

EU-STRAT is an international research project that studies the relationship between the European Union and the countries in the European Eastern neighborhood. The project started on 1 May 2016 and will continue until the end of April 2019.

The main ambition of EU-STRAT is to provide an inside-out analysis and strategic assessment of the links between the EU and Eastern Partnership countries.

EU-STRAT will address **two main questions**:

First, why has the EU fallen short of creating peace, prosperity and stability in its Eastern neighbourhood?

And second, what can be done to strengthen the EU's transformative power in supporting political and economic change in the six Eastern Partnership (EaP) countries?

To stay in touch with EU-STRAT, you can visit our website:

<http://eu-strat.eu>

or follow us on **Twitter** and **Facebook**

Click on the icon below to visit our TT account and fanpage!



You can also get in touch with us directly at:

eustrat@zedat.fu-beflin.de

POLICY COMMENT

(MARCH 2018)

One country - two economic systems? The 'partial reforms' experiment in Belarus

by [Kamil Klysiński](#) (OSW)

On December 22, 2017, Belarusian president Alexandr Lukashenka signed two important decrees: the first 'On the Development of Entrepreneurship' and the second 'On the Development of the Digital Economy'. The decrees foresee an unprecedented opening of the private sector in Belarus, and give strong legal and tax incentives to the IT sector. They are the latest expression of a path that Belarus has taken over the past few years, in the course of which the IT sector has become a priority issue in economic policy. At the same time, Belarus has firmly neglected recent calls by the International Monetary Fund (IMF) to restructure its state-owned sector. The Belarusian authorities have thus sent conflicting signals by building islands of a modern economy based on high-tech technologies, a developed service sector and private entrepreneurship, while still sustaining the old ineffective economic model of command-and-control.

The creation of islands of modernity

In 2017, the Belarusian president intensified the positive rhetoric regarding modern technologies and small and medium-sized businesses, which had been around for several years. This development reflects the growing conviction of authorities that the degradation of a significant section of Belarus' outdated and ineffective industry is irreversible, and that it is necessary to find new sources of budget revenues and drivers of economic growth. The rhetoric was then channelled into legal action, when Alexandr Lukashenka signed a number of decrees, the most important of which were those 'On the Development of Entrepreneurship' and 'On the Development of the Digital Economy'. The former reduced the bureaucratic burden for private enterprises by allowing new firms to submit a single statement for registration without the need to wait for the permission to operate. The decree was supplemented by other regulations that replaced regular inspections of all businesses with random inspections of only selected entities. The new regulations received a lukewarm response from representatives of Belarus' business circles. Used to a policy of strict control and far-reaching regulation of the private sector, business owners stressed that much depended on whether and how the regulations would be applied in practice. They have also been sceptical of the possibility that authorities will financially sanction improper organization of work and ineffective management.

The business community evaluated the unprecedented liberal decree concerning the IT sector much more positively. Over the past few years, the IT sector has become – also in the government’s rhetoric – a kind of model for development and innovation to be followed by the entire Belarusian economy. IT firms, part of which are concentrated in the High Technologies Park (HTP) located near Minsk, are among the most rapidly developing business entities in Belarus. Their share in GDP has been steadily increasing. Over 90 % of their production is exports whose value exceeded US\$1 billion in 2017, and was 25 % higher than the year before. According to governmental forecasts, the annual income generated by the IT sector will exceed US\$2 billion after 2021 and US\$4 billion in 2030. The aim of the decree is to accelerate this sector’s growth by attracting foreign investors and qualified specialists from other countries, and developing cutting-edge IT technologies for the financial sector – above all cryptocurrencies. For this reason, the HTP comes with a specific special legal status. This status provides HTP-located firms with guaranteed tax reliefs or complete tax exemptions (for example, from value-added-tax), unlimited possibilities for using cryptocurrencies (which in effect implies the legalization of such currencies), as well as visa-free entry and 180-day stays for foreigners employed there. This special legal status has been granted until 2049. Furthermore, residents of the HTP have gained significant liberties with regard to the opening of bank accounts, settlements with foreign contractors, and the circulation of accounting and technical documentation. Such an island of modernization is unprecedented not only in Belarus, but also globally when it comes to the use of cryptocurrencies. Even though the decree will only come into force on March 28 this year, and some international financial organizations have raised doubts over whether Belarus’ regulatory bodies have sufficient oversight capacity for its implementation, IT companies from many countries worldwide (including Brazil, Japan, Israel, Russia and India) have already expressed strong interest in starting a business in Belarus, especially in the area of cryptocurrency trade.

The preservation of the command-and-control economy

In parallel to these liberalizing moves, however, the Belarusian government is continuing to support the increasingly ineffective and expensive economic system based on top-down orders and distribution. Its essential element is the industrial sector, which is predominantly state-owned, produces around 70 % of total GDP, and operates according to Soviet planning and management principles. Alexandr Lukashenka, fearing that the social situation might destabilize in the case of massive dismissals of employees (given that 40 % of the employed worked in the public sector in 2017), for years has consistently blocked not only the liquidation but also the privatization of unprofitable state-owned firms. Revenues from privatization in 2017 only slightly exceeded US\$1 million, while the planned budget revenue from privatization was US\$140 million. The privatization goals for 2018 have been reduced to US\$128 million, which still seems hard to meet.

A serious problem is posed by the increasing debt of state-controlled companies, which already shows some features of a loan spiral, given the fact that most of them are *de facto* insolvent. As a result, some of these companies are short of funds, not only for investments and buying raw materials, but also for paying wages on time. The government thus tries to reconcile a policy of subsidizing these entities, with a rigid loan policy of Belarus’ central bank. According to the IMF, the annual cost of subsidizing the state-owned sector equals 2.2 % of GDP. Consequently,

Kamil Klysiński is a Senior Research Fellow at the Centre for Eastern Studies (OSW) in Warsaw.



the IMF made the opening of a new credit line for Belarus dependent on the implementation of a programme for restructuring of the state-owned sector, amongst other things. This resulted in a deadlock in the negotiations. Although the authorities do not entirely reject the IMF proposals, they claim that their consideration will be possible at the earliest in 2020 after the parliamentary and presidential elections.

The command-and-control-economy also prevails with regard to Belarus' wage policy. Last year the president promised to raise the average monthly wage in the country to US\$500. To achieve this goal in a highly difficult macroeconomic situation, the government used administrative means of pressure towards the end of the year, and threatened to impose fines or conduct extraordinary audits. In order to meet the requirements, some of the companies needed to take on additional loans. A continuation of this policy may further lead to another devaluation of the rouble. There is also no indication that the authorities will abandon another controversial policy that punishes the unemployed: Lukashenka has recently approved a decree on the so-called fighting against 'social parasitism'. Even though it is still unclear how this policy is supposed to work in practice, from January 1, 2019, unemployed citizens of working age are charged with a special duty to cover the full costs of social services (e.g. healthcare). A similar attempt in 2017 led to a wave of massive protests that eventually forced the Belarusian authorities to modify the decree. The continuation of those activities may not only cause social unrest but may also further strengthen the conservative track in Belarus' economic policy that counters rather than promotes established principles of liberal market economies.

Dangerous illusions

The Belarusian government's economic policy moves are contradictory. On the one hand, 'manual steering' (or state interference) is still used to support the predominantly inefficient state-controlled sector, which puts a serious burden on the state budget. On the other hand, the government has decided to launch unprecedented liberal reforms in selected sectors. If fully implemented, in the IT sector these reforms might even set the standard for a modern post-industrial economy. As a result, the government has consciously brought about a situation in which two radically different economic models are operating in parallel within one state. It appears that the profitable, already reformed sectors are tasked with financially supporting the inefficient state-controlled sectors, which is expected to ensure social stability.

Ultimately, in the long term, the government hopes that the proportions will be gradually reversed, and that the rapidly developing segments will form the foundation of the Belarusian economy. The first steps of such a very cautious reconstruction of the economy, which will take years, have been taken. However, the deterioration of foreign trade along with rising debt levels in 2017 suggest that a comprehensive and dynamic reconstruction of the economy is immediately needed in order to build stable foundations for economic growth. Otherwise, Belarus might find itself in a so-called low growth trap for the next couple of years, oscillating around 2 % of GDP, which is insufficient for developing countries trying to approach a higher level of development. It could also plunge back into recession, or even face outright economic collapse. Without further reform of its economy, the political regime of Belarus may risk its own stability.