

Belarusian Economy and the EU Cooperation Prospects

TURNING POINT

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The Belarusian economy's ability to begin transformation in the context of its possible future entry into the European Union

When we call something “a system” we do not always make sense. Sometimes it happens that “systems” are like the stars in the sky — a set of elements that form an integrated whole only in our imagination. But there are things that are interlinked, and if one element were missing, the whole structure would be incomplete and unable to perform the functions for which the individual parts were collected and organised.

Europe, an integrated whole of interdependent entities, shied away from the east for two centuries. Two decades ago, the process stopped and Europe began expanding eastward. The time has come to think about the territory on which a predominantly Belarusian population has lived for centuries. The territory may become the last element to return to the integrated whole. Can this branch, which was cut off long ago and put down new roots in foreign soil, be engrafted back on the mother tree?

In deliberating on this question, it would be useful to compare trends that have been observed in Belarus and elsewhere in Europe, and then extrapolate out to the fairly distant future, at least 20 years from now. If the reintegration of the country begins now, formal entry procedures are unlikely to be on the agenda earlier than in 20 years' time.

Let us see what Belarus and the EU have in common and what the country needs to change to become a member of the EU. Afterwards, let us esti-

mate the costs of the changes. And, finally, will our economy remain a single whole as a result of the transformation?

General

The Border. One thing that Belarus definitely has in common with the EU is the border (see Figure 1). Back in Soviet times, it was carefully equipped to make sure that “a fly will not fly over unnoticed.” But the Soviet-built infrastructure secured only the 399-kilometre Belarusian-Polish border. Lithuania and Latvia were quite open. Naturally, there are two development options for the border infrastructure— to dismantle the Soviet-built infrastructure or to build similar installations on the shared border with the Baltic countries.



Source: interenvirexperience.iatp.by

Figure 1. Belarus' shared border with the EU.

The latter option would cost a lot of money, as much as \$10,000 per linear metre if the infrastructure is to be up to the standard of the Belarusian-Polish border. Belarus has a 462-kilometre border with Lithuania and a 143-kilometre border with Latvia. Yet statements made by the Belarusian leader suggest that the government has chosen the costly option.

One fundamental question still lingers: Where is the border of Europe? I do not mean to question the delimitation and demarcation agreements and efforts of governments. What I mean is the functional edge of Europe as a

whole, beyond which life is absolutely different. We believe this is Belarus' eastern frontier.

Therefore, in the next 20 years the border infrastructure would have to be rebuilt in all directions. In the first place the interests of the Russia and the EU would have a stake, while our country would play an intermediary role at best. But this position has not yet been properly verbalised, discussed and included in economic and architectural plans. Customs and consignment warehouses, logistics centres, cargo terminals and gas storage depots have been erected without taking into consideration the fact that Europe's edge is somewhere between the River Bug and the Kuril Islands. It may be good that construction is making slow progress, as there will be an opportunity to do everything right technologically and economically, if the necessary institutional changes take place in the country.

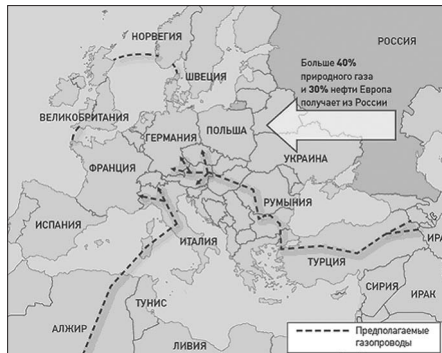
Supply Lines. The belligerent rhetoric and defence hysteria surrounding US and Russian military plans cannot stop international trade. Vilnius is located 215 kilometres from Minsk, Riga 470 kilometres and Warsaw 550 kilometres. Supply and communications lines run across the borders. Oil and gas pipelines play an especially important role at present (see Figure 2). Belarus also has pipelines on its territory, pumping \$100 billion to \$125 billion worth of oil and gas from Russia to Europe every year. One of the major pipelines is Yamal-Europe. The Europeans have plans for new supply routes, which are shown on the map below.

The reality is that Russia will have sold out all of its natural gas before 2033. It will not have enough cash for prospecting and building new supply lines. It has quite a dubious plan to build a new gas pipeline to link Russia and Germany via the Baltic Sea. It also plans to build an oil pipeline by-passing Belarus.

Reform of the gas pipeline system appears to have begun in Belarus, but the acquisition of a stake in Beltransgaz by the Russians has not made the system more technologically reliable, effective and convenient to operate, i.e. more similar to such facilities in Europe. The same is true of oil pipelines and refineries. There is not a big technological difference between the Navapolatsk and Mazyr-based refineries, operating as part of Slavneft. The Soviet-built Druzhba is still pumping oil, but it is unreliable.

The country's leadership is pinning its hopes for a revamp of the gas transport and distribution systems, and the necessary strategic investment, on the Russian middlemen swarming around Belarus. The Russians would take ad-

vantage of Belarus' huge debt (a debt surge is quite possible) to take control of oil and gas pipelines, storage depots, distribution facilities and refineries. They would do so with the only purpose of reselling the infrastructure to the highest bidder. And they will successfully resell it, because they have done so in the past on many occasions. The local nomenklatura still cannot figure out how to profit from these takeover deals. The opposition is working to figure out how to prevent it.



Source: *Izvestiya*, 15.11.08

Figure 2. Europe's plans to build new gas pipelines

Meanwhile, Asian exports would flow through Belarus. A reasonable solution would be to make the final consumer, not the supplier, responsible for reliable delivery. But that would be impossible without creating institutional conditions for the country's participation in an upgrade to Community Gas Ring standards of pipeline systems.

Land Routes. Highways and railroads account for a greater share of import and export flows to and from the European Union. In money terms, up to \$200 billion worth of goods are transported via land routes every year. Import-oriented shipments exceed exports because the former include goods consigned to the territory of the former Soviet Union and also Japan and China.

An examination of changes in Eastern Europe's night-time lights in the last 10 years (Figure 3) suggests that, along with the old major routes linking Saint Petersburg and Odessa (blue line), and Moscow and Warsaw (red line), a new land route, linking the southern city of Homel with the Baltic Seas ports (yel-

low line leading to Vilnius), is gaining more and more strategic importance. The role of railroads and highways is unlikely to diminish.

The main question for the next few decades is how to maintain the land transport infrastructure under conditions that ensure its interoperability within the European infrastructure. Obviously, the government already faces a shortage of money for this purpose. The quality of the transport network has been diminishing. If the trend continues for years to come, it may slow the integration of Belarus' land transport network into the European infrastructure.



Source: NOAA/NGDC — Earth Observation Group — Defense Meteorological Satellite Program,¹ Level of lighting: white — bright steady; yellow — usual steady; red — going brighter; blue — going dimmer.

Figure 3. Economic dynamics in Europe in 1998-2007.

Costs of the unnecessary

Collective farms. Collective farms are something that the EU definitely does not need. Certainly, things have changed and collective farms are no longer called collective farms. But the desperate state of Belarus' "agricultural enterprises" and their social organisation is incompatible with the concept of sound and rational management. The government has acknowledged the failure of its plan to boost the agriculture sector by building agro-towns and

¹See how to make and study comparative maps in: Elvidge C.D., Baugh K.E., Safranb J., Tuttle B.T., Howard A.T., Hayes P.J., Jantzenb J., Erwin E.H. Preliminary Results From Nighttime Lights Change Detection, NOAA National Geophysical Data Center, Boulder, Colorado 80305 USA; Cooperative Institute for Environmental Research, University of Colorado, Boulder, Colorado 80303 USA. www.isprs.org/commission8/workshop_urban/elvidge.pdf

establishing big exemplary farms. But it keeps defending its agricultural policies, claiming that Belarus is running neck and neck with the world's leading food producers.

What is the real state of affairs in the agriculture sector? It is very fragmented. Belarus' farmers work tiny plots of land. A survey conducted by the economy ministry found 13.9 percent of farmers owned plots of less than 0.06 hectare, 32.6 percent had plots between 0.06 and 0.2 hectare, 10.4 percent had plots between 0.2 and one hectare and only 0.6 percent were farming more than one hectare.

In the meantime, personal plots rank second among Belarusians' sources of income, followed by dachas. Personal plots and dachas are the main source of income for 40 and 30 percent of households, respectively. The percentages correlate with the populations of villages and small towns (Belarusian district centres cannot be considered urban settlements, by any stretch of the imagination) and the number of pensioners in the country.

General economic trends do have an effect on this sector of the economy. A third of Belarusian households live in villages and are engaged in subsistence farming, and close to half a million urban residents have dachas. One in four city residents help their relatives to cultivate their tiny plots.

Incidentally, the Belarusians have an enormous passion for farming and manual work. They are used to picking berries and mushrooms, cutting firewood, and digging clay and sand when possible.

At the beginning of 2008, Belarusians owned and used more than 1.5 million hectares for various purposes. An estimated six million people, out of a total population of ten million, dug potatoes during the 2008 harvest season. As the Belarusian saying goes, "We're gonna eat what we've harvested."

But what does subsistence farming have to do with the 21st century, industrialisation or information technology? Quite the contrary, the country has experienced a trend towards a deindustrialisation of the agricultural sector. The sector is plagued by fake subsidies and distorted prices. The average ratio of the Industrial Producer Price Index to the Agricultural Producer Price Index has been nine to eight in the last six years. This explains some of the government-reported agricultural output numbers for the government-controlled sector (Table 1).

Table 1. Some agricultural output indicators for 1990 and 2007

	1990	Average for 2000-2005	2007	2007 as % of 1990
Gross production of potatoes, thousand tons	8590	8436	8744	102
Cattle stock, thousand	6975	4030	4007	57
Cows	2362	1696	1459	62
Milk production, thousand tons	7457	3380	5909	79
Hog numbers, thousand	5051	3395	3598	71
Poultry numbers, million	50,6	26,2	29,4	58

Source: The National Statistics Committee of the Republic of Belarus

The sector will soon be hit by demographic and staffing problems. Fewer working-age men engage in food production. As many as 1.1 million men aged between 16 and 59 worked the fields in 1970, whereas now just over 700,000 do so. Life expectancy for men is 17 years shorter than for women in the rural areas, mainly because men drink themselves to death.

Noteworthy is the growing importance of dachas as a source of household income, against the backdrop of a certain decline in the role of personal plots. Stone-age technologies are used for growing 60 percent of “secondary,” by collective farm standards, crops, such as beans and turnips.

Non-locals find it hard to understand the role of collective farms in the social security system in the rural areas. If it were not for collective farms, there would be no one to take care of pensioners, children and other vulnerable groups. No one in Europe would be happy with a backward agricultural sector like this, and no one expects it to become part of the EU.

Meanwhile, the collective farm system is the last thing the government wants to change because agricultural reform is expensive and it may spark social tensions. Farms would need to sell off their harvest for three consecutive seasons, leaving nothing for their own consumption, to pay off their overdue debts. The government would do better to give up its Soviet-style megalomania in agriculture and fork out \$3 billion to \$4 billion for restructuring.

Planning System. The government-employed planning system is unlikely to bolster Belarus’ bid to return to Europe. One can hardly describe it as planning because forecasts are based on directives that the president gives to the nation and the government at unconstitutional People’s Assemblies.

Government agencies note his directives and use them as the basis for drafting presidential edicts.

The real needs of the people and industry are not essential. Feedback does not go directly to the representatives elected by the people or influence groups in government agencies, but to employees of ministerial secretariats. This breeds corruption and slows the information flow from the global market to enterprises, and from consumers to enterprises, converting their reactions into an awkward struggle for the distribution of resources.

As a result, the economy reacts to external signals with a delay. To eliminate the flaws, it will be necessary to spend between \$1.5 billion and \$2 billion on governance reform.

The Education and Social Security System. The Pension Fund and Healthcare. The Army and the Law Enforcement Agencies.

All these sectors fall short of European standards and the gap has been widening. Let us examine the two most critical sectors to save space.

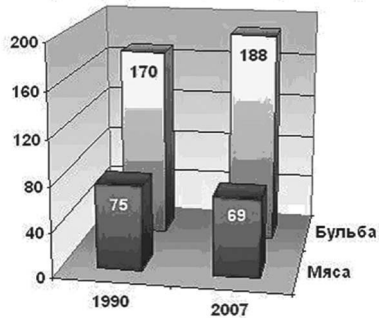
The healthcare system consists of two groups — those who need care and those who take care of them. What the Belarusians have come to notice is that both groups are miserable. Why?

I believe they have lost confidence in the future. Tens of thousands die because of drugs, alcohol, tobacco, gluttony, sexually transmitted diseases and suicides. Drinking water and food are contaminated with chemicals and radionuclides. The nation is getting older because of a low birth rate. In addition, one in three conceptions ends in an abortion. As many as 100,000 abortions were registered in the last two years, while only 200,000 children were born during the same period.

Frustrated parents are abandoning their infants. More than 30,000 children are being raised at the country's state-run orphanages. In rural areas, in one in ten families with children kids are not fed enough protein because their parents have boozed their brains out. The same often happens in cities.

We have gotten off the ground but have not reached the sky. That is why this nation is dying out.

Meanwhile, Lukashenka's aides are trying to serve us GDP instead of food, but even the official indicators weigh heavily on the propagandists (Figure 4).



Source: <http://belstat.gov.by>

Figure 4. Meat (red) and potato (yellow) consumption in 1990 and 2007 (kilogrammes per capita per year)

According to communist traditions, one should admit that “the complicated environmental situation and other factors” have a greater effect on people’s health than GDP, because diseases rise at the same rate as crop yields.

Good doctors advise people “to make it a habit to read the labels on food products carefully, to know exactly what you are eating,” given the lack of obstacles to junk food, whether made in Belarus or imported from all over the world.

Another excellent piece of advice is that children should be given the opportunity to do sports together with their parents at school gyms. Meanwhile, the average family spends much more money on cigarettes and liquor than on health. In the second quarter of 2008, spending on liquor jumped by nearly 30 percent.

It can be said that caring about one’s own health is not a function of GDP. Individuals take care of themselves when they have the will and awareness to do so. Will and awareness come with education. Education fully depends on one’s language, which stores the nation’s heritage, created over millennia. Primitive people without their own language do not understand the world around them, cannot stand this life and literally go mad. Not incidentally, the incidence of mental disease jumped by 34 percent during the last five years of economic boom. This is the highest rise among newly diagnosed diseases.

Successful farming in the territories contaminated with radioactive substances contributed also to a sharp rise in cardiovascular diseases (28 percent), malignant tumours (25 percent) and pregnancy complications (14 percent). Poor infants get sick twice as often as in 1990. Sad to say, but people can live even in worse conditions.

Meanwhile, a lack of will, awareness and confidence in the future of our godforsaken country is responsible for the rising suicide rate. Some 200,000 people are treated for alcoholism, while the rest of the 800,000 alcoholics think they are not sick and keep enjoying drinking. Every third person who perished in the battle for GDP was drunk to the point of incoherence. Officials reported that those who committed suicide during the six months of robust economic growth in 2008 include 1,075 people capable of working, nine legal minors and 329 retirees. As many as 2,030, including 85 boys and 69 girls, tried to kill themselves but failed. Despite the rise of agro-towns, rural men keep setting shocking records — more than 100 suicides for every 100,000 people. To better understand the number — this is 50 times the suicide rate in Armenia. Five suicides for 100,000 were registered in Tsarist Russia; and 30 in the Soviet Union.

On the other hand, as the government boasted, scavengers from prosecutors' offices have recently discovered flaws in the sector, although people have complained about these problems for years:

- 1) poor quality specialised care;**
- 2) disregard for professional ethics;**
- 3) disregard for sanitary standards;**
- 4) patient accommodation irregularities;**
- 5) violations of services-for-a-fee rules;**
- 6) failures to meet deadlines for the examination of complaints.**

How could it be different if the national staffing levels among doctors stood at 95 percent (70 percent in emergency hospitals), more than 6,000 doctors were over the retirement age, and only 80 percent of the 52,000 general practitioner positions were filled at the beginning of 2008? The sector is short of 34,000 employees. This is not surprising, considering the country's average doctor earns just 3,500 rubles (\$1.5) an hour, while the nation's average pay is 4,400 rubles per hour (\$2), and 5,100 rubles (\$2.3) in the manufacturing sector.

The government spent \$0.5 per person a day on healthcare this and last year. Healthcare funding was 19 times that level in the EU and 37 times that level in the United States. Belarus' health spending makes up less than five percent of GDP, while European nations believe that health costs more, allocating nine percent of GDP. In the United States, health expenditures account for 15 percent of that country's huge GDP.

Our bureaucrats know which side of their bread to butter, which is why they earmarked 1 trillion rubles for healthcare this year, and twice as much for their own protection, the police and the Committee for State Security (KGB).

It will be impossible to integrate into the EU with a flimsy healthcare system like this. Huge investment is needed to revamp the whole system, from institutional changes in the first place to moves towards free private enterprise and reliable targeted assistance.

Incidentally, a target-oriented approach is the main problem in all of the above-mentioned areas, not only healthcare, because the government still uses Soviet-style methods of tackling issues en masse. Specially designed for the era of militant communism, the approach does not work in a post-industrial society in the information age.

A low life expectancy and a high incidence of disease amongst working-age people (9-10 days of paid sick leave per person every year) cannot be tackled overnight. But capital investment is required immediately. It is expected to pay off within ten years.

Housing Construction. No matter how hard the president and government have tried, waiting lists for housing have not become shorter. A quarter of city residents and one in five villagers are in need of housing as before. Maybe it is because the government's declared desire to address the housing problem was not genuine (see Table 2). Housing credit programmes surged in the last two years. It is unclear why the surge occurred so late.

Table 2. Number of apartments built per 1.000 residents per year

1970	1980	1990	1999	2006
10	8	8	4	5

Source: The National Statistics Committee of the Republic of Belarus

Not by any stretch of imagination is it possible to spot an upward trend in these numbers. Given such "progress," the waiting lists should have expand-

ed. But that has not happened because of a decrease in the young population in the country.

I cannot even say that those who bought new apartments gained enough space for living. Belarus is at the bottom of the European countries' ranking in housing floor space per capita (Table 3).

Table 3. Housing indicators for some European countries

Country	Live together, people.	Floor space, sq M.	Floor space per capita sq m.
Belgium	2,6	201	77
Lithuania	2,9	112	39
Slovakia	3,3	109	33
Denmark	2,2	62	28
Poland	3,3	92	28
Belarus	2,8	69	25

The ranking is based on the average area of housing space per person living permanently in a certain apartment or home. Source data: <http://www.stat.gov.pl>, <http://www.worldbank.org>; and the author's calculations.

Officials have discussed several ideas of how to address the housing problem. One is to print money and offer credit. One of the results of such a policy worth mentioning in the historical perspective is currency depreciation. Another is to stimulate natural demand. With half a million households on the waiting list, real estate prices in Belarus have skyrocketed to reach the levels of major European capitals. Apartments will soon be cheaper in Brussels, a city swarming with highly-paid bureaucrats, than in Minsk.

Our own: A Turning point

They say aviation manuals include the rule concerning the point of no-return, after which the aircraft can not return because it has not enough fuel. Here is the question: What distance will Belarus cover in the next few years in the direction of Russia?

In the grand scheme of things, there are only two reasons why Belarus is leaning toward the East — energy and Lukashenka. Belarus is becoming more dependent on energy, not only because of its geographic location as a border

and transit nation, but also because of poor management. The latter is not only attributable to the fact that Belarusians say “A settled stone gathers moss,” whereas the Europeans say “A rolling stone gathers no moss.” The real reason is that industry and agriculture remain unreformed. It is hard to say when Belarus’ Soviet-style economy will get on the European track. Let us consider the comparative energy consumption numbers in Table 4.

Table 4. Primary energy consumption measured in kilogrammes of standard oil per \$1,000 of GDP (In 2000 prices)

Country, region	On purchasing power parity basis		
	1995	2000	2008
World	240	220	205
Belarus	700	510	420
Russia	670	590	470
EU-25	180	160	150

Computed on the basis of: Energy Balances of Non-OECD Countries, 2003-2004, 2006 Edition, OECD/IEA, Paris, 2006, pp.II.333-II.338

A troubling trend has persisted against the backdrop of rising exports of raw materials and a heavier reliance on raw materials processing. Imported fuel and energy has been used less efficiently. The country’s foreign trade is in deficit and the gap keeps widening.

Based on a scenario selected for this article, Belarus’ population will decline to 8 million by the time it applies for EU membership (Table 5)

Table 5. Description of the country’s socioeconomic state

	1990	1995	2000	2001	2002	2003	2004	2005	2006
Population at the end of the year, thousand people	10190	10177	9990	9951	9899	9849	9800	9751	9714

Source: The National Statistics Committee of the Republic of Belarus

In 1995, Belarus’ population fell by 463,000 people. Because of a high death rate among working-age men, the life expectancy gap between men and women has widened to 15 years. The main causes of death are cardiovascular diseases, which account for more than half of all cases. The labour market will

shrink after 2010, and again after 2030 because of the population decline in 1990 through 1995.

Table 6. The average number of people employed in the economy, thousand people

1990	1995	2000	2001	2002	2003	2004	2005	2006
5151	4410	4441	4417	4381	4339	4316	4350	4362

No shift has been observed in the employment structure towards more advanced sectors of the market. An estimated 300,000 people are permanently looking for work. The official number of unemployed persons stands at about 70,000. About 160,000 employees work part-time during an average year.

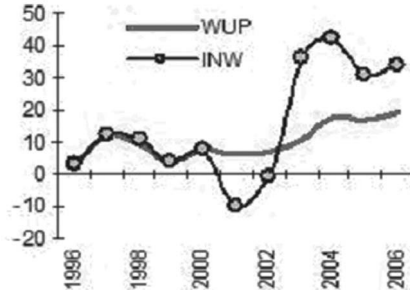


Figure 5. Investment rise in 1994 prices with 1995 = 100 percent.

Approximately 30,000 new jobs have been created every year, but this is half the required number, taking into account equipment depreciation and ageing. At least 250,000 people, registered by official statisticians as full-time employees, work abroad on a part time basis (an optimistic estimate based on reported numbers of Belarusians convicted abroad).

The government does not have evident fiscal problems because of a flawed process in the consideration and adoption of Budget Laws. Meanwhile, the taxation base has not shown a clear steady trend towards expansion. A quarter of the enterprises registered in the country cause the net budget losses. VAT levied from sales revenues accounts for the largest proportion of tax arrears, nearly 40 percent, and excise duties make up about 10 percent. Overdue debts account for 20 percent of enterprises' total debt - about 5 trillion

rubles for goods supplied on credit. Naturally, debts are likely to worry potential investors.

GDP growth has been real even if Gross Domestic Product is calculated in prices adjusted for inflation. After 2002, growth was propelled by a wide difference between the prices of imported crude oil and exported petroleum products, but the terms of foreign trade have worsened and therefore the short-term outlook is not optimistic.

The grandeur of accomplished public works projects — 1,500 religious buildings, ice hockey arenas, the Stalin Line of Defence memorial, agro-towns — has been out of proportion with reported expenditures because the government has blended economics with ideology.

Investment in fixed assets has been insufficient. Evidence for this is provided by a slowdown in productivity growth inconsistent with the reported surge in investment.

Figure 5 indicates that the government has reacted to the situation, but effects will manifest themselves no earlier than in three or four years if conditions are favourable. But conditions have somewhat deteriorated.

People see the comforting effects of Foreign Direct Investment (FDI) when new jobs are being created. It is better when jobs are created for highly-skilled workers. It is better still when one has to undertake additional training to be able to compete for a job.

This is why it is not as important to know the total amount of FDI as to trace the FDI flows to specific sectors. It is also essential to find out what kind of money it is — loans, equity investment, investment in equipment or in personnel skills.

FDI increased by 16 percent in Central and Eastern Europe last year. FDI flows markedly shifted eastward. The EU's new members saw their share shrink to 44 percent from 55 percent in 2006. The Balkan countries accounted for just ten percent, while as much as 47 percent went toward Belarus, Moldova, Russia and Ukraine, up from 35 percent in 2006 (Table 7).

The EU's new members are losing steam because privatisation is largely complete there, foreign multinationals have finished their takeovers of local markets and unit labour force costs are rising. Additional investments take place primarily within existing companies, by reinvesting profits.

The Baltic and Adriatic Sea countries saw investment flow into the real estate and business services sectors. It should be noted that Russia is eyeing similar sectors in Belarus (the Minsk City project, etc.). However, a major problem with this type of FDI is that it will not generate the exports which Belarus critically needs to correct its soaring foreign trade deficit. It should also be kept in mind that Russia plays a big role both as an investor and a receiver of FDI. Its share in the FDI inflow in the region rose from 17 percent in 2005 to 38 percent in 2007.

The rise is linked to Russia's dynamic consumer goods sector, favourable terms of trade in oil and other raw materials, and its buoyant financial sector. Incidentally, Belarus benefited indirectly from the FDI surge in Russia. However, Russia's unpredictable politics, from foreign investors' point of view, means that Ukraine and Belarus are more attractive investment destinations.

The region has been unsettled by a grim outlook for financial markets in late 2008 and early 2009. In my opinion, investment in non-manufacturing sectors may decrease, while FDI in export-oriented industries may grow because decreasing sales may prompt international corporations to channel their capital into new plants in countries with economically advantageous conditions. A Euro appreciating against the dollar may challenge the external competitiveness of European producers and they will turn their attention to Belarus.

Noteworthy are the discrepancies between forecasts made by the Vienna Institute for International Economic Studies (WIIW) in spring 2008 and data from the Ministry of Statistics and Analysis. The ministry reports a 44-percent year-on-year increase in FDI in the real sector (excluding banks) in the first six months, to €2 billion.

Regrettably, less than half of all investments flowed to the manufacturing sector, with loans accounting for 2/3 of the amount. It should be noted that portfolio investment has no effect on the country's economy, because of the underdeveloped stock market.

Russia accounted for about 30 percent of FDI, Switzerland for about 20 percent, the UK for about 14 percent and Austria about 10 percent.

The ministry's report indicates that the investment has been rising at a higher pace, but, obviously, drastic institutional and legislative changes are needed to make sure that it soars to the required level in per capita terms.

Table 7. FDI in Central and Eastern Europe (€ million, 2001–2007)

Country	2001	2002	2003	2004	2005	2006	2007	2008*
Albania	232	143	158	278	224	259	463	600
Bulgaria	903	980	1851	2736	3152	5961	6109	4500
Belarus	107	262	152	132	245	282	1293	300
Bosnia	133	282	338	567	478	564	1478	800
Hungary	4391	3185	1888	3633	6172	5428	4049	3500
Latvia	147	269	270	512	568	1326	1589	1100
Lithuania	499	772	160	623	826	1448	1412	1200
Macedonia	499	112	100	261	77	345	239	500
Moldova	116	89	65	121	159	193	335	200
Poland	6372	4371	4067	10453	8317	15198	12834	13000
Russia	3069	3660	7041	12422	10354	25979	38344	35000
Romania	1294	1212	1946	5183	5213	9060	7141	8000
Serbia	184	504	1204	777	1265	3504	2258	2000
Slovakia	1768	4397	1914	2441	1952	3324	2093	2000
Slovenia	412	1722	271	665	473	512	1073	500
Ukraine	884	734	1260	1380	6263	4467	7720	7000
Croatia	1468	1138	1762	950	1468	2738	3626	2800
Montenegro	5	76	44	53	393	644	1008	800
The Czech Republic	6296	9012	1863	4007	9374	4797	6674	6000
Estonia	603	307	822	775	2255	1341	1815	1200
Average in 20 countries	1469	1661	1359	2398	2961	4369	5078	4550

*WIIW forecast

Data:

	FDI in 2007 as %age of FDI in 2001-2007		Total FDI, million euros 2001-2007
Belarus	52	Russia	100869
Montenegro	45	Poland	61612
Bosnia	38	Czech Republic	42023
Russia	38	Romania	31049
Ukraine	34	Belarus	2473
Average in 20 countries	26	Average in 20 countries	14252

Source: WIIW Database on Foreign Direct Investment in Central, East and Southeast Europe, 2008

Let us take a look at Belarus' imports and exports. Both have soared in the last 14 years. At the same time, growing foreign trade has boosted traffic capacity in the channels through which the country imports problems from its neighbours. The demand for Belarus' goods has decreased and prices for imported goods have changed.

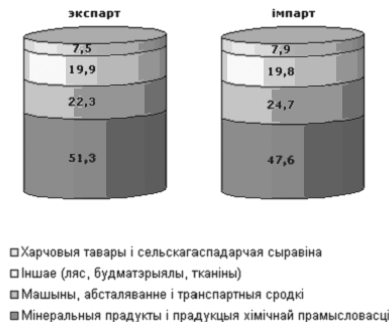
Table 8. Key foreign trade indicators (US\$ million)

	1995	2000	2005	2007
Exports of goods, including to:	4803	7326	15979	24275
Russia	2185	3710	5716	8879
West	1776	2927	8919	13054
Imports of goods, including from:	5564	8646	16708	28693
Russia	2965	5605	10118	17205
West	1887	2576	5566	9677

Source: The National Statistics Committee of the Republic of Belarus

Table 8 shows that trends radically changed the direction in the middle of the period, after the 1997-1998 financial crisis, — exports to the West skyrocketed, surpassing exports to Russia, while imports from Russia also rose dramatically. These trends are linked to prices for crude oil and fertilisers.

As prices kept rising, the commodity structure of exports (Table 9) began to change and additional foreign currency revenues flowed in, helping the government to address some of its internal issues. The rising foreign currency revenues from external trade, the inflow of cash earned abroad by migrant workers (an estimated 250,000 Belarusians have worked abroad full time in each of the last five years) and a foreign debt increase (Table 13) enabled the National Bank of Belarus to keep the national currency steady against the dollar and build up foreign exchange reserves (see <http://www.nbrb.by/statistics>).

Table 9. The commodity structure of exports and imports in 2007 as a percentage of the total

Right — exports; Left — imports

Boxes from the top down: Food and agricultural produce; other (timber, building materials and textiles); machines, equipment and vehicles; mineral and chemical industry products.

Source: The National Statistics Committee of the Republic of Belarus

The disappearance of the above-mentioned factors will lead to various consequences. Therefore, the main question connected with the crisis for this country is to identify a general direction based on expected changes. Let us start with oil, petroleum products, potash fertilisers, natural gas and the major internal market indicators such the demand for housing, brand-new vehicles and computers (Tables 10 and 12).

Tables 10. Some import and export indicators in physical terms

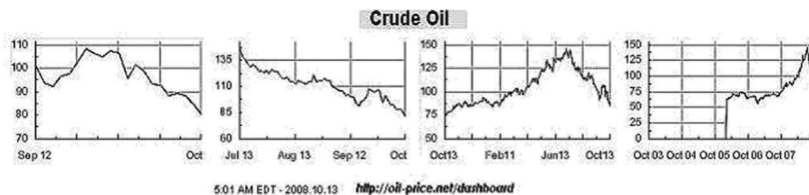
	2000	2005	2007
Crude oil imports, million tons	11.9	19.2	20.0
Petroleum exports, million tons	7.8	13.5	15.1
Natural gas imports, billion cu metres	17.1	20.1	20.6
Potash exports, thousand tons	2840.2	4288.7	4354.0
Car imports, thousand cars	57.7	131.3	180.4
Computer imports, thousand computers	1001.6	738.1	1747.4

Source: The National Statistics Committee of the Republic of Belarus

All the selected indicators have been rising. It is important to note a steady domestic demand for imported oil and a rise in the consumption of natural gas to what appears to be an upper limit.

Petroleum products accounted for more than half of Belarusian exports (Table 9). Oil prices have been falling as a result of the crisis (Table 11). Prices are decreasing amidst a shrinking demand for petroleum products. The country will import less oil and export less petroleum (it should be noted that Russia will claim a greater share of the petroleum export duty).

Table 11. Crude oil prices in the previous month, quarter, year and five years



These trends are obviously not favourable for Belarus. That natural gas will be cheaper following an oil slump is not a big relief, because, as the foreign trade gap narrows, the country will lose its competitive edge, which is di-

rectly proportional to the difference between the average price of gas in Europe and the discounted price paid at the Belarusian border. Gazprom's poor financial position also does not inspire hope for relief. The nation will not be able to substantially change its fuel consumption pattern over a short period of time.

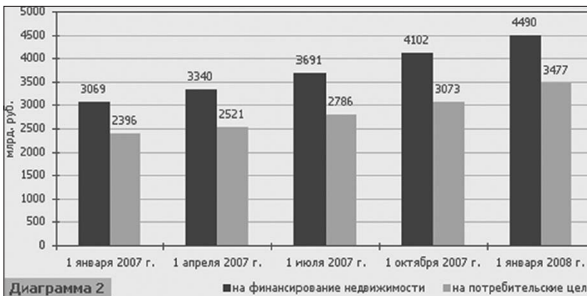
Hopefully, potash fertiliser consumers in India, China, Brazil, the United States and Poland will remain solvent.

As for the so-called "authoritarian modernisation," it is a product of the imagination of the Lukashenka propaganda apparatus. During the crisis, it would be possible to increase sales of the products of Belarus' barely competitive equipment manufacturing industry, but only in the former Soviet republics and through barter transactions. A major setback for Belarusian enterprises will be the likely launch in Russia of plants that manufacture the same products but use more advanced technologies.

Incidentally, the crisis has triggered layoffs in all the neighbouring countries. As a result, a workforce shortage was eliminated in Belarus' construction industry. The inflow of money from migrant workers slowed down.

Meanwhile, Belarusians are on a spending spree as they have become used to a better quality of life. The consumption boom was fuelled by the banking sector as the credit market expanded for six years. The borrowers, mostly persons aged between 20 and 50, were in the red by more than 10 trillion rubles (approximately nine percent of GDP in 2007) in mid 2008.

Table 12. Commercial bank loans to households



(In billions of rubles). Data for 1 January 2007, 1 April 2007, 1 July 2007, 1 October 2007 and 1 January 2008. Navy blue: the real estate market; light blue: loans provided for the purchase of consumer goods.

Table 13. The gross foreign debt of the Republic of Belarus in 2003-2007 (US\$ million)

	01.01.04	01.01.05	01.01.06	01.01.07	01.01.08
Gross foreign debt	4,174.9	4,935.4	5,128.2	6,844.1	12,493.5
Governmental agencies	343.9	492.1	606.8	589.0	2,036.3
Banks	400.7	625.8	948.3	1,486.7	2,570.8
and other sectors	2,853.6	3,402.5	3,219.1	4,368.0	6,782.0
Direct investment:	293.0	338.2	353.3	399.7	508.2
Loans among companies					

Source: the National Bank of the Republic of Belarus

The government, commercial banks and enterprises have fallen deeper into debt. Given considerable debts amassed by the latter, short-term liabilities create risks for the manufacturing sector. The foreign debt totals nearly \$15 billion and is still rising.

The government declared a plan to borrow an additional \$4 billion from Russia and the International Monetary Fund (IMF), which corresponds to the country's foreign trade deficit at the end of the year. It should be noted that the debt changed according to a well-known pattern of growth on the basis of discreet and limited resources. In particular, it reached a point where the debt growth and contraction process can no longer be regarded as linear. Calculations suggest that with the current pace of growth, the foreign debt will range between \$17 billion and \$20 billion at the end of 2009, because loans will only be approved for debt restructuring. If a steady increase continues, cyclical fluctuations may turn into a chaotic mess.

State and private sector borrowers adjust their liabilities and payment discipline in proportion to the money supplied by banks, based on market changes.

The government took urgent measures in response to the crisis (see below, selected data from the National Bank of the Republic of Belarus). One of the steps in this direction was the president's decision to fully guarantee all bank deposits.

Table 14. Data indicative of action in response to the crisis Bullion prices for precious metals (rubles)

Date	Gold (1g)	Silver (1g)	Platinum (1g)	Palladium (1g)
01.08.2008	61,986	1,164	119,146	25,691
01.11.2008	49,654	633	53,846	13,359

Refinance rate

Effective from	Base refinance interest rate, % per annum
2008	
15.10.2008	10.75
13.08.2008	10.5
01.07.2008	10.25

Ruble exchange rate

	August 1	October 1
US dollar	2123	2114
Euro	3301	2691

Source: The National Bank of the Republic of Belarus

Ruble deposits rose by 26 percent, or nine trillion rubles, in the first nine months to October 2008. Hard currency deposits reportedly increased by \$2 billion. The urgent measures adopted helped curb the surging demand for foreign cash, although in some sectors, demand is ten times higher than the supply.

In this situation, banks are seeking to create a “safety cushion.” In September alone, the National Bank’s gold and foreign exchange reserves plunged by \$700 million to \$4.9 billion.

The government has an effective set of tools to alleviate the effects of the global economic crisis:

- 1) privatisation of state enterprises (although their price will go down);
- 2) economic liberalisation (the government has declared its intention to liberalise the economy, but has taken few real steps so far);
- 3) agricultural reform (aimed to stir up social and economic activity);
- 4) ruble devaluation (the government sees this as a last resort measure).

The Belarusian leader’s long-term goals and priorities. Alyaksandr Lukashenka urged his government to achieve the following mid-term objectives: boost exports and food production, and build more houses. He expects the government to maintain public sector domination over the private sector, and keep adopting budgets oriented toward social needs.

Among factors that may contribute to success, Lukashenka mentioned 1) a higher solvent demand and the expansion of Belarus’ share in foreign mar-

kets; 2) innovation; 3) the streamlining of government administration and management system; 4) the diversification of foreign suppliers of raw materials; and 5) continuing integration with Russia.

Conclusions

Official statistical data do not provide a full picture of long-term economic trends in Belarus because structural defects generate factors beyond the limits of the economy. Methods employed by the government to manage the economy enable it to manipulate resources, regardless of ownership. Inventories do not directly depend on the internal and external demand, and deviations increase. Russia remains the major market for Belarusian goods but it has become less reliable as both investor and consumer. The type of relationship established with Russia helps the government to delay restructuring and distorts conventional market signals. Unwelcome trends in relations with Russia force the government to take more unconsidered steps and tighten policies.

Forecast. Resources of extensive growth, on which the government has relied from 1995 until the present, are becoming exhausted for the following reasons:

- 1) Enterprises need more loans, while internal and external credit is now more expensive;
- 2) The price gap impairs the interoperability of agriculture and industry, while a global market uncertainty casts doubt on steady export growth;
- 3) Belarus' dependence on Russia for energy will increase;
- 4) The defence industry and industries that supply it with components will remain heavily dependent on Russian interests;
- 5) The shadow sector will expand and economic crime will rise because people are not in a mood to reduce their consumption;
- 6) With time, Belarus' output will become less and less compatible with the output of developed countries.

What alternatives are realistically possible?

Foreign businesses crop up, lured by Belarus' "constructive offers" and intellectual potential, on concessions-in-exchange-for-markets terms.

The government offers tax breaks only to companies offering environmentally friendly technology-intensive projects.

What are the possible adverse consequences?

Officials are already fighting with each other for the right to distribute and use foreign loans.

The living standards have risen temporarily, but considerable numbers have not earned a better living.

Foreign loans mainly go towards the overproduction of unnecessary goods.

The country is growing dependent on foreign loans.

The following conclusions can be drawn from what has been said above:

- 1) Energy is the root of all problems;
- 2) Europe is battling for future energy prospects using legal tools; Russia employs financial and bullying tools; while Belarus relies on ideological and political tools;
- 3) Transformation in Belarus is quite possible and it would benefit Europe;
- 4) In five years, if current trends continue unabated, Belarus will only be able to integrate with what will be left of Russia at the time.