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From the Editors: In this issue, we revisit the study *30 Years of Economic Transformation in CEE: Key Five Lessons for Belarus* recently concluded by CASE and CASE Belarus to present the highlights and key recommendations. In so doing, our brief rehearses issues that will be put up for debate during the first Belarusian Economic Forum organised by CASE Belarus on March 19 in Warsaw (see page 3 for more information).

Belarusan Reforms: A Path Less Trodden

Krzysztof Głowacki, CASE Economist, with contributions from the CASE Belarus Team

With fresh memories of a recession and its GDP per capita (PPP) lingering at 64% of the reference group, Belarusan economy shows plenty of room for reforms. If these are stepped up, the experience of CEE countries such as Poland may provide useful lessons.

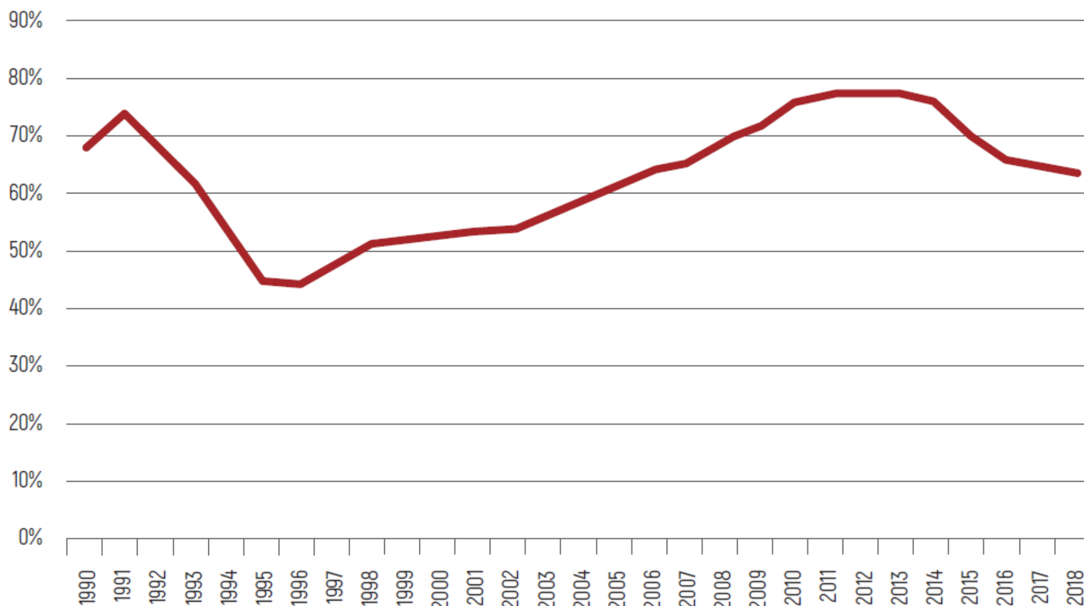
The economic history of independent Belarus is a story of twists and turns. After sinking into economic turmoil, like many ex-Eastern-Bloc economies in the first half of the 1990s, the country managed to rebound and entered a path of dynamic growth for sixteen years between 1996 and 2011, nearly doubling the size of its economy – with not even the 2008 financial crisis forcing it into recession. Between 2012 and 2014, however, the growth decelerated to the range of 1-1.7%, and Belarus actually experienced recession in the years 2015-2016 (of -3.8% and -2.5%, respectively) before returning to moderate growth (1.5-3%) sustained ever since. With Belarusan GDP per capita (PPP) lingering at 64% of that in Central Europe and Baltics (Figure 1), it seems that the growth model based on rationalising the command economy and striking opportune deals with geopolitical wooers from the West and the East has burnt out its fuel. New, organic engines are needed to kick-start the Eastern European economy before macroeconomic imbalances begin to threaten the carefully nurtured social order.

The growth engines Belarus needs can be unlocked by a **policy mix** comprised of **microeconomic liberalisation, macroeconomic stabilisation, and institutional transformation**, a package that had once helped transform Central Europe from a post-Communist backwater into an EU growth champion. First, the continued reliance in today's Belarus on state-owned enterprises (SOEs) as primary business vehicles undermines long-term development, calling for **microeconomic liberalisation**. Because the Belarusan SOEs consistently underperform as compared to private enterprises, the continued public support they receive is effectively a misallocation of resources and a distortion of competition. It strains public finance (to the extent of coming directly from state budget) and penalises performance (to the extent of coming as cross-subsidies from more to less profitable entities), and it should be phased out. Likewise, to enable a level-playing field in the economy, SOEs should be made able to undergo bankruptcy – rather than enjoy the guarantee of sustained operation irrespective of performance – and eventually, solid anti-monopolistic legislation should be adopted (see also below).

Second, while savings on SOE subsidies will work toward easing the fiscal pressures, further efforts will be needed to enhance **macroeconomic stabilisation**, including phasing out energy subsidies to households and keeping the wage growth within the confines of the productivity growth. Today, the balance between the two is undermined by the

centrally planned wage targets, which may fuel inflation and should be eliminated. In Poland, which faced a similar challenge, a temporary tax dubbed *popiwek* was used in the early 1990s as a wage control mechanism, applied initially to all enterprises and later exclusively to SOEs. Another pressing issue related to macroeconomic stabilisation is foreign borrowing. By unlocking additional opportunities for consumption and allowing for technology imports, this mode of financing may seem advantageous in the short term but is very risky in the long term. In Poland, the consumption and investment spree of the 1970s, financed by foreign debt, led to severe macroeconomic imbalances a decade later, becoming a contributing factor to the fall of the Communist government in 1989. The noxious effects of foreign borrowing are also beginning to weigh on the Belarusian economy. With the external debt at 28% of the country's GDP and access to low-interest IMF loans obstructed due to stalled reforms, any future borrowing abroad should be carefully considered.

Figure 1: Belarusan GDP per capita (PPP, constant 2011 international USD) in 1990-2018 as percentage of the average in Central Europe and Baltics



Source: Own calculations based on the World Development Indicators

Third, for Belarus to steer clear of the oligarchic pitfalls suffered by its neighbours to the east and south – which reformed their institutions less than they liberalised their economies – genuine commitment to **institutional transformation** will be needed. Ultimately, the institutional transformation must encompass mechanisms that may seem prima facie unrelated to the market but that in fact have a fundamental effect on economic exchange. Crucial among them is **the rule of law**, which through the channels of property rights, legal certainty, checks and balances, and an independent judiciary promotes market exchange by increasing inclusiveness of transactions and decreasing their costs. A similar, transaction-enabling logic should guide the development of anticorruption mechanisms. In all, it is essential that such mechanisms work in social practice rather than merely as legal acts, posing a challenge for civil society to not only demand and monitor, but also inspire and promote policies.

Of course, institutions of immediate economic relevance, such as **anti-monopolistic legislation**, **an independent Central Bank**, and **a macro-prudential framework** are also indispensable to a sustainable economy and should be

strengthened where deficient. Fiscal rules, for example, exist in Belarus but show incoherencies across the central and the local levels of government and should be harmonised. Moreover, a debt anchor of a comprehensive scope, set at a sufficiently prudent but at the same time realistic level, should be introduced. In Poland, for example, a 60% debt to GDP ratio is entrenched in the Constitution, prohibiting the general and local governments to take loans or provide guarantees above that value in total, and the Public Finances Act lays down prudence thresholds of 55% and 60%, which, if breached, trigger countervailing measures such as a ban to increase wages or to index pensions and an obligation to prepare a corrective plan.

It is important to note that the reform avenues described above – microeconomic liberalisation, macroeconomic stabilisation, and institutional transformation – form a mutually-complementary set of reforms that cannot be picked à la carte. For one, as the economic theory suggests and the CEE countries' experience confirms, macroeconomic stabilisation is intimately linked with microeconomic liberalisation. Without the efficiency maximising effect of the latter, the Belarusian economy will continue to consume more than it is able to produce, undermining the budget or risking social discontent in case of sudden cuts. Likewise, without an equality of opportunity in economic life, vindicated by a strong rule of law, no true liberalisation will be allowed to occur.

Another caveat is that very different timespans apply to the different components of the reform package. While all should be undertaken as soon as possible, institutional transformation is almost guaranteed to take up longer time horizons than microeconomic liberalisation and macroeconomic stabilisation, due to the underlying inertia of social and political arrangements. Such has also been the fate of reforms in the CEE countries. In Poland, for instance, the macro-prudential framework has suffered a number of setbacks, such as in 2013, when an erstwhile 50% prudence threshold was suspended in the face of post-financial-crisis turbulences, or in 2015, when a freshly introduced stabilizing expenditure rule was disarmed by a change in the forecasted inflation parameter. More worryingly, Polish commitment to the rule of law, until recently deemed all but complete, has since 2015 been put into question, with an erosion of checks and balances, infringements on the judiciary, and diminishing transparency, among others.

Indeed, there is no denying that the path of reforms is rough, winding, and often unpredictable. Whatever the future has in stock for a reforming Belarus, however, that stock certainly holds more promise than a path well-trodden but dead-ended.

The article is based on the outcomes of the project 30 Years of Economic Transformation in CEE: Key Five Lessons for Belarus *conducted by CASE and CASE Belarus between October and December 2019. A paper with key findings is planned for publication shorty.*

On March 19, CASE Belarus organises Belarusian Economic Forum (BEF) in Warsaw, with over 15 speakers from 5 countries, including Minister of Economics of Belarus Aleksandr Chervyakov (TBC) and CEO of the Warsaw Stock Exchange Marek Dietl. You can see the agenda and register here.

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Trade, Innovation, Productivity

Following a monetary expansion that began in 2019, the newly-incurred debt of the global non-financial sector amounts to USD 2.1 trillion, according to OECD's newest (2020) report *Corporate Bond Market Trends, Emerging Risks and Monetary Policy*. This record-high borrowing co-occurs with an unseen-before build-up of corporate debt since 2008, translating into an outstanding stock of non-financial corporate debt of USD 13.5 trillion. Apart from its mind-boggling size, the very quality of the debt has changed in the last decade: compared with the past credit cycles, the current one shows a much lower overall credit quality and longer – and thus riskier – maturities. In the current, prevalently low-risk economic environment, companies have been able to maintain their credit ratings within the investment grade category and simultaneously increase their debt-to-equity ratios. At the same time, the once-clear demarcation lines between investment and non-investment grade securities have become muddled. Assuming that the low-interest economic environment fails to support the lukewarm business dynamics, or in case of a sudden market crash, the extant credit rating mechanisms, which permitted elevated leverages, may lead to severe credit risk corrections. These, in turn, will be reflected in ballooning financial costs and a diminishing investment potential of the non-financial sector.

Labour Markets and Environment

In early February, UK's main advertising watchdog – the Advertising Standards Authority – banned Ryanair's commercials that featured a claim of the Irish carrier being Europe's *lowest emissions airline* and a leader in the aviation industry's effort to cut pollution. In contrary, environmental experts responsible for the preparation of the EU's top 10 carbon emitters ranking recently estimated that Ryanair emitted almost 10 million tons of CO2eq in 2018, which puts the company in the top 10 of the EU's biggest polluters alongside the Mediterranean Shipping Company and several coal-fired power stations. Ryanair, however, counters that is calculates CO2 emissions in a different way, focusing predominately on emissions per passenger-km, where indeed more seats per plane and high fill rates act to Ryanair's advantage. Roughly at the same time as the ban was issued, the Sustainable Aviation group that consists of Airbus, Boeing, Rolls-Royce, London's Heathrow airport, BA, and EasyJet made public their ambitions of becoming carbon neutral by 2050.

Macroeconomics and Public Finance

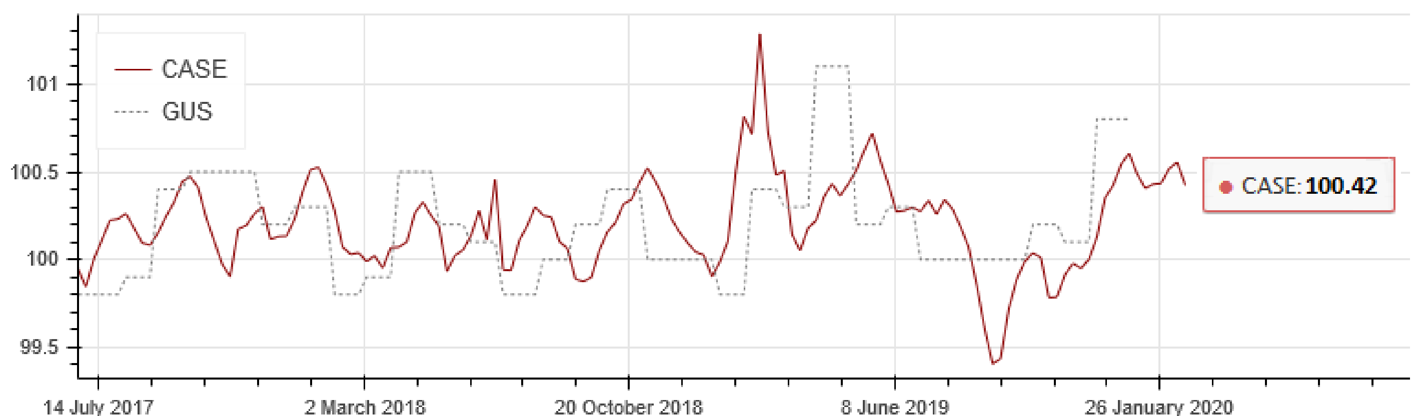
On February 17, Poland's Ministry of Finance published information on the 2019 budget implementation. The long-awaited data show a decrease in the general government deficit of PLN 15 billion compared to the draft budget, down to 0.7% of GDP, owing mostly to income tax revenues. The revenues from PIT and CIT increased by 9.9% and 15.5% y/y respectively. The optimistic news on the income tax revenue is overshadowed by a rather modest increase in the VAT revenue. It is likely that after three years of sky-rocketing VAT revenues a steady decline of the VAT gap, the trend has decelerated. According to our quick estimates, the VAT gap may in fact have increased, from 9.5% to 10.6% of the total VAT liability. In general, the optimistic plans to further increase VAT compliance and meet a balanced budget are becoming less likely.

The Weekly Online CASE CPI

The online CASE CPI is an innovative measurement of price dynamics in the Polish economy, which is entirely based on online data. The index is constructed by averaging prices of commodities from the last four weeks and comparing them to average prices of the same commodities from four weeks prior. The index is updated weekly. For more information on our weekly online CASE CPI, please visit: http://case-research.eu/en/online-case-cpi.

The mid-February read-out of the Online CASE CPI shows that the trend of strong price increases, which started at the end of last year, continues. Our data shows that the most significant price increases are in *Housing* (up by 1.6% month-to-month), led by the prices of electricity (up by 6.3%) and heating (3.2%). The prices in the largest observed basket category – *Food and Beverages* – went up by 0.3% on average. Prices in the *Transportation* category, on the other hand, went down slightly – by about 0.1%.

Our Weekly Online CASE CPI



Monthly CASE Forecasts for the Polish Economy

Every month, CASE experts estimate a range of variables for the Polish economy, including future growth, private consumption, investments, industrial production, growth of nominal wages, and the CPI.

CASE economic forecasts for the Polish economy
(average % change on previous calendar year, unless otherwise indicated)

	GDP	Private consumption	Gross fixed investment	Industrial production	Consumer prices	Nominal monthly wages
2020	3.3	3.7	3.6	2.9	3.3	6.0
2021	3.1	3.4	3.4	2.7	2.8	5.1

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