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The impact of the global financial crisis on Belarusian economy

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1 Introduction

The global financial crisis is affecting the whole world. Not only the developed countries, but increasingly emerging economies and least developed countries are suffering the effects of this global financial crisis. Financial markets have collapsed, lending and investments opportunities are declining and exports are falling as demand decreases. In addition, developing countries, facing already higher food and energy prices, lack the means and resources to protect their financial institutions or banks from bankruptcy. The results are falling stock markets, rising interest rates, and less government resources for socio-economic investments that benefit the poor.

Every country of the world tries to do everything possible to go out from this crisis with fewer losses. Around the globe, policy makers have already reacted strongly in several ways in the hope of avoiding a recession in their countries: while central banks have cut interest rates, finance ministries have adopted fiscal policy measures such as tax cuts to support their economies. Addressing the dampening impact of the crisis on international trade and investment to restore growth, and reviewing development policies and partnerships to create sustainable practices and greater resilience to future shocks, must be key priorities in the multilateral agenda.

The Republic of Belarus was also being hit hard through capital reversals, rising borrowing costs, collapsing world trade and commodity prices, and subsiding remittance flows. Comparison of the country's previous economic performance illustrates the negative impact of the crisis. A decrease of external demand hit Belarusian industry and increased external imbalances, while the fall of energy prices and deterioration of enterprises deteriorated government revenues. All of these factors unveiled structural problems that required appropriate action. This paper tries to assess these risks and the associated policy implications both in the short and the longer term.

The purpose of this report is to provide an early assessment of the economic crisis and its effects on Belarusian trade in goods and investment, particularly from a development perspective.

The paper presents the analyse of global crisis impact on Belarusian economy and gives some policy recommendations for further development. Part 1 gives an overview of the macroeconomic development of the Republic of Belarus with a comparison of other CIS countries in terms of financial crisis. This analysis is based upon the data of Interstate Statistical Committee of the Commonwealth of Independent States and summarizes some potential risks.

In other parts of this paper the impact of global crisis on trade and financial flows of Belarus, the privatisation process as a key factor of economic development are analyzed. In all parts of the research the role of the state in promoting development and building a new consensus on sound and suitable strategies at the national, regional and global level is shown.

Part 2 discusses the decline in goods traded as a consequence of the crisis. Part 3 assesses the impact on external borrowing of Belarus and FDI, including FDI inflows into Belarus. Regarding financial integration, starting from a low level, over the last couple of years the country became a more active borrower on international markets and attracted more FDI. A major challenge for Belarus is to continue to attract foreign investment during the crisis to stimulate economic activities, especially for such investment that serves long-term development goals and enhances competitiveness.

Using the analytical framework established in part 2, parts 3 and 4 identify potential future risks for Belarus in the short term, conclusions and provide some more long term-oriented policy recommendations for the Belarusian authorities are given in the final part of this report. In particular, we focus on the structure of trade and capital inflows, as a way for reducing the potential negative effects of the crisis on Belarus.

2 Belarus among other CIS countries during the global financial crisis

The global crisis is having a profound impact on all regions in the world, including the CIS countries. However, the extent and timing of the effects differ depending on structural characteristics and policy responses of the countries. In addressing the crisis, policy makers in the region face significant challenges in order to ensure economic stability and sustainable development. Additionally, all countries are expected to experience recessions in 2009.

The impact of world financial crisis can be characterized in the form of a complex of the various external shocks which have sharply shaken local economy. A sudden stop of crediting, falling of the raw prices and a collapse of labour markets – here three main problems which CIS countries have faced. However sensitivity of every country to this or that shock is different. So, two most typical parameters for each type of a shock have been chosen. Such indicators as "External debt/GDP, %" and "External debt/International reserves" are chosen for definition of susceptibility to external financing shock; "Export/GDP, %" and "Raw materials/export, %" - to a shock from falling of raw export; "Remittances of labour migrants/GDP, %" and "Unemployment rate, %" - to a shock of labour markets. The maximum limits of the given indicators are also defined. It helped to show the susceptibility (low, moderated or high) to this or that shock of the CIS countries (table1).

Table 1 Some macroeconomic indicators of the CIS countries (on 01.01.2009)

	External debt/ GDP,%	External debt/ international reserves, %	Export/ GDP, %	Raw materials/ export, %	Remittances of labour migrants/ GDP, %	Unemployment rate, %
Russia	40	140	27,5	93	0,3	3,2
Ukraine	90	360	37	50,1	3,9	3,6
Belarus	32	400	72	35,6	0,8	0,8
Kazakhstan	102	540	51	82,8	0,2	1,6
Moldova	75,1	253	27,6	6	38,3	3,1
Georgia	20,4	131	20	23,1	6,8	7,3
Armenia	23,3	176	27	24,9	13,5	6,7
Azerbaijan	18.6	130	64	90,5	4,4	1,9
Turkmenistan	5	5	78	81,4	3	6,7
Tajikistan	40	1400	11	59.3	45,5	2,5
Uzbekistan	17,5	60	36	49	8	1,8
Kyrgyzstan	65	200	58	28,7	19	3,6

Source: data of the World bank, IMF, the European bank of reconstruction and development, statistical services of the CIS countries

The note to the table:
Susceptibility to a shock from external financing
Low – International reserves completely cover an external debt
Moderated - the external debt does not exceed 50% GDP and 250 % International reserves
High - the external debt exceeds 50% GDP and 250 % International reserves

Susceptibility to a shock from falling of raw export
Low – the share of export doesn't exceed 25 % GDP, the raw materials share in export doesn't exceed 25 %
Moderated – the export share makes from 25 to 50 % GDP, raw materials share in export - from 25 to 50 %
High - the export share exceeds 50 % GDP, the raw materials share in export exceeds 50 %

Susceptibility to a shock of labour markets
Low – the share of remittances of labour migrants less than 5 % GDP, unemployment rate – less than 5 %
Moderated – the share of remittances of labour migrants makes 5-20 % GDP, unemployment rate – 5 - 10 %
High – the share of remittances of labour migrants exceeds 20 % GDP, unemployment rate – above 10 %.

The first and most significant external shock is so-called «sudden stop» - a stop of crediting of economies of CIS countries by foreign banks. In these conditions companies with big debts lose access to external resources and are compelled to repay the saved up loans from own capital, to use the national credit market or to resort to the help of the state.

Very painful «sudden stop» shock has tested the economies saved up the big debts and having long-term deficit of trading balance. Kazakhstan has felt the given shock a year earlier, than other CIS countries. In August, 2007 the stop of crediting by foreign banks has led to classical symptoms of financial crisis: credit compression, sharp decrease of

GDP growth and powerful speculative attack to national currency. The National bank of Kazakhstan had to support a tenge rate selling of international reserves. About a quarter of all gold and exchange currency reserves of the state have been spent. The tenge rate has quickly returned to normal level. However in modern conditions to cope with this problem with the same ease it will not turn out any more.

In Ukraine where the external debt is almost equal to the size of GDP, «sudden stop» is felt also rather painfully. The shock was heavy for Moldova, Tajikistan, Kyrgyzstan and Belarus. The external debt of Belarus exceeds its international reserves almost in 5 times. However, in Tajikistan the debt exceeds international reserves in 14 times. Besides, import of the goods to the given countries considerably exceeds export. It means that to repay external credits and to pay for import of the goods at the same time will be extremely difficult.

As a result National bank of Belarus on January 1, 2009 devaluated the Belarusian ruble on 20 %. Step-by-step decrease in BYR against USD exchange rate did not exceed 2.5%, BYR strengthened by 2.8% and 12.2% against EUR and RUB respectively.

Since the summer of 2008, nominal exchange rates have depreciated in Russia (by one third), Ukraine (by more than 40 %) and Armenia (by one quarter).

The second type of an external shock is sharp reduction of export gain because of a collapse of the export prices. The prices for oil and iron have fallen more than in 3 times since August, 2008. Coal began to cost less by 4.5 times. Inevitable drop of industrial production has lowered also demand for some kinds of raw materials, first of all on metals that have even more strongly hit on raw economies. As a result, national budgets and the enterprises have not received in addition incomes not only because of a collapse of the prices, but also because of reduction of physical volumes of export.

The fallen prices on metals and hydrocarbonic raw materials have struck most painfully across Ukraine, Russia, Kazakhstan, Azerbaijan and Turkmenistan. So, basic export article of trading balance of Ukraine is trade in metal. Simultaneous reduction of prices and volume of exported production leads to practically full paralysis of sector and to an excessive warp in trading balance. Besides, sharp reduction in demand for the given goods has led to “hryvnia” exchange rate falling, unemployment growth, a collapse of industrial production and economy recession.

From four largest economy of the states CIS — Russia, Ukraine, Kazakhstan and Belarus - a situation in Ukraine is the heaviest. The political disorders, the increased cost of energy carriers, a collapse of the export prices for metals - all it does not give optimistical forecasts on stabilisation of position in nearest future.

In Belarus negative tendencies in the foreign trade were determined by both unfavorable dynamics of prices and physical volumes. In January-June 2009 average export prices dropped by 32.4%, while those of imports by 22.1%. Physical volume of exports dropped by 47.7%, while those of imports by 33.4%.

In order to limit the growing deficit, government adopted a Regulation that stipulates state-owned enterprises to purchase imported investment and intermediary goods only under the permission of chairmen or vice-chairmen of government bodies. Moreover, the government intents to stimulate exports having introduced the system of transport costs compensation, when the products are supplied for long distances – more than 1 thsd km. But it seems unlikely to be effective from the view of the competitiveness of the Belarusian exporters.

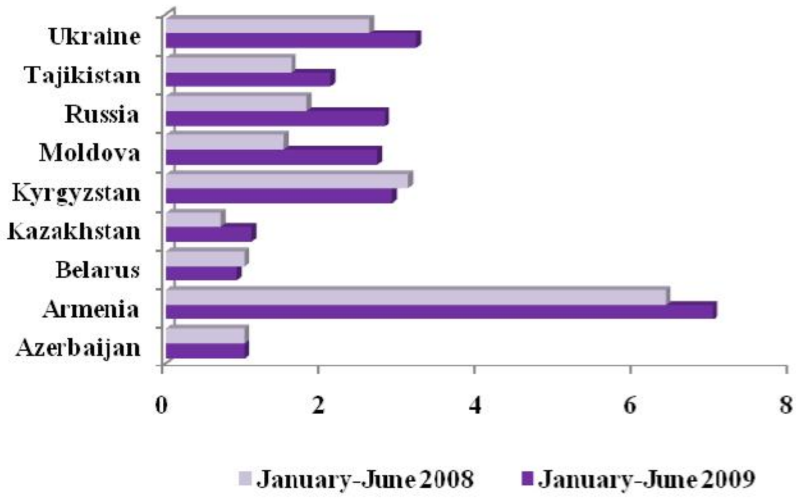
And at last, the third type of an external shock is a-collapse of labour markets. The most sensitive to it there were the poorest CIS countries. The considerable part of GDP of these states is made by remittances of labour migrants. However volumes of the given transfers each month are considerably reduced. Migrants appear without work because of slump in production abroad.

Till May 2008 the basic source of the development of economy of such countries as Tajikistan, Moldova, Kyrgyzstan, Armenia and Georgia were money of labour migrants. For example, according to the official statistics the volume of the Moldavian export in 2007 has made USD 1.3 billion, import – USD 3.7 billion, and the formed negative trading balance more than on 50 % has been covered by currency transfers of citizens of the country working abroad.

In 2008 the situation has changed. During the crisis remittances of the citizens working, as a rule, in Ukraine and Russia, were considerably reduced.

In economy of Tajikistan the volume of remittances of labour migrants in 2008 was close to USD 2 billion. It's almost half of GDP of the country. Today streams not claimed migrants come back home without money and without hope to find work at home. As a result the statistic of unemployment is following (figure 1).

Figure 1 Number of unemployed as % of number of economically active population



Source: data of Interstate Statistical Committee of the Commonwealth of Independent States

Belarus has one of the lowest official unemployment rates in Europe, at a mere 1%. And indeed the Belarusian social model is based on full employment, as unemployment benefits are relatively limited. Open unemployment so far remains very low, even with the current downturn, but there are reports of forced temporary leave in many industries, a direct effect of larger unsold inventories, which have increased very significantly (up 66% by February 2009, and up by over 80% for the machinery industry). The number of employees on part-time work doubled in January 2009 compared with November 2008, and the number on unpaid leave was 3.6 times higher.

As a result of all this shocks, average GDP growth in the CIS countries fell sharply from 8.6 % in 2007 to 5.4 % in 2008, although this figure was still significantly above the global average (Table 2).

Table 2 Volume indices of Gross Domestic Product of the CIS countries (as percentage of the previous year)

	2001	2003	2004	2005	2006	2007	2008	January-June 2009
Azerbaijan	109,9	111,2	110,2	126,4	134,5	125,0	110,8	103,6
Armenia	109,6	114,0	110,5	113,9	113,2	113,8	106,8	83,7
Belarus	**104,7**	**107,0**	**111,4**	**109,4**	**110,0**	**108,6**	**110,0**	**100,3**
Georgia	104,8	111,1	105,9	109,6	109,4	112,3	104,0	94,1
Kazakhstan	113,5	109,3	109,6	109,7	110,7	108,9	102,4	95,9
Kyrgyzstan	105,3	107,0	107,0	99,8	103,1	108,5	107,6	100,3
Moldova	106,1	106,6	107,4	107,5	104,8	103,0	107,6	93,1
Russia	105,1	107,3	107,2	106,4	107,7	108,1	105,6	86,6
Tajikistan	109,6	111,0	110,3	106,7	107,0	107,8	107,9	102,8
Uzbekistan	104,2	104,4	107,7	107,0	107,3	109,5	109	108,2
Ukraine	109,2	109,6	112,1	102,7	107,3	107,9	102,1	79,7
CIS average	**106**	**108**	**108**	**107**	**108**	**109**	**105**	**91**

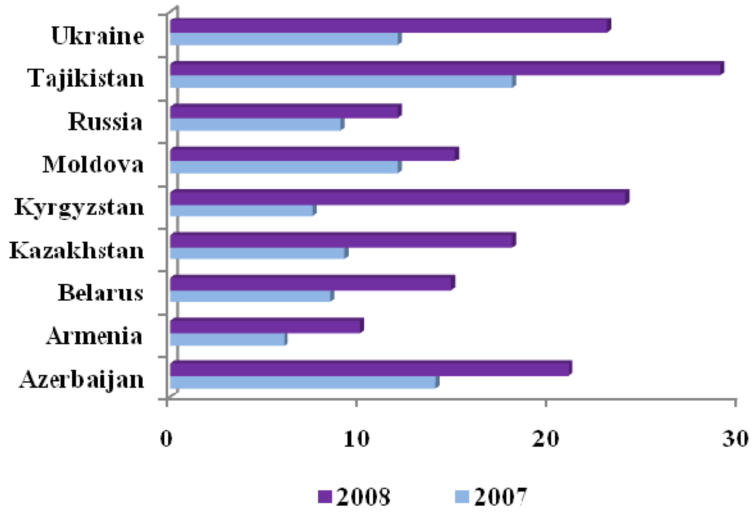
Source: data of Interstate Statistical Committee of the Commonwealth of Independent States

The deceleration was general, with all western CIS countries (bar Belarus, Moldova and Tajikistan) experiencing lower growth than in 2007. Russia, by far the largest regional economy, accounting in 2008 for over 84 % of the combined output of the area at market exchange rates, saw real GDP growth fall from 8.1 % to 5.6 %. However, the sharpest fall in the region was in the second largest CIS economy, Ukraine (responsible for almost 10 % of regional output). There, growth fell from 7.9 % in 2007 to 2.1 % in 2008, as the country was the hardest hit in the region by the collapse in commodity prices and the abrupt loss of access to international capital. These external shocks were also compounded by a less adequate policy response in some countries, most notably in Ukraine.

Belarus has had a rather impressive economic performance during most of the 2000s. The average annual growth in 2001-08 is estimated at 8.3%. Nevertheless, the global economic and financial instability that spread to emerging markets during the second half of 2008 has now caught up with it. In January-June 2009, real GDP was 0.3 %. In July it grew by 0.4%, which is 0.1 percentage points more than in previous months of this year. This was due to a moderate acceleration of growth in construction, agriculture, trade and deceleration of fall in transport. The growth in construction is much due to the authorities' policy of domestic demand stimulation. First, in June and July fiscal expenditures including those for capital investments grew substantially. Second, National Bank of the Republic of Belarus kept active refinancing of banks in order to maintain high growth of credit to the economy (in the 1st half 2/3 of the investments growth were financed by banks). However, the perspectives of such policies are restricted by the commitments taken by the government and the National Bank of the Republic of Belarus within the IMF Stand-by arrangement.

Average inflation in the CIS countries increased from 11% in 2007 to around 15% in 2008. Azerbaijan, Ukraine, Tajikistan and Kyrgyzstan remain the regional 'champions', with rates above 20% (figure 2).

Figure 2 Inflation in selected CIS countries, 2007-2008



Source: data of Interstate Statistical Committee of the Commonwealth of Independent States

Armenia is still among the CIS countries with the lowest inflation level in the first half of 2009 as compared to the same period of last year.

In Belarus inflation increased from 8.4% in 2007 to 14.8% in 2008 (average over the year). The inflation was fueled primarily by outside factors such as growing prices for imported energy, raw materials, and food. January 2009 saw monthly inflation as high as 4.1 per cent, which is attributed to the Belarusian ruble devaluation by 20 per cent. According to the data of the National Statistics Committee in annual terms the inflation amounted to 12.9% (13.4% in June 2009).

In the wake of the global increase in risk aversion and the sharp reduction in capital flows, net FDI flows in the CIS countries are expected to fall in 2009 to below 1 % of GDP, after having averaged around 3.5% of regional GDP in 2007 and 2008.

In conditions of the recession, sovereign credit ratings of a number of CIS countries (including Russia and Ukraine) were downgraded. In 2009 sovereign ratings previously assigned to the Republic of Belarus did not change: Standard & Poor's confirmed a long-term rating in foreign currency «B+», Moody's confirmed foreign currency rating for government bonds to «Ba2» and foreign currency deposit rating to «B2». But the International Standard & Poor's rating agency has downgraded the forecast of the credit rating of Belarus from "stable" to "negative".

Stable growth of the level of currency reserves, and at the same time measures taken for reinforcing external competitiveness and decreasing dependence of the Belarusian economy on import would be the conditions for reassigning the stable credit rating again. And on the contrary, considerable growth of the current account deficit and deterioration of external liquidity could follow in rating's dropping.

The analysis showed that all CIS countries suffered much from the global crisis. But the degree of this involving in every country is different. Such CIS countries as Russia, Ukraine, Kazakhstan, which were integrated in global economy dipper than others, were hit by crisis more. Downfalls of a number of international financial markets didn't involve on Belarus so much, as there were no shares of Belarusian companies on these markets. Such specific character allowed Belarus to hold out longer that other CIS countries. But first quarter of 2009 showed that involve of the crisis on Belarusian economy is really hard. And the Belarusian government should do everything possible to avoid lots of problems in the future.

3 Effects on merchandise trade flows

Towards the end of 2008 the global recession started to manifest itself in international trade. The fall in global demand and the slowing-down in economic growth translated into a substantial reduction in international trade that has affected the cross-border trade of virtually all countries and economic sectors. In most developing countries, international trade (exports and imports) serves an engine of growth and helps in a substantial way to fight poverty and raise living standards. Trade integration (by maintaining and increasing share of trade to generate development finance and drive industrialization) has been one of the main pillars of the development strategies for many developing countries, concomitant with deepening processes of liberalization and globalization.

The world financial crisis had a significant negative impact on the structure of foreign trade of the Republic of Belarus. The country is all set to beat the record of the foreign trade deficit for the whole history of its sovereignty.

To understand the nature of high trade deficit it's necessary to analyse the structure of Belarusian turnover trade in goods (table 3).

Table 3 Turnover trade in goods, USD billion

	2005	2006	2007	2008
Total turnover in goods	32.7	42.1	53.0	72.4
Export of goods	16.0	19.7	24.3	33.0
Import of goods	16.7	22.4	28.7	39.4
Balance	-0.7	-2.7	-4.4	-6.4
CIS countries				
% of total	55.7	54.9	57.0	55.9
Balance	-4.1	-5.9	-7.8	-11.6
The share of Russia in CIS countries				
Total turnover	15.8	19.9	26.1	34.2
% of CIS countries	86.8	86.1	86.4	84.5
Balance	-4.4	-6.2	-8.3	-13
Non-CIS countries				
% of total	44.3	45.0	43.0	44.1
Balance	3.3	3.3	3.4	5.1

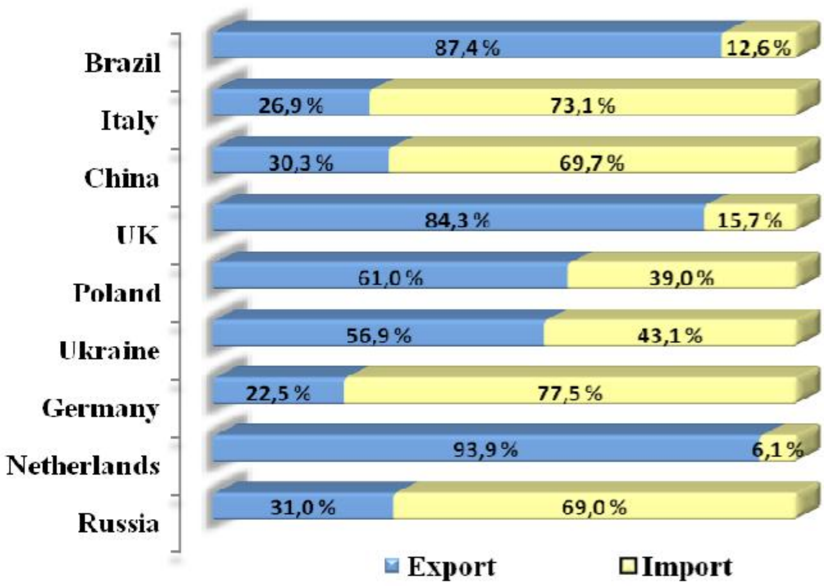
Source: data of National Bank of the Republic of Belarus

In 2008 the foreign trade turnover in goods amounted to USD 72.4 billion, a 36.6 % increase compared with 2007. 55.9 % of total turnover or USD 40.6 billion felt the CIS countries, including Russian Federation (it share was 84.5 % of CIS countries or USD 34.2 billion); the non-CIS countries – 44.1 % or USD 31.6 billion, including the EU countries (31.3 % or USD 22.6 billion).

The balance of foreign trade in goods was negative and made USD 6.4 billion (10.1% GDP). It has been caused by deficit of foreign trade with the CIS countries which was USD 11.6 billion, including Russian Federation – USD 13 billion. With the non-CIS countries the balance of foreign trade in goods was positive in the amount of USD 5.1 billion.

The structure of export-import of the Republic of Belarus with major trade partners (Russia – 47.2% of the whole trade turnover volume, the Netherlands – 8.2%, Ukraine – 6.8%, Germany – 5%, etc.) in 2008 has shown on the figure 3.

Figure 3 The structure of export-import of the Republic of Belarus with main trade partners in 2008

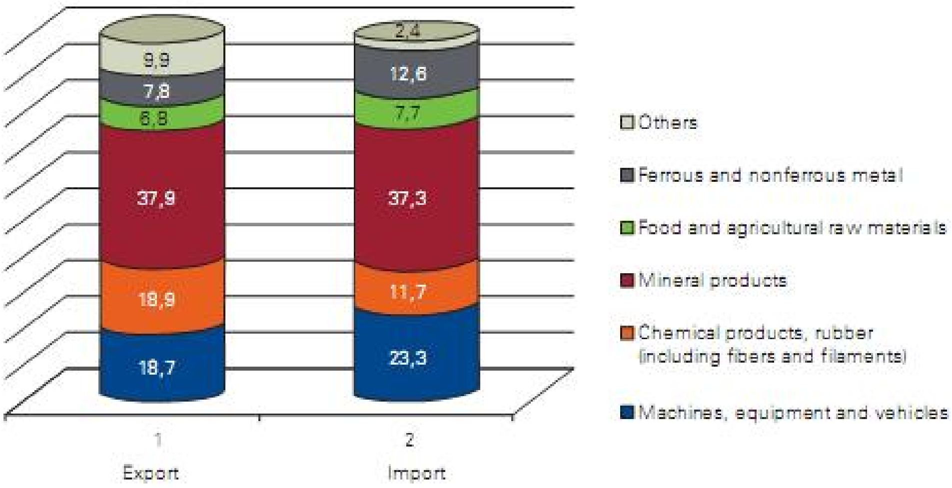


Source: data of National Bank of the Republic of Belarus

To such countries as Russia, Germany, China and Italy, Belarus imports more goods then exports. And the situation is different with such countries as Brazil, UK, Poland, Ukraine and Netherlands.

The major import and export items are mineral products and machinery and equipment. These sectors contribute 56.8 per cent to total exports and 60.6 per cent to imports. Belarus depends heavily on supplies of Russian natural resources and raw materials, and on exports to Russia of value-added products. The main export items from Belarus to the EU are mineral products, petrochemicals and fertilizers, ferrous metals, textiles and textile goods, wood and wood products (figure 4).

Figure 4 Commodity composition of export and import in 2008, % in total



Source: National Statistics Committee of Belarus

The Belarusian goods were delivered on the markets of 139 states. To the EU countries 43.9 % of total exports of the goods have been put and the share of mineral products in export to these countries made 74.8%. The share of the Russian Federation in export of goods has made 31% of which 39.6% made deliveries of vehicles, cars and equipment.

Belarus imported of the goods from 168 states. The basic supplier of the goods there Russian Federation which share in import of the goods made 69 %. From Russia mineral products (59.7 % of total import from Russia) and not precious metals (13.1%) were delivered basically. The share of import of the goods from EU countries made 21.6%. These countries delivered cars and the equipment (33.8% of import from the EU countries), vehicles (12.6%) and production of the chemical industry (12.2%).

In the situation when the import is much bigger than export, the Belarusian government makes the policy of import substitution. They think, that it is especially important at the present stage of economy development because apart from saving hard currency reserves of the country and reducing the dependence of Belarus on imports the efforts help companies penetrate into new markets, increase export and thus boost the country's hard currency earnings. In conditions of the world economic crisis import substitution is essentially one of the key parts of the structural development of the industry.

There are plans to start up manufacturing new products in line with the President-approved scheme of imports substitution. The plans are based on an analysis of three main groups of products that Belarus imports and manufactures. As far as the first group is concerned, efforts are being put into increasing the output of products manufactured in insufficient amounts. The second group comprises products that Belarus is about to start manufacturing as part of import substitution programmers and other import-substituting efforts. The third group identifies products, which manufacturing has been deemed inadvisable so far.

According with the 2006-2010 National Export Development Programme the share of imported components in the products Belarusian companies make should be reduced by 10% at least in 2009.

In view of the goal the Industry Ministry has been assigned with tasks regarding the top-priority substitution of several components used to make basic products with Belarus-made counterparts. The replacement of the diesel engines imported by Gomselmash and Minsk Automobile Plant with those of Minsk Engine Plant is expected to produce the largest hard currency saving effect along with the use of Belshina tyres in BelAZ products, the use of products by Izmeritel and Vitebsk Plant of Electric Measuring Instruments, tyres made by Bobruisk Plant of Tractor Parts and Aggregates and hydraulic control valves made by Gidroprivod for substituting components imported by MTZ and for several other projects.

Purchased materials account for a noticeable part of the hard currency spent on manufacturing. The Industry Ministry is focused on saving hard currency reserves via implementing system-wide measures, including those aimed at reducing materials consumption and total manufacturing costs. Belarus is in the initial phase of the implementation of the new complex of measures developed in this area. Their effectiveness will depend on smooth and coordinated interaction of all branches of the economy for the sake of reducing imports.

But in the situation of global recession, there is a risk of more protectionist trade policies being implemented simultaneously by many governments. It's now widely recognized that increased and excessive trade protection in one country is likely to lead to realization by other countries in the presence of a global negative shock. The overall results can only be a worsening of the situation for each single country. That's why Belarus should be careful with its policy of import substitution.

4 Effects on financial flow

4.1 The Debt during the financial crisis

The last year has demonstrated that the Republic of Belarus is unable to solve problems without international borrowing, which ensures the stable performance of national economy and financial system. During the time when the financial crisis is on the peak Belarus needs a large amount of capital. But at the same time active borrowing leads to debt increase that is making the country more dependent from different negative situations and crisis.

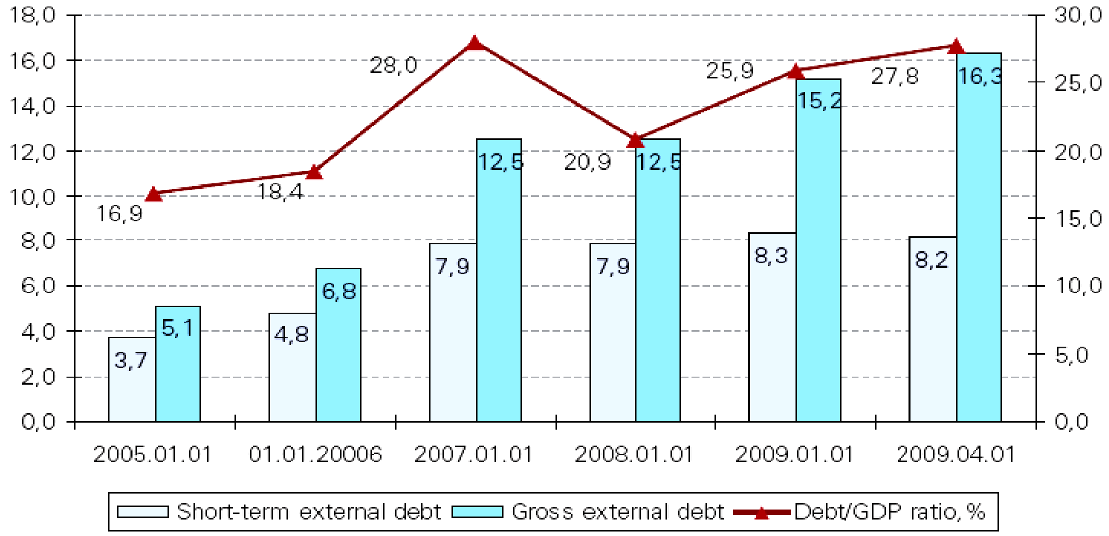
During 1991-2006 years, Belarusian gross external debt was extremely low partly due to economic growth fueled by privileged prices on Russian energy goods. The situation radically changed in 2007, when gas prices rose more then two times. The current account deficit grew in several times from 1.4% of GDP in 2005 to 6.7% of GDP in 2007.

Some policy measures, including tightening of fiscal and monetary policies, improving energy efficiency, and diversifying exports, have been introduced in recent years to minimise the effect of the crisis for Belarus, but external borrowing has been the main mechanism used to manage the growing pressures on the economy.

In November 2008, Belarus reached an agreement with Russia for a USD 2 billion stabilisation loan. In December 2008 Belarus received a state loan of USD 500 million from Venezuela for seven years. On 12 January 2009, the IMF Executive Board gave final approval to a stand-by loan of SDR 1.62 billion (approximately USD 2.46 billion at the date of providing the loan) releasing USD800 million immediately, with the remainder to be disbursed subject to quarterly reviews. The IMF loan is to finance a 15-month programme of economic reform. On 29 June 2009 the IMF Executive Board, following its completion of the first review of Belarus's performance under a program supported by a stand-by arrangement, approved the release of the second disbursement of the loan in the amount of USD 680 million and increased the total amount of the stand-by arrangement by additional USD 1 billion to the total of USD 3.52 billion.

Consequently, in 2007 Belarus external debt grew from 18.4% to 28.5% of GDP and reached USD 12.7 billion in absolute terms compared to USD 6.8 billion at the beginning of 2007 (figure 5).

Figure 5 Foreign debt dynamics in Belarus 2005-2009, USD billion



Source: National Bank of the Republic of Belarus

While favorable external economic conditions – high prices for petroleum products and depreciation of US dollar – prevented debt accumulation until October 2008, the economic crisis resulted in a rise in debt. In January-March 2009 the external debt increased by 7.7 per cent from USD15.2 billion and reached USD16.3 billion as of 1 April 2009 (27.7 per cent of the annual GDP and 49.2 per cent to export of goods and services) (table 4).

Table 4 Public and private external debt in Belarus 2005-2009, USD billion

	1.1.2005	1.1.2006	1.1.2007	1.1.2008	1.1.2009	1.4.2009
Total external debt	4,9	5,1	6,8	12,5	15,2	16,3
Public external debt	0,5	0,6	0,6	2,0	3,6	5,0
Private external debt	4,4	4,5	6,2	10,5	11,6	11,3

Source: National Bank of the Republic of Belarus

As of 1 January 2009, Belarus's external public debt stood at USD 3,718 million, which constituted 48.8 per cent in total government debt and 6.5 per cent of 2008 GDP. The external government debt showed 59.7 per cent increase for the year 2008.

In January-March 2009 the external governmental debt increased by further USD 1,266.8 million or 34 per cent and reached USD 4,985.7 million by 1 April 2009, roughly 8.5 percent of annual GDP. The regulatory limit for external government borrowing for

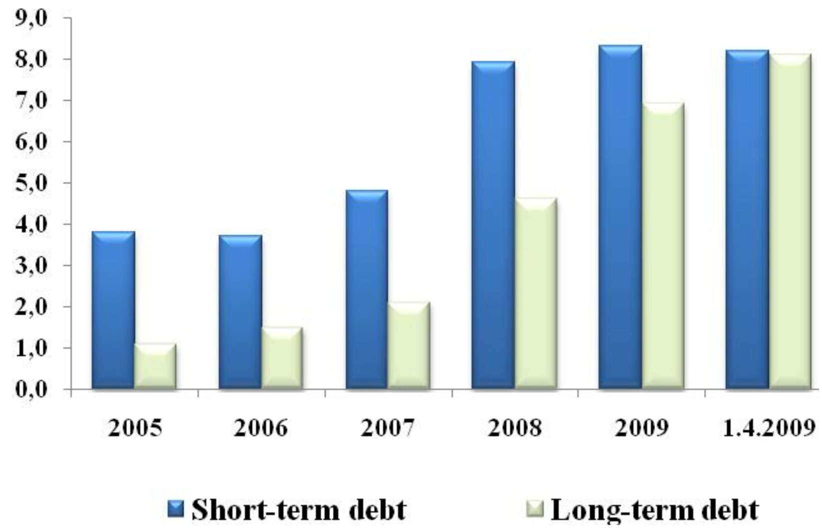
31December 2009 was raised in May by USD2 billion to the total of USD8 billion (estimated 13-14 per cent of GDP), while the approved safe threshold is set at 20 per cent of GDP.

Despite the fact that Belarus' external debt increased a lot in 2009, it remains at a relatively low level compared to other countries of CIS and CEE, where in some states it exceeds 100% of GDP.

While the external debt of Belarus remains on moderate level compared to other countries, its current structure and prevalence signalizes potential problems.

The first problem consists in that more than half of total external debt is short-term (figure 6).

Figure 6 The shares of long-term and short-term debt in Belarus, 2005-2009



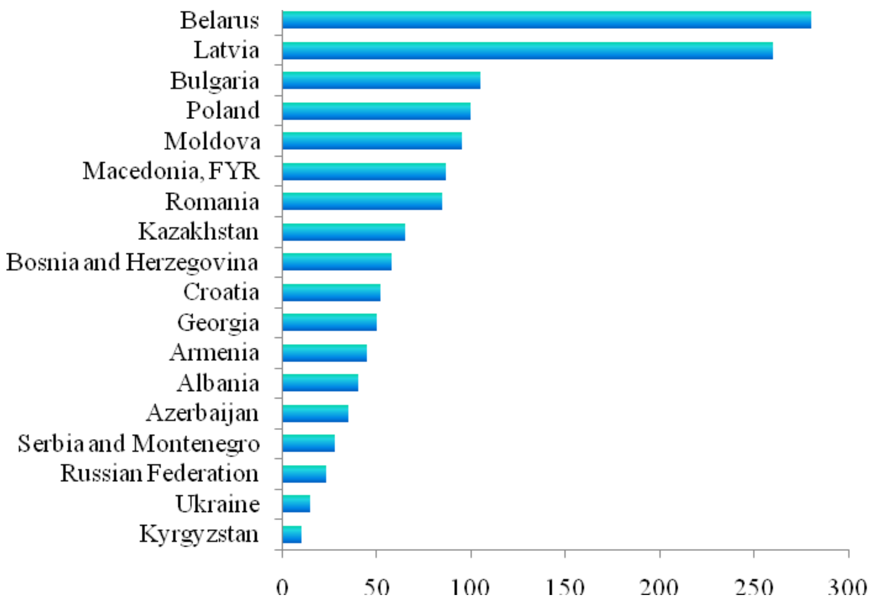
Source: National Bank of the Republic of Belarus

As of 1 January 2009, the short-term debt for one year or less constituted the major portion of external debt and amounted to USD 8.3 billion. This debt has increased by 5.2 per cent compared to 1 January 2008.

The major share of external debt is attributed to credit and loans (59.5 per cent of the total sum of external debt as of 1 April 2009). The other significant portion of the external debt of 28.4 per cent relates to trade financing.

The share of short-term debt to total reserve rations of Belarus is also too high (figure 7).

Figure 7 The share of short-term debt to total reserves ratios in Europe and Central Asia (Projected short-term debt due in 2009 (percent of reserves in February 2009)



Sources: International Financial Statistics; Bank for International Settlements; World Bank staff calculations.

Among the countries with high short-term debt levels, only Russia could foot the bill from reserves or its current-account surplus if external finance were not forthcoming. As of February 2009, Belarus, Bulgaria, and Latvia held insufficient international reserves to cover debt coming due in 2009.

Belarus international reserves cover only 55.4% of short-term debt, which is less than in other countries. This negative aspect, that undermines debt sustainability, is mitigated by the fact that short-term debt is formed mainly by trade loans, which has been further complicated by the global economic crisis. Belarusian enterprises are obliged to follow strict production plans despite the current crisis. As the demand for their products – especially on Russian markets – shrinks, companies pile up their products in warehouses.

With their assets frozen in the form of finished goods inventory, enterprises currently face a risk of a shortage of assets to repay trade loans.

The second problem is the high costs of servicing Belarusian external debt. Between 2003 and 2007, these amounted to 7.5–10.0% of GDP (10.8% of GDP in 2009). This indicator is close to the external debt service payments of Hungary, Latvia and Lithuania, even though the gross external debt in these countries (95.9, 142.5 and 78.4% of GDP respectively) is much higher compared to Belarus (28.5% of GDP). Principal repayments constitute almost 95% of Belarus external debt servicing.

The third problem is an influence of the world crisis on interest rates growth of international borrowing. Interest rates increased from 200 to 600 base points from September 2007 to September 2008. In 2007 and in 2008, Belarusian banks attracted mainly syndicated loans with a fixed schedule of repayment. Interests rates for these loans were quite stable (around 300–350 base points). Starting from the second half of 2008 no syndicated loans were attracted as there was a lack of liquidity on international markets. Other kinds of loans by Belarusian banks were also limited due to the same reason. Normally, this would mean that gross external debt is not exposed to interest rate fluctuation. But the growth of the latter in a crisis environment and the global lack of liquidity have significantly constrained possibilities for the further attraction of loans from abroad. Furthermore, it has also limited the possibilities for refinancing current external debt. This applies both for banks' syndicated loans which are usually obtained for a period of 1-1.5 years, as well as loans by enterprises.

As a result, the major risks due to global financial distress here may be formulated as follow: lower access to foreign capital, higher interest rates and shorter period of loans and credits. And to avoid for further risks Belarusian government should be careful with borrowing policy during the crisis.

4.2 FDI inflows

The global crisis is having a negative impact on foreign investment. Tighter credit conditions and lower corporate profits have weakened companies’ capability to finance their overseas projects; while the global economic recession and a heightened appreciation of risks have eroded business confidence. Many large TNCs have revised their global expansion plans downward, and divestments have taken place. The trend is widespread, hitting all sectors and all major types of foreign investment. FDI flows to financial services, automotive industries, building materials, intermediate goods, and some consumption goods have been the most significantly affected, but the consequences of the crisis have been quickly expanding to FDI in other activities, ranging from the primary sector to non-financial services. Concerning the prospects for FDI inflows, almost all developing countries and countries with economies in transition have been affected by the global financial and economic crisis, but to different degrees.

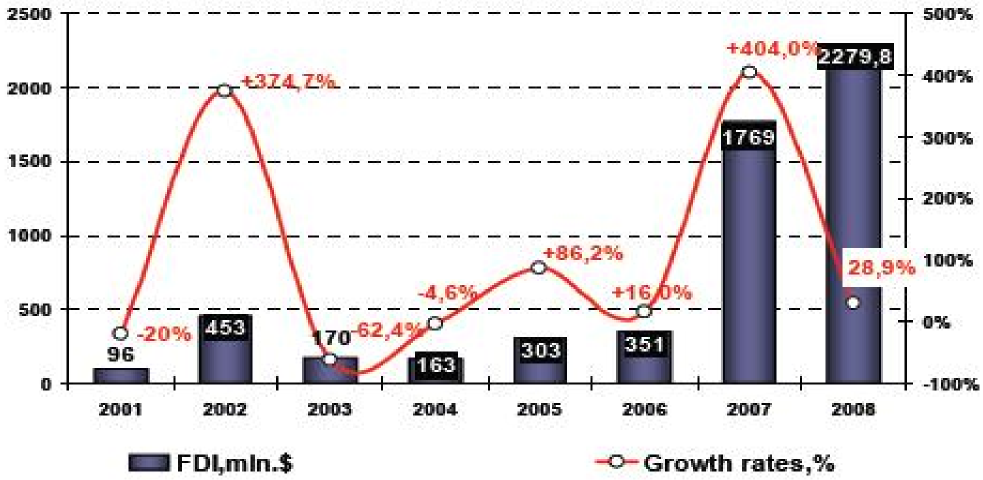
Till 2007 Belarus was almost closed for foreign investment. But in the time of financial crisis the government changed the policy of attracting FDI, making it a key factor of economic development of the country. The efforts has been making to improve the investment climate and encourage inflow of foreign capital, e.g. the acquisition and sale of land was eased, the tax burden was reduced and there is intention of its further cut down, the government set the target to appear among top 30 countries with the best condition of doing business, golden share was cancelled, the privatization program was resumed. It should be mentioned, however, that privatization target for 2008 was not met and the level of FDI in the next two years is uncertain as financial crisis combined with economic slowdown could adversely affect the capacity and willingness of foreign firms and banks to invest abroad.

Governmental efforts have resulted in outstanding growth of FDI inflow (a fivefold increase). Within the past few years many foreign strategic investors have entered the Belarusian market.

Nowadays, favorable geographical position, highly-skilled workforce, low competition in many industries, lots of privatization opportunities, low crime and corruption level are only some of advantages of investment cooperation with Belarus.

Rapid growth of foreign direct investment has been recently observed in Belarus. Since 2005 the value of net FDI into Belarusian economy increased almost seven fold and reached USD 2.3 billion in 2008 (Figure 8).

Figure 8 FDI dynamics in Belarus, 2001-2008, USD million



Source: National Bank of the Republic of Belarus

FDI inflow into the Belarusian economy speeded up in 2007-2008. In 2008 it grew by 28.9% and reached USD 2.28 billion. Over the last three years, FDI as a share of GDP grew from 7% to 10.0%, and as a ratio of gross investment – from 3.8% to 12.9%. FDI in Belarus increased 18.7% on the year in January-March 2009 to USD 129.4 million. By April 25, 2009, 55 investment projects had been financed from foreign sources. This is a logical bottom line of consistent governmental steps made towards reformation of the investment environment and further economic liberalization of the Belarusian economic life.

By definition, FDI comprises equity investment, reinvested earnings (earnings not distributed as dividends and earnings of branches not remitted to the direct investor), and intra-company debt transactions (the borrowing and lending of funds, including debt securities and trade credits, between parent and subsidiaries and among subsidiaries). During a crisis in a host country, repaying loans or repatriating earnings is often easier than selling off direct equity. Also, a direct equity holding usually reflects a long-term strategic commitment and may not change immediately following a crisis— although it may change if the crisis is prolonged. This can be seen from the experience of some countries that faced financial crises, where the decline in intra-company loans following the crisis was significantly larger than the decline in the equity component of FDI.

Most of the net inward FDI in Belarus was associated with equity capital that amounted 80.4% in 2007 (77.4% in January-September 2008), reinvest earning constituted 10.5% (12.6% in January-September 2008), and intra-company loans was 9.1% (10% in January-September 2008) (table 5).

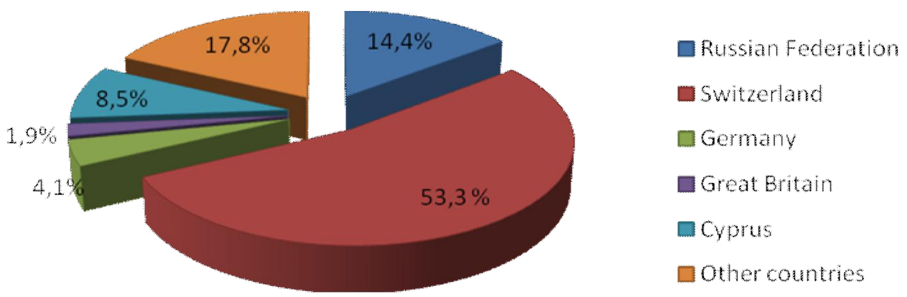
Table 5 FDI flow by type of investment, USD million

	2005	2006	2007	2008	2009 (January-June)
FDI	303.0	351.0	1769.2	2149.2	1426.3
Equity capital	279.1	301.9	1422.5	1685.7	748.8
of which to banking sector	2.2	7.1	86.7	384.8	288.3
Reinvest earning	32.5	58.4	185.2	261.1	396.3
Intra-company loans	-8.7	-9.3	161.5	202.4	281.2

Source: National Bank of Belarus

According to the data of Ministry of foreign affairs of the Republic of Belarus, Switzerland is a leader between direct investors and its share is 53.3% of the total influx of foreign direct investments or USD 1215.7 million (figure 9).

Figure 9 The major direct investors in Belarus, 2008



Source: Ministry of foreign affairs of the Republic of Belarus

Russian Federation is on the second position – 14.4% or USD 328.5 million. Then goes Cyprus (8.5% or USD 263.1 million), Germany (4.1% or USD 93.7 million), Great Britain (1.9% or USD 42.2 million).

In 2009 the ministry drew up a schedule to consider 114 proposals from foreign investors, totaling USD 19 billion, of them 19 projects from Russia, worth a total of USD 10.322

billion, seven from the UK, totaling USD 2.175 billion, eight from China, worth USD 1.11 billion, five from Iran, four from Italy and five from the United Arab Emirates.

So far preliminary agreements have been reached on 62 investment proposals, with possible investments totaling USD 11 billion. Another 47 projects worth USD 7.7 billion will be considered in the near future.

There are some main deals in 2007-2008.

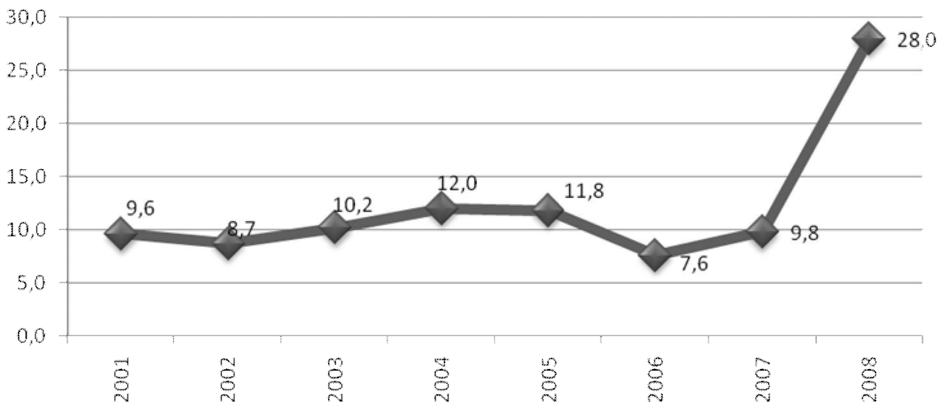
The largest transactions in 2007-2008

- **GazProm** is in the process of acquiring a controlling stake in BelTransGaz for USD 5 billion during the period 2007-2010;
- **Russian insurance companies** strengthened their positions in Belarus through acquisitions of controlling stakes in 2 insurance companies (RESO Group);
- **Mobilkom Austria Group** acquired 70% of mobile service provider MDC (Velcom) for EUR 730 million;
- **Turk Cell** acquired state-owned mobile phone operator BEST for USD 600 million;
- **Heineken NV** bought Syabar brewery the second-largest beer brand in Belarus for EUR 70 million and 51% stake in Rechitsa brewery for EUR 6.4 million;
- **Olvi plc (Finland)** acquired a controlling stake in Lidskoe Pivo Brewery for USD 32 million;
- **Baltic Beverages Holding** (Carlsberg) acquired Alivariya brewery;
- **Ergo Group** acquired a private insurance company in 2008;
- **PPF / Generali** created a risk insurance company in Belarus;
- **Horizon Capital (US based PE fund)** is the ever first PE fund that entered Belarus in 2008;

- **Silvano Fashion Group (Estonia)** was the first company owning predominantly Belarusian assets (Milavitsa lingerie manufacturer) listed at foreign capital market (Warsaw stock exchange);
- **Kesko (Finland)** acquired the leading construction materials retailer in Belarus.

The foreign capital is present in the banking system of Belarus for a long time. However the volumes of such capital were significantly low until 2008 - within 10 % from total actives. In 2008 the given indicator has reached record level in 28 % (Figure 10).

Figure 10 Dynamics of a share of foreign capital in banking system of Belarus, %



Source: National Bank of the Republic of Belarus, 2009

The rapid growth of the share of foreign capital in 2008 is connected with acceptance of the decision of National bank of the Republic of Belarus to increase a quota of foreign capital from 25 % to 50 %.

As of January 1, 2009, foreign capital was part of the authorized funds of 24 out of 31 Belarusian banks. In 18 banks the share of foreign investors exceeded 50% (in 7 banks the share amounted to 100%, in 11 – from 50% to 100%, besides, in two banks only one share was owned by residents of the Republic of Belarus). The banks' authorized funds are comprised of capital from more than 10 countries including Russia, Austria, Ukraine, the Great Britain, Kazakhstan, Poland and some others.

The most significant transactions on banking capital sale to foreign investors in the Republic of Belarus from 2007 for 2008 are in table 6.

Table 6 Transactions on banking capital sale to foreign investors in the Republic of Belarus (2007-2008)

Object of sale	The buyer	The country of the buyer	Share fraction, %	Deal value, mln USD
Slavneftebank	VTB	Russia	50%	25
Belvnesheconom-bank	Vnesheconom-	Russia	65%	30
Mezhtorgbank	Alfa -Bank	Russia	39%	12
MTB	Horizon Capital	USA	32%	21
Atom-Bank	Delta Bank	Ukraine	100%	20
International Reserve	Dogmat	Ukraine	90%	N/A
SomBelbank	Getin Holding	Poland	75%	N/A
Lorobank	Home Credit Bank	Czech Republic	100%	N/A
Golden Taler	Fransa-Bank	Libya	98.93%	12
Priorbank	Raiffesen Bank	Austria	50%	30
AstanaExim Bank	Turan Alem Bank	Kazakhstan	50%	N/A
Paritetbank	AFK Systema	Russia	51%	N/A

Source: Banks reports, 2007-2008.

Despite the increment of foreign direct investments, Belarus has been lagging behind most countries in the region in attracting FDI, and the level of foreign direct investment per capita is still far below most of other transition economies.

There are main problems that make investment climate of Belarus not so attractive, especially for europeanian investors:

- the role of administrative barriers concerning ¬ many parties of enterprise activity are great¬: registration, placing, licensing;
- low level of independence of Belarusian companies and enterprises makes considerable impact on acceptance of investment decisions;
- the big share of state property;
- not adjusted property relations (in particular,¬ landed property), that excludes mortgaging guarantees;
- nonconstancy of customs treatments;
- a low level of development of numerous elements of market ¬ infrastructure, weak development and a high deterioration of an industrial and transport infrastructure;

- backwardness of financial system. In the country there are practically no investment funds to accommodate resources (primarily small private investors).

For investment climate improvement it's necessary to finish up the formation of legal base in the field of tax, credit, currency, custom regulation of investments and provide foreign investors with stable, favorable conditions for business.

5 Privatisation in Belarus during the global financial crisis

Until 2007, state ownership was one of the pillars of the socio-economic model implemented by Belarus. Accordingly, privatisation was not considered as an important policy goal for the country. However, this policy changed at the start of 2007. Privatisation and foreign direct investment became central goals of economic policy and were set high on the political agenda.

A number of steps to improve the business climate and the regulation of foreign investment were taken and several privatisation deals were conducted in 2007, 2008 and 2009.

Until the end of 2007, economic policy making in Belarus was based on the principle of state ownership and on a special relationship with Russia, including a customs union and heavy Russian subsidies through artificially low energy import prices.

The situation changed a lot when Russia decided to change the energy policy concerning Belarus. Following this "energy shock", it became clear that the old way of economic development couldn't exist anymore. And the privatisation of state assets became the key factor for the modernisation of national economy.

State property privatisation carried out in the course of state enterprises reformation. It is regulated by laws "On denationalisation and privatisation of state property in the Republic of Belarus", "State privatisation programme", decrees and edicts of the President of the Republic of Belarus, Government resolutions, normative acts of administrative-territorial bodies of state administration.

The Decree of the President of the Republic of Belarus dated April 14, 2008, No.7 "On insertion of changes and additions in the Decree of the President of the Republic of Belarus dated March 20, 1998, No.3" stipulates formation of the privatisation plan elaborated for state property objects within 3 years – the list of Republican Unitary Enterprises subject to privatisation by means of their transformation into open joint stock companies, and a within-three-year formation of joint stock companies with their stocks belonged to the Republic of Belarus saleable.

The first stage (starting from June 1, 2008) experiences abolishment of restrictions for alienation of shares in such companies which do not have state-owned shares in their authorised funds at all or this share amounts to 75 percents and more. Complete abolishment is also applied for alienation of shares of companies transferred to enterprises manufacturing agricultural and bakery products for their production activities.

At the second stage (since January 1, 2009) restrictions on alienation of shares of joint stock companies with the share of the state exceeding 50% are abolished. It is worth mentioning that the first and the second stages are not abolish restrictions on shares of companies providing for operation of strategically significant economy branches.

The third stage (since January 1, 2011) will see complete abolishment of all restrictions.

The Resolution of the Council of Ministers of the Republic of Belarus dated July 14, 2008, No. 1021 approved the List of state property objects included the Privatisation Plan of 503 objects and the List of joint stock companies created in the course of privatisation of state property for the period 2008-2010. The List includes 146 joint stock companies.

The main technique to privatise objects of state property is transformation of enterprises into joint stock companies. Corporisation of state enterprises provides for investment attraction both at the transformation stage, and in the process of the new economic entities further operation by the following direction:

- participation of investors in establishment of a joint stock company at the stage of transformation of a state-owned enterprise by means of allocation of monetary or asset contributions;
- acquisition of state owned shares in joint stock companies for investment projects implementation;
- acquisition of additional equities issued for a particular investment project at joint stock companies;
- establishment of joint ventures in Belarus.

One of the main targets set by the Head of State and the Government during the reformation of state unitary enterprises was attraction of local and foreign investors interested in technical retooling and an increase in competitiveness of enterprises being privatised avoiding sharp job cuts and social tension in the country's real sector of the economy.

The decisions on whether to sale state owned stocks of open joint stock companies are made by the President of the Republic of Belarus on the basis of propositions of the Goskomimushestvo and the national bodies of state administration, exercising possessory supervision in these organisations.

In order to involve unused state property located in small inhabited localities and rural areas in economic turnover, there was adopted the Presidential Edict dated February 27, 2007, No.108 "On certain measures to involve unused state property in economic turnover" enabling selling of unused state property located in small inhabited localities and rural areas at auction with establishment of trigger selling price equal to one base value, conveyance of such unused property to uncompensated use to individual entrepreneurs and non-state legal entities for implementation of definite investment projects, carrying out the property write-offs after detailed discussion on impossibility of its further use.

Obligatory conditions of the auction with setting a trigger selling price equal to one base value are as follows:

- the Buyer's performance of entrepreneurial activities at the property object, creation of additional jobs by the Buyer;
- prohibition of the Buyer's sale or other alienation of the object until the Buyer fulfills sales and purchase agreement conditions.

Selling state-owned immovable property in the Republic of Belarus (capital buildings (buildings, facilities)) one simultaneously exercises sale of the right to conclude rental contract agreements for a land lot needed to serve this property.

According to the Edict of the President of the Republic of Belarus dated February 25, 2008, No.113 "On procedure and terms of sale of enterprises as property complexes of loss-making state organisations to legal persons" loss-making state company can be sold as property complexes to legal persons in the course of privatisation at a competitive basis provided they present an investment project, which underwent examination on development of buying company in compliance with the procedure set by the legislation.

Obligatory conditions for sale of enterprises as property complex at tender are as follows:

- implementation of an investment project and social programmes of an enterprise being acquired by the buying company;
- preservation of jobs for the period of debt redemption of a loss-making state-owned organisation;
- creation of new jobs according to the investment project;
- the buying company's assumption of obligations of the loss-making state-owned organisation connected with payment of taxes, charges (dues), interests payable in compliance with the tax and customs legislation, credits, loans, other obligatory payments in the national and local budgets (including the state special purpose budgetary funds). The buying company shall also assume obligations connected with payments in State non-budgetary funds social security of the population of the Ministry of Labour and Social Security, economic sanctions, payment of fines and penalties charged for violation of legislation, other undrawn commitment;
- the buying company's conclusion of land plot rental contract.The starting price of the sale of the enterprise as a property complex is determined in the amount of 20 percent of its assessment value on January 1 of the current year. When the assessment value is equal to zero or has a negative value, the starting price of the enterprise as a property complex shall be one base value.

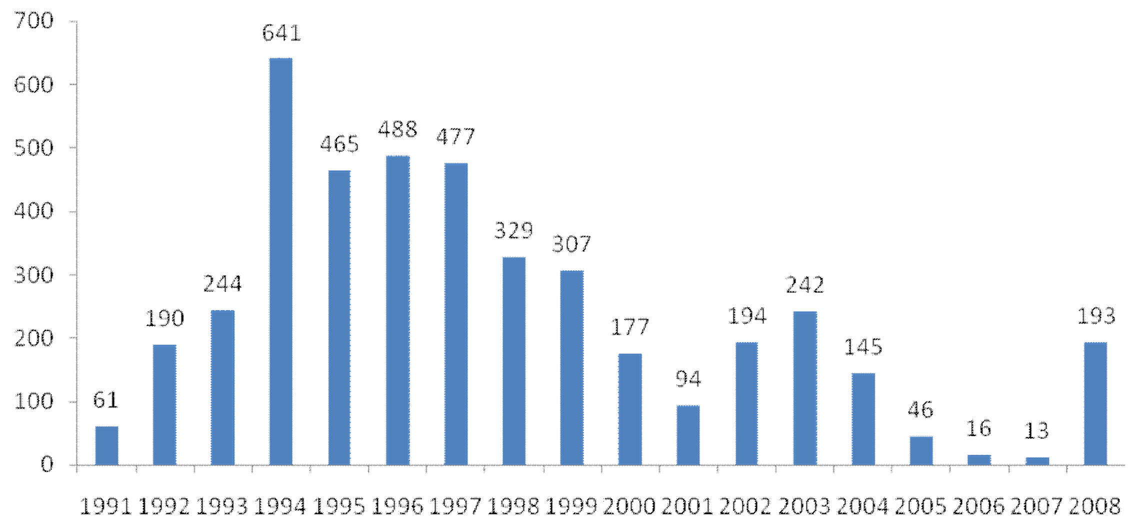
Organisations that acquired an enterprise as a property complex are provided with a three-year deferral of repayment of the acquired loss-making state organisation debts. The buying company shall settle the following arrears:

- on tax, charges (dues) in the national budget (except for value added tax payable when importing goods in the Republic of Belarus from the Russian Federation);
- on customs payments in compliance with the Customs Legislation;
- on repayments of budgetary credits, including interests for their use, and repayment of budgetary loans.

Moreover, buying companies can count on a six-year installment payment for the enterprise acquired as a property complex.

As a result of such liberalisation in the sphere of privatization in the Republic of Belarus some progress has been done. The dynamic of reforming of state property during 1991-2008 is shown on the figure 11.

Figure 11 The dynamic of reforming of state property during 1991-2008



Source: State Property Committee of the Republic of Belarus

However, the impressive records in 2008 came to a sudden stop in 2009. Besides the selling of 12.5% of Beltransgas for USD 625 million, a deal already signed in 2007, no major privatisation deals took place in 2009.

There are two sides of privatization process in Belarus during the time of global crisis. On the one hand, there is an objective need to go ahead with the privatisation process initiated in 2007. From a structural point of view, privatisation is crucial to modernise the capital stock and to introduce modern management skills at the company level. This serves as an important anchor to restore the medium-term economic growth potential, and thus to secure macroeconomic stability over the longer term. And also from the point of view of the balance of payments there is a major role to play for privatisation. Following the energy shock in 2007, but also due to the "sudden stop" in private capital inflows that started in end-2008, the country needs additional sources of capital inflows to rebalance the foreign exchange market and to support the national currency. Finally, privatisation is also important from a fiscal point of view. Privatisation receipts would be highly welcomed today as the fiscal pressures become evident, not only in Belarus.

On the other hand, the global environment is currently not supportive for privatisation deals. Companies around the world are facing their own problems and their appetitive for "risky" investments abroad has strongly diminished. In the current global economic conditions, investors prefer to wait. As a result of this negative environment, the prices/valuations for companies have plummeted world-wide. This is especially true for Central and Eastern Europe, a region particularly hardly hit during the crisis. The fall in stock market valuations in the region can be used as a very rough proxy for the probable decline in prices to be fetched for the privatisation of large state companies in Belarus. Thus, in case Belarus decides to go on with its ambitious privatisation plans, it is quite likely to secure very modest prices for its assets.

As a result, Belarus faces currently a major dilemma regarding the future course of its privatisation policies. On the one hand, a continuation of the privatisation process is of paramount economic importance; on the other hand, nobody really wants to sell a large number of valuable assets at discount prices.

6 Conclusions and policy implications for Belarus

The analysis of the impact of global crisis on Belarusian economy lead to following main conclusions:

1. The analysis of the development of CIS countries showed, that those countries in the region that were mostly integrated into the world economy, for instance, via trade and capital flows, and that took further steps towards liberalisation were likely hardest hit. Macroeconomic stabilisation factors, namely sound fiscal positions (high primary surpluses, low debt), rather robust fiscal rules, large hard currency reserves and flexible exchange rates, did not insulate the countries from the crisis: even economies with very large reserves and very low state debt as Russia were significantly affected. Belarus is now closely linked with the global economy by trade and foreign investment flows, and its economy is more sensitive to falling international demand. That's why the financial crisis also hit Belarus and the government should do everything possible to go out from this crisis with fewer loses making favorable conditions for trade expansion and sustainable development.

2. The rapid spread of financial crisis provides tangible evidence that the financial system and trade of the Republic of Belarus needs to be profoundly reformed to meet the needs and changed conditions of the 21st century. During the global economic crisis Belarus needs to look for new markets for its goods and also change its orientation on Russia as the main external partner. Now Russia buys fewer Belarusian goods, non-payments started and protectionism became stronger. The high rate of the negative foreign trade balance can be accounted for by increase in prices for energy resources which are mainly imported from Russia. Belarus has a big trade deficit with Russian Federation. At the same time the balance of foreign trade in goods with non-CIS countries is positive. The Belarusian policy focused on the countries of the Middle East and Latin America for several years. However soon it became clear that those markets could not meet the requirements of Belarusian exporters. Moreover there are no free investment resources available in all in these countries, while such resources are necessary to modernize the Belarusian economy. Investment resources are available in the developed countries only. Only the counter-movement of the European Union in

the framework of the Eastern Partnership opens an opportunity to attempt to attract Western investment to Belarus.

Recommendation 1: *Belarus needs to find new markets for increasing its export and to try to cooperate with EU countries more closer, because only in well- developed countries there are investment resources that really need to modernise the Belarusian economy.*

3. Belarus's economy is highly centralized. Total government expenditures, including consumption and transfer payments, are high. The majority of Belarusian GDP is produced by stateowned or state-controlled enterprises (75% of national GDP). The private sector in Belarus produces only 25% of national GDP despite employing 47% of all employees in the domestic economy. The potential for the development of the private sector in Belarus in terms of productivity and share of GDP is great. Small and medium-sized enterprises can become a leading force in acheiving that potential.

Recommendation 2: *To allow market forces to play a major role in the allocation of resources, state intervention in the economy should be significantly reduced:*

- *Price controls need to be reduced to the minimum so that the price signal can direct the flow of resources and help adjust excesses and shortages in the economy;*
- *Wages need to be liberalized to reward high productivity, and the labor market developed so that workers can move to jobs where they are most productive;*
- *The regulatory burden on the private sector should be further reduced, and greater flexibility in setting prices, wages and margins allowed;*
- *Mandatory quantitative targets at the macroeconomic and enterprise levels need to be abolished as it has become more difficult to manage an increasingly sophisticated economy through central planning;*
- *The banking system shall be allowed to make lending decisions based on the profitability and risks of the projects rather than government directions or recommendations.*

4. From 2007 privatisation became an important part in the policy of modernisation of Belarusian economy and attraction FDI. Belarusian government issued huge number of laws, decrees and edicts, improving the process of privatisation. The List of state property objects was even approved, which includes the Privatisation plan of 503 objects and 146 joint stock companies for 2008-2010. And some progress was made. But in 2009 the privatisation process has run into a standstill. So far, practically no new big deal was conducted in recent year. A major factor for this development is the clear decrease in prices, which can be secured for privatisation deals today, as compared to last year and before. The Belarusian government doesn't want to sell states companies "under" value. But it's necessary to understand that the privatisation is not just a fiscal exercise, but a crucial measure for modernisation and improvement of the competitive position of the country in the world, which raises the medium-term grows potencial of the country.

Recommendation 3: *Consequently, privatisation as a crucial part of the structural changes needs to be stepped up on the principals of transparency, competition and openness. It is very important that the privatisation framework follows best international practices. Some of previous privatisation deals were not in line with these demands. They were conducted mainly by direct sale (in 4 cases by issuing a presidential edict) and the negotiations exhibited a closed character (including no official publishment of the final price). Procedures provided by the respective law such as organizing a tender or contest, as well as the possibility to buy shares of a new emission of shares were not followed. And to attract foreign investors to participate in Belarusian privatisation process the government should:*

- *give the investor more flexible policy concerning additional conditions of privatization (about employment, production and sale policies, obligation to keep social infrastructure etc.);*
- *limit possibilities of interference after prevatisation (price policy, investment or employment policies);*
- *avoid abrupt policy changes: At the beginning of 2007, there were negotiations on privatising cement plants, but later the government decided to develop the cement industry itself. The same situation applied to cases in*

the brewery and food industry. This sudden reversion of planned privatisation plans was in the eyes of many interested foreign investors a major set-back in terms of a transparent, orderly and reliable privatisation process.

5. Some of the most important lesson from the crisis relate to long-term policies regarding the attraction of foreign capital. The global crisis involved a lot on Belarusian debt policy. The external debt increased in several times in 2009, but with comparison of other CIS and CEE countries external debt of Belarus is much lower. Belarus has gotten loans from Russian Federation, Venezuela, IMF, etc. Borrowings by government in Belarus are mainly based on the bilateral intergovernmental loans and have no direct relation with market tendencies. As for commercial credits, usually they are closely connected with export-import transactions of enterprises and provided for the short term. Belarusian banks also attracted mainly short-term capital in form of syndicated loans during 2007-2008. As a result the structure of this debt showed that the short-term debt is very high and to serve this debt is very difficult during crisis.

Recommendation 4: *Belarus should decrease the share of short-term debt and to diversify the instruments of external borrowing (for example the issue of Eurobonds). To make the country more resilient to global financial distress, domestic capital markets need to be further developed, including the participation of non-residents. The country should not repeat the mistakes of other countries like Kazakhstan and overstress foreign borrowing. Belarus should always remember, the IMF and foreign goverments loans are not investments in modernisation, they are resources for relative stabilisation. Therefore only private investments may be involved in upgrading.*

6. Among all financial flows, FDI are the most important for Belarus. Belarus officially welcomes FDI and has undertaken several measures to attract them to the country. The policy has been taken on the ground that the incoming FDI brings about transfer of technology and managerial know-how, which will spill over to domestic firms, enhance their competitiveness and integration with the global economy. Companies with foreign direct investments are less labor intensive and more capital intensive, and consequently more technologically sophisticated than domestic firms. The country needs to attract foreign capital to absorb the energy shock and to remain competitive

on the global economy. And to avoid being hit by future global financial problems, some recommendations for making Belarus more robust against turbulences on international market are proposed.

Recommendation 5: *First, due to its many advantages, Belarus should generally preferred FDI as the major form of foreign investment. Second, the crisis abroad has shown that a diversified share of FDI in the banking system (as opposed to short-term foreign borrowings) provides an important anchor of stability. Third, for further FDI increase the process of making favorable investment climate should be continuing.*

High and sustainable growth in future can be achieved with improvements in productivity and increased foreign direct investment. Economic liberalization and accelerated privatization efforts can produce these results. The exchange rate level and regime appear appropriate, but a move to a more flexible system would be warranted once a strong institutional framework is in place to support it.

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