Belarus and the IMF

JVI Course - Financial Programming and Policies
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Three phases in Belarus macro performance since independence:

- Post independence contraction (1992-1995)
- Boom years (1995-2009)
- Slow growth and recession (2010-201x)
Sharp decline in GDP in the early transition

Real GDP per capita, PPP-adjusted
(t=100)

- EST
- POL
- CZE
- SVK
- BGR
- ROM
- BLR
- LVA
- LTU
- RUS
- UKR
- MDA

$\text{t}=1991$ for former soviet republics (solid lines)
$\text{t}=1989$ for other countries (dashed lines)
1995-2008: rapid growth

Real GDP per capita, PPP-adjusted (1995=100)
Since 2009, growth has slowed sharply.
Seen over entire 1990-2016 period, growth in Belarus has not been bad...
But this largely reflects very rapid growth during boom years.
Why has economic performance deteriorated?

- Is it due to *external* reasons (including recession in Russia and Ukraine)?
- Or were there also *internal* reasons? Was the growth model unsustainable?
- Which reforms could help to restore growth?
- How can the IMF help?
External Reasons for the Growth slowdown
External factors have certainly played a role in the slowdown: Belarus export markets have done poorly.

Note: export market growth is weighted average of Belarus’ trading partners real GDP growth, covering over 95 percent of exports.
Global growth has been fairly stable in recent years...
But growth in emerging markets has slowed—particularly outside China and India
Within CESEE, there were significant differences in growth....
As CIS was in recession, and the rest of CESEE was growing quite strongly.
Russia and Ukraine suffered from shocks, and Belarus from spillovers.

- Collapse of commodity prices
- Sudden stop in capital flows to Russia, result of sanctions on Russia
- Conflict in Ukraine
Exchange rate flexibility was unavoidable given the limited buffers...
...but increased inflation and reduced real wages
Ukraine and Russia are now recovering (helped by rising oil prices)
No signs of recovery yet in Belarus; recession driven by sharp drop in domestic demand.

Demand and supply components: contribution to GDP in 2016 (percent)

Belarus

Demand: -12
Supply: -9
Exports: 0
GDP growth: 0
Imports: 0
Statistical discrepancy: -3

Russia

Demand: -3
Supply: -3
Exports: 0
GDP growth: 0
Imports: 0
Statistical discrepancy: -3

Ukraine

Demand: 3
Supply: 0
Exports: 3
GDP growth: 0
Imports: 0
Statistical discrepancy: -3

Belarus

Exports
GDP growth
Imports
Statistical discrepancy

Demand
Supply

Russia

Demand
Supply

Ukraine

Demand
Supply
Forecast for 2017: Non-CIS similar as 2016; pick-up in CIS; Belarus still in recession

GDP growth (percent)

Note: CIS countries in red.
Internal Causes for Growth Slowdown
Belarus growth model was unsustainable

- Growth was increasingly driven by unsustainable investment/domestic demand boom
  - This led to BOP crises
  - Productivity (TFP) declined, offsetting the impact of the larger capital stock
Investment to GDP ratio increased sharply in the 2000s
As domestic saving was not sufficient...
...the current account deficit increased sharply...
...and would have been even higher without support from Russia.
Wages increased strongly

Average monthly wages in USD

USD 500 line
External debt accelerated

External debt
(percent of GDP)

As did public debt.
The result was several BOP crises

Changes in exchange rate and official reserves

- BYR/USD exchange rate (monthly changes, percent)
- Official reserves, rhs (percent of GDP)
Reigniting growth
Exchange rate has now stabilized

BYR/USD
(Jan-2013=100)

Floating of BYR

Depreciation
How can growth be reignited?

GDP growth in Belarus
(percent y/y)
Not by generating another investment boom

- Without improving exports, investment boom would increase the current account deficit and lead to another BOP crisis
- We cannot count on a return to past higher growth rates in Belarus’s key trading partner Russia
- Nor the same level of favorable energy import pricing.
Without meaningful SOE restructuring, investment alone will not improve productivity and exports.
Increasing efficiency rather than increasing inputs

- Instead, growth will to a much larger extent need to come from increasing efficiency rather than increasing inputs.
- Indeed, what sets Belarus apart from other countries, is not low investment or low employment, but, rather low productivity.
Investment in Belarus is quite high

Investment to GDP ratio, 2016
What sets Belarus from other countries is low productivity.
Economic efficiency may be hampered by the too limited role of the price mechanism in allocating resources.

Examples:

- Absent hard financial constraint, many state-owned enterprises are loss making.
- Household energy prices are below cost-recovery levels.
Losses of SOEs create macro problem

- They have to be compensated by
  - Higher fiscal expenditures
  - Or by cheap credit (directed lending)

- While current policies have protected employment in inefficient SOEs, this comes at the cost of seeding the sows of the next crisis.
Simply stopping transfers may create a banking sector problem

- SOEs need to be restructured
  - IMF providing TA on how to do this
- Strong social safety net needed to cushion adverse impact on unemployment
- Growth-enhancing policies, such as lending programs for privately-owned SME may help
- The World Bank is working on a loan/project to support SME lending.
Setting heating tariffs at cost-recovery levels and reducing cross-subsidization means lower subsidies and more incentive to use more energy-efficient technologies.

Source: IMF Staff Report, September 2016. Methodology for calculating cost-recovery in Belarus has since changed.
Belarus needs to catch-up with transition

EBRD transition indicators

Small scale privatization
Trade and forex system
Price liberalization
Large scale privatization
Governance and restructuring
Competition policy

SEE EU
Belarus

*CE4 includes Hungary, Poland, Slovakia and Slovenia.
Lessons from Early Transition

- In the early 1990s economists had strong disagreements about whether transition should be gradual or more rapid.

- In the end, some countries (Czech, Poland, Baltics) opted for rapid; others (CIS, Bulgaria) for more gradual.
What were the results?

- Rapid liberalizers had a much shallower recession—as well as strong long-term growth

- So waiting with liberalization did not moderate the pain—it exacerbated it.
Postponing reforms can be costly

- Reforms can certainly be painful in the short run, but not transforming the inefficient economy can have even larger costs.

- Example: in 1989 Poland and Ukraine were equally poor. Poland pursued transition reforms quickly, as opposed to Ukraine.
Today, Poland is three times as rich

Change in light during the night between mid 90’s and 2012-13, based on satellite images

Note: the map shows the differences in intensity of brightness between the averages of 1992, 94, 96-97 and 2012-13.
Belarus and the IMF
Belarus has had several IMF Programs since independence.

IMF arrangements with Belarus and credit outstanding (SDR billion)
Many promised reforms not implemented

- Many of the structural reforms pledged in STF have still not been done.
  - SOE Reform
  - Utility Reform
Last program in 2009/10

- Achieved temporary stability, but
- Macro-adjustment was not durable
  - Directed lending increased sharply during program
  - Shortly after program ended, policies were loosened
  - BOP crises followed
- Few structural reforms
Belarus and IMF have been talking on and off for the past two years about a possible new program.

- **Goal** is to reach agreement on a 3 year EFF program.
  - Macro-adjustment to reduce vulnerabilities
  - Structural reforms to reignite growth (and further reduce vulnerabilities)
More contentious elements of program

- Pace and depth of SOE Reform
- Raise cost recovery for utilities
- Adequacy of Social Safety Nets
Experience in other countries suggests “ownership” is important

- Programs are most successful if governments implement reforms because they believe in them—not because they feel they have to
- Examples of successful IMF programs with ownership
  - Korea
  - Ireland
  - Latvia
The IMF is a strong supporter, not just of growth, but of inclusive growth. That is why we advocate reforms that will support economic growth, with targeted support for those in need.

We cannot and do not want to impose reforms. But we can help countries that want to reform. We hope that we will be able to help Belarus to reform.
Conclusions

- Belarus has had rapid growth
- But growth model no longer sustainable
- Reforms and more market mechanism needed
  - To fix macro problems
  - To fix micro problems
- Waiting with reforms may exacerbate pain—not lessen it.
Thank you