Foreign Trade Policymaking in Belarus: Current Practices and Problems

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Integration of Belarus into the world economy is one of the official priorities of Belarusian national policy. However, despite numerous government economic programs, Belarus does not have a well-defined foreign trade strategy. Understanding the problems related to the development of such strategy is of paramount significance.

As Anne O. Krueger notes, "Ideas with regard to trade policy and economic development are among those that have changed radically."[1] It has been internationally recognized that trade policy is a central driving element of economic growth and development—an integral part of general reform strategy in most transitional economics.[2] It is especially critical for Belarus to develop an efficient trade policy so that it can establish a qualitatively new system of relations with the world economy, restructure and modernize its national economy, and implement economic reforms to ensure sustainable development in line with the new geopolitical situation of the country.

Belarus began to set up its own foreign economic relations management system in 1992, after it became politically independent. Total government control over export and import operations was replaced with a more flexible arrangement allowing more freedom to individual companies, more in line with international foreign trade practices.[3]

The Organization for Economic Cooperation and Development (OECD) has produced a three-stage pattern to describe the evolution of trade regimes in the Newly Independent States of the former Soviet Union, based on such measures as import and export regulations and foreign exchange control. During 1995 and 1996, Belarus was at the intermediate stage of trade policy reform; it had gradually decreased state ownership and inflationary pressure while implementing a regulatory framework and international methods and instruments for trade.[4]

However, at the beginning of 1997 national economic policy, including trade policy, made serious shifts toward centralized government management, and the

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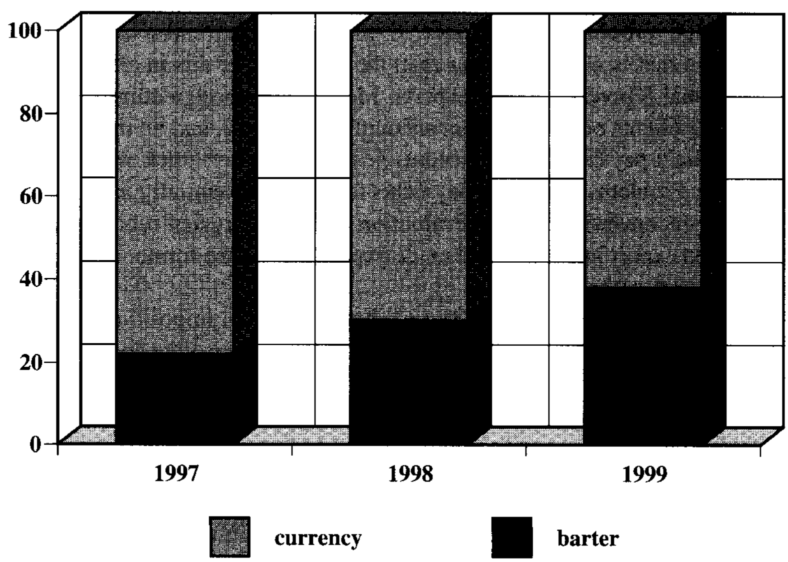
national economy worsened rapidly.[5] The government limited the size of the private sector (to 15 percent or less of national industry), imposed direct control of most prices, and increased intergovernmental barter (see figure 1). As the degree of state intervention increased, so did hyperinflation. Belarus took a step backwards to the first stage of the OECD's pattern for trade regimes.

It should be taken into consideration that national foreign trade policy was emerging in Belarus amid a struggle between two antagonistic approaches. Some maintained that the faster and more comprehensive foreign trade liberalization, the sooner the national economy would be incorporated into the global economic system. The experience of the Baltic states and East European countries shows that rapid and successful reform is possible with liberalization of trade and external payments, as well as of the financial sector as a whole, and with radical economic policy.[6]

The other viewpoint held that during the transition process it was dangerous to attempt immediate and far-reaching liberalization of foreign economic relations. It was feared that liberalization of foreign trade could provoke deterioration of the macroeconomic situation, with massive bankruptcies among domestic producers who would be unable to compete with imported goods, loss of jobs, and high inflation.[7] Other countries' transition experience had already shown that having a balance of trade deficit could become a serious problem. Foreign trade reforms could result in an increasing budget deficit due to shrinking foreign trade tax revenues. In Belarus, customs duties have always been a major source of bud-

FIGURE 1. Share the barter in Belarusain exports 1997–99



get revenues, accounting for 15.8 percent of total revenues in 1998; the 1999 projection stands at 14.2 percent.

There were also doubts as to whether foreign trade liberalization would result in accelerated economic growth. Economic progress in newly industrialized Asian countries and Japan was linked to the government's conducting an actively protectionist policy to defend export-oriented branches of economy. In Belarus, 40 percent of imported products have tariffs of 0–15 percent, and another 50 percent are subject to tariffs of 15–30 percent. The Memorandum on Belarus Foreign Trade Policy quoted an average weighted tariff rate of 14.2 percent, which is similar to rates in many developing and postsocialist countries and much in excess of rates in the European Union (EU), the United States, and Japan.

Those opposing liberalization also affirmed that despite an overall trend toward trade liberalization, many countries vigorously defended their domestic markets, widely employing both tariff and nontariff protection methods. Interestingly enough, reduction of tariffs usually widens the gap between the average level of protection of raw materials and semifinished goods on the one hand, and finished goods producers on the other hand. For instance, following the Uruguay Round that gap almost doubled, with most tariff protection being granted to knowledge-intensive and high-tech industries, as well as other newly emerging, highly competitive industries. Therefore, most shifts in the global material production structure were accompanied by this so-called sliding protectionism, which favors the avant-garde of the world economy.

The complex and contradictory influence of the above factors, which discourages quick trade liberalization, has molded a trade policy that embraces rather tight government controls over foreign trade activities: exchange controls, instructions to maximize exports and reduce imports to meet official targets, wide use of nontariff import regulations, and so forth. For instance, 30 percent of foreign exchange proceeds are subject to mandatory surrender at an official exchange rate that is 40 percent less than the market rate; this in effect amounts to an additional 8 percent tax on exports. Meanwhile, foreign currency may be purchased for clients only for current account transactions, and no more than one thousand dollars per day. Oftentimes businesses have been stuck with hard currency claims. Problems in making payments for trade substantially increase transaction costs. Inconvertibility and revaluation of the Belarusian ruble have negatively affected export incentives and made export outside the former Soviet Union relatively less attractive.

Belarus's experience vindicates those who believe that imposition of government controls and introduction of protectionist restrictions isolate domestic prices from world prices and prevent manufacturing industries from adequately reflecting global economic developments. Administrative intervention into economic processes and lack of economic accountability, including the use of bankruptcy procedures, deprived Belarusian companies of meaningful incentives to ensure efficient use of available resources. For instance, the share of intermediate consumption (raw materials and semi-finished goods) in total Belarusian production amounts to 60 percent (up to 70 percent in industrial production). Production efficiency is in a permanent decline. During the last five years, labor productivity in the national economy decreased by almost a third, resulting in a high labor-to-capital ratio, or labor intensity growing faster than labor productivity. In other words, society pays more and more for each percent of increase in labor productivity. The situation is exacerbated by technological obsolescence (on average, equipment is used two times longer than its design intended), low product quality, inefficient price structure, and the fact that social infrastructure maintenance costs borne by companies are incorporated into their production costs. This makes Belarusian products lose their competitiveness in foreign markets, creates a growing balance of payments deficit, and causes macroeconomic disequilibrium. These trends spell disaster.

Belarus's economy is characterized by high export and import quotas, which create so-called functional openness, a condition where the well-being of the national economy is highly dependent on the state of its foreign economic relations and the degree of its incorporation into the world division of labor through export and import operations. It is represented by the share of foreign trade turnover—of exports and imports in gross domestic product (GDP).[9]

In Belarus the shares of export and import in GDP in 1998 amounted, respectively, to 55 percent and 62 percent, among the highest of the countries of Central and Eastern Europe. One of the chief reasons for this, as in any other small economy, is the tightness of the domestic market. Certain companies are able to sell domestically only 5 percent of their output; for instance, domestic sales of Belarusian tractors never exceeded 10 percent even in the best of times. But economies of scale are critical to attaining competitive production cost levels. In addition, the country has to import most of its raw materials for production, which are unavailable internally due to the lack of natural resources, low quality of domestic products, and high prices vis-à-vis similar foreign products.

However, the degree of economic openness of a country is not determined solely by its functional aspect. Economic openness also includes the degree of freedom of trans-border movement of goods, services, capital, and labor, in terms of the freedom of producers to select their partners in both the domestic and foreign markets; the freedom of foreign competitors to enter the domestic market; the comparability of domestic and world prices; the liberalization of the currency market; and the presence of an infrastructure compliant with world quality standards.

Consequently, the high share of exports and imports in the national GDP does not necessarily amount to a genuinely open economy, which should be associated with minimal entry barriers for foreign producers and minimal exit barriers for domestic producers.[10] In Belarus, the trade system is subject not only to the well-known traditional rules, but oftentimes also to unpredictable government edicts, particularly in the areas of foreign exchange controls, import controls and, increasingly, intervention of the central government into the decision-making processes of private companies that are involved in foreign economic relations.

As was mentioned above, this strategy of governmental intervention has failed to provide efficient incentives for foreign trade development. The balance of trade and the balance of payments remain negative (12 percent and 9 percent of GDP, respectively, in 1998), and imports grow faster than exports, which testifies to the gradually decreasing efficiency of Belarusian exporters' operations abroad. Introduction of additional import restrictions proved a poor remedy, as more than 70 percent of imports are raw materials required for domestic production, while Belarusian goods manufactured from domestic raw materials make up less than 20 percent of the country's total exports.

In 1997 the government came up with an import-substitution program to at least partially relieve the country's excessive reliance on imported supplies and assist national producers in their efforts to bring down production costs. The program aimed to reduce imports and increase domestic production. However, its results fell short of expectations. First, it soon became evident that the domestic products being substituted for imported products were of lower quality and represented inferior technologies, but were priced almost the same as the imports. Second, companies involved in the import-substitution program were artificially insulated from competition and given carte blanche to continue production of substandard goods, thus in effect squandering scarce resources. It became clear that not only did the program fail to improve the prospects of Belarusian products in foreign markets, but it actually hampered the much needed overhaul of the export structure.

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The kinds of exports the country specializes in are a legacy from Soviet times. The bulk of exports consists of goods qualified as low and medium technology-intensive according to the OECD classification: regular industrial products—which are of relatively low quality by international standards—including chemical/petrochemical products, black metallurgy, transport engineering, light industry products (i.e., bulk consumption goods such as textiles and carpets), and wood-processing industry products; raw materials and primary products such as mineral fertilizers and timber; and services, predominantly transportation. Such exports are in the product-decline stage—the very end of the so-called life cycle of the product:

Belarus does not have any significant natural resources or advanced production technologies, and the emphasis on exporting energy- and material-intensive products is economically unfeasible because it requires importation of a significant amount of raw materials. It would be preferable to follow the mainstream global trade trend and concentrate on capital- and resource-saving, knowledge-intensive production; sophisticated high-tech products currently account for more than half of world trade.

However, it appears unlikely that in the foreseeable future Belarus will shift its export specialization to competitive, knowledge-intensive, and high-tech products, primarily due to the lack of direct foreign investment (less than 1 percent of GDP in 1998), modern technologies, and advanced management techniques; the virtual nonexistence of cooperation with industrially developed economies; and the almost total depletion of internal development resources. It has been calculated that to implement the long-term investment programs required to modernize and expand national production would require capital expenditure in the real (capital goods–producing) sector of the economy as high as 30 percent of GDP. The actual figure for 1998 was 14.6 percent (without taking into account inflation, which amounted to 90 percent for the year), with 11 percent of the funds being provided by the companies themselves, 1 percent coming from individual ruble-denominated term deposits, and 1.6 percent from the Belarus banks' equities.

The extent to which the national export structure corresponds to global trade development trends is reflected in the Revealed Comparative Advantage index (RCA). High RCA index values show that an export item enjoys a comparative advantage in a certain market. The highest RCA index values in trade between Belarus and foreign countries that are not part of the Commonwealth of Independent States (CIS) were for textiles, nonprecious metals, chemical products, and timber. Somewhat lower values were registered for construction materials, transportation vehicles, and mineral fertilizers, while such items as machinery and equipment enjoy no comparative advantage in these markets. As regards trade with CIS countries, high index values are typical for textiles, transportation vehicles, and construction materials, with significantly lower values for timber and wood products, plastics, and raw rubber, and close to zero value for machinery and equipment. All these data indicate unfavorable shifts in the country's export specialization—a decreasing competitiveness of Belarusian exports.

Accordingly, a government program was developed in 1998 to support Belarusian exporters. The program envisaged identification of, and extension of government support to, priority industrial sectors. Eventually fifteen companies representing traditional Belarusian exports (i.e., potassium fertilizers, tractors, ferrous metal rolled stock) were granted credit, tax, and other privileges, accompanied by mandatory instructions to increase their exports. However, the program failed to attain its objectives. There was no shift in the structure of exports to increase the share of energy- and resource-saving and high-tech production, and the actual growth of exports fell short of expectations. It became clear that exporters valued free access to imported raw materials, the ability to freely dispose of their foreign exchange proceeds, avoidance of national currency devaluation, and the elimination of multiple exchange rates more than they valued government subsidies.

Attempts to galvanize foreign trade through regional integration with Russia and establishment of a customs union have also failed to yield the desired effect, although regional integration did give Belarusian producers certain benefits.[11] Most export taxes and import duties on trade with Russia were abolished. The two republics harmonized some of their trade regulations, according to the Agreement on Custom Union, and eliminated export taxes ranging from 2 to 10 percent, but left export quotas and licensing requirements intact. However, inasmuch as customs tariffs unification embraced 85–90 percent of the entire range of commodity items, Belarus was compelled to hike its import customs duties, in some cases by 100 percent or more, on products that weren't coming from customs union countries.

Another serious problem was presented by the requirement to unify tax treatment of third countries. Belarus was obliged to apply the same tax treatment to third countries as Russia, which disrupted its trade relations with a number of its CIS partners, such as Ukraine and Moldova, and the Baltic republics, inevitably resulting in reduction of mutual trade. For instance, Belarus had to denounce several favorable trade agreements with Lithuania. Negotiations between Belarus and Estonia on a most favored nation–status treaty stalled, because Russia is currently applying double tax rates to Estonia and is not going to change its position on that issue. By the same token, Russia has repeatedly changed its customs tariffs without consulting Belarus, which in many cases has damaged Belarusian economic interests. For instance, in 1998 Russia successfully negotiated an increase of its quota for the exportation of textiles to European Union countries without considering Belarusian interests, even though textiles are a major export of Belarus. Moreover, in response to the EU concession, Russia reduced its import customs duties for EU-manufactured carpets, which compete with Belarusian carpets in the Russian market.

Now Belarus depends entirely on Russia's pace of trade liberalization. But the structures of export and production are absolutely different in the two countries. Contrary to Belarus, Russia's economy is characterized by less external trade than internal trade; Russia can therefore permit itself to be a protectionist country. However, it hampers the process of external liberalization and ruins Belarusian bargaining power. And the treaty creating a union between Russia and Belarus, which was signed 7 December, leaves Belarus entirely at Russia's mercy.

All these factors contribute to the deterioration of trade between Belarus and the rest of the world.[12] One way to quantify changes in terms of trade is the use of a ratio in which the average export price index is divided by the average import price index. Reduction of the value of the ratio, or its falling below 1.00, reflects a deterioration of terms of trade. According to National Bank experts, in 1998 the average export price index was smaller than the average import price index, which testifies to the fact that Belarus's terms of trade have become less favorable due to a relatively faster growth of import prices as compared to export prices.

This trend is especially alarming because it fully applies to Belarus's trade relations with Russia, which account for the bulk of Belarusian exports. For instance, in 1997 export prices fell for fourteen out of twenty machine engineering commodity items. Overall, prices were reduced for 56 percent of all Belarusian export commodity items, while import price reductions affected only 38 percent of Russian commodity items. It is also noteworthy that certain major items that Belarus imports from Russia (oil and gas condensate, petroleum products, power, ferrous metal scrap, etc.) became more expensive for Belarus. The reasons for that are numerous, including the frequent use of barter (34.5 percent of total exports), which severely distorts pricing, and the low solvency of Russian companies. However, it does not change the fact that Belarusian manufacturers have to reduce their prices to avoid being crowded out of the Russian market, because low production efficiency and the use of obsolete technologies make Belarusian goods lose their competitive edge otherwise.

Another serious problem is the emerging preference of Belarusian companies for inferior and in some cases more expensive local products due to high import duties and lack of hard currency. This results in the so-called trade diversion effect described by Jacob Viner, where local consumers tend to prefer less-efficient internal goods supply sources, which, without a doubt, negatively affects the well-being of the countries that are members of the customs union.[13]

This is borne out by the fact that expansion of trade with Russia was accompanied by a considerable shrinking of exports outside of the customs union, which reinforced inefficient resource allocation practices (see table 1).[14] Because barter is the predominant settlement method in dealings with Russian companies (at some enterprises accounting for up to 90 percent), foreign exchange proceeds have dwindled and, consequently, manufacturers in Belarus have been deprived of the capital required to modernize production, improve the quality of products, and eventually increase their competitiveness. Finally, dependence of 65 percent of national exports on the market of a single country is simply economically unsafe, as was amply demonstrated by the crippling effect of the Russian crisis on Belarus's economy. Furthermore, all of the Newly Independent States participating in the customs union (Russia, Belarus, Kazakstan, Kyrgyzstan, Tajikistan) together account for no more than 2 percent of world trade; if Belarus joined the

TABLE 1. Geographical Pattern of Belarusian Foreign Trade in 1997–98 (percentages of total)

	Exports		Imports	
Trade partners	1997	1998	1997	1998
CIS	73.7	72.8	66.9	64.7
Russia	65.5	65.0	53.8	54.3
Ukraine	5.8	5.5	11.1	8.7
Other CIS countries	2.4	2.3	2.0	1.7
Europe	16.1	17.6	26.1	28.5
Central and Eastern	8.7	9.9	8.9	9.4
Western	7.4	7.4	17.2	19.1
EU	6.7	7.3	16.5	18.3
Asia	4.1	4.1	3.0	3.3
North and SouthAmerica	4.4	3.2	3.7	3.1
USA and Canada	1.3	1.5	1.7	1.5
Rest of world	1.7	2.3	0.3	0.4

EU, it would have increased access to that market (23 percent of world trade) and would be better able to develop new incentives for both export and import.[15]

Consequently, even though regional integration did give Belarus certain advantages, the trade diversion effect evidently outweighed the trade creation effect generated by the establishment of the customs union. Economically and geographically Belarus is doomed to cooperation with Russia, but today it must capture other, especially non-CIS, markets to retain the Russian market.

The national foreign trade policy should be aimed at expanding trade both inside and outside of the region. That entails undertaking a drastic reform of current foreign trade policy to create more liberal conditions for the development of foreign trade activities. The experience of countries that have successfully implemented such reforms shows that to minimize the development of unbalanced international economic relations, it is vital to promote exports and scale down the use of protectionist measures. Special importance should be attached to liberalization of foreign trade relations as indispensable for increasing the competitiveness of Belarusian companies and helping them become technologically up-to-date. Liberalization primarily means abatement of government intervention and restoration of confidence in market-based pricing mechanisms. To be effective it should be supplemented with macroeconomic stabilization, structural reforms, commercialization of companies, development of the financial sector, and devaluation of the national currency.

NOTES

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3. Constantine Michalopoulos and David G. Tarr, eds., *Trade in New Independent States* (Washington, D.C.: The World Bank, 1994), 280.
4. See, for example, *Designing New Trade Policies in the Transition Economies* (Paris: OECD, 1997), 231.
5. See general barriers to trade and changing foreign trade-related regulations in *Trade Policy and the Transition Process* (Paris: OECD, 1996), 237.
6. Georges de Menil, "Trade Policies in Transition Economies: A Comparison of European and Asian Experiences," in *Economies in Transition: Comparing Asia and Eastern Europe,* ed. Wing Thye Woo, Stephen Parker, and Jeffrey D. Sachs (Cambridge, MA: MIT Press, 1997), 257–97.
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15. *Foreign Trade Indicators in January–July 1999* (Minsk: Ministry of Statistics and Analysis of the Republic of Belarus, 1999), 52.