

## Chapter II. Economic Opportunities and Poverty\*



This chapter assesses the relationship between growth, economic opportunities, and poverty reduction in Belarus and the prospects for the future. Almost all poverty reduction in the last few years is found to be due to growth, shared proportionally across most households. Thus Belarus' ability to improve living standards for its population is linked closely to its ability to generate economic growth that is both broad-based and sustainable. The Belarusian economy is characterized by several sources of vulnerability, however, raising concerns about the fragility of its sources of growth.

- First, while labor markets in Belarus have been restructuring gradually, there is an ongoing tension with the policy of administratively set wage increases to fulfill social objectives. As a result, real wage growth has outstripped productivity growth in recent years. While contributing to the pro-poor nature of growth in Belarus in the short-term, this trend aggravates the weak financial position of state-owned enterprises or SOEs (World Bank 2003), a weakness evidenced by, among other things, widespread wage arrears in rural *and* urban areas. This enterprise weakness imposes limitations on the ability of the economy to invest, modernize, maintain a competitive footing, and thereby to sustain growth.
- Second, Belarus' dependence on Russia as its key international trading partner both underpins the viability of the Belarusian economy, as well as constitute a source of vulnerability and uncertainty for the future. Russia has already significantly reduced its energy subsidies and is expected to continue doing so. The growth and poverty impact of this change is expected to be far-reaching.
- Third, the labor market is already showing evidence of strain, with increasing levels of open and hidden unemployment—especially among youth—as well as a slow pace of creation of *new* jobs. The growth of Small and Medium Enterprises (SMEs), which could absorb labor and play an important poverty reduction role, has been hampered by one of the most expensive and burdensome registration processes in the region. At the same time, minimum wages appear to be unusually low relative to the average wage, especially when compared to other transition economies. This has resulted in a significant number of working poor in Belarus.

The analysis of this chapter thus demonstrates that there is scope and need for selective reform of wage policy, SME licensing policy, active employment programs, and basic labor market data collection to generate greater labor market dynamism and expand economic opportunities for the majority of households in Belarus. There is also need for further analysis to assess the overall prospects for growth under the "Belarusian model". This analysis is not within the scope of the poverty assessment *per se* and will be addressed in the context of the Country Economic Memorandum being prepared by the World Bank and the government.

### 2.1 Macroeconomic Background

At the time of its independence in 1991, Belarus inherited from the former USSR a developed industrial sector and educated labor force. On average, the Belarusian population enjoyed higher living standards than those in most other regions of the former Soviet Union (FSU), which was partially due to a rate of growth during 1985-1989 above the USSR average. Belarus' primary role in the FSU as a producer of complex finished industrial goods, however, made it highly dependent upon imports of energy and raw materials (especially from Russia) and highly vulnerable to terms of trade shocks. The absence of independent institutions and the need to cope with the consequences of the Chernobyl nuclear accident further complicated the country's initial conditions.

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\* This chapter is based on the findings reported in Bakanova (2003) and Kuddo (2003).

Similar to other transition economies, initial reforms in Belarus were accompanied by a severe output contraction and pick-up in inflation. Despite this economic instability in the first three years of independence, new market institutions started to emerge. Stabilization was far from being reached, but inflation was reduced from a four- to a three-digit level in 1995. By mid-1995 most prices were liberalized and significant progress was being made in small-scale privatization, while limited advancement was achieved in large-scale privatization.

**Gradualist approach to reforming.** From the end of 1995 onwards a move towards the “socially-oriented market economy” became an officially adopted target, implying slowing down and in some cases even reversing market reforms. Though positive economic growth has resumed, postponed structural reforms and an unfavorable business environment continue to lead to concerns over the sustainability and quality of the economic growth.

**Table 3. Belarus Selected Macroeconomic Indicators, 1992-2002**

	1992	1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
%changes over the previous year											
GDP	-9.6	-7.6	-12.6	-10.4	2.8	11.4	8.4	3.4	5.8	4.1	4.7
Industrial Output	-9	-10	-19	-10	5	18	10	10	8	6	4.3
Agricultural Output	-9	4	-14	-5	2	-5	-0.7	-8	9	2	1.5
Consumer Prices	971	1190	2221	709	53	64	73	294	169	61	42.6
Real Wages	-12	-6	-31	-5	5	14	18	7	12	30	8
Unemployment rate,%	0.5	1.4	2.1	2.9	4	2.8	2.3	2.1	2.1	2.3	3.0
General Government Balance,%GDP	-1.9	-5.5	-3.5	-2.7	-1.9	-2.2	-1.4	-2.9	-0.6	-1.6	-0.2
Population, m	10.24	10.24	10.21	10.18	10.14	10.09	10.05	10.0	9.99	9.95	9.90

*Source: Ministry of Statistics and Analysis of the Republic of Belarus.*

Although there have been some positive developments from end-2000 onwards, the major problems are still in place.

- Thus, in spite of tightening of monetary policy and the reduction in quasi-fiscal activities, inflation in Belarus remained the highest in the CIS, and central bank credits remained the major source of budget deficit financing (including that for housing construction). The exchange rate was unified in September 2000, and from 2001 a crawling band regime was adopted with the Belarusian Ruble (BYR) pegged to the Russian one, but a continuous real appreciation of the BYR vis-à-vis other currencies is creating destabilizing expectations of devaluation in currency markets. The fiscal burden remains high, while the relatively low fiscal deficit figures do not adequately reflect the fiscal stance given the persistence of off-budget funds and the scope of the Government’s contingent liabilities.
- Although many state companies have been transformed, for example, corporatized, the controlling stake is still with the state. According to official statistics, these companies and employees on the payroll are considered as non-state. As the recent World Bank review of public expenditures (2003) indicated, however, the Government retains pervasive control throughout all sectors of the economy, be it through ownership or direct regulation. Ministries exercise control and oversight of enterprises and ministerial decisions can affect decisions on output, investment, location and provision of social assistance programs at the enterprise level. These controls can even seek to cover private enterprise. Local governments also keep an eye on the production and behavior of enterprises under their jurisdiction, since their performance will affect tax revenues and hence their own budgetary resources.

- Administrative wage increases, including the implementation of an across-the-board average monthly wage of USD 100 level at the end of 2001—one of the promises of the Presidential election campaign that year—without any reference to productivity growth, has contributed to macro instability, increase in budget arrears, loss of profitability and competitiveness, and a fall in investment. This has also, however, been a key contributor to the continued decline in poverty.

## 2.2 Economic Growth and Poverty

The previous chapter documented that sustained growth, coupled with a relatively stable income distribution, succeeded in reducing absolute poverty headcount from 39.4% in 1997 to 18.5% in 2002. This section investigates the proximate factors associated with this impressive reduction in poverty: growth, redistribution, and changes in the occupational or sectoral structure in Belarus.<sup>4</sup>

**Data limitations do not permit analysis of chronic vs. transient poverty.** In the absence of panel data—which track the welfare of the *same* households over time—the analysis can only shed light on factors associated with *net* changes in poverty over time, and does not capture economic mobility. It is thus not possible to distinguish between those households who are able to take advantage of economic opportunities and improve their position (in relative or absolute terms) within the income distribution; those who are stuck in poverty and deprivation at the bottom of the income distribution; and those who are able to maintain their (relative or absolute) position over time. Thus we cannot assess which households suffer from long-term vs. short-term poverty.

**Growth vs. redistribution: growth effects dominate.** Poverty changes are due to two proximate causes: changes in mean consumption (growth) and its distribution. Our analysis covers a period of 1998-2002. Almost all poverty reduction was found to be due to growth, shared proportionally across most groups of households. It was analogous to a tide lifting all boats at the same time. At the same time that growth had a large impact on the net reduction in poverty, the moderate increase in inequality noted earlier, had a modest opposite effect.

**Are poverty changes due to shifts within or between groups with different economic opportunities?** According to a decomposition analysis of changes in household consumption levels, more than 95% of the reduction in poverty recorded during 1998-2002 is attributable to *intra-sectoral effects* rather than movements of population from a low-performing to better performing sectors. While the poverty headcount changed from one year to the next in line with the overall macroeconomic performance, the relative risk of poverty for different groups remains largely unchanged throughout the period. *Collective farmers and the unemployed are the only notable exceptions; their relative risk of poverty increased.*

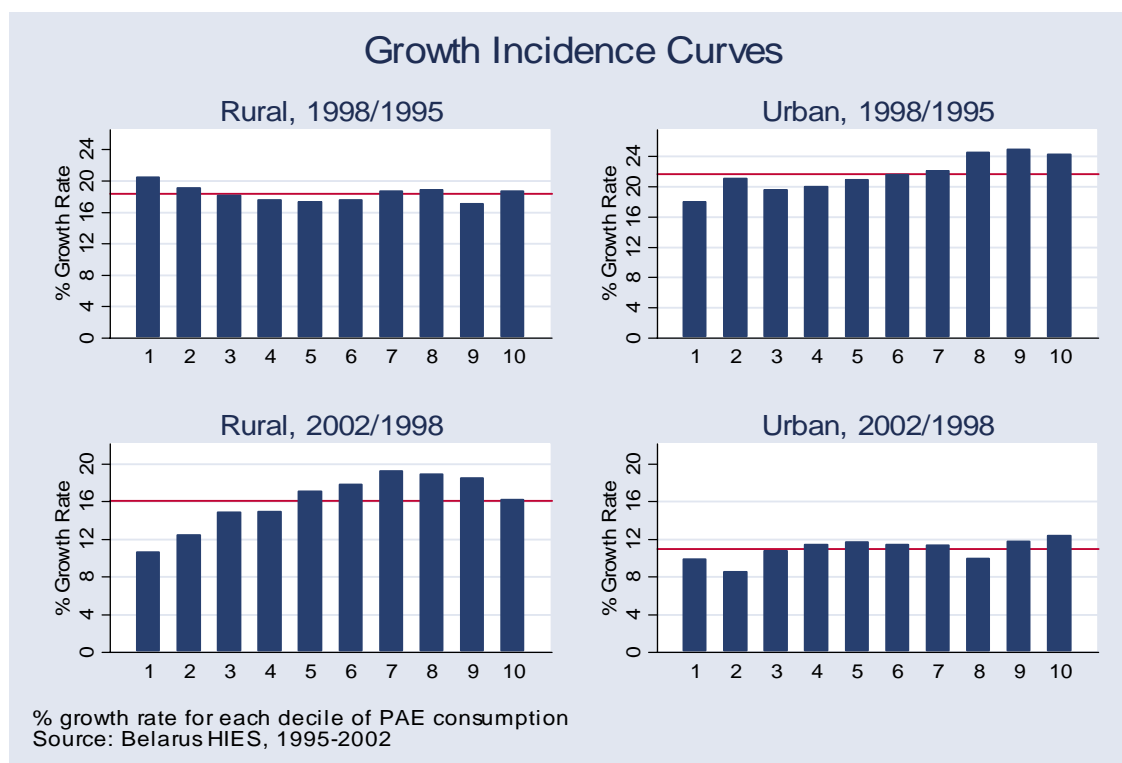
**Who captured most of the gains from growth?** Given the substantial poverty reduction impact of economic growth over the last eight years, is it safe to say that the growth was pro-poor? “Pro-poor growth” indicates a pattern of growth that brings proportionally greater benefits for the poor than for the “middle-income” or rich households. The extent to which growth is pro-poor can be illustrated through “growth incidence curves”. Figure 8 reports growth incidence curves by area

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<sup>4</sup>The analysis focuses on the role that economic growth has played in poverty reduction. A full analysis of the sources of growth and the prospects for growth in Belarus is not within the scope of the poverty assessment per se. It will be the central topic addressed by the Country Economic Memorandum currently under preparation by the World Bank and the government.

of residence. The vertical axis measures cumulative growth (or decline) in consumption for the whole period for each decile of population from poorest to richest groups; the horizontal axis shows the population deciles (poorest to richest). The pattern of growth in urban areas was slightly pro-poor, while in rural areas the rich deciles benefited more. From 1998 to 2002, the agricultural sector recorded a modest growth rather than a decline. The higher growth in rural areas was accompanied by widening inequalities (within the rural areas), with the consumption levels of the poorest two deciles growing only 10 to 12% compared to 16% on average.<sup>5</sup> This underscores the need to address pockets of poverty in rural areas. In urban areas, the pattern of growth was more or less similar across the deciles.

**Figure 8. Growth incidence curves, by Area of Residence, 1995-98 and 1998-2002**



**What are the country's prospects for growth, inequality and poverty over the next five years?** Growing imbalances and other worrisome trends in public finances pose serious threats to macroeconomic stability and the future growth of the Belarus economy and private consumption. In the last years, growth decelerated substantially in Belarus. Moreover, the country competitiveness is rapidly losing ground, while the main trading partner—Russia—is reducing its preferential access policy towards Belarus. Given this background, most analysts have revised downward Belarus' growth prognosis.

For illustrative purposes, we estimated the impact of alternative medium-term (for 2002-2007) growth scenarios on poverty in Belarus, making additional assumptions on likely changes in inequality. Three growth scenarios are considered: *modest* (annual per capita consumption growth

<sup>5</sup> In contrast to the earlier experience where lower income households in rural areas benefited slightly more than other rural households.

at 1.5% per annum), *moderate*: 2.5% per annum, *optimistic*: 3.5% per annum; together with three inequality scenarios: *constant consumption inequality* (Gini index stays at 0.228); *modest increase* in inequality (Gini index increases to 0.270); and *moderate increase* in inequality (Gini index increases to 0.300).

Even a small increase in inequality, coupled with modest or moderate growth, will likely bring poverty numbers up in Belarus (results summarized in Table 4). The cases where 2007 poverty rate would be higher than in 2002 are presented in **bold**. In the future, a relaxation of the incomes policy, a friendlier business climate, and growth in private sector enterprises, may indeed result in higher inequality *and* higher growth. These simulations imply an **elasticity of poverty to economic growth between -2.5 and -2.8** for the (total) poverty headcount, and from -3.0 to -4.1 for extreme poverty headcount. In other words, a 1% change in growth would lead to a reduction in poverty by 2.5-2.8%. The resulting elasticity of poverty to growth is much higher than in Latin America and the Caribbean (an average of -1.3) or Sub-Saharan Africa (-0.9 to -1.4), for instance, regions where inequality is relatively higher, but is similar to what was found in other low-inequality settings, or in South-Asia.

**Table 4. Changes in Poverty Headcount, 2007 vs. 2002**

Reduction in .. Poverty, %	Extreme	Total
Growth @:		
<i>Slow: 1.5% p.a.</i>		
ineq const	-32%	-22%
ineq small increase	<b>17%</b>	<b>-3%</b>
ineq moderate increase	<b>37%</b>	<b>10%</b>
<i>Moderate: 2.5% p.a.</i>		
ineq const	-45%	-35%
ineq small increase	<b>7%</b>	-19%
ineq moderate increase	<b>31%</b>	<b>-2%</b>
<i>High: 3.5% p.a.</i>		
ineq const	-57%	-47%
ineq small increase	<b>-4%</b>	-38%
ineq moderate increase	<b>25%</b>	-16%

Thus, all indications are that the distributional pattern of growth in Belarus is such that growth benefits the poor disproportionately more than the rich. In the following section we explore the extent to which this pattern and level of growth can be sustained.

### 2.3 Economic Trends and the Labor Market

The poor tend to participate in economic growth via their participation in the labor market. For this reason, this section provides a brief overview of the salient macro-economic trends from a labor market perspective.

**Labor market participation rates have declined.** In 1989, Belarus had one of the highest employment rates of working age population (16-54/59) in the USSR at 87.0% (including 0.3% engaged in subsidiary household plots). Since then the employment rates have declined to 73.9% (working age population) as per the 1999 population census. Compared to other FSU states, the decline in aggregate employment by 12.8% in a decade is more gradual than those realized in other FSU and CEE countries, but is significant nonetheless.

For the age group 15 years and over, the labor force participation rate (LFPR) in Belarus was 58.7 percent. By international standards, this can be considered a low LFPR. In the USA, Australia, Canada, Japan, Netherlands, UK and Sweden, the labor force participation rate in 2000 (1999 in some countries) equaled between 62% and 67%. Among the most developed countries, the LFPR was lower only in France (56%), in Germany (55%), and in Italy (47%). Lower LFPRs in Belarus are due to low retirement age of the population—especially females drop out from the labor force at a relatively early age—despite the fact that life expectancy at that age is similar to that in industrial countries.

**To what extent have labor markets been restructured in the 1990s?** Popular opinion suggests that labor markets have restructured very little over the past decade. The evidence marshaled here, however, supports a view whereby labor markets have restructured, but where further shifts are warranted.

- *Sectoral employment changes.* In most CIS states, there has been a major shift of employment from the secondary to the tertiary sector. In Belarus in 2001, the share of the service sector in total employment reached the level of 51.8%, and increased by 12% compared to 1991. As in other transition economies, job opportunities in Belarus emerge mainly in the services sector, including in public services, while many jobs in the manufacturing sector and in agriculture are at risk. This change in the structure of output entails a fall in demand for blue collar workers and physical labor and the rise in demand for white collar workers with skills required in the service sector.
- Employment in industry has declined from 30.9% in 1990 to 27.4% in 2001 and even to 26.7 in 2003, and in still heavily subsidized construction, from 11.1% to 7.4% respectively. The share of employment in agriculture has declined from 19.1% in 1990 to 13.3% in 2001 (and 11.3 in 2003). From the point of view of inter-industry shifts, therefore, the evidence does not support the claim that restructuring has been particularly sluggish in Belarus.
- *Job creation and destruction.* To better understand if restructuring has been taking place it would be important to evaluate job flows, or job creation and destruction rates in Belarus. High job turnover (with high job creation and destruction rates) is associated with productivity gains and higher efficiency because the process allows the destruction of less productive jobs and the creation of more productive ones. In certain sectors of the economy job destruction has been significant. For example, between 1990-2001, the shedding of excess labor was the highest in agriculture, which has lost more than 40% of jobs, and in construction, where 44% of jobs were lost.
- A legitimate question arises: if there has been this much job destruction, where have all these workers gone? A part of these people have gone to the service sector but it is likely that most of them have fallen into inactivity, that is, there are almost one million more inactive able bodied people today than a decade or more ago. As mentioned above, the employment rate of working age population has declined from 87.0% in 1989 to 73.9% in 1999. In absolute terms it means that employment has declined by 693,000 people of working age compared to 1989. In total 1.210 million people of working age bracket are inactive, including 689,900 pupils and students. Moreover, an employment rate of population above working age has declined from 18.9% in 1989 to 9.1% in 1999. In absolute terms it means that 177,000 fewer retirees are working today than in 1989.

### Box 7: "Over-employment" in Education and Health...?

In the last decade in several budget financed public sectors, the number of employees has significantly increased, such as in health and social protection, by 22%, and in state administration, by 86%. Over-employment in these sectors is overwhelming. For example, the basic health system is extensive. Some health system indicators, such as the number of physicians per thousand population, much exceeds the average level in OECD countries (2.5 physicians per 1000 population). In 2000, Belarus employed 4.6 doctors and other medical professionals for every 1,000 people - compared with 1.6 doctors in the UK, 2.1 in Canada or 2.5 in Netherlands. A second example of a sector where labor restructuring has yet to be done, is in education. In 2000 alone, the number of students in general schools dropped by almost 50,000 due to declines long-standing fertility declines in Belarus. However, in 1995-2001 the number of people employed in the education sector has increased by 13%, but has decreased in 2002 and 2003. One of the qualitative indicators that can be used for comparison is student/teacher ratio. In 1999 in Belarus, the ratio equaled 10.5 students per one teacher which is almost two times lower than in many OECD countries.

- At the same time, among key sectors of the economy, more than 51% of new jobs were added in trade and catering, and 48% in housing and communal services sector. In some key sectors, however, the need for labor restructuring is apparently delayed (Box 7).
- *Small businesses and self-employment.* Other important factors that contribute to the stability of employment dynamics in transition countries are the rapid development of SMEs, the informal sector and household businesses. Unfortunately especially the SME sector is underdeveloped in Belarus. In 2001, SMEs only provided 8.6% of total employment. The household survey data confirms that only around 3% of the population aged 16 years and over consider themselves private farmers or entrepreneurs. Belarus has the smallest number of SMEs per 1,000 population in comparison with its neighbors, less than 3 as compared to 6 in Russia, 4 in Ukraine and 35 in Poland. Moreover, it is the only transitional economy in which the number of private SMEs decreased between 2000 and 2002.
- In most countries private self employment is a very important category of employment, both in the sense that displaced workers from old enterprises may find livelihoods working independently and because it may represent the beginnings of entrepreneurship. By the official statistics, Belarus has the lowest ratio of self-employment in total employment, while in Armenia, Kazakhstan, Moldova and Tajikistan, self-employment exceeds 40% of total employment, and in Kyrgyzstan even 60%.

### Box 8: Small Business Environment—Some Perceptions

Small and micro business is supported only verbally. An unemployed person finds it more and more difficult to start business. There are too many limitations in terms of starting and doing small business while the chances to maintain it for at least a couple of years are shrinking. Private retail trade at the markets tends to decline every year. (Grodno)

I tried to do some business, but I don't have time to follow changes in taxation rules, it was my luck that I was allowed not to pay a fine, they spared me. (Grodno)

If earlier (at the beginning and in mid-1990s) there was a tendency of opening a business by many representatives of various authorities and these people tended to leave the government sector for market economy, today the trend is quite the opposite. If there's a chance to get a position in the government system, many former officials, who have tried to work in the private sector, prefer to give up business without any regrets. (Grodno)

*Source: Interviews, June 2003.*

- One of the reasons for the slow growth in numbers of SMEs, low employment in the SME sector, and low self-employment might be the fact that, as the recent evaluation by the World Bank showed, Belarus has one of the most prohibitive and expensive private business registration procedures. It involves on average 26 steps and requires an equivalent of 0.41% of GDP per capita in fees (see also Box 8 above).
- *Labor hoarding.* Labor hoarding can be measured by comparing the dynamics of output and employment. Belarus seems to have a relatively modest labor hoarding index (the difference between the overall drop in GDP and decrease in employment), compared to most other CIS states. The highest labor hoarding index appeared to be in the mid-1990s, while by 2001, the index was close to zero. Nevertheless, over-staffing in enterprises is significant witnessed by overall low productivity. This is additional evidence that central and local pressure is commonly applied through ‘discussion’ with enterprise managers that encourages them to slow down the pace of layoffs and engage in job preservation programs.
- *Labor turnover.* The number of staff reductions has also tended to decline in the second half of the 1990s: in 1995, 83,400 of workers and employees were laid-off due to staff reduction, but in 2000, the number equaled 12,900 and 22,600 in 2001. In 2003, the level of hired workers almost fully compensated the attrition levels: hiring represented 95.1 percent of attrition workers, compared to only 84.4 percent in 2002. Although labor turnover and hiring rates are high in Belarus, in fact only a few new jobs are created. In particular, in 2001, 796,500 workers and employees were hired but only 46,300 workers, or 5.8% of those hired were placed in new jobs. The rest was inter-firm mobility of labor. Slow restructuring of the economy is also confirmed by the fact that a vast majority of separations (80% in 2001) are on a voluntary basis.
- The *Labor Code* gives employers flexibility to adjust to changing market conditions. However, by some anecdotal evidence, employer reluctance to lay off workers comes from administrative pressure. Poor incentives to restructure are compounded by soft budget constraints, or ability of loss making enterprises to obtain tax concessions or non-cash settlement for utility payments. All these factors work together to dampen incentives for enterprises to restructure their labor force. Recent evidence for 2002 and 2003 indicates a reduction in forced part-time jobs and those on involuntary or unpaid leave suggesting improvements in the use of working time. A detail analysis of labor markets is needed to better understand the precise impact of regulations on labor market arrangements.

Overall, the evidence on labor market dynamics in Belarus suggests that restructuring has been underway, but may have slowed down. State control and persuasion to maintain employment rates in enterprises continues and appears to have had some unintended effects: the rate of creation of new opportunities—new jobs—appears to be very low.

#### **2.4 Open and Unregistered (“Hidden”) Unemployment**

Among the most vulnerable groups in Belarus are the able-bodied population who are temporarily not working. Poverty among the unemployed is the highest and the unemployed may quickly be “trapped” in poverty. Unemployment is an urgent issue for policy in all transition countries.

**Unemployment rates are modest but increasing.** Based on the 1999 population census data, the unemployment rate of working age population in Belarus, by ILO definition, is quite modest by regional standards and equaled 6.3% (population aged 15 years and over) and 5.8% while excluding students and pensioners. Open (registered) unemployment has also been very low and

in December 2002 was 3.0% of the economically active population, but has been steadily increasing (in December 2001 was 2.3%). However, the number of registered unemployed is steadily increasing and by the end of 2002 reached 130,500 individuals (a year ago, 102,900 people). In 2003 the unemployment rate marginally increase to 3.1% suggesting a slowdown in the increase of unemployed individuals compared to previous years (about 136,100 individuals). Compared to other CIS states, Belarus has a relatively high share of registered unemployed out of the total, around 44% in early 1999 when the population census was conducted. In many other CIS states, including in Russia, the ratio of registered unemployed out of the total, by the labor force survey or population census data, is around 10-15%.

**Which groups comprise the majority of the unemployed?** Based on the 1999 population census data and ILO definitions, the unemployment rate was slightly higher for males, 6.6% versus 6.1% for females. The share of young people looking for jobs is relatively high but a large part of them are recent graduates of different types of schools. This reflects the mismatch between the skills and knowledge of job seekers, and labor demand, which has altered in the transition years. Unemployment was highest among youth aged 16-19 years, 20.7%, and aged 20-24 years, 10.5%. Regional variation in unemployment is almost non-existent in the Census data: the highest rates was registered in one of the key industrial regions of Gomel oblast – 6.9 percent, and the lowest in Mogilev oblast, 5.7 percent. Both are Chernobyl-affected regions. Recent data, however, suggests significant variations in the distribution of unemployment among regions: 4% in the Vitebsk oblast; 2.9% in the Minsk oblast and 1.6% in Minsk.

As in the case of employment, there is a clear correlation between the level of education and unemployment rate. The unemployment rate for people with secondary general education was more than two times higher than for job seekers with higher education, 7.8% and 3.5% respectively.

**Box 9: Average Duration of Unemployment is Low and Stable**

One of the peculiarities of Belarus is that the average duration of registered unemployment has not changed much during the transition years. In 1996, the level was 6.7 months on average, and in 2001, it has actually declined to 6.4 months (the highest average duration of unemployment was registered in 1997, 8.4 months). In 2001, "only" 11.9% of registered unemployed were out of a job for more than one year. Absence of considerable long term unemployment is one of the peculiarities of the Belarus labor markets. For comparison, by the EUROSTAT survey conducted in 11 EU Candidate Countries in the spring of 2001, the highest rate of long term unemployment was registered in Slovenia, 63.3%, followed by Bulgaria, 63.1%, and the lowest rate among transition countries was in Hungary, 44.8% (in EU-15 countries, 44.0% on average).

**High participation rates in active labor market programs (ALMPs).** Compared to other CIS countries, Belarus probably has the highest participation rates of registered unemployed in active labor market programs, training programs and public works. For example, in 2002, around 8% of registered unemployed completed training courses, and 23% participated in public works programs. There might be several reasons for this: the open and hidden unemployment is relatively modest, and employment funds are still capable of providing quite efficient employment services with high placement rates. However, the net impact of ALMPs has never been assessed, and so we do not know the cost effectiveness of proposed measures.

**Unemployment benefits do not have disincentive effects on job-seeking, but also do not provide much protection.** In Belarus the early Law on Employment approved in 1991 established rather generous replacement levels for the wage-related unemployment benefit. According to amendments to the law approved in 1999, the replacement level was reduced to

70% for the first 13 weeks of payments, and to 50% during the next 13 weeks. Necessary work record in the last 12 months was reduced to 12 weeks. However, a major restriction was imposed that the benefit could not be lower than the basic amount and not higher than two times the basic amount.<sup>6</sup> Since the level of basic amount in the country is very low (see below), the

**Table 5: International Assessment of Unemployment Benefit Programs**

Scheme	Financing	Strengths and Weaknesses
Unemployment Insurance	Payroll Tax	Allows risk pooling; and provides consumption smoothing. Performs well where labor market institutions encourage flexibility; informal sector is small; there is strong administrative capacity to monitor program and control incentives. Benefits/taxes must be kept low to avoid adverse incentive effects
Unemployment Assistance	General Revenues	<i>Means tested Benefits:</i> Is very progressive; but may have disincentive effects similar to UI if benefits are too high; where means tested requires strong administrative and monitoring capacity; and low informal sector. <i>Flat Benefit:</i> Regressive: potential to work well in countries where administrative capacity is weak and informal sector activity is high. Duration of benefit and replacement rate should be set low to avoid adverse incentive effects.
Individual Savings Accounts	Worker Contributions	Works well in low or middle income countries; Avoids disincentives to work; good self-monitoring features; but does not cover poorer and/or informal sector workers; largely untested
Severance Payments	Financed by Firm	Unfavorable option; strong negative efficiency effects—limit hires; limited risk pooling; politically contentious.
Public Works	General Revenues	Can reach informal sector workers and poor for income support where administrative capacity is weak; entails large non-labor costs; is often temporary in nature; does not help increase wage or employment prospects (see ALMP section below).

Source: Betcherman 2000

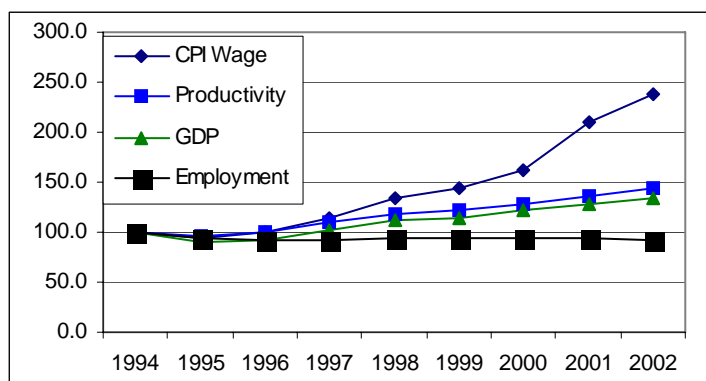
unemployment beneficiaries receive very low compensation from the SES. In 2002, the average unemployment benefit equaled BYR. 18,900, or only 9.9% of the average wage in 2002 of BYR. 191,600 (contractual wage level). Therefore, in Belarus the level of benefit for those who receive it is low relative to international norms. In a situation of low unemployment rates, existing unemployment compensation really acts as an incentive to re-integrate quickly in the labor market, or for job seekers with low job motivation, not to register at all. However, such a low level of benefit is a serious problem for households in depressed regions, or for those families relying on such benefits to maintain their living standard.

<sup>6</sup> During the preparation of this report the Government of Belarus introduced the concept of *basic amount* to eliminate the linkage between social transfers (based on the basic amount) and the minimum wage that is the anchor for wage policies (Decree of the President, No. 3, February 2002).

## 2.5 Wage Policies

Wage statistics in Belarus, as in other transition countries, should be treated with caution. In some

**Figure 9. Belarus: GDP, employment, productivity and CPI-deflated wages in 1994-2002, %**



cases, officially reported wages may overstate actually received wages, due to wage arrears and forced in-kind substitutes. Specifically, wage data represents wages due rather than paid, as wage arrears are not taken into account.

**Real wage growth has outstripped real GDP and productivity growth.** In the early 1990s the level of real wages declined rapidly. By official statistics, during 1991-1994 nominal wages increased

by around 3700 times while CPI increased by 6400 times. Since 1996, however, the Government is pursuing a policy of accelerated and administratively determined real wage growth. The average wage levels are targeted to wage benchmarks in hard currency. In particular, the Government's Program on the Socio Economic Development in Belarus for 2001- 2005 calls for an increase in wages from an average of US\$ 100 per month in mid-2001 to US\$ 250 per month by end 2005. In December 2002, the average wage stood at US\$ 113 (or BYR 220,900) per month.

Moreover, despite the impressive performance by Belarus in terms of recovery of GDP growth after the initial years of transition, the dynamics of GDP, employment, productivity and CPI-deflated wages create a cause for concern (Figure 9). These data confirm that trends in major socio-economic indicators are out of proportion. By 2002 Belarus had almost reached pre-transition output levels: GDP in 2002 equaled 97.8% of the level in 1991. This is the second highest GDP recovery level after Uzbekistan. *However, while GDP increased cumulatively by 33.4% in 2002 compared to 1994, CPI wages have increased by 138.7%, or more than doubled, and labor productivity has increased "only" by 44.4%.* Especially rapid increase in real wages took place in 2001: real wages increased by 29.6%, while labor productivity increased by 5.2%. This trend has slowed down since real wage increases went from 7.9 in 2002 to 3.2 in 2003.

Partially the rapid growth of real wages in the second half of the 1990s "compensates" for a sharp decline in wage levels in the early transition years. Such policies have, however, had major implications on the macroeconomic balance, enterprise performance, and social policies. The ratio of wages in GDP has increased from 43.8% in 1999 to 48.3% in 2001 and 46.7% in 2002. Wage costs in total expenditures have also increased: in the economic sector the share of wages increased from 11.8% in 1999 to 14.2% in 2001. In construction, a labor intensive sector, the share of wages in total expenditures increased from 20.8% in 1999 to 24.6% in 2001.

**Appreciation of the Belarusian ruble and the administrative wage policy leave little room for profits and job creation...** The large administrative wage increases in 2001 and 2002 – combined with a substantial real appreciation of the Belarusian ruble – adversely affected corporate finances and profitability, while inventories of unsold goods and domestic payments arrears increased. The overall level of profitability of products (goods and services) declined

from 15.2% in 1999 to 8.2% in 2001, and the ratio of loss making enterprises has gone up from 16.9% to 34.2% respectively (even 44.1% in the first quarter of 2002) (see also Table 6). Enterprises lack funds for investments and the depreciation of capital reached over 60%. The financial burden of wages and social contributions amongst enterprises result even in higher inter-enterprise arrears. These factors have major implications for the ability of enterprises to create new jobs.

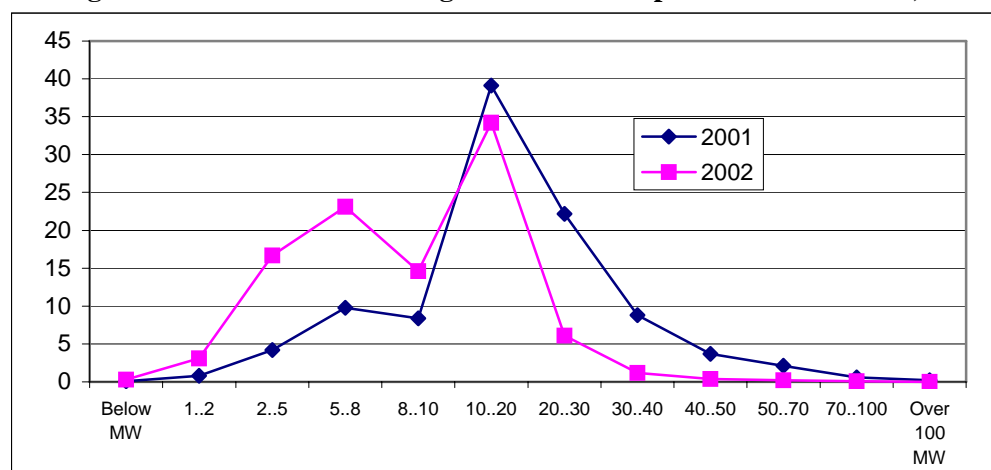
**Table 6. Number of Loss Making Enterprises in Belarus, 1996-2002**

Year	Number of Loss-Making Enterprises (LMEs)	Losses of LMEs as % of GDP
1996	1737	1.5
1997	1351	0.7
1998	1815	2.7
1999	1935	1.4
2000	2613	1.7
2001	4002	2.2
2002	4082	2.0

Source: National statistics; World Bank staff calculations

**Compared to other transition countries, wages in Belarus are more compressed.** While increased dispersion of wages is an inevitable process of the transition to market, the level of wage inequality in Belarus is not very high by FSU and CEE standards. Based on the data of wage surveys, almost one third of workers and employees receive wages between 10 and 20 times the minimum wage (Figure 10). Agriculture especially is characterized by low wages and a high incidence of wage arrears, making it the lowest paid sector of the economy. In agriculture, average (contractual ) wages equal 64% of the national average, while average wages in the financial sector are 83% higher than the national average. In most other sectors, wages are close to the average in the country. This factor, in addition to high participation rates, also contributes to the fact that income inequality in the country is relatively modest.

**Figure 10. Distribution of Wage Levels in Comparison to Minimum, %**



Note: Based on the data of wage surveys conducted annually in May. In May 2001, the minimum wage equaled BYR 5,700; in May 2002, BYR 17,000.

Source: Ministry of Statistics and Analysis (2002). *Trud i zanyatost' v Respublike Belarus*. Minsk.

**Minimum wage level is very low.** The role of minimum wages is controversial. The underlying idea is simply to set a floor on what employers can pay in order to ensure that employees receive a “fair, living wage” and thus to support the incomes of low-wage workers and their families. While minimum wages can boost the earnings of low-income employees, they can also lead to

unemployment where the minimum wage is above the market-clearing level and where it is actually binding. In Belarus, due to high inflation rates, the level of minimum wages has been adjusted regularly but still the level relative to average wages is among the lowest in CIS states (Table 7). In January 1, 2003, the level of a minimum wage was raised to BYR. 40,670, which equaled 18.4% of the average wage in the country in December 2002 (BYR. 220,900).<sup>7</sup>

The level of minimum wages in Belarus is still too low to be binding (i.e., to affect wage and employment decisions). On the other hand, workers with earnings close to a minimum wage (especially in agriculture) are likely to fall into poverty.

**Table 7: Ratio of the Official Minimum Wage to An Average Wage in CIS (2002), %**

	January	June
Armenia	21.2	19.1
Azerbaijan	9.2	8.8
<b>Belarus</b>	<b>6.3</b>	<b>8.7</b>
Georgia	...	...
Kazakhstan	23.1	19.9
Kyrgyzstan	7.0*	...
Moldova	17.5	15.2
Russia	8.0	10.0
Tajikistan	15.1	11.9
Turkmenistan	...	...
Ukraine	43.6	37.1
Uzbekistan	...	...

\* - Average in the first quarter of 2002

Source: CIS STAT (2002). Statistical Bulletin No 15 (294). Moscow.

**Wage arrears are pervasive, especially for rural workers.**<sup>8</sup> A key feature of the labor market transition in Belarus, is the use of wage arrears and sometimes forced in-kind substitutes. Delaying wage payments may be a particularly effective cost-reduction mechanism for firms under the high inflation environment in Belarus. Unfortunately, the real cost of adjustment is borne by the worker.

In 2002 (January-November), the level of wage arrears (as a ratio of unpaid wages to average monthly wage fund) has fluctuated significantly from 6.8% in January to a particularly sharp jump of 19.2% in September. The latest available data for November 2002 indicates that wage arrears equaled 12.1% of the average monthly wage fund. There were almost no wage arrears in Minsk (0.4% of the total wage fund in November) but in Gomel oblast, arrears have reached the level of 23.0% of the wage fund, and in Mogilev oblast, 19.2%.

Variation across industries is also large. By far the biggest arrears are in agriculture where by November 30, 2002, the level equaled 76.8% of the monthly wage fund in October, followed by manufacture, 8.4% and housing and communal services, 8.1% of the monthly wage fund.

Wage arrears were also reviewed using the additional module of the household survey conducted in the fourth quarter of 2002 (Table 8). The household survey confirmed that in the fourth quarter of 2002, more than one third of the working population had wage arrears, with an average of 12

<sup>7</sup> Recent evidence suggest that the picture may be transforming rapidly: between January and April 2004 the ratio of the minimum wage to the average wage was already 27.6%.

<sup>8</sup> Wage arrears reduced substantially in 2003-2004 and stopped being such an acute problem as at the time of analysis.

days delay in payment. The highest level of arrears was among the rural population: more than half of them reported having wages in arrears, on average for 14 days. By regions, wage arrears are quite equally spread.

**Table 8. Wage arrears in the 4<sup>th</sup> quarter of 2002, HIES special module**

	Total	By types of settlements				Rural
		Urban	Including:			
			Minsk	Big cities	Small cities	
Share of working population with wage arrears, %	35.1	29.0	12.9	32.3	37.3	52.0
Delays in wage payments, days	12	11	9	11	11	14

## 2.6 Changing Regional Economic Policies

A fundamental factor of Belarus' economic development is its relations with the Russian Federation. Unlike for other CIS countries, the importance of Russia as a main trading partner for Belarus has been increasing. Thus, between 1995 and 2000 the share of Russia in Belarus' exports increased from 45% to 51% of total exports, and for imports the share increased from 53% to 65% of total imports. Integration with Russia provided for a privileged access to Russian markets for Belarusian goods. Even more important were the implicit subsidy via supply of energy resources at below-market prices. In year 1999 only the size of the implicit gas subsidy was estimated to be in the range of about 5% of Belarus' GDP. If Belarus were to pay the same price for gas as Ukraine, i.e., if world prices were paid, gas imports would be equivalent to 16% of Belarus' GDP.

As of 2002/3 Belarus' vulnerability in this area increased greatly as Russia started to reduce the subsidies it has been providing on utilities. The latest reports indicate that Russia's Gazprom supplied gas to Belarus at 660 Russian rubles for 1000 cubic meters between May 1 and July 1, 2002 and at 760 rubles since July 1. On January 1, 2003, it raised the price to 912 rubles (around \$30 at the official exchange rate at present). Utilities constitute a significant share of expenditures by both households and service institutions.

The Belarus government, which has typically subsidized utility prices for households and service institutions, has begun to reduce this generally untargeted subsidy and is passing through a higher share of the production cost of energy to consumers. This development is beneficial for the viability of enterprises which cross-subsidize household utility consumption, but low-income households will face a significant additional economic burden. If enterprises are able to become more profitable and hence able to expand investments and/or employment, in the medium term the poverty reduction impact of the decline in cross-subsidies may be positive. In the short-term, however, a negative impact via a higher cost-of-living may occur.

The above discussion illustrates the fundamental importance of Russia's economic policies and political economy stance towards Belarus in determining whether or not the "Belarus model" of economic growth will be sustainable or not (see also Table 9).

**Table 9: Belarus' Reliance on Russia As Major Economic Partner: Benefits and Risks**

Short-Run Impact on Growth	Problems So Far	Medium and Long-Term Impact on Growth
<ul style="list-style-type: none"> <li>▪ Subsidies in the form of gas supply at below-market prices</li> <li>▪ Barter trade and barter payments for energy resources</li> <li>▪ Production on a "give-and-take" basis</li> <li>▪ Privileged access to the Russian market for Belarusian goods (due to the Customs Union)</li> </ul>	<ul style="list-style-type: none"> <li>▪ Low incentives to changes in technology</li> <li>▪ Fears of cuts in supply of gas and oil due to the arrears</li> <li>▪ Barter deals are not always in terms favorable for Belarus</li> <li>▪ High sensitivity to changes in the economic situation in Russia (example, Russian crises)</li> <li>▪ Unification of tariffs with Russia led to the increase in tariffs for some categories that is not in the best industrial interests of Belarus</li> </ul>	<ul style="list-style-type: none"> <li>▪ Commercialization of Russian energy sector is already imposing constraints and will impose it further by reducing supply to Belarus at lower than the world gas prices, and also through lower acceptance by Russia of goods for payment arrears. This will reduce the demand for some Belarusian goods and will also increase substantially costs of production and reduce the competitiveness of Belarusian goods in the absence of restructuring</li> <li>▪ Reluctance with redirection of Belarus' trade is dangerous as the Russian crisis of 1998 demonstrated; although recovery in Russia is beneficial for Belarus' trade and growth, the situation in the aftermath of the crisis is different from that in 1996. The post-1998 Russian recovery was partially based on a real devaluation with expenditure switching effects, leading Belarus to lose price competitiveness in Russian markets compared to domestic Russian producers</li> <li>▪ Trade diversion effect from economic integration with Russia might be significant for Belarus and this also can effect the competitiveness of Belarusian goods</li> </ul>

Source: World Bank staff analysis.

## 2.7 Policy Recommendations

Based on the analysis, key questions remain. Structural changes have occurred in the Belarusian economy and labor market, but it is not clear to what extent, or in which direction, this restructuring process will be carried forward. Incentives for growth of the SME sector and more productivity-based performance of the state enterprise sector are essential to stimulate investments and for job-creation. In terms of policy and monitoring, options include:

- *Wage policies.* The practice of setting large wage increases based on a dollar wage target has clearly had a beneficial impact in terms of poverty reduction in Belarus. Yet this same wage policy is probably a major constraint to the viability of existing enterprises and the emergence of more productive ones. In order to determine the most appropriate wage policy for Belarus' future, it would be highly beneficial if a thorough analysis is undertaken of both the *static and the dynamic benefits and costs* of the. Such a study should cover fiscal and dynamic dis/incentive effects of the wage policy. A wider study is also called for focusing on the incentive effects of very low minimum wages and the overall compressed wage spectrum identified in this assessment.
- *Incentives for SME growth.* Belarus could benefit in terms of both growth and poverty reduction by facilitating the expansion of SMEs. This would require a review of the existing procedures for licensing of new enterprises, legal and administrative framework, tax regime, and so on with a view to reducing the barriers to entry.
- *Energy price shock.* As noted, a major source of vulnerability to growth prospects is the reduction by Russia of its energy subsidies. The growth and poverty impact of this change and Belarus' policy options in this context constitute an important area for policy analysis.
- *Evaluation of ALMPs.* Although in Belarus active labor market programs have been successful in placing job seekers in jobs, impact evaluations of all the ALMPs is important. A number of dimensions need to be assessed: to define whether the resources spent are being efficiently utilized, whether programs are having the intended impact on poverty alleviation and unemployment reduction, and on the basis of this analysis to formulate judgments as to whether each program should be expanded, scaled down, targeted or even shut down in some cases. Moreover, it is not clear how effective these programs can be in the case of large-scale layoffs in major enterprises and firms, and by regions. An evaluation could assess the gains in terms of employment and wages of program participants relative to a control group of non-participants with roughly the same characteristics. Evaluation of the net impact of ALMPs in some of the transition countries, such as Hungary, the Czech Republic and Poland, showed mixed results.
- Furthermore, the potential design for a labor redeployment program could also be explored to help redundant workers to cope with their new status and reintegrate into the labor market by providing income support, information, counseling and self-employment assistance, thereby reducing the short-term negative impact of labor restructuring on affected workers and communities. The structure of the program should be adopted to the profile of the workers expected to be laid-off, and also to the economic conditions of the communities where the lay-offs take place. It would need to address pre-lay-off services, post-lay-off services, grants for local economic development planning, social monitoring and evaluation.
- *Labor market analysis.* In order to move from a supply-driven to a demand driven employment policies, the overall state of the labor market should be thoroughly analyzed including new forms of employment, underemployment and unemployment, components of labor force growth, age structure, industry and occupation structure; labor market segregation (for example, by age or gender), regional imbalances, and so on. These allow not only to identify the general trends in the labor market but to make projections on labor supply and demand. In particular, the current information basis does not allow to monitor the training system, the labor market and the link between them, to forecast skills requirements of labor market and, therefore, training needs. Belarus lacks instruments to assist in the identification

of present and future skills requirements by the local economy during a period of economic transformation and uncertainty.

- Most transition countries have already launched regular labor force surveys and started collecting comprehensive and internationally comparable employment and unemployment statistics, to help address the data needs for policy formulation. A regular Labor Force Survey is long overdue in Belarus.