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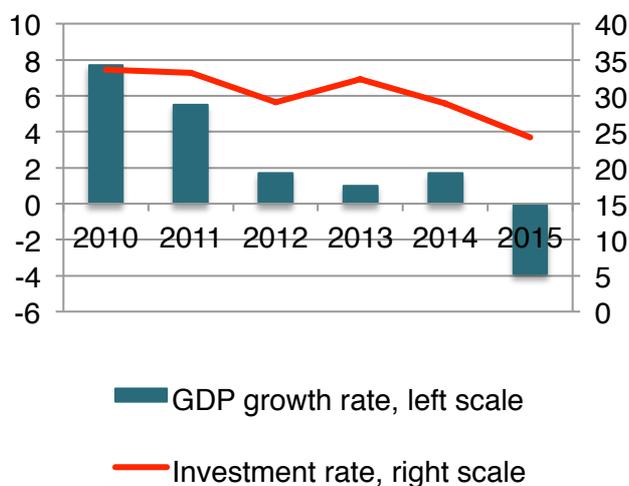
The Anatomy of Recession in Belarus

After impressive growth in the 2000s, Belarus' economy has since the currency crisis of 2011 stalled. Structural issues – dominance of the state sector and directed lending practices – have made growth anemic. Recession for Belarus' main trading partner and the decline of oil prices has aggravated the long-run problems. We perform growth diagnostics to separate the effects of total factor productivity (TFP) growth from capital accumulation over the recession. We show that, as in the 2000s, capital accumulation had the largest positive effect on growth in Belarus, but TFP gains were very low, or even negative in the years of recession.



During the 2000s, Belarus experienced extraordinarily high growth rates, despite a lack of economic reforms and low performance in the EBRD transition indicators. In Kruk and Bornukova (2014) we show that the growth was extensive in its nature, and mainly driven by capital accumulation. The total factor productivity (TFP) contribution to growth was low. After the currency crisis of 2011 in Belarus, however, growth rates have stagnated. Despite a high investment rate (which declined dramatically only after 2015) the growth rates were below 2 per cent per annum, which is a non-satisfactory performance for a developing economy (see Figure 1). In 2015, Belarus entered its first recession in the last 20 years with GDP declining by 3.9 per cent, and the recession has continued in 2016.

Figure 1. GDP Growth Rates and Investment Rates in Belarus (%), 2005-2015.



Source: Belstat

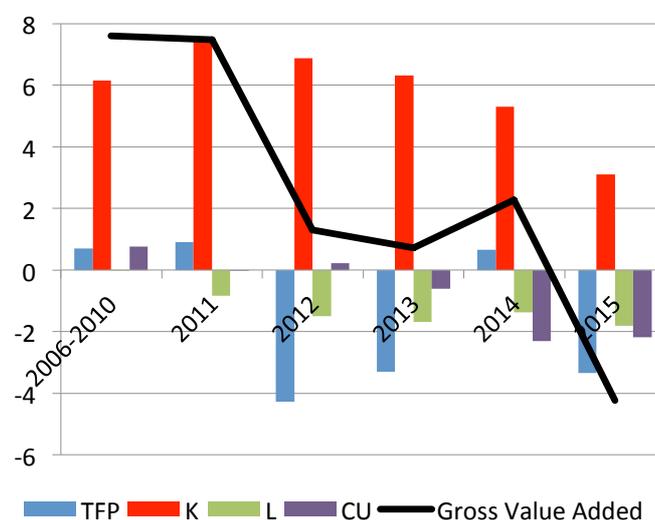
In the 2000s, the Belarusian government relied on directed-lending programs, and subsidized the interest rates for state-owned enterprises' (SOE) loans. After the currency crisis of 2011, which many blamed on the loose monetary policies connected to directed-lending programs, the government switched to a so-called modernization policy that underlined the need to invest in new equipment and introduce new technologies. So far this policy have not bear

fruits in terms of economic growth, but did it increase efficiency?

Growth Decomposition 2011-2015

Using the standard capital services approach modified for the Belarusian data in Kruk and Bornukova (2014), we decompose Belarusian economic growth in 2011-2015 into the growth of factors (capital and labor) and growth of TFP. We find that the lack of growth in TFP explains the lack of GDP growth and GDP decline over these years.

Figure 2. Gross Value Added Growth Decomposition in Belarus, 2006-2015.



Source: Author's calculations based on Belstat data. Note: K stands for capital, L for labor, TFP for total factor productivity, and CU for capacity utilization.

A noteworthy fact about the Belarusian growth decomposition is that the direction of growth rate of capital and TFP has been persistently opposite in 2012-2015. Presumably, accelerated capital accumulation vs. stagnating/lowering TFP could be explained by initially insufficient levels of it (i.e. less than steady state). However, this explanation seems to be improper for the Belarusian path. According to our assessments, a capital stock has passed its steady state level at the turn of 2013-2014. Despite this, capital kept growing rapidly, while productivity contracted.



An alternative explanation – a growth of the capital stock was secured by specific directed instruments; this artificial capital accumulation caused an endogenous contraction of TFP, as confirmed by the data.

Indeed, a TFP decline could accompany capital accumulation due to expanding allocation and technical inefficiencies. This explains the meltdown of economic growth in Belarus by 2013-2014 and its transition to the negative spectrum later on. In late 2014-2015, this was supplemented by exogenous negative shocks affecting TFP – deteriorating terms of trade and a shrinking energy subsidy from Russia – which caused a rapid dip into recession, which should be classified as structural adjustment.

In 2015-2016, lack of TFP growth and excessive capital accumulation caused further adjustments: firms reduced capital investments radically and contracted capacity utilization. These mechanisms amplified structural recession by a cyclical component.

Sectoral dimension: manufacturing

Out of all the manufacturing industries, only one – manufacturing of electrical, electronic and optical equipment – had positive TFP growth in 2011-2015. On average, manufacturing has lost 4.1% of TFP over this period, with the highest TFP losses in the industries that have always been hallmark for Belarus: manufacturing of machinery (-7.6%) and transport equipment and vehicles (-8.8%). The wood-processing industry has notoriously obtained huge financial aid during the modernization campaign (over 1 billion USD – but Belta (2015) lost 5.6% of TFP over 2011-2015).

We also find that the capital market continues to be distorted by the government interventions, leading to inefficient allocations in the sense that investment is not going to the most efficient industries. On the contrary, there is a negative

relationship between the capital growth rate and the TFP growth rate in manufacturing industries. The labor market, which faces less government intervention, functions more efficiently. Labor growth is higher in the industries with higher initial labor productivity.

International comparisons

While comparing the TFPs of Belarusian industries to each other makes little sense (like comparing apples and oranges), comparing them to the TFPs of corresponding industries in other countries might shed some light on the comparative efficiency and competitiveness of the Belarusian economy. Table 1 lists the industries and sectors of the Belarusian economy that are the most and least competitive in a relative TFP sense.

Table 1. TFP winners and losers in Belarus

	2014 TFP relative to	
	Czech Republic	Sweden
Winners		
Petroleum products	1.98	-
Transport services/communications	1.67	0.70
Trade and repair	1.37	1.77
Financial activities	1.33	-
Chemicals manufacturing	1.17	-
Losers		
Transport vehicles	0.72	-
Machinery and equipment	0.70	0.34
Textiles	0.68	0.26
Woodworking	0.56	-
Electricity, gas and water	0.41	0.22
Agriculture	0.40	-

Source: Author's calculations.

The majority of the industries in the “winners” category are non-tradable (services like communications, finance, trade and repair). Coincidentally, trade, transport and finance also have relatively high shares of private ownership.



Another group of winners are rent industries (petroleum benefitting from cheap Russian oil; and chemical industry built on potassium salts extraction).

As for the most of the manufacturing industries, where the government dominates, and where extensive financing was available at subsidized rates, TFP levels are relatively low. While the TFP performance of the manufacturing of transport vehicles, machinery and other equipment was also reported as low in 2010 (Kruk and Bornukova, 2014), the woodworking industry reached high levels of inefficiency after 2010, when the “modernization” program of this industry received a huge influx of capital.

The relative levels of TFP are good predictors of the future exports performance: higher-TFP industries are more competitive in the international markets. The current low relative TFP of the manufacturing sectors suggests that manufacturing exports will not recover in the coming years.

Conclusion

As in the 2000s, Belarus relies on capital accumulation to generate economic growth. In recent years, however, more investments have not generated growth and rather led to losses in TFP, aggravated by external factors. The current recession in Belarus is mainly a structural adjustment, driven by distortive policies of capital accumulation and allocation; and only partially driven by external shocks.

Lack of TFP growth leads to loss of international competitiveness, causing a collapse of exports. Deep structural reforms are necessary to revive growth and recuperate the lost export potential.

References

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