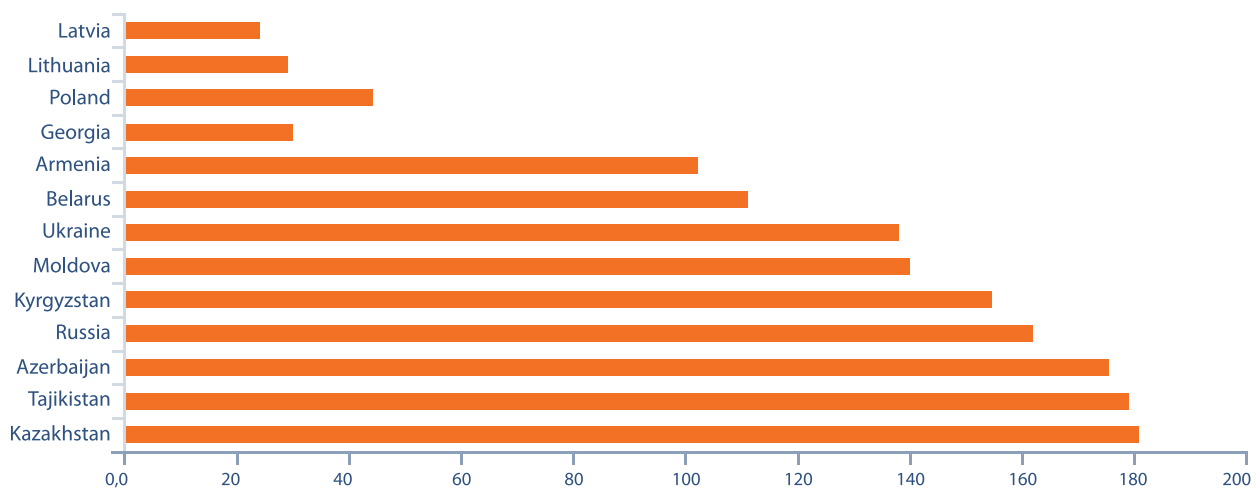


Source: World Trade Indicators, the World Bank.

Belarus continues to have a low ranking on the trading across borders index (moving up in 2008- 2009 from the global 129 to 128th place out of 183. The Index is comprised of six indicators,

including the number of documents required per shipment, time for exporting and importing in calendar days, and fees levied on a 20-foot container in US dollars.

Figure 2.10.
Trading across borders country ranking, 2006-2009



Source:
World Trade Indicators, the World Bank.

Recently, the government of Belarus has implemented a range of policies to ease administrative regulation of foreign trade. Central to these policies are measures towards de-bureaucratisation of foreign trade and simplification of administrative oversight procedures, introduced by Presidential Edict № 104 of 19 February 2009. The Edict replaces the time-consuming transaction passport procedure with transaction registration, performed at a bank within 24 hours from the receipt of application from the client. The Edict also expands options for payment in foreign trade transactions available to Belarusian firms, including possibility to pay for imports prior to delivery to Belarus (subject to permission from the National Bank). Currency control procedures were eliminated for some transactions, and the calculation and payment of some customs taxes and duties were simplified. A national automated electronic declaration system was launched by the State Customs Committee Directive of 4 September 2009.

Other activities aimed at improving Belarus' ranking by the Trading Across Borders index included:

- Implementation in Belarus of the automated export/import declaration system. As of November 2010, over 90% of exports and 20% of imports were declared through the automated system. Automated declaration reduced average customs clearance time eight-fold, from 4-6 hours to 10-15 minutes, with corresponding decreases in the cost burden on exporters and

importers. The automated system includes a registry of permits issued by the Ministry of Trade, Ministry of Health, and Ministry of Environment, enabling the application of the one-stop shop system in customs processing;

- A system for advance notice of export and import has been introduced, enabling completion of customs formalities before the actual exit or entry of goods. As a result, customs processing time was reduced by a further 50-60%, and costs to exporters/importers by 20-25%;
- The risk analysis and management system is being upgraded. At present, customs inspections are being performed based on operational intelligence, risk profile and risk indicators. Use of the system can reduce the number of inspections by over five times;
- Significant reductions have been achieved in the cost of export and import transactions. In Commodity stamp fees were abolished in January 2010. Work is in progress on connecting the customs authorities to the uniform clearing and settlement system to expand payment options for customs duties. Exporters and importers will be able to pay customs taxes through ATMs, payment terminals, and through the Internet;
- The list of goods and services subject to mandatory certification has been reduced by around 40% from 2008 to 2010. Amendments have been drafted to a number of laws on

quality certification, standardisation and technical specifications, further reducing the nomenclature of goods subject to certification of compliance with standards and technical specifications;

- An expert panel has been created to work on reducing transportation costs to exporters and importers. Typical cost items are being analysed, and options are being explored to minimize those costs.

2.3 Integration in the world economy and accession to WTO

Because of its openness to foreign trade, the Belarusian economy is highly sensitive to fluctuations in international markets. Elaboration and pursuit of adequate trade and industry policies to support are becoming increasingly important as means to support export-oriented sectors, and

maximise competitive advantages. In the previous sections, we identified a number of adverse trends affecting Belarusian exports, including growing export concentration, diminishing diversification, and weakening international competitiveness of Belarusian goods.

*Table 2.11.
Revealed comparative advantage indices by export commodity and market*

SITC		non-CIS			Russia		
		1999	2008	2009	1999	2008	2009
0	Live animals and products	0.16	0.28	0.50	1.77	2.97	4.39
1	Beverages, spirits, tobacco	0.74	0.15	0.10	1.09	0.13	0.26
2	Crude materials, inedible, except fuels	1.71	0.45	0.64	1.06	0.44	0.58
3	Mineral fuels, lubricants and related materials	2.34	4.08	4.50	0.22	0.03	0.03
4	Animal and vegetable oils, fats and waxes	0.03	0.17	0.74	0.28	0.14	0.25
5	Chemicals and related products.	2.60	2.05	1.48	0.87	0.43	0.49
6	Manufactured goods classified chiefly by material, including.	126	0.70	0.77	1.56	1.61	1.63
67	Iron and steel	2.85	1.41	1.84	1.26	1.46	0.78
7	Machinery and transport equipment, including	0.32	0.13	0.22	0.88	1.11	0.81
78	Road vehicles	0.56	0.21	0.33	1.63	1.80	1.10
8	Miscellaneous manufactured articles	0.85	0.22	0.26	0.99	1.09	1.03
9	Commodities and transactions not classified elsewhere in SITC	3.08	0.17	0.25	0.67	0.81	0.82

Source:
own computations based on data from UN Comtrade.

Belarus is facing diminishing competitive advantages in the Russian market for ferrous metals, machinery and equipment, and motor vehicles. Belarus has almost lost its competitive advantage for chemical materials and products, and for commodities listed under the section "crude materials, inedible, except fuels". Conversely, Belarus has increased competitive advantages in the Russian market for manufactured goods and for food

products (notably, meat and dairy products). In non-CIS markets, acting as a "litmus test" for competitiveness of Belarusian exports, Belarus has mainly specialised in chemicals and related products, and products at initial stages of the product life cycle, such as raw wood, fibre, oils and lubricants. Only the latter two goods were growing in competitiveness. Industrial goods, machinery and equipment, by contrast, were uncompetitive in the world markets.

Conformity of structural change in exports with the global trends can be measured by the trade dissimilarity index. The Index measures the degree to which a country's export basket is similar to the structure of demand in the world market. High or rising index value suggests that a country exports commodities with relatively low international

demand. The index tends to be lower for the industrialised nations, as their export structure is similar to the structure of world trade. The trade dissimilarity index is decreasing for developing countries and emerging market economies whose export structure is becoming more oriented towards commodities demanded by the rest of the world.

Table 2.12.
Trade dissimilarity index in Belarusian exports to Russia and non-CIS countries

	1999	2005	2008	2009
Russia	0.35	0.40	0.42	0.42
Non-CIS	0.51	0.59	0.62	0.64

Source:
own computations based on data from UN COMTRADE.

As seen from Table 2.12, Belarus has a low trade dissimilarity index in its exports to Russia and non-CIS markets. The average index for OECD exports is 0.56, indicating that the structure of the Belarusian export basket reflects the hypothetical world demand structure. However, the index is increasing in time, indicating a shift in the export basket towards commodities that are in low demand in the world markets. China's trade dissimilarity index is 0.54, and decreasing, and the trade dissimilarity index of the newly industrialised nations of Southeast Asia is 0.56³⁰.

To assess the degree of Belarus' integration in the world economy, we relied on data from UNCTAD's International Trade Centre, which monitors and reports on an annual basis current trends in export development and export competitiveness, and computes the Trade Performance Index (TPI) for 187 countries and 14 sectors. Altogether, TPI consists of over 20 indicators of competitiveness and diversification in 24 export sectors, combined to form a ranking among the countries. All computations are made using the COMTRADE database at the six-digit level of the Harmonised Commodity Description and Coding System (HS)³¹.

Table 2.13 presents a selection of indicators computed by ITC for Belarus³². The data refer to 2008. As seen from the table, Belarusian export sectors have a very low share in the world market, ranging from 0.33% for chemicals (37th place among 150 countries) to 0.08% for fresh food (86th place among 180 countries). Relative to other countries, the share of IT and consumer electronic is particularly low – at 0.01% (66th place among 114 countries).

The chemicals sector, which contributed the highest proportion of world trade, was also the least diversified (Belarus ranked 133rd among 152 countries by the number of equivalent products). Other poorly diversified sectors included electronics, minerals, IT and consumer electronics. Belarus had some of the highest export diversification rankings in the following sectors: wood products (22nd among 118 countries), textiles (48th among 129 countries), and processed foods (47th among 162 countries).

Diversification of products was poor across all sectors, except chemicals, indicating a high level of dependence on a few partner countries. Fresh foods had one equivalent market, and most other sectors had 2 – 4 equivalent markets. Relative change of world market share was negative for five (mostly labour intensive) sectors out of fourteen, notably clothing, textiles, wood products, leather products, and consumer electronics.

The adaptation effect captures a country's ability to adjust the supply of exports to changes in world demand. The adaptation effect is positive if a country has experienced an increase in its market

share on dynamic markets, or a decrease in its market share on recessive markets. Conversely, the adaptation effect is negative if a country is increasing market shares on recessive markets (+,-) or losing market shares on dynamic markets. Alarmingly, the adaptation effect for Belarus was positive on only two markets, and negative on the remaining twelve markets.

Table 2.13.
Trade performance index: Belarus (2008)*

	Fresh food	Processed food	Wood products	Textiles	Chemicals	Leather products	Basic manufactures	Nonelectronic machinery	IT and consumer electronics	Electronics components	Transport equipment	Clothing	Miscellaneous manufacturing	Minerals
Number of exporting countries for the ranking in the sector	180	163	144	129	152	118	147	143	114	121	135	124	150	163
Share in world market	86	42	54	42	37	58	49	43	66	50	44	57	47	46
Product diversification	73	47	22	48	133	29	55	127	95	55	86	58	26	134
Product concentration	75	54	48	42	83	34	54	78	94	51	64	51	44	95
Market diversification	175	150	86	110	38	98	108	133	113	111	119	83	138	101
Market concentration	151	104	79	81	47	86	73	76	94	80	68	87	82	79
Adaptation effect, p.a.	126	52	55	102	114	94	109	118	98	89	116	93	113	98
Matching with dynamics of world demand	90	53	138	52	53	93	68	113	62	97	131	85	87	72
Average index: current index	121	48	41	36	26	62	66	71	99	58	41	54	42	82
Average index: Change index	77	39	137	65	36	108	69	107	62	103	134	72	89	64

*Data refer to 2008. 2009 data for Belarus were not available at the time of writing.

Source: ITC, UNCTAD.

Matching with dynamics of the world demand is an indicator that reflects a country's ability to adjust its exports to changes in the world demand (Table 2.13). Belarus had some of the lowest international rankings by this indicator in the following sectors: wood products (138 out of 144), transport (131 out of 135), non-electronic equipment (113 out of 143), and electronic equipment components (97 out of 121).

In sum, Belarus is below the world average on most indicators of trade performance. According to ITC data, the sectors with the highest degree of integration in the world economy (as measured by the Trade Performance Index) are chemical products, wood products, and textiles. Some of the least integrated sectors included IT and consumer electronics, non-electronic machinery, electronic components, transport equipment, and basic manufactures. These sectors, along with wood products,

transport equipment and leather products have experienced negative change in the TPI over time.

Integration of Belarus in the world economy is closely linked to competitiveness, determined to a large extent on productivity in the manufacturing industries. Cost competitiveness can be defined as lower average costs per unit of production relative to other economies. According to ITC data, the information technologies sector has the lowest cost competitiveness in Belarus, with unit costs of production exceeding the world average by 3.5 times. On the other hand, unit costs in many sectors are significantly below the world average, making them potential areas of export specialization. These include chemical products, electronics, nonelectronic machinery, transport equipment, and miscellaneous manufactures (Table 2.14).

Table 2.14.
Unit production costs by sector by industry relative to the world average, 2008*

	Fresh food	Processed food	Wood products	Textiles	Chemicals	Leather products	Basic manufactures	Nonelectronic machinery	IT and consumer electronics	Electronics components	Transport equipment	Clothing	Miscellaneous manufacturing	Minerals
Number of exporting countries for the ranking in the sector	180	162	144	129	152	118	147	143	114	121	135	124	150	163
Relative unit cost of production, relative to the world average	1.1	1.1	1.2	1.0	0.9	0.7	1.0	0.7	3.5	0.8	0.8	1.0	0.9	0.7

*Data refer to 2008. 2009 data for Belarus were not available at the time of writing.

Source: ITC, UNCTAD.

A country's export potential is also affected by participation of its firms in global production chains. Globalisation and ICT development are accelerating change in the global production, marketing and finance systems, and call for deeper partnerships with international manufacturers and marketing agents. Increasingly, such partnerships are becoming

essential for entry to international markets. Participation in global production chains also provides exposure to new technological, management and quality assurance practices.

A country's inclusion in the globalisation process and global FDI flows can be measured by UNCTAD's transnationality index, calculated

as the average of four shares:- FDI inflows as a percentage of gross fixed capital formation for the past three years; FDI inward stocks as a percentage of GDP; value added of foreign affiliates as a percentage of GDP; and employment of foreign affiliates as a percentage of total employment. Belarus has one of the lowest TNIs in the region (3.0), four times less below Russia's, six times below Moldova's, and 7.5 times below Ukraine's.

One key element of integration in the world economy for Belarus is accession to WTO. It submitted a request for accession in 1993, a memorandum on the foreign trade regime in 1996 and initial goods and services offers in 1998-1999. The initial goods and services offers have been modified during the negotiation process. Work has begun on bringing the national legislation into conformity with WTO rules. The norms of GATS, GATT and other WTO agreements have been incorporated in the national laws "On technical norm setting and standardisation", "On quality and safety of raw and processed foods", "On amendments and additions to the law "On trade and service marks", "On postal communications", "On amendments and additions to the law "On the Customs Tariff", "On amendments and additions to the Customs Code", and "On state regulation of foreign trade activity". In the course of the accession process, Belarus has had bilateral negotiations with ten WTO members out of 22, including Moldova, China, Cuba, Armenia, Kyrgyzstan, Turkey, Bulgaria, India, Panama, and the Dominican Republic. Under a memorandum of understanding between Belarus and the People's Republic of China, both parties granted each other market economy status. Belarus has made significant progress in negotiating accession conditions, and narrowed the range of unacceptable demands from the WTO member states. However, despite a lengthy negotiating process, no decision has been made on the drafting of a Report of the Working Party with a summary of proceedings and conditions of entry.

Cost-benefit analysis using the computable general equilibrium model (GAMS CGE) shows that WTO accession will have a net benefit for Belarus from tariff reductions, improved market access and domestic tax reform. It is estimated that the value of the Belarusian consumer welfare will rise by about 1.6% after WTO accession, and that GDP will rise by 3.4%. Industry-specific data suggest that the largest gains to Belarus will derive from increases of exports. Metallurgy, machine building, oil, coal and other fuels, as well as chemicals and petrochemicals are the sectors that should expand the most as a result of WTO accession³³. At the same time, WTO membership will require a reduction in state support for agriculture, and elimination of tariff peaks on a range of agricultural products – such as meat and dairy – resulting in diminished competitiveness of agricultural producers³⁴.

After the formation of the EURASEC Customs Union, its three member states -- Belarus, Kazakhstan and Russia – expressed the intention to make a WTO bid jointly. Belarus had hoped that the joint bid would accelerate the WTO accession process for Belarus. Later, the customs union member states – notably Russia – decided to pursue WTO membership separately. The adoption from 1 January 2010 of a common customs tariff, the launch of the EURASEC Customs Union from 6 July 2010, and the expected formation from 1 January 2013 of a Common Economic Space will require some coordination among parties of their WTO accession efforts. Such coordination should not only address market access issues, but also cover a range of trade-related measures, such as investment, sanitary and phytosanitary regulations. This will make the coordination process a politically sensitive and technically complex task³⁵. It should also be remembered that coordination with Russia could be problematic because it had made the most progress in the negotiation process and plans to complete pre-accession negotiations in 2011 within the working

³³ Pavel F., Tochitskaya I. (2005). The Implication of Belarus WTO Accession: General Equilibrium Modeling. *Belarusian Economic Journal*, No. 3.

³⁴ Matthias Luecke, Georgeta Mincu (2010). Policy Options for Reducing Sector-Specific Risks of the Accession of Belarus to the WTO.

³⁵ For more detail, please refer to Matthias Luecke, Georgeta Mincu (2010). Policy Options for Reducing Sector-Specific Risks of the Accession of Belarus to the WTO, report for the UNDP project "Assisting the government of Belarus in WTO accession through strengthening national institutional capacity and expertise".

group format. Coordination with Kazakhstan is possible only on a narrow range of issues, as Belarus and Kazakhstan have a very different structure of the national economies. Despite these difficulties, EURASEC member states

have formed a joint delegation to negotiate the terms of WTO accession, in accordance with the relevant decisions of the EURASEC Interstate Council and the Customs Union Commission.

2.4. Participation in regional trade agreements³⁶

Turning into the dominant factor of the world trade, regionalism affects both economic and political relations between countries, confronting them with the choice should they enter trade agreement, which form of integration should be preferred and who should be a partner. Such questions have been discussed among new independent states after the break-up of the USSR, which was followed by economic disruption. The CIS countries had the aspiration to maintain and restore the economic ties as well as desire to remain in traditional export markets and to decrease the competitive pressure from the rest of the world using high external trade barriers. Therefore in the first half of the 1990s a large number of regional trade agreements have been signed within CIS.

The CIS countries *Free Trade Zone* should be considered as a first attempt of trade cooperation between Armenia, Belarus, Georgia, Moldova, Kazakhstan, the Kyrgyz Republic, the Russian Federation, Tajikistan, Ukraine, and Uzbekistan. However, this agreement has not been ratified by Russia, who asked for exemptions from FTA (particularly on oil and gas), and therefore Free Trade Zone has not come into force.

In 1995 three countries – Belarus, Kazakhstan and Russia – established a Customs Union that Kyrgyz Republic and Tajikistan agreed to join in 1996. In October 2000 member countries decided to reorganize it into Eurasian Economic Community. This decision was ratified in May 2001. The countries intended to set a common external tariff with respect to the rest of the world countries (non-CIS) and harmonize the non-tariff barriers. Yet, member states failed to reach the announced aims. The reason for this was diverse structures of the economies

and different levels of economic development in Belarus, Kyrgyzstan, Kazakhstan, Russia and Tajikistan. As a consequence, the countries' willingness to protect or open economic sectors to international competition did not coincide. Besides, Kyrgyzstan has been a WTO member since 1990 and hence should conduct its trade policy in accordance with accepted obligations, including the level of external tariff. In addition, due to different reasons, the countries have increasingly reoriented their trade away from RTA. This led to excess of extra-regional trade over intra-regional for all member countries. As a result, the share of intra EURASEC exports shrank and accounted for only 9.5% in total export in 2008; in its turn intra-block imports reduced to 18.5%.

Beyond the above mentioned agreements Russian and Belarus signed in 1999 the Treaty on Union State Formation, it provided for formation of the common economic space and monetary union, establishment of supranational institutions, i.e., Supreme State Council, Council of Ministers, Union Parliament. Integration with Russia undoubtedly brought numerous long-term benefits for Belarus, such as free access to the Russia market, and preferential prices of energy goods. However, many economic undertakings have failed to fully materialise within this Union.

Despite the dubious success of previous regional trade initiatives within CIS, in September 2003 Belarus, Russia, Kazakhstan and Ukraine concluded a draft agreement on Single Economic Space (SES). The concept of SES was rather vague, mainly due to the position of Ukraine, which avoided participation in RTAs that presupposed the creation of supranational

³⁶ This section is based on the following material: Tochitskaya I. The Customs Union between Belarus, Kazakhstan and Russia: An Overview of Economic Implications for Belarus. Policy Paper Series [PP/02/2010]. IPM Research Centre.

bodies and went beyond free trade agreements. In addition, Ukraine introduced the proviso clause that SES must not contradict Ukrainian constitution and strategic goal of integration into EU. In the process of SES formation, countries had different positions and visions of this RTA. Russia and Belarus wanted to introduce a common currency and to form a customs union, while Ukraine insisted on free trade zone without exceptions and limitations. These apparent contradictions resulted in the failure of the SES regional initiative.

A new wave of regionalism within CIS arose in 2007 when EURASEC member states understood that it remained an incomplete free trade zone with trade discrimination problems (e.g., antidumping investigations), and countries were unable to settle their differences. Therefore it was decided to implement regional integration initiatives within this RTA at diverse speed and different levels, i.e., Belarus, Kazakhstan and Russia planned to set a common external tariff and to create a customs union, while Kyrgyzstan and Tajikistan intended to stay in free trade zone. In addition, EURASEC has remained operational.

In 2009 the presidents of Belarus, Kazakhstan and Russia reached an agreement on creation of a Customs Union that came into effect on January 1, 2010. On 27 November 2009 the Interstate EURASEC Committee (supreme body of the Customs Union) approved a Customs Code and Common External Tariff (unified external duty rates). In addition it was announced that the countries would seek to join the World Trade Organization (WTO) simultaneously and form a single economic space in 2012. Undoubtedly, the fact that the member countries managed to resolve the controversy concerning the type of RTA, its functioning, possible supranational bodies and tariff regimes and was able to introduce the common customs tariffs was an important step towards real integration of the three countries. It should be mentioned that all earlier efforts failed to bring desirable results, primarily because member countries (except Belarus and Russia) were reluctant to unify national tariff regimes.

The import tariffs unification before the creation of the EURASEC Customs Union was at the level of 65%. Belarus and Russia harmonised 95% of tariffs, while Russia and Kazakhstan harmonised only 38% (as a consequence, the countries had to raise tariffs on more than 5,000 goods).³⁷ The tariff regime of the new Customs Union is based substantially on Russian duties (92%). In addition, the countries adopted a list of 1141 sensitive goods, the tariffs on which should be kept unchanged; 632 of these positions are important for Belarus. These sensitive positions include meat of bovine animals, meat of swine, meat and edible offal of poultry, fish, milk and cream, butter, cheeses, sugar and sugar confectionery, vegetables and other foods, as well as freezers and refrigerators, man-made staple fibres and fibreglass.

Belarus, Kazakhstan and Russia approved the mechanism of distribution of import customs duties between the countries on 25 March 2010. According to this decision, Belarus will obtain 4.70 % of the total sum of customs duties, Kazakhstan – 7.33 %, Russia – 87.97 %. These ratios were calculated on the basis of data on volume of imports from the three countries, which was obtained from UN database COMTRADE and mean effective values of import duties in the amount of 23.77%, based on the data on imports to Russia in 2009. Customs payments will be transferred in each country to special accounts in national currency³⁸.

Because a large proportion of Belarusian customs tariffs had already been unified with Russia, 78.1% of commodity items were not affected by the new tariffs, the tariffs for another 16.3% of items decreased (including for 10.7% by 5% or less, for 4.2% by 5-10%, and for 1.2% by 10-20%). The tariffs for 5.6% of items increased, including for 1.5% by over 20%, and for 1.1% by 10-20%. Table 2.15 shows the distribution of customs tariffs before and after the accession of Belarus to the Customs Union. The data in the table were calculated from the national customs tariff of Belarus and the Common Customs Tariff of the Customs Union. Specific tariffs were recalculated

³⁷ http://www.government.by/en/eng_dayevents20091204.html.

³⁸ http://www.tsouz.ru/KTS/meeting_2010_03_25/Pages/R_199.aspx.

into the ad valorem equivalent at the ten-digit level of TNBED³⁹. Note that the data are highly sensitive to the method for recalculating specific tariffs into ad-valorem equivalents.

After accession to the Customs Union, the distribution of external tariff rates was as follows:

13.6% of commodity lines have import duty set at 0-5%, for 30.8% of goods rates vary from 5% to 10%, for 20% of items from 10% to 15%, for 22.4% of commodities from 15% to 20%. Import duty higher than 20% is applied to 13.2% of goods, at that 1.1% of commodity lines have tariffs that exceed 60% (only 0.6% in 2008).

Table 2.15.

Import tariff rates in Belarus before and after accession to the Customs Union (%)

Import tariff rate (range)	2008	After creation of the Customs Union
0-5%	9.2	13.5
5-10%	32.1	30.8
10-15%	16.5	20.0
15-20%	25.7	22.4
20% and above	16.5	13.3
Including 20-25%	12.8	7.2

Source:
own computations.

The most considerable increase in customs duties is registered in the following commodity groups: 02 "meat and edible meat offal"; 17 "sugars and sugar confectionery"; 76 "Aluminum and articles thereof"; 61 and 62 "Articles of apparel and clothing accessories, knitted or crocheted"; "articles of apparel and clothing accessories, not knitted or crocheted". Also, a significant rise is expected in the export tariff for the subgroup 87 "Vehicles other than railway or tramway rolling stock", within subgroup 8703 "passenger vehicles" in the group 87 "vehicles other than tramway or railway rolling stock, and parts thereof".

Customs tariffs have been reduced for the following commodity groups: 73 "iron and steel", 84 "machinery and mechanical appliances; parts thereof"; 85 "electrical machinery and equipment and parts thereof; sound recorders"; 51 "wool,

fine or coarse animal hair; horsehair yarn and woven fabric"; 65 "headgear and parts thereof"; 37 "photographic or cinematographic goods" and 58 "special woven fabrics; tufted textile fabrics; lace, tapestries; trimmings".

To predict the effect of the application of the common customs tariff on non-CIS imports by Belarus, we examined data on changes in the weighted average tariff (before and after formation of the CU) at the 2-digit level of TNBED, the volume of imports from non-CIS countries in 2008 at the 2-digit level of TNBED, and import demand elasticities⁴⁰.

The calculation showed that, as the result of the introduction of CET, the reduction in the volume of imports from non-CIS countries may reach 1.1 billion US dollars (8% of Belarusian non-CIS imports in 2008). It will be mostly

³⁹ For analysis is based on the computation of the Belarusian external tariff and Common external tariff (all specific tariffs are provided in ad valorem equivalents) at 10-digit level TN BED made at the Institute for the Economy in Transition. Weighted average tariff was calculated using the UN COMTRADE data on imports in 2008.

⁴⁰ Import demand elasticities were taken from Hiau Looi Kee, Alessandro Nicita, Marcelo Olarreaga (2004) "Import demand elasticities and trade distortions", Policy Research Working Paper Series 3452, The World Bank.

due to the cancellation of used cars imports from non-member countries. The share of this commodity in total volume of imports from non-CIS countries amounted to 8.2% in 2008. This will likely lead to a rise in supply of motor cars from Russia, which become more competitive in the Belarusian market as a consequence of the customs duty hike. However, it will be difficult to assess the price volume of this growth in imports, because it is not known at what rate Belarusian consumers will substitute the motor vehicles from outside the CIS for Russian ones. However, even assuming a three to fourfold increase in automotive imports, its total amount will not exceed 0.05% of the total imports from Russia.

Significant reductions in imports are expected to affect the following commodity groups: 02 "meat and edible meat offal", 11 "products of the milling industry; malt; starches", 17 "sugars and sugar confectionery", 18 "cocoa and cocoa preparations", 63 "other made up textile articles; sets; worn clothing and worn textile articles", 76 "aluminum and articles thereof", 87 "vehicles other than railway or tramway rolling stock". The increase in external tariff rates and reduction in imports for commodity groups 02, 11, 17, 18, 63 is favourable for Belarusian producers, as it will help them to improve competitive positions both on Belarusian and Russian markets.

The growth of customs duty for commodity group 76 will result in diversion of non-CIS imports and replacement by Russian manufactures. The upward trend in tariffs on products in the automobile industry (commodity group 87) also corresponds to Russia's interest due to the fact that Volvo and Daimler AG are opening truck assembly plants, while Setra and Mercedes buses and coaches have been already assembled in Russia. It can be expected that the above mentioned plants in the nearest future will be the main rivals for Belarusian automotive industry products in the Russian market. The growth in the import tariff for this commodity group is unlikely to result in an increase in Belarusian exports to Russia of cargo vehicles and tractor- trailers (representing 14-15% of the

total exports to Russia in 2008-2009). Recently, Belarus has been losing its share in the Russian market for cargo vehicles from an estimated 20%⁴¹ in 2008 to 5.9%⁴² in 2009 r.⁴³ The main beneficiary has been the Russian automotive manufacturer KAMAZ, which increased its market share in Russia from 28.2% to 56% when Russia increased import tariffs for cargo vehicles from 10-15% to 25%. This was only partly the result of increases in Russian government purchases, as the market share of KAMAZ without such purchases had also increased substantially, reaching 40%.

The introduction of the common customs tariff will bring about a rise in non-CIS imports of some groups of commodities due to lowering of the tariff rates. The following commodity groups will be affected: 15 "animal or vegetable fats and oils", 27 "mineral fuels, mineral oils and products of their distillation"; 39 "plastics and articles thereof"; 43 "fur skins and artificial fur; manufactures thereof"; 51 "wool, fine or coarse animal hair; horsehair yarn and woven fabric"; 54 "man-made filaments"; 57 "carpets and other textile floor coverings"; 58 "special woven fabrics; tufted textile fabrics; lace, tapestries; trimmings"; 61 "articles of apparel and clothing accessories, knitted or crocheted"; 64 "footwear, gaiters and the like; parts of such articles"; 84 "nuclear reactors, boilers, parts thereof"; 85 "electrical machinery and equipment"; 90 "optical, photographic, cinematographic, measuring, checking, precision instruments".

It should be noted that the decrease in tariffs on carpets, apparel, and footwear will make Belarusian companies less competitive in national and Russian markets, and may reduce Russian imports of the above goods. The growth of imports of commodity groups 84, 85 and 90, which belong to so-called investment goods, will promote technical upgrading of Belarusian enterprises, and undoubtedly should be treated as a positive fact, as it can result in the improvement of competitiveness of their products in the future.

⁴¹ www.expert.by/?act=news&mode, <http://news.gruzoviki.com/958.html>.

⁴² http://www.expert-rating.ru/research/auto/kamaz_2kv2009.html.

⁴³ Data is given on trucks

Exploration of the economic implications of entering regional trade agreements generally includes the study of dynamic and productivity effects in the member countries. Unlike static effects, dynamic effects are complex, and have multiple causes related to factor productivity.⁴⁴ Factor productivity growth may derive from agglomeration, economies of scale, convergence of member country incomes, and other sources. The growth effects of RTA membership are difficult to assess because of the great variety of such causal mechanisms.

However, it has been empirically proven that South-South regional trade agreements (i.e., among developing and transitional economies) are not conducive to formation in the member countries of a new structure of competitive advantages, and are thus likely to have only a limited impact on economic growth⁴⁵. Furthermore, members South-South RTAs gain few if any benefits from technology transfer (also an important factor of growth) through imports of equipment and intermediate goods⁴⁶. It should also be noted that the Customs Union member states mainly trade in goods with high shares of primary inputs and unskilled labour. Their competitive advantage structure has changed little throughout its participation in the regional trade agreement; intra-industry trade is poorly developed and declining.

An important focus of the debate surrounding all RTAs is how such arrangements may affect inward and outward foreign direct investment flows. Recent theoretical and empirical studies have posited that it is difficult (or even impossible) to make general predictions regarding the results of RTAs on foreign direct

investment decisions.⁴⁷ In fact, the existing literature provides evidence that the impact of integration agreement on FDI flows depends, in each individual case, on the change in economic environment brought about by the RTA, as well as on the locational advantages of the participating countries and industries, and the motives for foreign direct investment. Effects are likely to vary between small and large countries, and different integration agreements (North-North, North-South, South-South). Furthermore, empirical evidence shows that the liberalisation and macroeconomic stabilisation (e.g., comprehensive privatisation program, which opens several industries to foreign investment), strong property, legislative and regulatory environments surrounding foreign ownership rights appear to have been more important determinants of FDI inflows to countries like Belarus than the regional integration is. In addition it should be noted that in the case of South-South RTAs (EURASEC countries in the Customs Union) the inflows of FDI to the region are not likely to be distributed equally to all participating countries. It is reasonable to assume that in the regional arrangement in question Russia and Kazakhstan will be the main beneficiaries of FDI inflows.

Finally, the economic implications for Belarus of membership in the Customs Union will depend on whether this membership increases trade, or leads to a decline in NTB, as member-countries announced a gradual reduction of all barriers in mutual trade. It will also depend on whether it maintains or decreases protectionism, while generating greater amounts of public wealth and strengthening domestic producer competitiveness.

2.5. Impact of the world financial crisis on Belarusian foreign trade

The open-type economy of Belarus has mainly been affected by the world economic recession through foreign trade. Month-on-month

reduction in foreign trade, and particularly, in exports, was first recorded in July 2008. Year on year reduction in foreign trade with Russia began

⁴⁴ Brada J.C., Mendez J.A. (1988). An Estimate of the Dynamic Effects of Economic Integration. *Review of Economics and Statistics*, 70, 1, 163-168.

⁴⁵ Maurice Schiff, Yanling Wang, and Marcelo Olarreaga (2002) Trade-Related Technology Diffusion and the Dynamics of North-South and South-South Integration, Policy Research Working Paper # 2861, World Bank.

⁴⁶ Coe D.T., Helpman E. (1995). International R&D Spillovers, *European Economic Review*, 39, 5, 859-887.

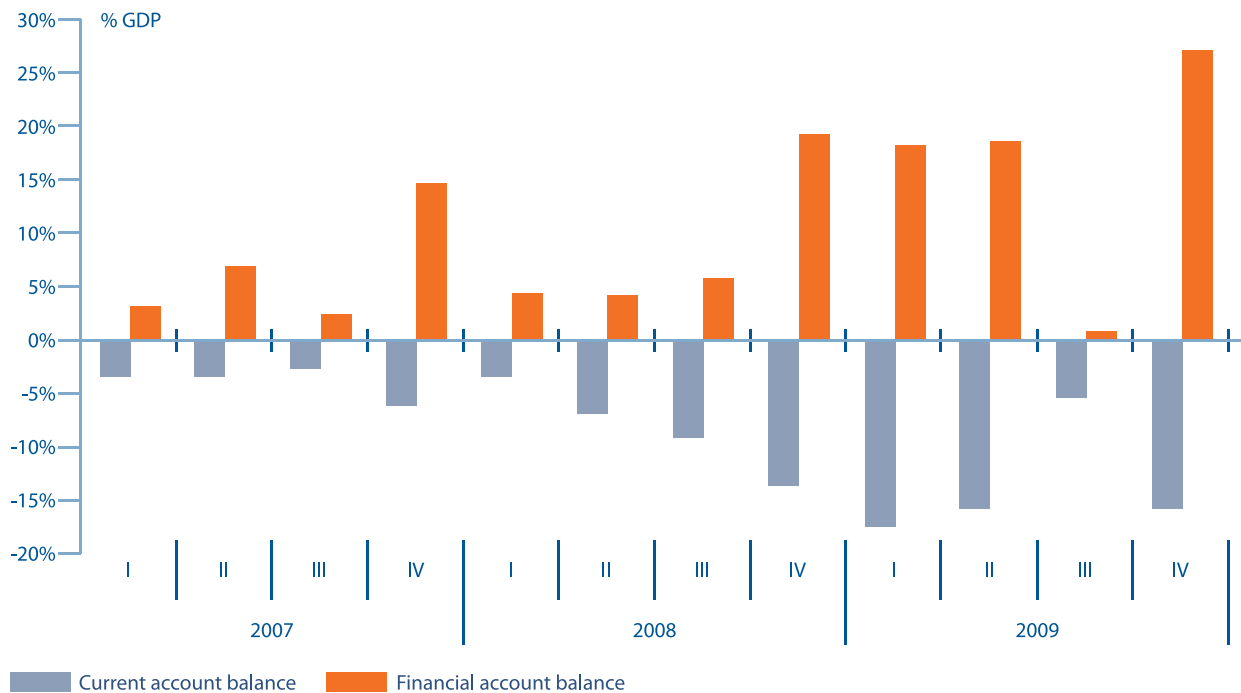
⁴⁷ Blomstrom M., Kokko A. (1997). Regional Integration and Foreign Direct Investment A Conceptual Framework and Three Cases, Policy Research Working Paper, World Bank, 1750.

from October 2008, and with non-CIS states from November 2008.

These declines were mainly the result of the drop in aggregate demand for Belarusian goods in Russia and the decline in the prices of primary inputs in non-CIS markets. The drop in exports and imports mostly affected trade with Russia and Ukraine. Over one-half of Belarusian exports of industrial goods and 77% of consumer goods go to the Russian market. Belarusian foreign trade was also affected by increases in customer payment arrears (“nonpayments”), particularly from October 2008 to March 2009. Past due account receivables of Belarusian firms grew by 19.6 times from October to November 2008. In December, it increased by a further 85.1% relative to October, and in January 2009 by 61.3% from December 2008. Nonpayments

and the reduction in exports affected the foreign currency revenues of Belarusian firms. In response, the Council of Ministers of Belarus adopted a directive permitting enterprises to price sell products at current market prices, even if the selling price is below the cost of production. In non-CIS trade, the drop in exports was first recorded in November 2008, due to reduction in physical delivery volumes. Exports outside the CIS decreased by 5.2% in October-December 2008 relative to the same period of 2007. The simultaneous increase in imports by 32.5% created a negative current accounts balance of trade with non-CIS states for the first time in many years. This foreign trade deficit compounded the systematic trade deficit with Russia, resulting in a considerable increase in the total deficit of foreign trade and the worsening of the current accounts balance.

Figure 2.11.
Current accounts and capital accounts balances in 2007 – 2009, as % of GDP



Source:
 National Bank of Belarus.

The negative impact of the global recession on foreign trade continued throughout the first and second quarters of 2009. Exports to the main trade CIS trade partners, Russia and

Ukraine, and to non-CIS markets dropped almost twofold, while imports, particularly from outside the CIS, decreased to a lesser extent (Table 2.16).

Table 2.16
Exports and imports, %, yearly

	2007	2008	2009	2008 (by quarter)				2009 (by quarter)			
				I	II	III	IV	I	II	III	IV
Exports, total	23.0	34.2	-34.6	68.3	55.9	43.3	-14.6	-49.0	-45.8	-35.8	2.9
CIS	30.3	28.0	-35.0	52.9	54.7	37.4	-19.8	-49.5	-45.8	-37.9	6.0
Russia	29.7	18.8	-36.3	41.4	42.2	23.3	-21.2	-47.2	-46.2	-41.5	0.5
Ukraine	19.1	89.0	-39.1	146.6	177.4	128.9	-20.9	-64.1	-46.1	-42.4	27.5
Non-CIS	17.3	39.5	-34.3	83.0	56.8	48.5	-10.3	-48.6	-45.8	-34.0	0.6
EU	16.8	33.5	-34.4	93.7	52.5	33.9	-17.9	-50.8	-47.1	-32.3	5.2
Imports, total	28.4	37.2	-27.5	55.8	55.3	53.1	-1.8	-31.5	-34.7	-37.1	-1.8
CIS	31.0	36.5	-29.8	75.9	61.7	51.2	-18.1	-39.1	-39.6	-38.9	10.9
Russia	31.3	36.6	-28.8	79.4	63.6	51.2	-20.3	-39.2	-38.6	-38.0	13.8
Ukraine	25.4	37.9	-39.0	50.1	46.8	53.5	6.6	-39.6	-49.3	-45.9	-16.1
Non-CIS	23.4	38.7	-23.0	21.7	42.7	56.9	32.4	-13.0	-24.0	-33.7	-18.1
EU	23.9	36.8	-23.4	17.7	46.0	55.0	28.0	-13.4	-25.2	-33.5	-17.9

Source:
own computations based on data from Belstat.

The drop in exports to Russia in January-June 2009 was largely the result of a reduction in physical volumes, caused by falling aggregate demand. In non-CIS trade, the reduction in exports was mainly caused by falling export prices of petroleum

products, ferrous metals and potassium fertilizers, representing 67% of total non-CIS exports. The drop in exports led to a twofold decrease in foreign currency revenues of Belarusian firms in January-June 2009 (Table 2.17).

Table 2.17.
Foreign currency revenues from exports, % change p.a

		I	II	III	IV
Exports of goods, total					
	2008	57.0	62.0	59.9	-7.7
	2009	-45.6	-44.8	-36.1	-15.4
Exports of services	2008	26.3	16.7	36.7	14.1
	2009	26.7	-20.5	-31.7	-10.1
Exports to Russia					

		I	II	III	IV
Goods	2008	43.4	45.0	18.7	-30.0
	2009	-53.8	-48.8	-40.1	-13.7
Services	2008	18.6	-7.5	40.1	14.5
	2009	62.1	-14.6	-47.5	-22.9

Source:
Bulletin of Bank Statistics 2008-2009, National Bank of Belarus.

The decline in exports slowed down in July-September 2009, eliminating the gap in the export and import dynamic. In November and December, exports began to recover, exceeding the growth in imports. The decrease in imports mostly affected non-CIS trade, and imports from Russia remained at 61-62% of the previous year's level. In July-September 2009, non-CIS exports were at 66.3% of July-September 2008, and in October-December 2009 at 81.9% of the same period of 2008 (as compared to 87% of January-March 2008 in the same period of 2009). The simultaneous recovery of non-CIS exports was attributable to growth in supplies of potassium fertilisers to the Indian market under contract between the Belarusian Potassium Company and Indian Potash Ltd (IPL) for 2009-2010. Foreign trade deficit began to improve as a result month by month and year by year (starting from October 2009).

The global recession did not bring substantial changes to the structure of Belarus' foreign trade. The sharp drop in demand for Belarusian goods in the Russian market and the resulting decline in sales brought the proportion of Belarusian exports to Russia down to 31.5% in 2009. This reduction was not the result of greater geographic diversification of Belarusian foreign trade, but rather the consequence of the slow recovery of demand in the Russian market. Unlike Russia, non-CIS countries, including the EU, had maintained their share in Belarusian exports at the pre-crisis level, while slightly increasing their share of imports to Belarus.

Exports of investment goods was the area most affected by the global recession, mainly as a result of the sharp drop in demand in Russia, the principal market for such goods. There was an almost threefold drop in deliveries of investment goods to Russia from January to October 2009, and an almost twofold drop in such deliveries in 2009 relative to the previous year. The reduction

in physical volumes of deliveries by more than two times was the main contributing factor, as the export prices were almost unchanged. The share of investment goods as a proportion of total exports to Russia declined from 28.4% in January-March 2008 to 17.1% in October-December. In 2009, yearly physical sales volumes of road building and construction machinery dropped by 4.4 times, metal working equipment by 1.7 times, tractors by three times, tractor trailers by 9.7 times, and cargo vehicles by 2.8 times. Simultaneously, the government's effort to reduce the stockpiles of unsold products resulted in monthly increases in the exports of investment goods, starting from the third, and continuing into the last quarter of 2009.

In 2009, imports of investment goods decreased by 30%, i.e., less than the exports of such goods. The reduction mainly affected non-CIS imports, and was the largest in the third and fourth quarters of 2009.

The largest decline in the exports of intermediate goods (by almost one-half) was recorded in the first and second quarters of 2009, followed by a slow recovery in the third and fourth quarters, particularly in the exports of energy inputs. The reduction was mainly the result of a twofold decrease in export prices, while the physical delivery volumes had remained almost unchanged, and began to recover from June 2009. The recovery in physical exports of energy inputs was the strongest to Ukraine.

The exports of food products was almost unaffected by the global recession. The drop in dairy exports to Russia in the third quarter of 2009 was mainly the result of a milk war. This controversy erupted when Russia's consumer protection agency Rospotrebnadzor demanded a halt to all milk deliveries from Belarus, citing failure of Belarusian exporters to abide by the new regulations on product documentation.

The largest drop in non-food exports was recorded the second quarter of 2009, and affected deliveries to Russia and non-CIS markets. Export prices decreased less than physical exports. The reduction of exports slowed down in the third quarter of 2009, and physical exports began to recover.

In order to regain competitiveness in foreign markets, domestic manufacturers were implementing cutting measures, which included wage freezes and hour reduction. This was not accompanied by any significant lay-offs, and the official unemployment rate (i.e., persons registered as unemployed with the state agencies for labour and social protection as a proportion of the total workforce⁴⁸) increased only slightly, to 0.9% in 2009 from 0.8% in 2008. The official unemployment rate does not paint a fully accurate picture of the labour market situation, as people tend to register as unemployed only when they absolutely need to (e.g., to obtain a pregnancy benefit or to be trained for a new qualification). The main disincentive to register is low unemployment benefits, averaging 45,000 (15 US dollars) and representing 18% of the official poverty line.

Under-employment grew particularly fast in late 2008 and early 2009. In December 2008, the number of employees working short hours at the employer's request grew by 2.4 times relative to November and by 5.9 times relative to October. The number of employers on employer-mandated unpaid leave grew by 10.5 times in December-October 2009. The largest increases were contributed by the machine-building, chemical/ petrochemical and light industries. Some 10.1% of the workforce were working short hours in 2009 (up from 3.9% in 2008), including 5.4% in January-March 2009 (up from 1.5% in the same period of 2008). The under-employment rate began to decline from August 2009, and the reduction in the number of workers on employer-mandated leave started from May 2009. These changes coincided with the upward trend in economic activity levels in the second half of 2009. As previously stated, this was accompanied by wage freezes and wage cuts implemented by some employers.

The Belarusian government instituted a range of policies to restrict imports and encourage exports. Some specific interventions were as follows:

Import restriction

- A presidential edict increased import tariffs on cargo vehicles and buses from 5-10% to 25-50% of the item's customs value for a period of nine months;
- Elevated tariff rates were imposed on a range of consumer imports from April 2009 for a period of nine months, with the aim of regulating consumer imports and supporting domestic manufacturers. Prohibitive import duties (180% of the customs value) were introduced for a six-month period on foods such as potatoes, onions, white cabbage, carrots and beets;
- A government directive was issued, requiring state-owned enterprises and enterprises with a government stake to seek permission from the head or deputy head of the relevant government agency to import investment or intermediate goods.

Export promotion

- The government introduced a scheme to subsidise shipment costs to exporters if the distance to destination exceeds 1000 kilometres;
- A presidential edict introduced a scheme to subsidise interest on loans for the purchase of Belarusian goods, if such loans were issued by the bank of a state that does not apply customs clearance and customs control procedures for shipments from Belarus. The main purpose of this intervention is to promote Belarusian exports of investment goods to Russia;
- To encourage exports of consumer goods, the government lifted controls and virtually abolished taxes on incomes received by sole traders from the sale of Belarusian products outside Belarus.

⁴⁸ Belarus does not conduct labour market surveys using ILO methodology. All unemployment data is based on registered unemployment.

3. Trade and human development: a sectoral analysis

3.1. Exploring the interrelationships between trade and human development

Trade policy and human development are components of an overall development strategy and have complex and multi-faceted interrelationships. Trade is a major source of economic growth, which in turn may lead to higher levels of human development. Trade affects growth in a number of ways, including through improved productivity, technology transfusion and the emergence of new markets. Trade may also have a direct effect on human development, by facilitating knowledge exchange, acquisition of advanced skills and by expanding opportunities from access to new markets.

Economic growth was long considered to be the principal development indicator for economic policy making. It was assumed that higher levels of GDP per capita would automatically increase overall wealth and decrease poverty. By extension, the economic growth that comes with the liberalisation and increase in foreign trade should also lead to higher output levels and greater overall wealth. However, as demonstrated by international experience, some countries have experienced increases in poverty, unemployment and environmental degradation despite strong economic growth. In light of these experiences, there is growing understanding that economic growth does not automatically translate into higher levels of human development; nor do trade liberalisation or increased foreign trade flows guarantee rapid economic growth or gains in human development levels in the long-term perspective. The state should utilise public resources and implement other policies to enable individuals to have a decent standard of living, increasing their choices to be educated, live long and healthy lives and participate in the lives of their communities. Rapid progress of globalisation, and growing international competition have redefined technologies and production, and generated new demands for education, training, knowledge and physical health of the workforce. This calls for new approaches to human capital formation, which is fast becoming a key resource for development. Development itself is being viewed largely as

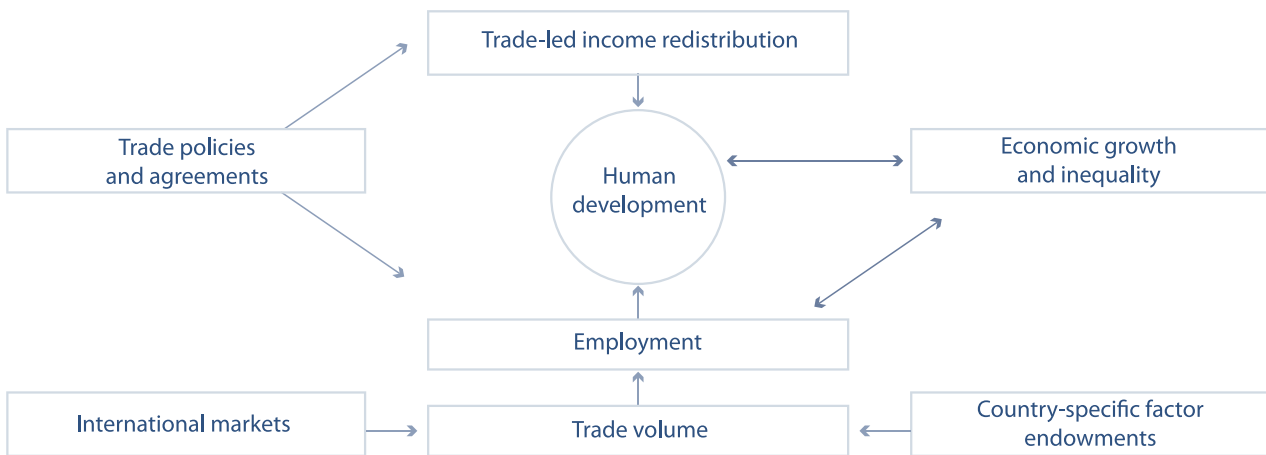
a process that enlarges people's choices. This definition of development was first proposed by Arthur Lewis, winner of the Nobel Prize in economics. The work of Nobel Prize winner Amartya Sen "Development as Freedom" (1999) further explores this concept of development. He argued for a people-centred development, defined not by income, but by people's freedom to improve their lives. Beyond income, societies should ultimately strive for increasing people's choices for health, education and improved standard of living. In this view, economic growth is not an end, but a means to human development.

These ideas form the basis of the UNDP concept of human development, first presented in the UNDP Human Development Report published in 1990. As defined in the report, human development is a process that expands people's choices. In principle, these choices can be infinite and can change over time. At all levels, the key aspects of human development include people's freedom to live long and healthy lives, acquire knowledge and have access to resources needed to secure a decent standard of living. Unless these basic choices are secured, much human potential will be frustrated.

Policies to improve health, education and incomes lead to improved levels of training and higher productivity, thus contributing to economic growth. This is confirmed by the examples of multiple countries that managed to accelerate economic growth by emphasising human development. In Singapore, the export promotion strategy included provision of universal health care and education as tools for enhancing workforce competitiveness and productivity. South Korea implemented a similar approach, by emphasising development of higher education and university-industry linkages to build a more export-oriented economy.

Trade and human development are mutually related and interconnected. The nature of this relationship is similar to links between human development and growth (Figure 3.1).

Figure 3.1.
Trade and human development



Source:
UNDP Regional Bureau for Europe and the CIS (2009). *Trade and Human Development - How to Conduct Trade Needs Assessments in Transition Economies*.

Trade enhances economic growth, and, consequently, human development by promoting more efficient use of resources, generating economies of scale, increasing variety of products and services for the consumer, and enable people to have more control over their lives. Better health, education and incomes, higher levels of prosperity, better working conditions and more equitable income distribution create new openings for productivity growth and improve competitiveness of national exports in international markets, ultimately increasing foreign trade and accelerating economic growth. Trade may increase as a result of increased workforce participation, increased employment of women, improved workforce training and higher productivity. A higher proportion of the workforce with secondary and higher education increases human capital, facilitates innovation and ultimately increases a country's exporting potential. Education also promotes entrepreneurial activity, the growth of new export-oriented businesses and, consequently, higher exports. By limiting income inequality, governments can improve the prospects for economic growth, FDI inflows and exports through greater economic and social stability.

A country's trade policies can have significant implications for human development. However, the impact of such policies – realized through prices, employment and government social expenditure – may vary greatly across different sub-populations. The lifting of tariff protections as a result of WTO accession may decrease in-

comes in industries that are subjected to greater foreign competition, and employees in these industries may face the need to reduce their essential expenditures. Conversely, employees in export-oriented industries will benefit from higher incomes deriving from improved access to international markets and the resulting rise in firm profitability. The aggregate benefits may exceed the total costs, resulting in a net benefit for the economy. For example, higher exports may generate additional tax revenue, consumers may gain access to cheaper goods, and increased competitiveness may result in efficiency gains. Government policies will need to support the sectors and firms that will suffer losses, including through retraining programmes, promotion of entrepreneurial activity, support for SMEs and other interventions that may help absorb the excessive workforce from the losing sectors.

Government trade policy should give adequate consideration to its potential gender implications. The expansion of export industries may generate new employment opportunities for women, including through the expansion of flexible part-time employment, improvement of working conditions and growth of wages. Conversely, stagnation of industries with high proportions of women workers may result in higher levels of female unemployment and decrease in their revenues. Trade policy decisions should consider the whole variety of linkages between trade and gender, without disregarding women's social role as homemaker and caretaker of children.

Trade policy may also have environmental implications for human development. Environmental assessment of trade policy is important because higher exports and incomes may be accompanied by depletion of

natural resources and result in higher levels of environmental pollution. The resulting risks of environmental degradation and deterioration in the quality of life for future generations should be anticipated and avoided as far as possible.

3.2. Light industry

3.2.1. Background and overview

Light industry produces goods for the consumer and intermediates for use by other industries. It has traditionally played a leading role in the Belarusian economy. It possesses a large production base, distributed among a total of 1914 enterprises of different ownership forms⁴⁹. Light industry employs 11.5% of industrial workforce, and contributes 3.6% of industrial output. Light industries play an important social role as producers of consumer goods such as clothing, footwear, textiles and knitwear. They also produce intermediate goods for chemical, automotive and printing industries, and for agriculture.

Light industry is facing problems of diminished competitiveness in domestic and foreign markets and, consequently as a result of increased competition from Turkey, China and Russia. As a consequence, growth performance

has deteriorated, particularly in clothing, leather/footwear and fur manufacturing (Table 3.1.). In 2005, output in clothing manufacturing grew by 10.6% and declined by 11% per annum in 2008-2009. Output in leather, furskins and footwear manufacturing has a similar dynamic, going from an annual growth of 6.1-6.4% per annum to a decline in output in 2007-2008. A significant proportion of the output is accumulated in stockpiles. As of January 2009, the stockpiles of unsold products amounted to 150% of average monthly output industry-wide, up from 124.1% in 2007 and 138.7% in 2008. Average product stockpiles in manufacturing industries were 61.1% of average monthly output in 2009, 54.5% in 2006 and 53% in 2007⁵⁰. Textile manufacturers were experiencing the greatest difficulties with sales, with stockpiles representing 156.7% of the average monthly output in 2009.

*Table 3.1.
Annual output in light industries as % of the previous year*

	Light industry-total	Including by subindustry		
		Textiles	Clothing	Leather, fur and footwear
2005	105.7	102.4	110.6	106.1
2006	102.6	102.7	100.4	106.4
2007	100.3	102.7	98.5	97.5
2008	100.7	102.5	96.7	100.9
2009	90.8	94.8	81.5	95.0

Source:
Industry in the Republic of Belarus. BelStat 2009.

⁴⁹ As of 2008, 88.9% of the enterprises were private, contributing 80.8% of the total output. 7.6% of the enterprises were state-owned and 3.8% were in foreign ownership. The shares of state-owned and foreign enterprises in the total output were 15.4% and 3.8%, respectively.

⁵⁰ The ratio of product stockpiles to monthly output reached 160% in January 2010.

Despite a positive dynamic in 2005-2008, profit margins were far below the average for manufacturing industries. Textile and clothing manufacturing had the lowest profit margins in 2008, at 8.5 and 9.4%, respectively (Table 3.2). By December 2008,

39.2% of enterprises in light industries had profit margins of 0-5%, and 20.6% of enterprises included in the state concern Bellegprom (contributing 80% of output in the light industries) were unprofitable (down from 26.4% in January 2008).

Table 3.2.
Light industry profit margins, by subindustry (%)

	Manufacturing industry-total	Light industry	Including by subindustry		
			Textiles	Clothing	Leather, fur and footwear
2005	15.4	4.0	1.1	9.1	6.0
2006	15.5	6.5	4.0	6.5	12.3
2007	13.0	7.7	5.0	9.6	12.7
2008	15.3	9.6	8.5	9.4	12.3
2009	10.2	9.9	11.2	8.9	11.0

Source:
Manufacturing industries in the Republic of Belarus. BelStat 2009.

Low profitability was a constraint to modernisation of the production base. Annual growth of fixed capital in the light industries decreased from 18% in 2006 to 1.4% in 2009, far below the average of 10% per annum across manufacturing industries. This tendency continued into 2009 (Table 3.3). Textile and footwear/leather manufacturing were the worst affected. Even as fixed assets depreciation had reached 60% and posed the greatest

challenge for the light industries, the value of new production facilities also decreased as a proportion of total fixed assets to 3.7% in 2008 (as compared to the manufacturing industry average of 6.3%). On average, foreign light industry firms replace production assets once in every 5-7 years. Therefore, slow asset modernisation and upgrading in Belarusian light industries had a clearly negative effect on productivity, product range and competitiveness.

Table 3.3.
Fixed assets, % annual increase

	Manufacturing industry-total	Light industry	Including by subindustry		
			Textiles	Clothing	Leather, fur and footwear
2005	3.0	-0.1	-1.9	-1.1	3.4
2006	17.8	18.0	22.4	9.8	17.6
2007	12.2	6.8	6.0	7.4	8.8
2008	9.9	1.4	0.0	9.9	0.4
2009	12.5	7.6	9.6	1.2	3.2

Source:
Manufacturing industries in the Republic of Belarus. BelStat 2009, Republic of Belarus 2010. BelStat 2010.

In 2005-2008, light industry not only had below-average productivity by comparison with manufacturing industries, but was also experiencing a decline in output growth. This was particularly true for clothing and leather/footwear manufacturing,

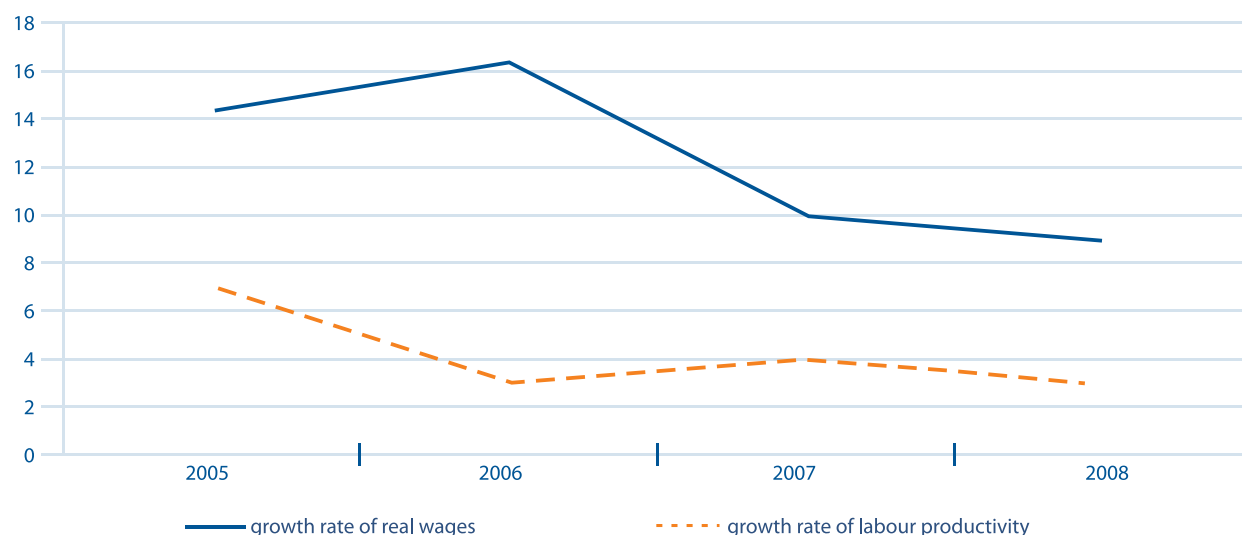
which were facing losses in productivity. Increases in real wages, by contrast, exceeded productivity gains. The gap between gains in productivity and real wages was closing in 2006-2007, but began to increase again after 2007 (Figure 3.2).

Table 3.4.
Labour productivity index (% of the previous year)

	Manufacturing industry-total	Light industry	Including by subindustry		
			Textiles	Clothing	Leather, fur and footwear
2005	110	107	106	108	112
2006	110	103	106	98	109
2007	109	104	108	100.4	98
2008	111	103	106	99	103

Source:
Manufacturing industries in the Republic of Belarus, BelStat 2009.

Figure 3.2.
Wage and productivity increases in light industry

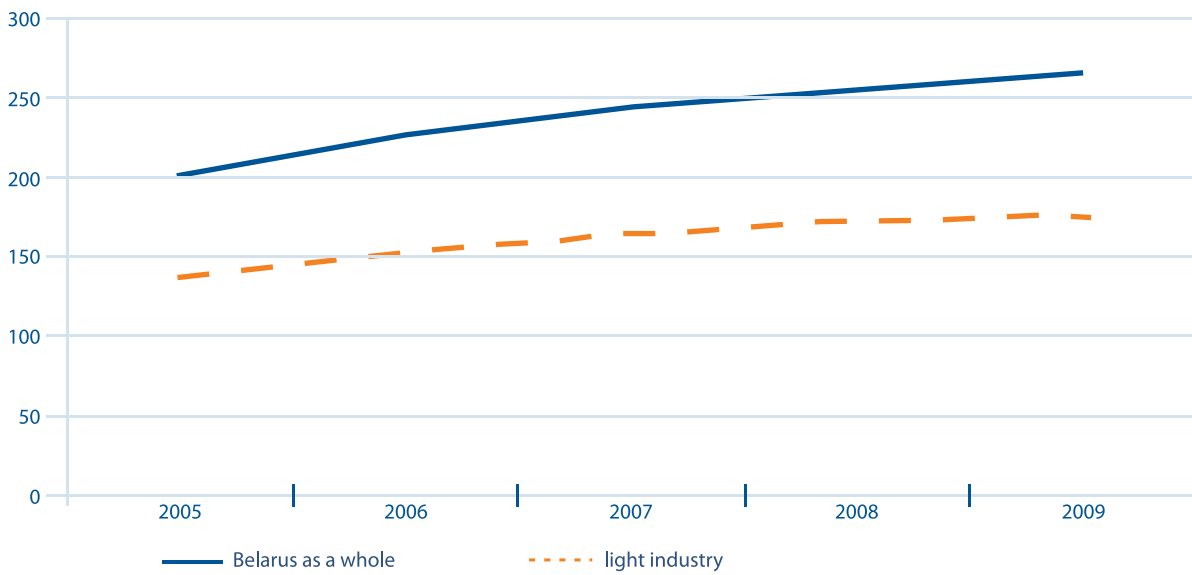


Source:
Manufacturing industries in the Republic of Belarus, BelStat 2009.

Despite the increase in real wages, light industries remained among the worst paid sectors of the economy. In 2008, wages in the light industries were 1.5 times below the national average, and only 72% above the minimum subsistence budget (Table 3.5.), i.e., the official

poverty line. As seen from Figure 3.3, the ratio of the average salary in light industries to the minimum subsistence budget was below the national average by only seven percentage points in 2005, while by 2008 this gap had increased to 22 percentage points.

Figure 3.3.
Ratio of the average monthly salary to the minimum subsistence budget (%)



Source:
Manufacturing industries in the Republic of Belarus. BelStat 2009.

This ratio was the lowest in the clothing sub-industry, at 153% (51 percentage points below the footwear subindustry, and 102 percentage points below the national average (Table 3.5). Low salary levels were not only a disincentive to productive employment, but also had a

range of negative social consequences. These included elevated risks of poverty in cities where light industries form the backbone of the local economy, and rising gender wage disparities (women represent 79% of employees in light industries).

Table 3.5.
Ratio of the average monthly salary to the minimum consumer budget in light industries, by subindustry (%)

	Belarus - total	Light industry	Including by subindustry		
			Textiles	Clothing	Leather, fur and footwear
2005	202	137	140	124	164
2006	227	153	162	129	189
2007	244	164	170	144	204
2008	255	172	179	153	204

Source:
Manufacturing industries in the Republic of Belarus. BelStat 2009.

3.2.2. Foreign trade performance

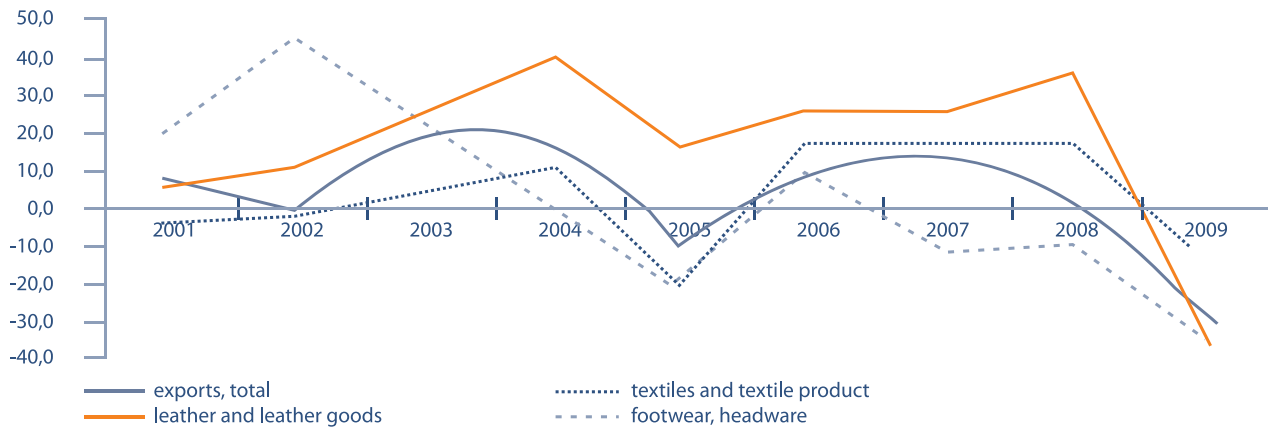
Inevitably, the negative trends affecting light industries had a negative impact on competitiveness, including export markets. Competitiveness is of vital importance to industry

because of its high export orientation. As in the Soviet era, it continues to exports around 60% of the output. In 2005-2008, Belarus exported 76% of the output of carpets and 39% of the footwear.

As seen from Figure 3.4, growth in the exports of the main commodity groups was below the national average. Starting from 2007, the exports of some commodity groups – such as articles of leather and fur – had declined, while the exports of other commodities

– including footwear and headgear – had increased (by 9.5% and 17.9%, respectively, from 2006 to 2008). Most of the exports were to the CIS (e.g. raw skins and articles of leather and fur, 55%, textiles, 74.5%, and footwear and headgear, 95%).

Figure 3.4.
Trends in light industry exports by commodity group (%)

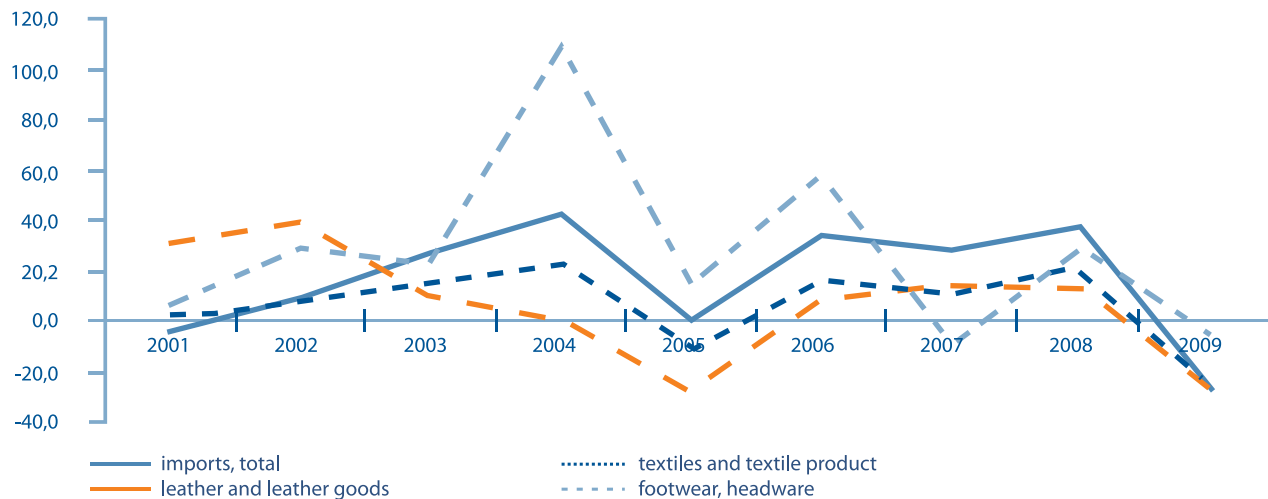


Source:
Foreign trade in the Republic of Belarus. BelStat 2009

Imports of textiles, raw skins and articles of leather lagged behind the growth in exports, while increases in footwear imports exceeded exports up until 2007, when excise stamps and higher tariffs were introduced to put

footwear imports in check. However, this attempt to support domestic manufacturers failed, as indicated by a sharp increase footwear imports resumed in 2008 (by 25.7% relative to 2007).

Figure 3.5.
Growth in the imports of light industry items, by commodity group (% per annum)

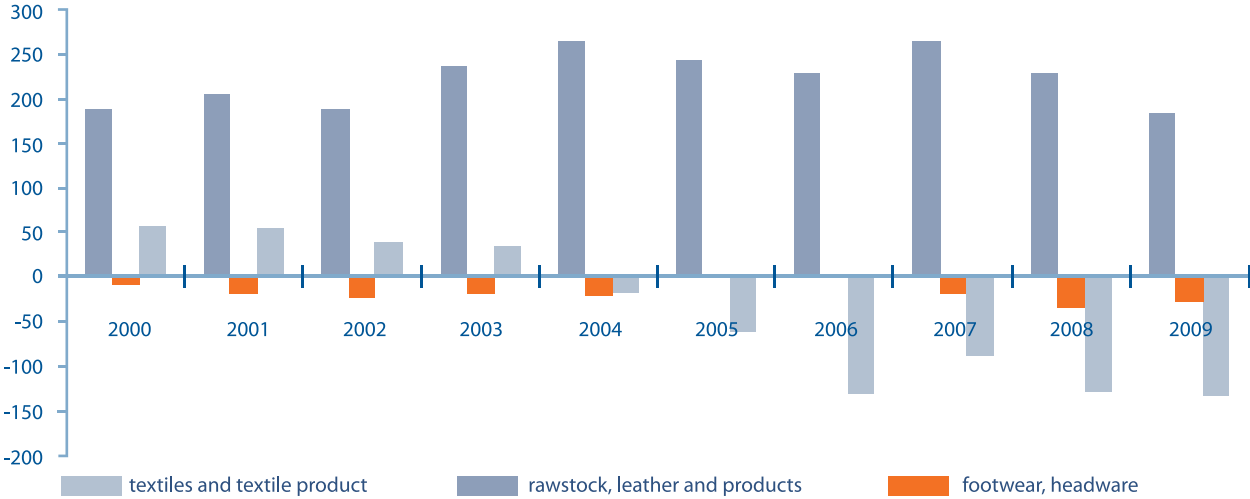


Source:
Foreign trade in the Republic of Belarus. BelStat 2010.

Out of three main light industrial commodity groups (textiles, raw skins and articles of leather and footwear), Belarus has remained a net exporter only for textiles. The excess of imports

over exports of the other two commodity groups suggests Belarusian producers of these goods may have become uncompetitive in domestic and foreign markets (Figure 3.5).

Figure 3.6.
Foreign trade balance by major light industrial commodity groups (US \$ millions)



Source:
Foreign trade in the Republic of Belarus. BelStat 2009.

3.2.3. Competitiveness and export potential

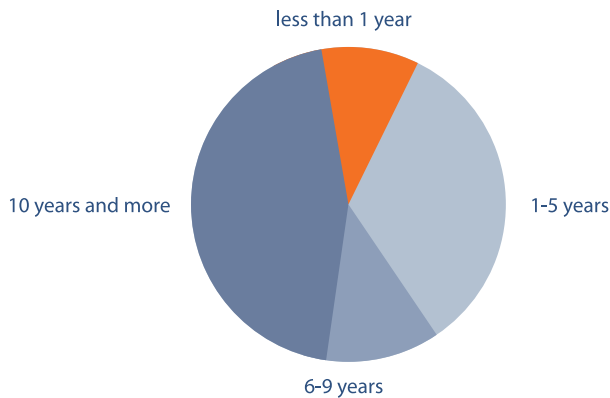
According to ITC data, Belarus is losing its share in the world exports of textiles and articles of leather despite the fact that unit production costs in these sectors do not exceed the world average (Table 2.13). As of 2008, unit production cost equalled the world average for textiles, and was below the world average for leather articles. Belarusian light industrial products, therefore, were fully competitive in the world markets. Exports of these commodity groups was fairly diversified (Table 2.13), putting Belarus in 29th place among 118 countries for leather articles and in 48th place among 129 countries for textiles. Geographically, the exports of textiles and leather articles are insufficiently diversified, depending on only a few markets and, consequently, were highly vulnerable to external shocks. By the geographic diversification index, Belarus ranked 110th among 129 countries for textiles, and 98th among 118 countries for leather

articles. Furthermore, exports of both commodity groups had a low adaptation effect, putting Belarus in 102nd place among 129 countries and in 94th place among 118 countries, respectively. This means that Belarusian exporters are losing market share on dynamic markets and increasing market share on recessive markets. On the other hand, Belarus has a good ranking on the indicator “matching with dynamics of the world demand” in the textile sector (52nd place among 129 countries).

In sum, Belarusian light industry has good potential for exports and competitiveness. Utilisation of this potential depends on technological innovation. At present, 44% of the technologies considered new or advanced have been utilized for ten or more years (Figure 3.7), suggesting that the pace of technological advancement is still too slow.

Figure 3.7.

Age of new or advanced technologies in the light industry (as of 2008)



Source:
Manufacturing industries in the Republic of Belarus. BelStat 2009

In 2006-2008, the proportion of innovative firms in light industry declined from 9.5% to 7.7%, as compared to the average of 17.6% for manufacturing industries. Of total innovation expenditures, 98.5% was on new equipment, 0.07% on staff upgrading, and 0.2% on marketing studies. Expenditures on development of new technologies were negligible. Most light industry firms have marketing and export departments, but many lack the knowledge and expertise for effective product promotion in Western and international markets. Although 84% of firms within the Bellegprom state concern have corporate web sites, only 10% of these are operating electronic trading platforms. Furthermore, most corporate web sites cater to customers from the CIS and do not meet client expectations from the non-CIS markets.

Light industry is facing major challenges to current and future competitiveness, which cannot be addressed by just acquiring new equipment. To compete successfully, Belarusian light industry firms need to seek out new market segments, pursue effective marketing strategies, learn to practice new methods of trade -- including e-commerce and e-trading platforms -- and implement progressive supply and delivery management systems. In China, unit production costs of clothing and apparel exceeded the regional and global average in 2005, but Chinese manufacturers are still highly competitive in international export markets⁵¹. Experts from UNCTAD's International Trade Centre attribute this success to the ability of China's manufacturers to operate effective supply and delivery systems, and to effectively utilise e-trading technologies.

3.2.4. Impact of accession to WTO and EURASEC Customs Union on trade and human development in light industry

As already mentioned, light industry is highly export-oriented, and depends heavily on imports of raw materials. Therefore, it is highly sensitive to change in economic and trading policies, including policies that affect employment, employee training, environment, regional

development, enterprise location, and other aspects of human development.

By joining the EURASEC Customs Union (See Section 2.5 of this Report), Belarus gains access to a larger market and may benefit from better

⁵¹ According to ICT technical paper "Source-it – Global Material Sourcing for the Clothing Industry" FOB prices of Chinese garments are already above the world average. The average pay of a Chinese worker is five times greater than in Bangladesh. The cost of producing a shirt in China is 33% higher than in Bangladesh.

opportunities for exports, improved workplace training and higher wages for light industry employees, most of whom are women. On the other hand, the introduction of a common tariff will mean a reduction of import duties for a range goods manufactured by light industry. This includes clothing and apparel (Groups 61 and 62 of the Commodity Nomenclature for Foreign Economic Activities), footwear (Group 64), carpets (Group 57) and head gear (Group 65). The importation by individuals of goods for

private use will also be simplified. Belarusian light industry should expect to face stronger competition in the CIS markets, including Russia, where the majority of potential consumers reside. Additionally, the open customs border with Kazakhstan makes Belarus accessible for gray imports from China. Table 3.6 presents a SWOT analysis of accession to the Customs Union of EURASEC for Belarusian light industry, conducted from a human development perspective.

Table 3.6. Human development implications of accession to EURASEC Customs Union – a SWOT analysis for Belarusian light industry

Strengths	Weaknesses
<ul style="list-style-type: none"> Increased exports and employee wages, improved employee training. 	<ul style="list-style-type: none"> Increased competition with imports – including gray imports – may increase the number of unprofitable enterprises and create more hidden unemployment, especially among the women residents of small cities, who depend on employment in light industry for their livelihoods
<ul style="list-style-type: none"> Non-tariff barriers will be removed when standardisation and certification systems are unified. This will increase exports and worker incomes. 	<ul style="list-style-type: none"> Partners in the Customs Union do not have access to new, environmentally friendly technologies that comply with higher environmental and occupational safety standards and improve productivity and workforce training.
<ul style="list-style-type: none"> Elimination of customs formalities will cut costs, improve competitiveness, increase enterprise profitability and wages. 	<ul style="list-style-type: none"> Due to increased competition, firms may seek to cut costs by economising on employee protection and occupational safety measures. This will have a disproportionate effect on women, who represent the majority of employees in the industry.
<ul style="list-style-type: none"> More scope for forming investment partnerships within the Customs Union. 	
Opportunities	Threats
<ul style="list-style-type: none"> Creation of a large common market of the Customs union will expand opportunities for increasing exports, and employee wages. 	<ul style="list-style-type: none"> By adopting the common customs tariff, Belarus will give up the freedom to utilize customs tariffs to protect its markets. This may lead to short-term increases in the number of unprofitable firms and, possibly, bankruptcies, thus increasing the risk of unemployment and social tensions in communities where light industry enterprises are prominent employers. As women form the majority of the workforce, they may be the worst affected.
<ul style="list-style-type: none"> Access to the large market of the Customs Union could bring more FDIs, thus creating new jobs, improving employee training and facilitating new business start-ups in the regions. 	<ul style="list-style-type: none"> Adoption of a common customs tariff will reduce tariff protection for some producers, resulting in increased competition with imports. In the short run, this may worsen financial performance of some enterprises, and lead to wage freezes
<ul style="list-style-type: none"> The common customs tariff will increase protection of some light industry manufacturers, which may improve their financial performance, and lead to higher wages -- especially for women, who form the majority of the work force. 	<ul style="list-style-type: none"> Belarus may become more accessible for gray imports from China through Kazakhstan and Russia. Domestic sales and exports may fall as a result, creating higher numbers of unprofitable firms, increasing under-employment, and, consequently, decrease employee wages
	<ul style="list-style-type: none"> Membership in the customs union does not encourage integration in global value chains outside the CIS, resulting in missed opportunities to adopt new technologies, improve employee qualifications and enter new markets.

As seen from the Table, accession to the Customs union creates both opportunities and threats. The threats include increased accessibility of Belarus for gray imports, stronger market competition, and loss by Belarus of its freedom to increase tariff protections for its light industry. This may increase the proportion of loss making firms, depress the salaries of employees (mostly women) through wage freezes, employee mandated leaves, hours reduction and revision of social benefit packages. It should also be emphasised that because the member countries have a similar level of technological advancement to Belarus, the Customs Union is unlikely to bring new technologies and managerial know-how for better competitiveness and improved employee qualifications. Nor should the Customs Union be expected to bring new environmental, hygienic and labour safety standards, including the intensity noise, vibration and other risks to health in the working environment, particularly for textile workers.

Belarusian trade and economic policies will likely be affected by accession to WTO. The sectoral implications of membership will vary,

as some sectors are likely to benefit, while others stand to lose. Computable General Equilibrium (CGE) Model computations⁵² suggest that WTO accession will open the Belarusian market to significant increases in the import of light industry products, leading to a small reduction of domestic output. CGE modelling has gained prominence in recent years as a tool for predicting the effects of economic policy decisions, such as accession to WTO or regional trade agreements. However, just like any other model, CGE is necessarily a simplified representation of structural relationships between industries, the government and the external environment. CGE computations, therefore, should be viewed as a starting point in economic decision making, and treated with a fair amount of caution. They should best be supplemented by other methods and approaches, particularly for purposes that go beyond simple prediction of specific indicators and include prediction of human development implications of the proposed policies. Table 3.7 presents a SWOT analysis of potential human development implications of WTO accession for Belarusian light industry.

*Table 3.7.
Human development implications of WTO accession for light industry – a SWOT analysis*

Strengths	Weaknesses
<ul style="list-style-type: none"> Increased output, employment and wages. 	<ul style="list-style-type: none"> High asset depreciation may limit the ability of domestic products to compete with imports.
<ul style="list-style-type: none"> Growth of SMEs, employment, new opportunities for flexible employment valued by women. 	<ul style="list-style-type: none"> Under-investment in technological innovation exacerbates threats to future competitiveness.
<ul style="list-style-type: none"> Access to new, environmentally friendly technologies can enhance productivity, personnel training, and promote occupational safety. 	<ul style="list-style-type: none"> Under-investment in marketing activities and market studies prevents adequate monitoring of customer needs and diminishes competitiveness.
<ul style="list-style-type: none"> The coming of Western manufacturers to small cities will improve the demographic situation by stemming the out-migration of young people. 	<ul style="list-style-type: none"> Low profitability prevents improvements in the working conditions and occupational safety (e.g. reductions in noise and vibration levels).
	<ul style="list-style-type: none"> Diminished opportunities to receive subsidies from the state.

⁵² Pavel F., Tochitskaya I. (2005). The Implications of Belarus WTO Accession: General Equilibrium Modeling. Belarusian Economic Journal, No. 3.

Opportunities	Threats
<ul style="list-style-type: none"> Exports and employee wages may grow as a result of improved access to EU markets. 	<ul style="list-style-type: none"> Belarus will give up the freedom to protect its domestic market with customs tariffs. In the short term, this may lead to bankruptcies, enterprise closures and employee layoffs, especially among women.
<ul style="list-style-type: none"> Lifting of non-tariff limitations may increase exports to the EU and raise employee incomes. 	<ul style="list-style-type: none"> High asset depreciation may make domestic products less able to compete with imports. The number of unprofitable enterprises may increase along with bankruptcies and enterprise closures. Potential consequences will be felt the most in single-industry cities.
<ul style="list-style-type: none"> Integration in global value chains will improve employee training and create new jobs. 	<ul style="list-style-type: none"> Increased competition in domestic and foreign markets may tempt some employers to cut employee wages and social benefit packages.
<ul style="list-style-type: none"> WTO accession may bring additional FDIs, contributing to job creation, higher employment and better job opportunities, especially for women. 	<ul style="list-style-type: none"> Risk of migration into Belarus of environmentally dangerous enterprises from Western Europe.
<ul style="list-style-type: none"> In the long run, WTO membership will lead to more efficient resource allocation and make the surviving firms more competitive. 	<ul style="list-style-type: none"> WTO membership will require additional expenditure on membership fees and representation in the amount of \$1-2 million US dollars per year. In conditions of a budget deficit, funding for social programmes may be affected.

Obviously, WTO accession will improve access to foreign markets, including by lifting non-tariff barriers for exports to the EU. Employee incomes can be expected to rise as a result of higher exports. WTO membership will also facilitate FDIs, and promote greater inclusion of domestic manufacturers in international value chains. This will improve employee training and facilitate creation of new jobs, particularly in the regions. FDIs can also bring new technologies that are healthier and more friendly to the environment, thus improving the working conditions and reducing occupational hazards to health, particularly for women who form the majority of the work force. However, WTO accession also carries major risks, by increasing competition with imports and limiting the freedom for Belarus

to implement tariff protection of domestic manufacturers. The resulting loss of profitability, and growth in the proportion of loss-making firms will inevitably have social consequences, including lower wages and reduction of social benefits packages for employees.

From a human development perspective, accession to the Customs Union and WTO will create benefits, as well as risks. Government policies should maximize the benefits, while anticipating and mitigating the risks, including by implementing worker training and retraining programmes, promoting small and medium-sized enterprises, supporting innovation activity, and facilitating FDIs in the least economically developed regions.

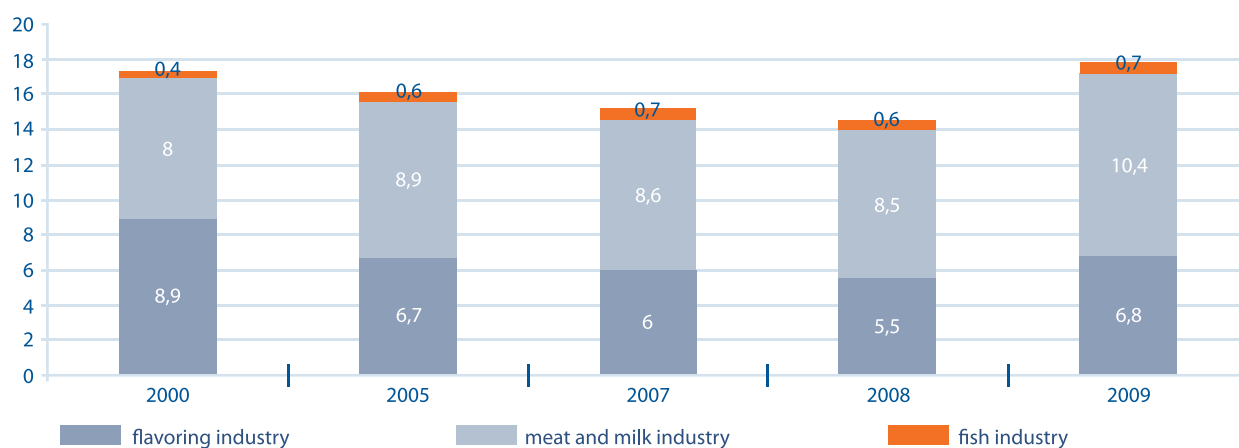
3.3. Food industry

3.3.1 Background and overview

In Belarus, the food industry consists of three subindustries – flavouring, meat and dairy and fish production, and has around 800 active firms. Food industry is an important component of the manufacturing sector, contributing 17.9% of industrial output in 2009. Unlike other traditional

industries, the food industry has maintained a stable share of industrial output for the last fifteen years and contributes a high proportion of total value added. The flavouring and meat and dairy subindustries have the largest shares in total output (Figure 3.8).

Figure 3.8.
Output in food industry as % of industrial output, by subindustry



Source: BelStat

The food industry contributes a large proportion of total employment. At present, it employs around 140,000, or 13% of industrial work force. Unlike most traditional industries, employment in the food industry is increase. The flavouring and meat and dairy sub-industries have the largest number of employed – around 73 and 60 thousand, respectively.

Rising employment and share in industrial production reflect the industry's strong economic performance in the face of the global recession. Unlike most other manufacturing industries, output in the food industry continued to grow during the recession. The meat and dairy sub-industry had the strongest growth performance (Table 3.8), attributable to a large extent to the high proportion of exports in the total output.

Table 3.8.
Change in total output in the food industry (as % of the previous year)

	Food industry	Including by subindustry		
		Flavouring	Meat and dairy	Fish production
2005	13.4	7.9	17.5	20.0
2006	6.7	2.7	12.7	29.1
2007	1.6	0.1	2.6	12.9
2008	8.7	6.0	13.5	6.7
2009	2.4	0.6	5.8	-13.2

Source: BelStat

However, financial performance of these sub-industries does not match the output trends. The Flavouring and fish sub-industries were able to maintain profitability at pre-crisis levels, while in

the meat and dairy subindustry profitability was close to zero. This variance cannot be attributed entirely to the global recession, as it had persisted over many years (Table 3.9).

Table 3.9.
Profitability trends in the food industry, by subindustry (%)

	Food industry	Including by subindustry		
		Flavouring	Meat and dairy	Fish production
2005	8.3	10.7	5.7	16.5
2006	8.4	13.1	4.9	5.0
2007	10.1	11.8	9.4	2.9
2008	5.9	13.9	0.6	8.1
2009	6.8	15.1	1.1	11.5

Source: BelStat

Multiple factors are at play. First, domestic prices of meat and dairy products are subject to extensive control by the state, while the other sub-industries are less affected by these price controls. Second, the financial performance of meat and dairy processors depends on the government-determined purchase prices of milk. State policies to support agricultural producers keep domestic prices low are pursued largely at the expense of diminished profit margins for meat and dairy firms.

The potential solution is to cut costs and increase productivity by implementing innovations and adopting new technologies. The industry has low accumulated depreciation of fixed capital (Table 3.10), which increases the chances of success. High asset depreciation, however, is an issue for fish production, while meat and dairy and food and flavours enterprises are in a better position compared to other manufacturing industries.

Table 3.10.
Accumulated fixed capital depreciation rate, by subindustry

	Food industry	Including by subindustry		
		Flavouring	Meat and dairy	Fish production
2005	47	45	50	28
2006	46	45	48	26
2007	44	44	46	27
2008	43	42	45	27
2009	40	41	41	28

Source: BelStat

In recent years, the food industry has demonstrated strong growth in productivity, comparable to other manufacturing industries (Table 11). This growth performance was

achieved despite price controls and other limitations. The exceptional drop in productivity in 2007 was likely the result of spike in employment.

Table 3.11.
Trends in labour productivity (% of the previous year)

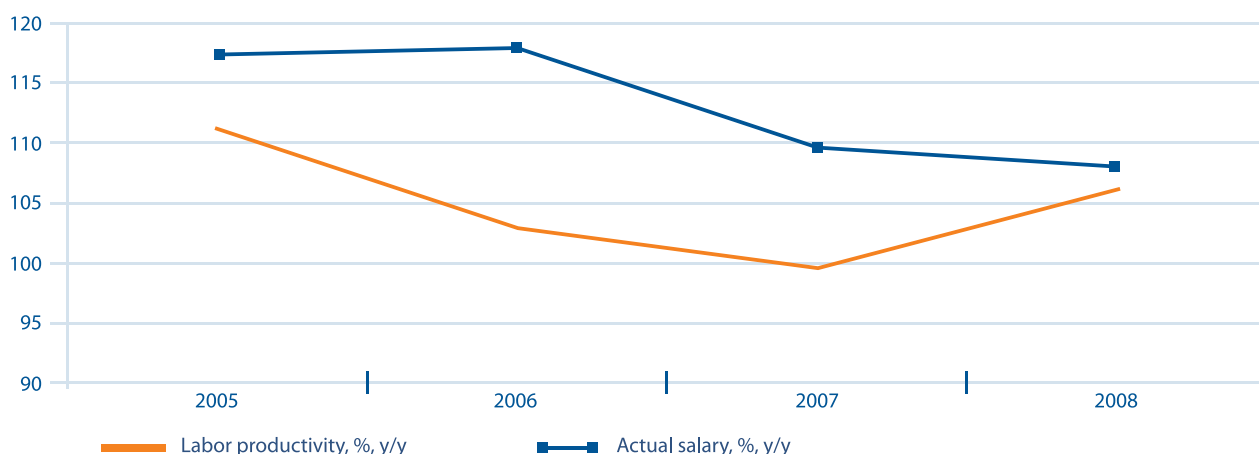
	Food industry	Including by subindustry		
		Flavouring	Meat and dairy	Fish production
2005	111	107	114	107
2006	103	101	108	121
2007	99.6	99	99.8	106
2008	106	105	110	102

Source: BelStat

However, the food industry was unable to fully benefit from the gains in productivity, as wages have tended to increase faster than productivity growth (Table 3.9). While being consistent with

national income policy objectives, this tendency increases labour costs per unit of production, and ultimately results in diminished competitiveness for the food industry in the export markets⁵³.

Figure 3.9.
Productivity and wage increases



Source:
Own computations based on data from BelStat.

3.3.2. Food industry development – context-specific factors

The food industry has close linkages with agriculture. The challenges of the agricultural sector – including poor product quality, insufficient capacity to meet current demand, high product prices and crop failure can easily be transmitted to the food industry. The development of the agricultural sector

and its ability to maximize efficiency and adapt to changes in the market are important determinants of competitiveness in the food industry. The performance and competitiveness of the food industry are also affected by government agricultural policies. This impact is exacerbated by the de facto restrictions on

⁵³ The use of deflators to compare wage and productivity increases may distort the results. A more adequate picture can be obtained by examining the cost of labour as a proportion of production costs. This proportion, however, has been also been rising in recent years (except 2008).

imports of agricultural produce for domestic food producers, thereby eliminating alternative supply channels.

Government agricultural policy seeks to maintain agricultural employment and guarantee a certain level of rural incomes. The state is also anxious to prevent a sudden collapse of agricultural output in the course of agricultural reforms. The state prioritized these concerns above economic efficiency, and thus has preferred to the present structure and organization of agricultural production. Subsidies to agricultural producers have been a hallmark of these policies over the past decade. State support to agriculture is estimated at 3-4% of the GDP⁵⁴, exceeding the levels of support in most transitional and many industrialised economies. However, despite the support, profitability in agriculture has consistently remained below the national average. Available estimates suggest that the share of uncompetitive agricultural enterprises may be exceptionally high, and that such enterprises are being kept afloat exclusively by state subsidies⁵⁵.

Admittedly, the high amount of subsidies for agriculture creates competitive advantages for the food industry in the form of low prices of food staples⁵⁶. For example, dairy firms, exporting a significant proportion of their output, rely on low milk purchasing prices as one of their leading competitive advantages. In 2009, for example, milk prices in Belarus were lower than in Ukraine by 19%, in the EU by 21%, and in Russia by 24%⁵⁷. These price differences would be somewhat lower if recalculated in accordance with the EU standards for fat and protein content (by 15%, 6% and 20%, respectively).

However, the food industry is also losing competitive advantages due to inefficient agricultural production. First, producers may be purchasing lower-quality food staples. Second, stringent price controls may lead to situations where increases in purchase prices are inconsistent with market trends, thus eroding price competitiveness.

Close linkages to agriculture makes Belarusian food manufacturers subject to direct government intervention and prescriptive target setting. For example, under the government programme on development of meat, dairy and sugar production for 2010, the government prescribed priorities for modernisation of production facilities and the exact number of enterprises in each sub-sector, and sought to establish a centralised marketing system. In addition, the government resorts to setting prescriptive targets for production, exports and product range. The dairy production development programme for 2010-2015 and the relevant edict of the president prescribe a similar set of measures for dairy manufacturers. The overall effect of such measures is to increase production concentration and create barriers to entry. From a competitiveness standpoint, the overall impact state intervention has an overall negative impact, by distorting the industry structure, restricting enterprise freedom to adapt to market dynamics and depriving them of flexibility in making decisions on production and pricing.

Because much of the food industry's production falls into the staples category, domestic prices are often subject to direct price control by the state. Faced by these controls, enterprises seek to recover their losses by exporting, which may have negative implications for the industry's ability to adapt to world market dynamics.

Despite these potential threats and limitations to enterprise flexibility, the industry has been successful in recent years in matching the dynamics of world demand (Table 2.1.3).

For example, world market conditions for milk and dairy products remained favourable by comparison with other markets (Figure 3.2.3). Belarusian dairy producers have relied expensively on exports to the Russian market. Despite a certain reduction in the export price, Belarusian dairy exporters have been able to maintain their market share in Russia (Figure 3.10).

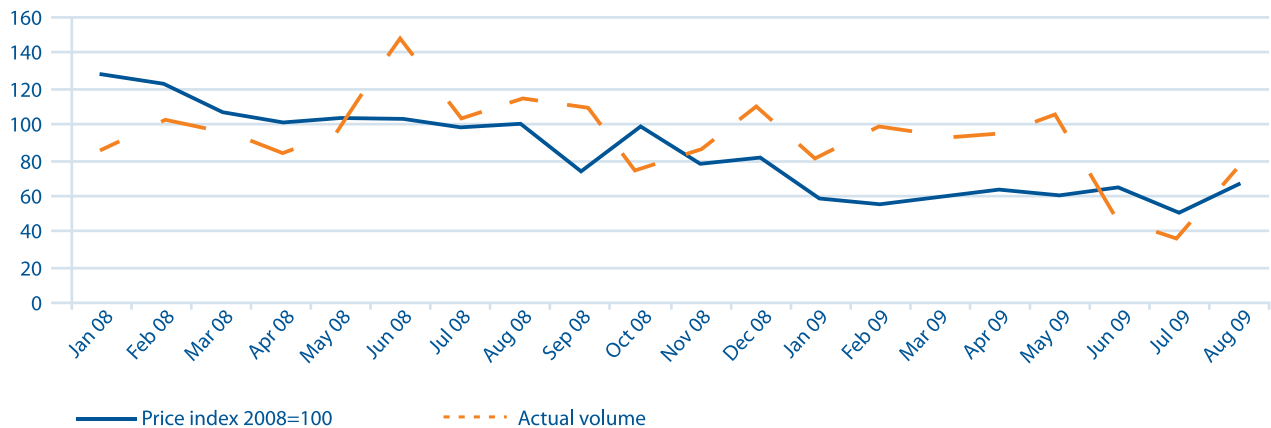
⁵⁴ For more detail, see Kramon – Trubadel et al. (2008). Competitiveness of Belarusian agriculture, IPM Research Centre Policy Paper, PP/02/08.

⁵⁵ Ibid.

⁵⁶ Belarus: foreign trade and competitiveness data. Economic policy notes. World Bank policy note № 2. 25 June 2010. World Bank.

⁵⁷ Data based on estimates from the Russian Association of Dairy Industries.

Figure 3.10.
Physical exports of milk and condensed milk to Russia
and trends in export prices



Source:
Rosstat, Federal Customs Service of the Russian Federation, BelStat.

Other segments of the meat and dairy markets experienced similar trends, and Belarusian meat and dairy producers were able to maintain growth, contributing to the overall growth in the output of the food industry. The flavouring industry, which was more oriented for the

domestic market, also avoided a decline, but its output remained largely stagnant. In general, the food industry has achieved a high degree of flexibility and responsiveness to world market changes through active participation in foreign trade.

3.3.3. Potential for increasing exports

Despite domestic constraints, meat and dairy producers have been performing quite successfully in the export markets. As shown in Table 1.9 above, meat and dairy has been one of the few sectors that was able to increase its market share in Russia. It was also observed that trade in food products

was highly diversified and adaptive to the dynamics of the world demand. The growth in meat and dairy exports in value terms was not only the result of higher export prices (as it had been for a wide range of Belarusian exports), but also of gains in physical exports (Figures 3.11 and 3.12).

Figure 3.11.
Determinants of exports in value, milk and dairy products (2004=100)

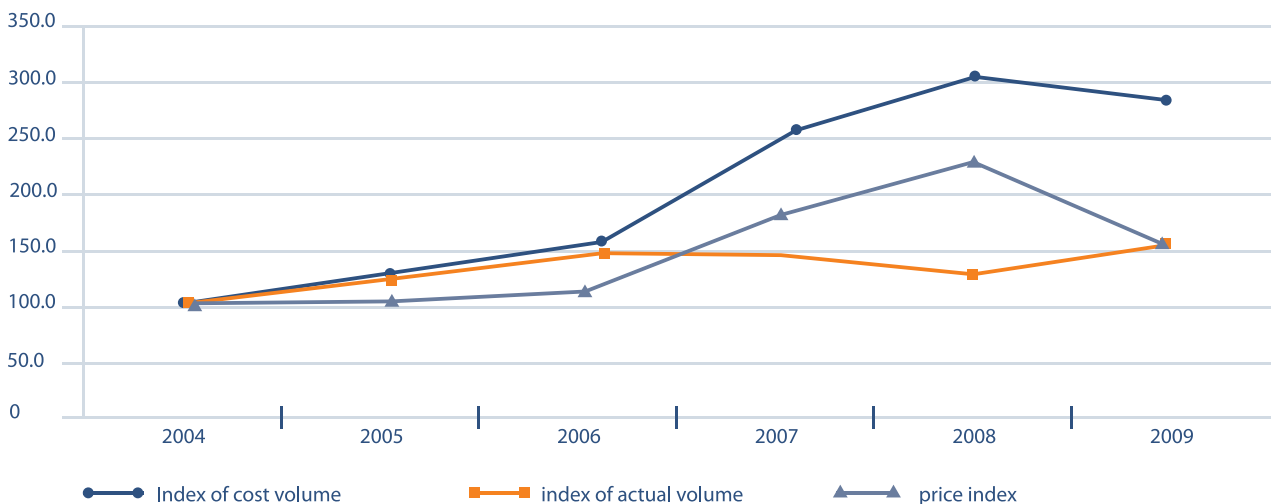
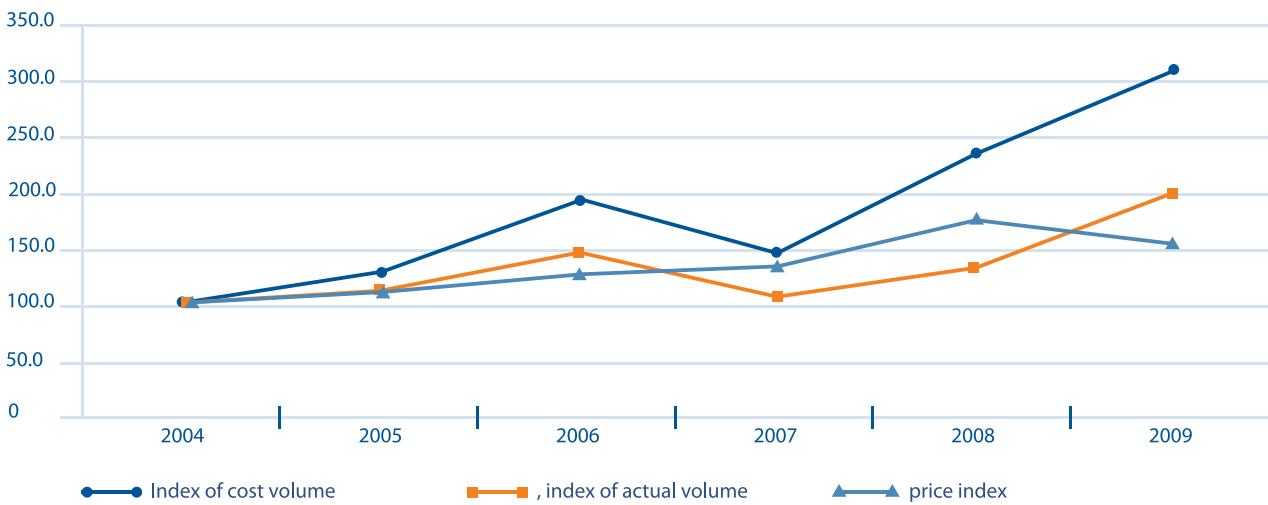


Figure 3.12.
Components of growth in the value of meat and dairy exports (2004=100)



Despite these positive trends, concerns still remain about future export performance of the food industry. One such concern is poor

geographic diversification of exports. For nearly all commodity groups, Russia is still the main export market (Table 3.12).

Table 3.12.
Share of exports to Russia as % of total exports of the relevant commodity group (%)

	2008	2009
Meat and meat offal	99.69	99.96
Fish, crustaceans, molluscs	53.13	66.05
Dairy products, eggs, honey	92.49	82.93
Cereals, flour, starch preparations and products	58.52	91.51
Meat, fish and seafood preparations	79.97	90.32
Sugar and sugar confectionery	38.47	41.46

Sugar, a major traded commodity for Belarus, is the only exception to this trend. At present, less than 40% of total sugar exports from Belarus are to Russia. This outcome is not due to objective reasons, but rather the result of import restrictions imposed by the Russian government.

Similarly, Belarusian dairy producers have had to accept voluntary export restraints at 2.5 million tons per year, or 11% below the 2008 level. Similar market protection policies in future may harm the export prospects for the Belarusian food industry, with important implications for growth and human development. These may include the reduction in employment and the

need to recover the lost profits in the domestic market, making it no longer tenable for meat and dairy firms to continue to subsidise agricultural producers and domestic consumers.

Export market diversification is an important priority for the food industry. The European Union is one of the best alternative markets, owing to its geographical proximity and large size. At present, however, exports are constrained by the EU import tariffs and a variety of technical barriers.

One notable example of such a barrier is the absence in Belarus of certification and

standardisation mechanisms compliant with the EU food safety standards. This problem has several components. One is the shortage of EU-compliant laboratory facilities. Second is the lack of trained specialists to implement the EU standards. Third is the need to upgrade the skills of the technical and engineering staff in the enterprises. Export market diversification for the food industry should start by addressing these concerns.

Other measures in this direction may include: adoption of new food processing methods, raising the sanitary standards of production, utilisation of energy efficient technologies, expanding the trade infrastructure in the border areas. Improving the skills of marketing staff would also be a useful strategy towards better adaptation of the Belarusian food industry to dynamics of the world market.

3.3.4. Human development implications of WTO and EURASEC Customs Union accession for the food industry

Tables 3.13 and 3.14 present a SWOT-analysis of the human development implications of WTO and Customs Union Accession for the food industry.

Table 3.13. SWOT-analysis of the human development implications of WTO accession

Strengths	Weaknesses
<ul style="list-style-type: none"> • Low purchasing prices in agriculture. 	<ul style="list-style-type: none"> • Relatively high depreciation of fixed assets limits the space for technological upgrading and innovation.
<ul style="list-style-type: none"> • Sustained improvements of productivity, staff training and human capital. 	<ul style="list-style-type: none"> • Industry performance is highly dependent on agriculture.
<ul style="list-style-type: none"> • Belarus has a stable market share in Russia and other CIS markets. 	<ul style="list-style-type: none"> • The industry is highly sensitive to the government's price policies, including changes in the purchasing prices and retail prices of the finished products.
<ul style="list-style-type: none"> • Enterprises are evenly distributed across Belarus and provide livelihoods for people in multiple communities. 	<ul style="list-style-type: none"> • High dependence on direct government interventions and control limits flexibility.
<ul style="list-style-type: none"> • The industry is a major employer, and generates employment in the upstream and downstream industries; adoption of new technologies creates demand for new in related industries. 	<ul style="list-style-type: none"> • High dependence on a single export market, the Russian Federation.
<ul style="list-style-type: none"> • Preferential access to capital. 	<ul style="list-style-type: none"> • Excessive regulation of the industry and barriers to market entry limit efficiency and flexibility.
<ul style="list-style-type: none"> • High flexibility and ability to adjust to changes in world markets. 	
Opportunities	Threats
<ul style="list-style-type: none"> • Harmonization of norms in the field of standardization and certification, which will contribute to the diversification of markets which will result in employment growth in the food industry and related industries 	<ul style="list-style-type: none"> • The requirements for WTO accession related decline in the value of agricultural subsidies may in the short term cause a sharp increase in procurement prices and cause a decline in employment, incomes of workers in the food industry
<ul style="list-style-type: none"> • Improved access to market of major EU trading partners, which, in addition, to income growth and employment can help improve product quality of the domestic food market 	<ul style="list-style-type: none"> • Sudden changes in related sectors (agriculture) may result in limitations of the commodity nomenclature of the products, as well as cause a shortage of certain products in the domestic market (from a list of low-profit socially important products)

<ul style="list-style-type: none"> • Additional opportunities to attract investments in the industry that will have a positive impact on employment, income, payments to the budget 	<ul style="list-style-type: none"> • Increased competition in the domestic and foreign markets may lead to lower costs by reducing the costs of salaries and other payments related to employees.
<ul style="list-style-type: none"> • Increased access to new markets may result in additional demand for more qualified work force, encourage additional investments of the industry in research and development projects 	<ul style="list-style-type: none"> • Requirements for accession to the WTO may lead to restriction of government support measures for the technical modernization of the sector which in the short run may have a range of negative consequences
<ul style="list-style-type: none"> • Eliminating excessive governmental regulation might lead in the long term to improvements in the industry, the expansion of allied enterprises at the expense of small and medium-sized enterprises, such as in agriculture, which will contribute to employment growth, income, and geographic diversification 	<ul style="list-style-type: none"> • Better food imports could lead to a decline in the share of domestic enterprises in the domestic market, representing a loss of income, employment, etc.

Table 3.14.

Human development implications of accession to the customs union – a SWOT-analysis

Strengths	Weaknesses
<ul style="list-style-type: none"> • Low purchasing prices in agriculture. 	<ul style="list-style-type: none"> • Relatively high depreciation of fixed assets limits the space for technological upgrading and innovation.
<ul style="list-style-type: none"> • Sustained improvements of productivity, staff training and human capital. 	<ul style="list-style-type: none"> • Industry performance is highly dependent on agriculture.
<ul style="list-style-type: none"> • Belarus has a stable market share in Russia and other CIS markets 	<ul style="list-style-type: none"> • The industry is highly sensitive to the government's price policies, including changes in the purchasing prices and retail prices of the finished products.
<ul style="list-style-type: none"> • Enterprises are evenly distributed across Belarus and provide livelihoods for people in multiple communities. 	<ul style="list-style-type: none"> • High dependence on direct government interventions and control limits flexibility.
<ul style="list-style-type: none"> • The industry is a major employer, and generates employment in the upstream and downstream industries; adoption of new technologies creates demand for new in related industries. 	<ul style="list-style-type: none"> • High dependence on a single export market, the Russian Federation.
<ul style="list-style-type: none"> • Preferential access to capital. 	<ul style="list-style-type: none"> • Excessive regulation and barriers to market entry limit efficiency and flexibility.
<ul style="list-style-type: none"> • High flexibility and ability to adjust to changes in world markets. 	
Opportunities	Threats
<ul style="list-style-type: none"> • Domestic market protection increases the share of Belarusian producers, as food products have been the most affected by increases in the customs tariff. 	<ul style="list-style-type: none"> • Customs union member states continue to apply non-tariff limitations to protect domestic food markets. These policies may have negative effects for economic performance, incomes and employment in Belarus.
<ul style="list-style-type: none"> • As standardisation and certification norms and practices are unified, members of the customs union will no longer be able to maintain nontariff barriers to market entry. 	<ul style="list-style-type: none"> • Exports are still excessively oriented towards Russia, and incentives to diversify are still weak. If the present export structure is maintained, firms will have few incentives to innovate. In the long term, the industry may be vulnerable to Russian export restrictions.
<ul style="list-style-type: none"> • Creation of a large common market of the Customs union will expand opportunities for increasing exports, and employee wages. 	<ul style="list-style-type: none"> • Weak incentives to upgrade quality standards in accordance with best international practices may result in deterioration of product quality in domestic markets.
<ul style="list-style-type: none"> • Access to the large market of the Customs Union could bring more FDIs, thus creating new jobs, improving employee training and facilitating new business start-ups in the regions. 	<ul style="list-style-type: none"> • Russian companies are likely to dominate as investors. If oriented towards the Russian standards, such investors may constrain export diversification.

WTO membership can have long-term positive implications for the food industry, by improving access to strategic markets, facilitating policy reforms, and increasing FDI inflows. Together, these benefits can contribute to human development in Belarus. However, WTO accession also brings a range of serious, if short-term, risks. One is the risk of negative shocks caused by the abrupt withdrawal of subsidies for agriculture. The results may include sharp cost increases and diminishing competitiveness. The industry may react by reducing the output of socially important but unprofitable goods. In addition, it may stand to lose its shares in domestic and foreign markets. Government policies will need to find the appropriate balance

between two conflicting goals: maximising the long-term benefits and minimizing the short-term costs.

Accession to the Customs Union will expand potential export markets, and reduce the urgency of the problem of different standardization and food safety regulations, thus reducing the scope for the application of non-tariff barriers. However, there is a risk that membership in the customs union may limit incentives for export diversification. However, these challenges can be effectively addressed if the customs union is viewed as a step towards increasing competition, rather than an alternative to WTO.

4. Conclusions and Action Matrix

Belarus inherited from the Soviet era a large, export-oriented manufacturing base. As a consequence, its economic prosperity is highly dependent on foreign trade. As shown by our analysis, trade still remains a key factor of economic growth. This growth fully meets the definition of pro-poor, as it has reduced the poverty rate, and increased the average income relative to the minimum consumer budget. The trade policies of the Belarusian government have promoted exports to foreign markets, particularly to Russia, and favoured large enterprises that employed a large proportion of the work force. Strong foreign trade performance helped maintain and increase employment. Large enterprises continued to own an extensive network of social service facilities, including outpatient clinics, kindergartens, and summer camps, and used a portion of the export revenues to maintain this infrastructure.

Alarming, Belarusian foreign trade has experienced a number of negative trends in recent years. First, many traded goods have been losing competitiveness in international markets, leading to persistent current accounts deficits. Second, Belarusian export specialization has shifted towards primary commodities, and away from investment and goods and high-tech products. The high proportion of resource-intensive exports by industries with limited growth potential points to unfavourable changes in the economy, affecting prospects for job creation and productivity increases. Furthermore, the Belarusian trade basket became less diversified in 1998-2008, particularly outside the CIS. High export concentration makes the economy highly vulnerable to negative shocks, as demonstrated by the impact of the global economic recession in 2008-2009.

According to data from the World Trade Indicators Database of the World Bank (Table 2.8), the level of tariff protection (or the weighted average tariff) in Belarus was below the world average, but significantly above the average level for the Europe/Central Asia region and for the EC-27. Of the CIS countries, only Russia had a higher weighted average tariff than Belarus (Table 2.9). Higher tariffs, however were applied only to 36% of imports from outside the CIS, as trade

with the CIS and Russia – Belarus' main trade partner -- was not subject to tariffs. In addition, all imports from developing countries are taxed at the rate of 75% of Most Favoured Nation tariff under the Generalised System of Preferences. By comparison with Europe and Central Asia, the Belarusian tariff schedule is more regular, and has lower deviation from the average nominal tariff (1.02%, as compared to 1.79% in Europe and Central Asia and 1.97% in the EU-27), and a lower proportion of tariff peaks, i.e., greater than three times the average nominal tariff.

Belarus continues to have a low ranking by the World Bank's trade facilitation measures (including the logistics performance index, and the Export Credit-Ensured Exposures indicator). The result is diminished competitiveness of Belarusian exports and limited capacity to attract FDIs. According to estimates and data from UNCTAD's ICT Belarusian exports are poorly adapted to changes in world demand and world market dynamics. Beyond economic growth, these trends also have implications for human development.

In light of the above, Belarus should:

- Diversify its exports, and promote export specialization in medium- and high-technology goods;
- Facilitate the inflow of FDIs to maximize their positive economic impacts and create competition. Stronger priority should be given to investments that facilitate the transfer of new technologies and know-how, maximise positive spillover effects, promote productivity growth in domestic enterprises, and create a new platform for exports. To attract FDIs to high value added sectors, it is essential to strengthen domestic firm absorption capacity, improve the finance system, strengthen the legal framework and protection of property rights, and increase the quality of the workforce;
- Develop a privatisation programme linked to the FDI promotion programme;
- Emphasise development of partnerships with international producers and sellers to

facilitate entry of domestic manufacturers to international markets. Participation in global value chains is an important means to access new technologies, and to adopt and comply with new quality standards;

- Accelerate WTO accession to facilitate integration in the world economy;
- Strengthen the institutional environment for foreign trade, and pursue trade promoting policies, including reduction of export and import formalities, improving foreign

trade finance, and closing the logistics development gap with the neighbouring states;

- Pay special attention to industries that are sensitive to trade policies, such as the food and light industries.

These are the measures that will not only promote export-based growth and increased competitiveness, but will also help increase human development levels, and improve the quality of life for all Belarusians.

Action matrix

	Activity	Target outcomes and indicators	Timeframe	Responsible parties
1	<i>Foreign trade policy</i>			
1.1	Diversify export basket.	Develop and implement appropriate measures of industrial, economic and foreign policies, coordinate these activities with FDI promotion.	Medium term	Ministry of Economy, Ministry of Industry
1.2	Shift export specialisation in the direction of the medium- and high-tech goods.	Develop and implement appropriate measures of industrial, economic and foreign policies, coordinating these activities with FDI promotion.	Medium term	Ministry of Economy, Ministry of Industry and other ministries
1.3	Determine priorities for increasing export competitiveness of Belarus.	Identify key export promoting interventions.	Short term	Ministry of Economy
1.4	Assess the economic impact of WTO accession on industry, services in the context of membership in the EurAsEC Customs Union .	Adopt an informed negotiating position on Belarus' accession to the WTO.	Short term	Ministry of Foreign Affairs, Ministry of Economy, Ministry of Industry
1.5	Link policies on investment with industrial and foreign trade policies.	Policies on FDIs should emphasise the following objectives: (1) transfer of technologies and best business practices; (2) maximizing spillover effects; (3) creating a new platform for exports. FDIs should be attracted to high value added industries, and local firms should be encouraged to develop their absorptive capabilities.	Short term	Ministry of Economy, National Agency for Investment and Privatisation, Ministry of Industry
1.6	Develop a program of privatisation linked to FDI promotion.		Medium term	
2	<i>Improving the institutional environment and facilitating trade</i>			
2.1.	Improve the institutional environment for foreign trade.	eliminate unnecessary administrative barriers to business (including with regard to registration, standardisation, certification, licensing, sanitary and fire regulations, etc.) and constraints on business development.	Medium term	Ministry of Economy, Ministry of Foreign Affairs
2.2	Close the technological gaps in logistics performance.	1. Reduce and simplify administrative procedures in transport and transport oversight. 2. Build transportation and logistics, wholesale and logistics and multiple-function logistical centres in Belarus. 3. Improve transport infrastructure (including construction of cargo airport in Orsha).	Short term	Ministry of Economy, Ministry of Transport

	Activity	Target outcomes and indicators	Timeframe	Responsible parties
2.3	Improve trade finance	Increase provision of export credits and expanding access to credit insurance.	Short term	
2.4	Facilitate foreign trade	Further simplify regulations governing the conduct of foreign trade transactions, increase payment options for importers, relax currency control procedures.	Short term	National Bank
3	<i>Increasing the export potential of Bellegprom group</i>			
3.1	Gather information about consumers and competitors, adjusting the product range to changes in market demand.	Develop information and marketing services of Bellegprom group members.	Medium-long term	Bellegprom
3.2	Participate in international fairs to gather information about consumers and competitors, and promote Belarusian products in foreign markets.	Participate in annual fairs -- Heimtextil (Frankfurt), Techtexil (Frankfurt), Texworld (Paris), Zoom by Fatex (Paris), MICAM Shoevent (Milan).	On a regular basis	Bellegprom
3.3.	Design and commission an electronic trading platform.	Expand wholesale and retail trade in light industry products.	Short term	Bellegprom
3.2	Further implement ISO 9000 quality management systems.	Improve product quality and competitiveness.		Bellegprom
3.4	Achieve integration in international value chains.	Achieve higher exports and stronger product competitiveness.	Medium term	Bellegprom
3.5	Involve international donors such as EBRD – as partners in technical upgrading and investment projects in light industry.	Grow investment, introduce new technologies.	Medium term	Bellegprom, National Agency for Investment and Privatisation
4	<i>Activities in the area of trade in food industry</i>			
4.1	ECImprove the training and qualifications of laboratory personnel, including mastery of procedures and the application of the EU food safety standards.	Diversify food exports.	Medium term	Belgospishcheprom, regional concerns, uniting producers of meat and dairy products, Scientific and Production Republican Unitary Enterprise "Institute of Meat and Dairy Industry"
4.2	ECAtract domestic and/or foreign investments to establish a food certification laboratory compliant with EU standards.	Diversify food exports.	Medium term	Belgospishcheprom, regional concerns, uniting producers of meat and dairy products, Scientific and Production Republican Unitary Enterprise "Institute of Meat and Dairy Industry"

	Activity	Target outcomes and indicators	Timeframe	Responsible parties
4.3	Create a trade infrastructure in areas adjacent to the EU border to promote food exports to the EU.	Increase food exports to the EU.	Medium term	Regional committees for food and agriculture, regional meat and dairy producer groups
4.4	Attract investments in new food processing technologies and energy efficiency.	Improve enterprise competitiveness, further diversify product range.	Medium term	BelGosPischeprom Group, Regional committees for food and agriculture, regional meat and dairy producer groups
4.5	Adopt the EU food safety regulations.	Improve enterprise competitiveness, further diversify the product range.	Long term	Parliament

5. Ideas for international technical assistance projects

5.1. Expanding trade and export potential of light industry in the Republic of Belarus

1. Rationale

Light industry is a leading export-oriented sector in the economy of Belarus. It numbers 1914 enterprises, employing 11.5% of the industrial workforce and contributing 3.6% of industrial output. As a result of adverse socio-economic developments in recent years, the industry has been slow to modernize its production base and increase productivity, and has been losing its markets in the face of growing competition. This creates serious social risks, as many enterprises form the core of the local economy, and a majority of their employees (79.7%) are women.

International Trade Centre estimates show that the Belarusian light industry has great potential to increase exports and improve competitiveness. It is quite competitive on cost, but its export is poorly diversified geographically, and has a weak adaptation effect.

Technological innovation presents a major opportunity for development of the export capacity. However, of total expenditures on innovations, 98.5% is on equipment, 0.07% on market research and 0.2% on workplace education. Nothing is spent on the acquisition and adoption of new technologies. At the same time, increased competition in the global market urgently requires the search for new markets, appropriate choice of marketing strategies, new methods to conduct trade (including e-commerce and the introduction of Internet Trading Systems), and new logistics and supply chain management practices.

2. The recipient of international assistance: Concern Bellegprom

Members of Bellegprom Group comprise 60% of the industry's workforce and contribute 80% of its output.

3. Aim and stages of the project

The aim is to promote exports of light industry products through ICT use and capacity building in commerce, exports and marketing.

The main objectives of the project are:

- Development and launch an electronic trading platform;
- Ensuring access of small and medium enterprises and businesses located in small towns and remote areas to the electronic trading system;
- Building capacity of Bellegprom group companies and individual enterprises in management of foreign trade, electronic commerce and marketing.

The target group of the project includes:

- Managers and specialists of the state concern, Bellegprom;
- Light industry enterprises, especially small and medium-sized and enterprises located in small towns, remote settlements.

Project stages

In stage 1, an Internet portal will be created, to be transformed into an electronic trading platform. At the initial stage, the ETP will be used for wholesale transactions. As the number of enterprises registered with the platform increases, it will expand to cover retail operations.

Specific activities in Component 1 include:

- 1.1. Design of the ETP, based on international best practices and customer expectations;
- 1.2. Commissioning of ETP (terms of reference, job descriptions, software and equipment, pre-testing and launch);
- 1.3. Implementation and regular monitoring of indicators (e.g. number of customers, sales volumes in the physical and monetary terms, the products range, and geographic diversification.
- 1.4. Information and advertising campaign (press conference, advertising and PR support, etc.).

Component 2 will improve the potential of electronic commerce, working in light industry of small and medium-sized enterprises, as well as firms located in remote areas and small towns.

This component provides the following activities:

2.1. Assessing the capacity and willingness of SMEs to conduct e-commerce (especially in the regions and small towns);

2.2. Support for web sites, training and staff development in e-commerce and web design.

Component 3 will strengthen the capacity of Bellegprom group firms, by helping them improve their trade and export strategies. Other light industry firms that are not a part of Bellegprom will also be invited to participate in the training workshops and activities, and will receive copies of all the project publications.

Specific activities include:

3.1. Developing training modules based on a needs assessment;

3.2. Conducting small group consultative sessions, short training courses, and study tours; advising senior business managers and professionals from "Bellegprom";

3.3. Conducting an international conference on improving trade and export strategies, and facilitating access to international production chains and distribution networks;

3.4. Publication of manuals on management of export activities.

4. Expected outcomes:

1. Creating a fully operational electronic trading platform, serving at least 85 Bellegprom Group firms.

2. Increasing the number of users and expanding geographical coverage of ETP.

3. Expanding opportunities for entry to foreign markets for small and medium enterprises, and enterprises located in small cities and district

centres (based on analysis of official statistics, exports).

4. Ninety percent of marketing and sales personnel will complete short workplace-based training courses.

5. Improving the competitiveness of Belarusian light industry firms, including small and medium enterprises; increasing exports in absolute terms and as a percentage of the total output.

5. Support for participation in international fairs.

As part of capacity-building activities the project will support participation of Belarusian light industry firms in international trade exhibitions to gather information about consumers and competitors, and to promote their products in foreign markets. Financial assistance will be provided for these purposes.

Specific international fairs to be attended include:

- Heimtextil (Frankfurt): home textiles;
- Techtexil (Frankfurt): Technical Textiles;
- CPD Dusseldorf (Dusseldorf): women's clothing and apparel;
- Texworld (Paris): textiles, fibres and yarns;
- Zoom by Fatex (Paris): features apparel manufacturers from Central and Eastern Europe, fulfilling orders from European and U.S. companies on processing terms;
- MICAM Shoevent-Exhibition of Footwear, Mipel: leather and leather products;
- Mifur: furs and skins.
- Modacalzado & Iberpiel: footwear and leather products;
- Home textile fabric sourcing: Home textile exhibition, international apparel sourcing show: textiles and clothing.

6. Total budget: US \$ 400,000

7. Duration: 30 months

5.2. Improving training and expertise of researchers and technicians working in the food industry and creating a network of certification laboratories to test food products for compliance with the EU food safety regulations.

1. Rationale

The food industry consists of three sub-industries: flavouring, meat and dairy, and fish production. There are around 800 enterprises, contributing 17.9% of industrial output in 2009. The food industry is also employs around 13% industrial workforce. Much of the output is exported. The export revenue enables most firms to remain cost-effective despite tight domestic price controls. Most food industry firms are highly successful in foreign markets. Competitive advantages include a high degree of diversification in the product range, and a positive adaptation effect. However, despite these advantages, most firms are de-facto dependent on one market, the Russian Federation. Recently, Russia has imposed import restrictions on Belarusian foods. In this situation, an urgent task for the Belarusian food industry is to diversify export markets, primarily to the EU countries. Because of its large size and geographical proximity, the EU market provides an excellent alternative. However, a number of problems remain to be addressed before this opportunity can be utilised. Of them, the absence of EU-compliant mechanisms for food safety certification and standardisation is the most important. One solution would be to improve training and expertise among employees of certification of laboratories, so that they could work in accordance with the standards. It is also necessary to build the expertise of technical staff employed by the food industry firms.

2. The recipient of international assistance: Belgospishcheprom, regional meat and dairy producer associations, Republican Unitary Enterprise "Institute of Meat and Dairy Industry".

To maximize involvement across the sub-sectors of food industry, a list of beneficiaries of technical assistance should be defined. Coordination among these sub-sectors will be the responsibility of various government agencies.

3. Goal and objectives

Goal: to diversify Belarusian food exports

Objectives:

1. Building capacity and expertise of laboratory employees on EU food safety standards and certification procedures;
2. Improving knowledge and expertise of technical personnel, enterprise managers and marketing departments in the area of EU food safety standards.

4. Methodology

The project's main activities will include training courses and seminars on some the following subjects:

Food security as an integral part of EU policy in the sphere of consumer protection and

- Health;
- EU legislation on food security: basic principles;
- Veterinary and phytosanitary legislation of the EU;
- Animal feed regulations
- Certification procedures and standards in the EU;
- Requirements for equipment certification lab;
- Studies in food safety assurance.

5. Expected outcomes

5.1. Food industry exports are compliant with the EU standards, exports are diversified to the EU markets, the diversification of their exports.

5.2. Increasing the contribution of the food industry to human development by promoting economic growth, increase employment, innovation, etc.

6. Budget

Funding for training courses on this topic (\$ US 150,000)

7. Duration: 30 months

5.3 Creating an Internet portal of the State Customs Committee of Belarus for electronic submission of notices of exports or imports

1. Rationale

The rapid increase in international goods shipments crossing the Belarusian border creates the objective need for new technologies and methods of customs administration. The framework standards promulgated by the World Customs Organization (WCO), establish two basic principles or “Pillars” of an effective national system of customs administration:

1. The interaction between the customs agencies of different countries.
2. The interaction between the customs agencies and participants in international trade.

There are four essential prerequisites to successful implementation of these principles:

- Preliminary information, use of electronic notices of international shipments of goods;
- Application of risk analysis and management;
- Selective customs control operations;
- A system of preferences for participants in international trade.

State Customs Committee of Belarus implements the principles and elements of the Framework at the national and international level. The greatest progress in this area has been made in partnership with the Customs Administration of the Russian Federation. In recent years, an effective system was put in place to monitor the movement goods across borders. The use of advance electronic notices of international goods shipments enables the customs agencies to:

- Create an enabling environment for carriers, primarily by reducing the time required for customs clearance formalities to several minutes;
- To minimise the threat of illegal activities by criminal groups to engage in illicit trade of various categories of goods;
- To introduce elements of risk analysis and management.

Customs authorities begin to organise a system of prior information in respect of goods imported

into the customs territory of the Republic of Belarus by road.

Implementation in the Republic of Belarus of the provisions of the Framework is fully possible without an effective system of interaction with the business community and customs administrations of other states. Moreover, this interaction should be based on the use of modern information technologies and be on the one hand, through the integration of various applications of information systems with each other, on the other – providing all interested parties the opportunity to provide electronic information to customs authorities, using Internet technologies, in the case absence of such persons and economically feasible to acquire and use specialised software is directly integrated with information systems of customs authorities.

In the framework of the Customs Union of the persons concerned are also entitled to provide preliminary information to customs authorities. However, the phased introduction of mandatory prior notification of customs authorities will carry out in 2012. In this connection, the customs authorities of the Republic of Belarus today there is a need for to start preparation for the launch of an advance notice system.

2. The recipient of international technical assistance: State Customs Committee of Belarus

3. Project objectives

1. Accelerate and simplify of customs formalities for participants in foreign trade;
2. Reduce the negative impact on the environmental and epidemiological situation in the border areas by reducing the time spent by vehicles at the checkpoints;
3. Implement the principles of selective customs control and the Framework Standards on Facilitating Global Trade;
4. Create a more enabling environment for foreign trade, provide customs authorities with advance information on goods shipment through safe data channels;
5. Design and commission an Internet portal of the State Customs Committee of Belarus to provide

interested persons the opportunity to submit an electronic advance notice of exports and imports, using of modern information technologies;

6. Improve and deepen coordination between businesses and customs;

7. Formulate prerequisites and technical solutions to ensure protection of goods across the customs border of Belarus, with the use of modern information technology.

8. Create conditions for further improvement and develop interaction between the business community and customs officers using electronic technology and electronic data interchange;

9. Formulate prerequisites and technical solutions to ensure integration with other similar information systems of customs services and interested parties.

4. Phases of the project

Phase 1. Preparatory phase:

Study the relevant experiences and practices from other countries, develop recommendations for Belarus;

Phase 2. Defining system requirements:

Define the technological and technical requirements for the system;

Phase 3. Implementation:

Software development;

Delivery (purchase) of equipment and system software required to deploy the system.

5. Types of assistance provided

1. Advisory support: seminar in the customs service of EU customs authorities of the Republic

of Belarus on the organisation of an electronic advance information, technologies, architectural and technical solutions in developing information systems based on Internet portal solutions;

2. Funding for software development (web portal);

3. Delivery (financing the purchase) of equipment and system software;

4. Commissioning.

6. Expected Results

Providing stakeholders the opportunity to report the preliminary information in electronic form and as a consequence, the acceleration of border crossing, resulting in the simplification of customs formalities and costs;

Creating an atmosphere of cooperation, mutual trust and ensuring the necessary transparency of foreign trade operations;

Providing a favourable effect on the environment along the roads and in the vicinity of crossing points and ecological environment as a whole by reducing the waiting time at the border, gassed areas, emissions from garbage and household waste, etc.;

Creating conditions for the minimisation of commercial fraud at the border, including through the use of risk analysis.

Expansion of the introduction and application of modern information technologies in customs operations and interaction with their help with the business community.

7. Main budget lines – 200 thousand US dollars.

8. Duration

12 months

Item of expenditure	Requested donor funding
1. Technical support	10.0
2. Software Development	90.0
3. Delivery of the equipment and system software	90.0
4. Commissioning	10.0
Total:	200.0

Bibliography

1. World Bank (2010). Belarus: Indicators of foreign trade and competitiveness. Analytical notes on economic policy. Analytical note No. 2. 25 June 2010.
2. Kolesnikova I., Tochitskaya I. (2008). Impact of direct foreign investments on trade and transfer of technologies in Belarus. AZ 07/2008. IPM research centre.
3. Kruk D. (2010). Impact of crisis on the perspectives of long term economic growth in Belarus. National competitiveness of Belarus, edited by I. Pelipas. - Minsk: "Belprint", pp. 159 - 199.
4. Kruk D., Tochitskaya I., Chimanovich G. (2009). Impact of the global economic recession on the Belarusian economy. IPM research centre working paper, WP/09/03.
5. ITC, UNCTAD, Map of competitiveness in trade <http://www.intracen.org/>
6. UNDP Regional Bureau for Europe and the CIS (2009). Trade and human development: how to assess the needs of trade development in countries in a transition period.
7. Chubrik A. (2005). 10 years of GDP growth in Belarus: factors and perspectives, *Ecovest*, 4, 3, pp. 454 - 474.
8. Chubrik A. (2007). GDP growth and population income in Belarus: who benefited from the economic growth. Growth for everyone? New challenges for the economy of Belarus/edited by Gaiduk K., Pelipas I., Chubrik A. - SPb.: Nevskiy prostor, pp. 48-78.
9. Blomstrom M., Kokko A. (1997). Regional Integration and Foreign Direct Investment: A Conceptual Framework and Three Cases, Policy Research Working Paper, World Bank, 1750.
10. Brada J.C., Mendez J.A. (1988). An Estimate of the Dynamic Effects of Economic Integration. *Review of Economics and Statistics*, 70, 1, pp. 163 - 168.
11. Chubrik et al. (2009). Social Protection and Social Inclusion in Belarus, Report for the European Commission, Directorate General for Employment, Social Affairs and Equal Opportunities.
12. De Melo M., Denizer C., Gelb A. and Tenev S. (1997). Circumstance and Choice: The Role of Initial Conditions and Policies in Transition Economies, World Bank Policy Research Working Paper, 1866.
13. Deardorf A. and R. Stern. (1997). "Measurement of Non-Tariff Barriers", OECD Economics Department Working Paper No.179, Paris, OECD.
14. Easterly W., Fischer S. (1995). The Soviet Economic Decline, *World Bank Economic Review*, 9, 3.
15. Hiau Looi Kee, Alessandro Nicita, Marcelo Olarreaga (2006). Estimating Trade Restrictiveness Indices. World Bank Policy Research Working Paper 3840.
16. Lipsey (2004). Home- and Host-Country Effects of Foreign Direct Investment. In: Baldwin R., Winters A. (Eds.). *Challenges to Globalization*, Chicago: University of Chicago Press.
17. Matthias Luecke, Georgeta Mincu (2010). Policy Options for Reducing Sector-Specific Risks of the Accession of Belarus to the WTO.

18. Maurice Schiff, Yanling Wang, Marcelo Olarreaga. (2002). Trade-Related Technology Diffusion and the Dynamics of North-South and South-South Integration, Policy Research Working Paper No. 2861, World Bank.
19. Pavel F., Tochitskaya I. (2005). The Implication of Belarus WTO Accession: General Equilibrium Modeling. Belarusian Economic Journal, No. 3.
20. Reinhart C., Rogoff K. (2010). Growth in a Time of Debt, American Economic Review, American Economic Association, Vol. 100(2), pp. 573-578.
21. UNCTAD (2009). Investment Policy Review: Republic of Belarus.
22. UNCTAD (2009). World Investment Report 2008. Transnational Corporation and Infrastructure Challenges.
23. World Bank (2004). Belarus: Poverty Assessment, World Bank Report No. 27431-BY, Europe and Central Asia Region Human Development Sector Unit.
24. Coe D.T., Helpman E. (1995). International R&D Spillovers, European Economic Review, 39, 5, pp. 859-887.

Copyright © UNDP Belarus 2011

All rights reserved

UNDP Office in Belarus
220050, Minsk, Kirov str., 17
Tel. +375 17 227 48 76
Fax: +375 17 226 03 40
www.undp.by

Cover Photos by:
Information and educational portal
Bymedia.net

Design and layout by:
Advertising studio «Zeppelin»

Edited by: Juliet Bruce

Printing by:
RUP «Minsktiproekt»

**UNDP Office
in Belarus**

17 Kirov Street, 220050 Minsk, Belarus

Tel.: +375 17 227 48 76

Fax: +375 17 226 03 40

www.undp.by