wiiw

Wiener Institut für Internationale Wirtschaftsvergleiche

The Vienna Institute for International Economic Studies

www.wiiw.ac.at

The Belarus Economy: The Challenges of Stalled Reforms

Presentation Minsk, 21 December 2016

Rumen Dobrinsky

Senior Research Associate, wiiw

wiiw

The Vienna Institute for International Economic Studies

- A leading European economic think-tank and research institute
- Analytical focus on CEE
- Economic research on economic restructuring in Europe; international trade; labour markets; etc.
- Twice a year produces Forecast Reports covering 22 CEE countries including Russia, Ukraine, Kazakhstan and recently Belarus.
- Occasionally produces special country reports (In 2015 it published a report on Ukraine: *How to Stabilise the Economy of Ukraine*)

Why Belarus in 2016?

- There is not enough information about Belarus in the outside world.
- Available publications often presents a distorted picture of the country and its economy.
- For 20 years the Belarus economy has been presented as «unsustainable» - can something which is unsustainable last for decades?

What is the purpose of this volume?

- An attempt to fill some gaps in understanding economic and political transformation in Belarus
- An attempt to provide an objective and independent analytical picture of the Belarus economy
- Mostly oriented towards the international readers: economists, policy makers, business people, wider public
- An unprejudiced look, partly coming from the outside could be useful for local experts as well
- It is NOT aimed at policy advice or recommendations; the main focus is on economic diagnosis; remedy policies are in the hands of local policy makers

The issue of “soft budget constraints”

- Formulated by Hungarian economist Janos Kornai to illuminate economic behavior in socialist economies
- Applied to SOEs: SBC indicates that the state is ready to act as lender of last resort in financial distress, rescuing SOEs from bankruptcy
- SOEs fall into financial distress due to inefficiencies and/or bad management: remedy is restructuring or privatization
- SOEs are rescued for purely political considerations, in the first place to preserve the jobs
- Rescue lending can take various forms: direct budgetary subsidies, budgetary credit, credit from state-owned banks, recapitalization of the firms

The issue of "soft budget constraints" (contd.)

- SBCs and financial rescue cushion firms from needed restructuring; but in the absence of change eventually these firms will fall into financial distress again
- This is in contrast to the "hard budget constraints" in which private firms operate: lasting financial distress results in bankruptcy and exit from the market
- The losses generated by SOEs form "quasi fiscal deficit": although they are not part of the open fiscal deficit they constitute contingent fiscal liability of the state
- With time, the quasi fiscal deficit gradually translates into open fiscal deficit and growing public debt

"Financial black holes"

- Loss-making SOEs under SBCs act as "**financial black holes**": they suck irreversibly public financial resources which sooner or later generate macroeconomic instability
- If the economy continuously generates large quasi fiscal deficit, this leads to macroeconomic destabilization and crisis. This did happen in some TEs during the 1990s
- The issue of SBCs was widely debated in the CEE countries in 1990s as all of them inherited a large and inefficient state-owned sector of the economy
- The policy intention to prevent such crises was one of the arguments for speedy privatization: transferring the responsibility of firm restructuring to the private investors.

"Soft budget constraints" in Belarus

- SBCs are a pervasive issue and problem in Belarus!
- Many BY SOEs are inefficient under market conditions and persistently generate losses but perform under SBCs
- The Belarusian state has been interfering in similar ways: directed lending; lending by state-owned banks; recapitalization of financially distressed firms, etc.
- In consequence some state-owned banks also fall in financial distress - but they also under SBCs
- The BY state also rescues banks: extraordinary refinancing by the NBRB, or recapitalization of the banks

"Soft budget constraints" in Belarus (contd.)

- Such operations are equivalent to the recognition of extra fiscal deficits (QFD is transformed into open FD) **=>**
- Extraordinary lending by the central bank if equivalent to the monetization of this deficit (money creation) **=>**
- Excessive money creation translates into high inflation and weakening of the currency
- This mechanism is one of the root causes of persistently high inflation and macroeconomic turbulence in BY (including three episodes of currency crises).
- It will be difficult to stabilize the Belarus economy without eliminating or at least reducing the existing "**financial black holes**"

The sustainability of the Belarus economy

- We divide this issue into two separate aspects: 1) the sustainability of the Belarusian economic model as such; 2) the sustainability of the macroeconomic policy course.
- The BY economic model is a variation of “state capitalism”: part of the economy is under state ownership.
- Experiences of other countries suggest that such a model can be successful and generate good economic results
- There are no obvious arguments to assert that this type of model would not be sustainable in Belarus

The sustainability of the Belarus economy (contd.)

- But: state capitalism assumes a level playing for all economic actors, i.e. state-owned firms should operate under hard budget constraints just like private firms
- This is a prerequisite for the state-owned sector to be efficient and compete successfully on the market.
- There is still more “state” than “capitalism” in Belarus economy as the latter still largely operates under SBCs
- The BY economic model can be regarded as sustainable provided SBCs are reduced and gradually eliminated
- For this to happen, it would be necessary to undertake reforms in the direction “more capitalism – less state”.

Thank you!

dobrinsky@wiiw.ac.at