



New Challenges, New Solutions

Belarus remains committed to the socially oriented economic model

Nikolai SNOPOKOV,
Economy Minister of the Republic of Belarus

Belarus' current economic difficulties are temporary. Their impact will be slowly weakening as the national economy will be getting back on track.

Reasons Behind Economic Woes

This year the national economy faced new challenges. Coupled with the existing factors, they resulted in currency market instability, devaluation of the Belarusian ruble and high inflation.

The factors that had and will have a destabilizing effect on the Belarusian economy include:

- an ineffective sectoral structure of production that is dominated by energy and material-intensive industries and industries with antiquated technologies. In terms of material intensity the Belarusian economy is placed ninth out of 44 countries of Central and Eastern Europe. In terms of energy intensity of GDP we are 29th in the world (out of 130 countries on the list) outstripping even Russia with its colos-

In H1 2011, car imports to Belarus exceeded \$2 billion, contributing 45% to the country's trade deficit



sal reserves of raw materials. High-tech export accounts for merely 2 or 3% of total exports. The modernization of a number of industries over the last 10 years helped reduce the capital consumption, but the capital consumption remains high in a number of industries, including machine-building (56.6%), chemical and petrochemical industry (56.1%), fuel industry (54.1%), power engineering (51.4%), and agriculture (40.4%);

- heavy reliance on imports that make up 38% of Belarus' economy. This is attributed to the fact that for many decades Belarus was "an assembly shop" of the former Soviet Union, though the country did not abound in natural resources;

- social issues resulting from "the transformational shock" which dragged Belarus down to the 105th position in terms of life expectancy (according to the UN terminology, "life expectancy at birth").

To eliminate these fundamental disproportions the government had to invest considerably into the real production sector and the social development.



I would like to note that the Belarusian economy has been demonstrating robust growth in the recent decade and avoided a major recession during the crisis year of 2009.

At the same time, “the energy shock” caused by a sharp rise in energy prices was aggravated by contracted demand for Belarus-made goods abroad during the global financial and economic crisis. The government managed to prevent a drastic decline in living standards, shutdown of companies and massive layoffs by focusing on the domestic market. However, this required considerable resources, including external borrowing, which was highly detrimental for the country’s balance of payments.

The misbalances became even more pronounced in the early 2011 following an energy price hike in January (our country imports 100% of natural gas and over 90% of oil) and increased car import in Q1. The latter was triggered by a rise in car import duties from 1 July 2011 in line with Belarus’ Customs Union obligations.

Car import in June hit an all-time record of \$644.4 million. In H1, the figure exceeded \$2 billion, up three times over the same period a year before. Car import accounted for 60% of Belarus’ non-food imports. Over the six months 2011, it contributed 45% to the country’s trade deficit.

Due to these factors alone the import soared by \$3.5 billion (\$1.3 billion was spent on cars, \$0.7 billion on gas and \$1.5 billion on oil), which widened the gap in the foreign trade balance of the country.

The partial blame for the instability of the exchange rate goes to the mild monetary policy accompanied by significant credit expansion in 2009-2010. The policy was aimed to minimize the impact of the global financial and economic crisis on the Belarusian economy. A considerable increase in salaries and a consumption-stimulating budget policy triggered devaluation and inflation expectations. All these factors altogether exacerbated the situation on the domestic currency market.

In March 2011 the National Bank refrained from currency interven-



tions in order to preserve gold and foreign currency reserves. This gave rise to the multitude of exchange rates across various segments of the currency market.

The multitude of exchange rates threatens plans to enhance the competitiveness and innovation potential of the national economy, and the large-scale economic liberalization stipulated in Presidential Directive No. 4. If we put this issue on hold, we risk incurring even greater losses and will find it more difficult to come back to sustainable economic growth.

Therefore, in late August this year we decided to balance out the exchange rate. To this end, we held an extra trading session at the Belarusian Currency and Stock Exchange in mid September. The participants of the trading session could freely buy or sell US dollars, euro, Russian rubles and other currencies.

All those willing to buy or sell foreign currency will be able to do it at the currency exchange. The exchange rate will be shaped purely by the market; the government is not going to bolster the exchange rate. Belarus has opted for a clean float.

Floating Belarusian Ruble

At present, the world knows two approaches to the formation of the exchange rate. The first is based on a system of floating exchange rates. More and more countries favor this approach. However, there are those who stick to a fixed exchange rate policy. Overall, about one third of the countries around the globe use some variety of fixed exchange rates, while two thirds prefer floating exchange rates.

The floating exchange rates are used by the overwhelming majority of developed countries (except for the EU member states), and developing economies (Afghanistan, Bolivia, Costa Rica, Ethiopia, Ghana, Jamaica, etc) and economies in transition (Armenia, Azerbaijan, Kazakhstan, Kyrgyzstan, Moldova, Mongolia, Romania, Tajikistan, Ukraine, Uzbekistan, etc).

Experts believe that this option boasts a number of advantages.

First of all, the currency market knows better than the government what the exchange rate should be.

Secondly, the country gets more opportunities to pursue an economic

A sharp rise in energy prices in early 2011 aggravated Belarus’ economic misbalances



In mid September Belarus started a transition to the floating currency exchange rate

policy it wants, as floating exchange rates mitigate external shocks.

Thirdly, floating exchange rates are greatly beneficial for foreign trade, because they give a competitive edge to exporting companies.

Fourthly, floating exchange rates discourage speculative dealings with foreign currencies, because they lead to a win-lose situation when some profiteers will gain only if others lose.

At the same time, the transition to the floating exchange rate is associated with some risks. In particular, the floating exchange rate may propel inflation if it gets more flexible. This means that to minimize potential risks, we need a program combining a tough monetary and fiscal policy and structural economic reforms (these measures should be clear and consistent; they should provide clear-cut guidelines for both economic operators and households).

Therefore, we have come up with an action plan for the rest of 2011 and the year 2012 which should mark the start of a balanced economic growth.

The following targets have been prioritized:

- a structural balance of the economy by means of diminishing government's interference in the redistribution of financial flows. To this end, we will reduce emission of money for government programs and re-channel resources into high-tech and export-oriented projects;
- an internal economic balance by means of making salaries commensurate with labor efficiency, and via reducing material and energy intensity of production;
- a foreign economic balance by means of shifting a focus from the domestic market to the overseas market with export growing faster than import.

New Approaches to Government Programs

In the previous decade the national economy considerably expanded on the back of generous government injections made both directly via the budget and indirectly via bank loans to implement government programs. The

funds earmarked for government programs rose from 3% of GDP in 2005 to 25% of GDP in 2010.

Money emission was widely used to accommodate the increasing number of government programs, as Belarus' own economic resources were inadequate. That was aimed to tackle most pressing socio-economic issues, like technological backwardness caused by considerable capital consumption, and social issues that accumulated during the period of "the transformational shock".

However, we were not happy that investments grew faster than GDP, because the bulk of investments was made up by installation and construction works. Back in 2006 they accounted for 42% of capital investments, while in 2010 their share rose to 50.6%.

At the same time, the share of investments into machines and equipment went down from 47% in 2006 to 38.1% in 2010, the lowest over the last decade.

The accelerated economic growth was backed up by growing investments into traditional indus-



tries and an increase in household incomes by means of government programs. No wonder, the domestic demand grew faster than production. In 2000-2010 the country's real GDP doubled, while the domestic demand expanded threefold. The export soared 3.4 times, the import 4 times.

Thus, we need to revise our approaches to government programs, reduce the government regulation of the national economy and focus on most strategic projects.

At present, 98 government programs are implemented in Belarus; most of them are set to run in 2011-2015. The most capital intensive industries are agribusiness and construction. This year we have optimized and streamlined the current government programs. The Council of Ministers adopted Resolution No. 490 of 13 April 2011 "On financing government programs" to put a cap on bank loans for the agribusiness. The financing was cut by Br10.4 trillion.

Restrictions on funding of government programs are also envisaged in a memorandum signed by the Government, the National Bank of the Republic of Belarus and the Eurasian Development Bank. In accordance with the document, the Government is to ensure that in 2011 net credit extension for programs from government resources will not exceed 4% of GDP.

However, in order to prevent deterioration in living standards, all government social programs will remain a priority and will not be curtailed even at this time of fiscal austerity.

In particular, the Council of Ministers of the Republic of Belarus issued Resolution No.883 on 30 June 2011 "On some issues regarding housing programs in 2011" directing to allocate Br1,863.8 billion worth of additional credits to fulfill housing construction targets. The government will make sure that the cost of one square meter of new housing will not be revised upwards for citizens in need of better housing.

We should stop using emissions to fund government programs if we want to stabilize the economy, ensure a single exchange rate and continue sustainable social and economic development.

Supporting New Ideas

The majority of countries provide assistance to key industries. By the way, the newly industrialized countries that have significantly advanced in their development owe their economic success not only to improvements in market institutions but also to a well-balanced policy to support certain industries.

In Belarus state support is provided to individual enterprises to help them smooth out current financial problems.

This approach does not help concentrate public funds on the sectors and programs which are most important for the country's economy. Instead investments are diffused and become inefficient. In fact, government funds are channeled

Economy Ministry conducted an analysis which shows that in 2006-2008 a number of state-owned enterprises reduced the share of exports despite receiving more government financial assistance.

In 2011 the government issued Resolution No. 490 on 13 April 2011 to reduce subsidies to agricultural organizations for the purchase of industrial machinery and equipment for construction, renovation and modernization of production facilities in 2011-2015 from Br4,900 billion to Br2,200 billion. This, in fact, prompted the industry to intensify efforts to expand into new markets and increase exports.

The analysis also confirmed the need to change the terms of providing state support. The government support should be offered to



not only into enterprises that implement large investment projects or new technologies (it is in these cases that the money really works ensuring returns to the state), but often into poorly-performing and insolvent companies unable to achieve a break-even position even with the help of government funds.

Moreover, the existing mechanism of state support became an obstacle to improving competitiveness of domestic enterprises. The

those companies that have won the tenders to implement programs in the priority economic areas rather than to those in dire straits in order to help them address their current issues.

As part of the new proposals on the terms of provision of government support to industrial companies, the President signed Decree No. 231 on 6 June 2011 "On some measures to stimulate the growth of highly-efficient enterprises."

The first three-star hotel opened in the center of the resort town of Naroch. The hotel boasts comfortable rooms that can accommodate 99 people. The hotel was renovated in line with the government program to promote the Naroch recreation area in 2011-2015



This instrument spells out the mechanisms for providing government support to highly-efficient enterprises working in priority industries and cuts off access to this support for inefficient enterprises.

The decree is intended, on the one hand, to encourage companies to achieve high quality performance: increase value added, return on sales and share of innovative products, in other words, to improve their competitiveness. On the other hand, it creates an enabling economic environment for investment projects with high value added, which will contribute to the national economy growth, reduce its energy and material intensity.

Price Factor

The price hikes in the consumer market this year were primarily the result of monetary factors. Growing prices in foreign markets had a significant impact on inflation in Belarus. Belarus is an open economy, and therefore the rises in prices in global commodity market generate price hikes in the domestic market.

With a significant share of imports in production costs (59% on average in January-June 2011), companies compensate their increased costs by rising prices for their end-products. In the eight months from January to August 2011 prices for industrial goods were up by 67.0%

ucts and to prevent the commodity deficit in the domestic market, the Government adopted a series of prompt measures to stabilize the situation in the consumer market. For example, the Government expanded the list of socially important goods the prices for which are regulated, put a cap on trade margins from 12 to 30% on a large number of food products, and imposed restrictions on the export of certain goods. The Government is continuously monitoring the prices for food and non-food products, and also the activities of monopolist companies.

Taking into account the effort to optimize the economic conditions and the approaches spelled out in Directive No. 4, we understood that restrictive administrative measures to “freeze” prices at a time of their continued growth in the global market and ongoing problems in the currency market could have the opposite effect. They could badly affect financial positions of businesses, production and import of certain goods and create their deficits, increase shadow turnover and lead to other negative consequences. In this situation it is important to keep the consumer market manageable, and to prevent uncontrollable price growth.

It should be noted that the current problems are temporary, and their impact will be gradually weakening as the economic situation is getting back to normal, the Belarusian ruble exchange rate stabilizes, the multiple exchange rates are eliminated and foreign currency becomes available and the market is saturated. This will be achieved through coordinated policies in pricing and taxation, income and wages, antimonopoly regulation, the saturation of the consumer market, including by means of purchase and commodity interventions. The situation with prices will depend on how effectively these levers of economic processes are engaged.

Exports Should Exceed Imports

In January-July 2011 the deficit of foreign trade in goods and services (according to the balance of payments methodology) was \$2.65 billion.



Protos, Mogilev District, has installed a new Finnish line to produce welded beam fitted with the US-based Lincoln Electric equipment. The company was the first in Belarus to turn out this type of products boasting a high export potential

The lists of such companies will be approved by the Belarusian Government in consultation with the head of state. By the way, in 2011, 38 companies of various forms of ownership took advantage of this document.

I would like to emphasize that the decree would help create high-tech industries including those of V and VI technological paradigms that produce new-generation goods (with lower energy and material input), and implement technology to manufacture competitive products with high value added.

(9.1% in the same period in 2010).

The uncertainty in the currency market made importers include possible exchange rate risks into wholesale prices.

In addition to these factors, the retail prices in Belarus were affected by the increased demand for Belarusian products in the neighboring regions because of the wide gap in prices. This sparked panic buying on the domestic market and price hikes for regulated food items.

In order to contain price growth for food staples and non-food prod-



MADE IN BELARUS

**CARRYING WATER,
CARRYING OIL****Grodno Mechanical Plant and
MAZ have started joint production
of tank cars for transporting
drinkable water in Syria.**

The tank cars can carry six cubic meters of liquid commodity. They are mounted on MAZ four-wheel drive chassis. This will be the first joint project of the Grodno company with MAZ aimed to promote domestic products abroad.

The company's initial business was the manufacture of spare parts to chemical, compressor and pumping equipment. At present it produces cisterns, trailers and semitrailers for transportation and temporary storage of oil products, liquefied gases, food and aggressive liquids as well as multipurpose insulated tankers.

However, it should be noted that the positive trends in foreign trade that emerged in previous months are strengthening. Export growth began to exceed import growth. For the seven months the gap was 10.8%, and is expected to reach 16.4% at the year-end. At the same time in July this year, we had a foreign trade surplus, something we had not had in many years.

Excess growth of exports over imports is mainly due to two factors: the decline in domestic demand due to the changes in the national currency exchange rate and better sales prospects for our products in foreign markets. As a result, the Government expects a significant increase in the share of manufactured exports in total production, from 46.5% in 2010 to 60% in 2011. This will boost exports by at least \$4.6 billion compared with the previous year.

It is expected that at the year-end 2011 the volume of foreign trade will exceed the pre-crisis level of 2008 by 10% in terms of exports and by about 10% in terms of imports. As a

result, the year-end deficit of trade in goods is projected to drop to \$7-7.8 billion.

In the medium term, the Government will implement the National Export Promotion Program in 2011-2015. It is based on the measures to redress the structure of exports by reducing the share of primary commodities and increase the supply of high technology, innovative and sophisticated products. In general, we plan to radically change the situation and get the foreign trade in a surplus position.

It is clear that there are no painless scenarios of overcoming the present economic difficulties. The tight monetary and fiscal policies will slow down the economic growth. However, if we do not eliminate the accumulated imbalances in the economy, the country will have fewer levers to minimize risks in the future as most economists are rather pessimistic in their forecasts for the global economy development. ■



The Rudakovo greenhouse complex, Vitebsk District, has launched Belarus' first tomato sorting line with the capacity of 10 tonnes per hour. The line can sort vegetables by color and size. Trading outlets of Belarus and Russia have already expressed interest in Rudakovo tomatoes