

CHAPTER III. BUDGETARY ALLOCATION AND ITS EFFECTIVENESS

Introduction

3.1 Belarus was one of the wealthiest states of the former Soviet Union. Now, it faces the challenge of using its wealth of human resources and strategic position to further advance the welfare of its population. Given the extended role of the state in the economy, meeting this challenge requires taking a hard look at both what the government does and what outcomes it obtains for resources expended. The experience of other transition economies, both positive and negative, stands in the background to provide Belarus with a valuable store of lessons. Creating a culture of critically analyzing the role for and efficacy of public expenditures is the only way to streamline public expenditures – and consequently reduce the tax burden on productive sectors. Belarus has in place much of the administrative infrastructure that could, with marginal improvements, support such a culture of systematically assessing the efficacy of government action.

‘Public’ Expenditures in the Economy

3.2 In Belarus the scope of government activity extends well beyond what is measured in resource flows. Indeed, government activity in the Belarus economy extends far beyond the OECD conception of ‘public expenditure’. The Government retains pervasive control throughout all sectors of the economy, be it through ownership or direct regulation. Public sector enterprises produce almost 90 percent of the national output. Ministries exercise control and oversight of enterprises and ministerial decisions can affect enterprise-level decisions – e.g. on output, investment, location, social assistance, etc. These controls can even cover private enterprise. Local governments also keep an eye on the production and behavior of enterprises under their jurisdiction, since enterprise performance affects tax revenues and hence local budgetary resources. The consequence – is a system that does not support clearly tracking the relation between resources applied, outputs generated and outcomes achieved. Collection of such performance or assessment information is a precondition for improving efficiency of public expenditures – while continuing to pursue government policy objectives.

3.3 There is much to be accomplished in the reform of the public sector and public expenditure even within a very gradual approach to reform. There are two important areas in which progress can be made. The first area relates to the definition of the role of the state in the economy, and the establishment of a clear demarcation line between public sector activity and the rest of the economy. This task is complicated by the fact that in Belarus the public sector owns a large percentage of the productive capacity. Still, proper management requires separation of the roles of the state as regulator and as owner. An arms-length relationship needs to be established between the public and enterprise sector. Considerable work would need to be done to improve the governance of the state enterprise sector, strengthen budget constraints, allow easier entry and exit, and provide greater independence and responsibility to enterprises. Removal of price controls and elimination of production guidelines (or “quotas”) would be an important first step in this direction.

3.4 The second area refers to improving the effectiveness of public expenditure in the areas that remain the direct responsibility of the state. This requires: (a) aligning public expenditure with strategic development objectives, and (b) seeking the highest efficiency in the use of public resources. The focus here would be improving the effectiveness of public resource use in what are typically considered to be areas for public delivery of services – e.g. social services, health, education.

3.5 The government is conscious that there is a very direct trade-off involved: resources absorbed by the public sector proper are not available for use in modernizing the productive equipment of the economy. Without such modernization, it will be impossible to maintain competitiveness and profitability in productive sectors. This necessarily means that the government will have to rationalize programs and seek improved outcomes from the same relative (if not lower) levels of public expenditures. What is needed now is to translate this awareness into concrete commitments and results.

3.6 An initial step in this direction is to gain clear understanding of both how the government has been allocating its resources and how resources have been applied to accomplish outcomes. This chapter seeks to do this given the available information.¹ While there is no ‘right’ formula for the allocation of resources across sectors in an economy -- since priority setting and resource allocation decisions are inherently political processes – countries tend to cluster into certain patterns of government expenditure, based on economic structure. This chapter compares the situation in Belarus with that of other countries to better assess the current situation. In doing so, the chapter focuses on social expenditures (i.e. social assistance and protection, health and education) because of their importance in Belarus.

3.7 In aggregate, social expenditures account for over 50 percent of public sector expenditure. Improvements in the effectiveness of social expenditure are important to address some of the most critical challenges of transition, and also to eventually lowering the fiscal burden on the productive sectors. This Chapter draws upon on-going Bank work on these sectors. The results show that there is significant room for improvement, highlighting actions that could be taken in the short-term. The analysis also shows that, although there is a valuable stock of information available, significant improvements are needed in the type, quality, use and dissemination of information. Returns to such improvement efforts would include: greater government capacity to assess effectiveness of public sector expenditures; a natural agenda for future reform efforts; and popular support for reform efforts necessary for enhancing efficiency of public expenditures.

¹ A recent report on Chernobyl, already completed and discussed with Government, sought a similar objective. Other previous Bank reports also have analyzed expenditure and presented recommendations. These include: Poverty Assessment (1996), Enterprise Reform (1997), Farm Sector Restructuring (2000), Health Policy Note (2002), and Chernobyl Review (2002) reports.

The Allocation of Budget Expenditures: Economic Classification

3.8 The economic classification of the budget focuses on the economic impact of particular expenditure. It shows the balance between recurrent (or on-going expenditures) and investment expenditure, which affects a country's capital stock. Within recurrent expenditures, the appropriate balance must be struck between expenditures on wages, goods and services and transfers to others. There is typically little flexibility with interest expenditures except through tighter management of government debt.

3.9 Table 3.1 shows the economic classification of general government expenditures for a variety of countries or country groups for average expenditure between 1998-2000.² As seen in Chapter II, general government expenditure, which averaged 45.5 percent between 1998 and 2000 is high relative to most transition economies. The average for all the CEEs is 40.9 percent. It is similar to the amount spent by the 15 EU countries and all of the OECD, but almost 10 points of GDP higher than the shares spent on the OECD countries excluding Europe.

3.10 *Current expenditures* consist of expenditures on goods and services (including wages), interest, and subsidies and transfers. At 36.6 percent of GDP total current expenditures seem to be on par with the CEE average (36.4 percent) and a bit lower than the EU-15 or OECD countries. Relative to other countries, Belarus spends more of its current resources on other purchases of goods and services, as well as subsidies and current transfers, and considerably less on interest payments.

3.11 *Wages.*³ While during the 1998-2000 period wages were not extraordinarily high as a share of GDP, in recent years the government's policy of increasing wages to reach specific dollar targets has raised their level to 9.4 percent of GDP in 2001 (Table 3.2) which makes the Belarus wage bill one of the highest in the CIS. In addition the effect of the wage increase has not been the same at different levels of government. At the Republican level, wages and charges grew from 11.4 percent of total Republican expenditures in 1999 to 17.4 percent in 2001. At the local level wages and charges grew from 30.2 percent of total local expenditures in 1999 to 37.8 percent of all expenditures in 2001. This increase in wages, a decision made at a higher level of government, is causing compression on all other categories of spending at the local government level.

² In order to be able to make comparisons the data used in Tables 3.1 is drawn from the IMF Government Finance Statistics. Because of differences in classification between the IMF system and the Belarusian government system there may be some slight differences between data in these tables and others in this chapter.

³ For a detailed discussion of wage policies and issues see the IMF, Selected Issues, Jan. 4 2002. Section III.

Table 3.1: Selected Countries' General Government Expenditure Avg. 1998-2000: Economic Classification
(percent of GDP)

	TOTAL EXPEN- DITURE	CURR. EXPEN- DITURE	EXP. ON GOODS AND SERV.	WAGES AND SALAR.	OTHER PURCH.OF GOODS AND SERV.	INTEREST	SUBSID. AND OTH.CURR. TRANSF.	CAPITAL EXPEN- DITURE	INVEST. EXPEN- DITURE	CAPITAL TRANS-FERS
BELARUS	45.5	36.6	17.6	7.6	10	0.7	18.2	9	n.a.	1.4
RUSSIA	36.2	32.6	13.8	5.7	8.1	4.5	14.3	3.5	n.a.	0.04
UKRAINE	37.5	34.4	14.9	7.7	6.7	2.4	17.1	3.1	n.a.	1.1
LITHUANIA	35.4	31.4	18.5	7.9	10.6	1.5	11.4	3.9	2.7	1.2
LATVIA	41.3	36.9	16.2	7.7	8.5	0.9	19.8	4.4	1.6	2.8
ESTONIA	39.6	35.6	19.7	6.5	13.2	0.5	15.4	4.0	3.8	0.2
CZECH REP.	42.5	37.0	19.2	7.6	11.6	1.1	16.7	5.5	3.6	1.9
POLAND	43.1	39.8	16.1	7.1	9.0	3.0	20.7	3.3	2.8	0.4
ROMANIA	34.9	31.7	11.9	5.2	6.7	5.0	14.9	3.2	n.a.	n.a.
HUNGARY	47.0	40.8	14.6	7.5	7.1	7.1	19.1	6.2	4.2	1.9
BULGARIA	39.0	34.7	16.4	5.8	7.1	4.2	14.0	4.4	3.9	1.9
SLOVENIA	44.1	39.4	17.9	9.6	8.3	1.4	20.1	4.7	2.9	1.8
SLOVAK REP.	41.8	36.8	16.1	9.4	6.6	3.1	17.7	4.9	3.4	1.5
Av. CEECs	40.9	36.4	16.7	7.4	8.9	2.8	17.0	4.5	3.2	1.5
Av. Cohesion count	39.7	34.2	16.6	11.2	5.3	4.3	13.4	5.4	3.6	1.8
Av. EU-15	45.6	41.9	20.0	10.4	9.6	4.2	17.8	3.7	2.3	1.4
Av.OECD a/	43.2	40.0	18.5	10.8	7.8	4.7	16.8	3.2	3.2	0.0
Av. OECD, ex. Con	36.1	32.6	16.9	9.6	7.3	3.8	11.6	3.4	3.2	0.2

Source: IMF(GFS), European Commission General Government Data (ESA95), OECD Government Finance statistics
a/ average for 1995-2000.

*Subsidies and other current transfers in cohesion group and EU-15 include subsidies and social transfers

Table 3.2: General Government Expenditures: Economic Classification, 1999-2001

Source: Ministry of Finance.

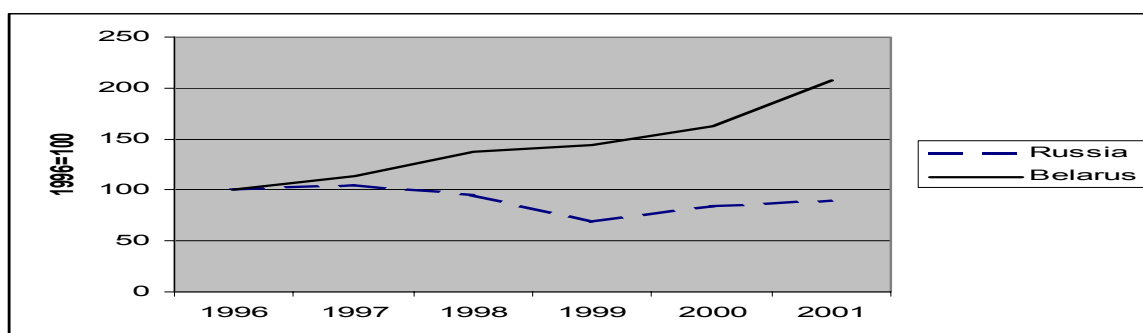
Total General Government Expenditure	as share of GDP			as share of expenditure		
	1999	2000	2001	1999	2000	2001
Total Expenditures	47.6	46.0	46.8	100.0	100.0	100.0
CURRENT EXPENDITURES	36.8	37.0	39.2	77.4	80.6	83.7
<i>PROCUREMENT OF GOODS AND SERVICES</i>	17.2	17.3	18.7	36.2	37.6	39.8
<i>Wages and Charges</i>	7.3	7.6	9.4	15.4	16.6	20.1
<i>Other Goods&Services</i>	9.9	9.7	9.3	20.9	21.0	19.8
INTEREST	0.6	1.4	0.7	1.4	3.1	1.6
<i>Interest to NBB and on Bonds</i>	0.4	0.6	0.4	0.9	1.3	0.9
<i>Other Domestic Interest</i>	0.0	0.1	0.1	0.1	0.2	0.2
<i>Interest on Foreign Debt</i>	0.2	0.1	0.2	0.4	0.3	0.4
SUBSIDIES AND CURRENT TRASNFRS	18.9	18.9	19.8	39.8	41.2	42.3
<i>o/w transfers to the SPF</i>	0.3	0.1	0.0	0.6	0.2	0.1
CAPITAL EXPENDITURES	10.7	8.3	6.5	22.4	18.2	13.9
<i>Capital Investment</i>	6.9	6.5	5.3	14.5	14.1	11.3
<i>Capital Transfers</i>	3.8	1.9	1.2	7.9	4.1	2.6
LENDING MINUS REPAYMENT	0.1	0.6	1.1	0.2	1.2	2.4
of which:						
Republican Expenditure						
Total Expenditures	21.8	14.6	14.6	100.0	100.0	100.0
CURRENT EXPENDITURES	14.7	6.8	7.6	67.7	77.4	77.4
<i>PROCUREMENT OF GOODS AND SERVICES</i>	6.6	2.7	3.3	30.1	36.3	40.1
<i>Wages and Charges</i>	2.5	4.2	4.3	11.4	14.2	17.4
<i>Other Goods&Services</i>	4.1	0.8	0.7	18.7	22.0	22.8
INTEREST	0.6	0.6	0.4	2.9	4.4	3.8
<i>Interest to NBB and on Bonds</i>	0.4	0.1	0.1	1.9	3.2	2.2
<i>Other Domestic Interest</i>	0.0	0.1	0.2	0.2	0.4	0.5
<i>Interest on Foreign Debt</i>	0.2	6.7	6.3	0.8	0.7	1.0
SUBSIDIES AND CURRENT TRASNFRS	7.6	0.1	0.0	34.7	35.3	33.5
<i>o/w transfers to the SPF</i>	0.3	4.8	3.7	1.2	0.5	0.2
CAPITAL EXPENDITURES	7.0	3.0	2.5	31.9	25.7	19.7
<i>Capital Investment</i>	3.3	1.8	1.2	15.0	16.1	13.1
<i>Capital Transfers</i>	3.7	0.0	0.5	16.9	9.5	6.6
LENDING MINUS REPAYMENT	0.1	0.0	0.0	0.4	-0.1	2.9
Local Expenditure						
Total Expenditures	16.0	11.9	12.8	100.0	100.0	100.0
CURRENT EXPENDITURES	12.3	10.3	11.0	76.7	71.9	79.2
<i>PROCUREMENT OF GOODS AND SERVICES</i>	10.6	4.9	6.1	66.3	62.2	67.9
<i>Wages and Charges</i>	4.8	5.4	4.9	30.2	29.8	37.8
<i>Other Goods&Services</i>	5.8	0.6	0.0	36.1	32.4	30.1
INTEREST	0.0	1.9	1.8	0.0	3.5	0.1
SUBSIDIES AND CURRENT TRASNFRS	1.7	0.0	0.0	10.4	11.3	11.3
<i>o/w transfers to the SPF</i>	0.0	3.5	2.8	0.0	0.0	0.0
CAPITAL EXPENDITURES	3.7	3.4	2.8	23.3	21.1	17.3
<i>Capital Investment</i>	3.6	0.1	0.0	22.6	20.7	17.3
<i>Capital Transfers</i>	0.1	0.6	0.6	0.6	0.4	-0.1
LENDING MINUS REPAYMENT	0.0	0.0	0.0	0.0	3.5	3.5
Social Protection Fund						
Total Expenditures	9.8	10.5	11.8	100.0	100.0	100.0
CURRENT EXPENDITURES	9.8	0.1	0.1	100.0	100.0	100.0
<i>PROCUREMENT OF GOODS AND SERVICES</i>	0.1	0.0	0.0	1.1	1.3	0.9
<i>Wages and Charges</i>	0.0	0.1	0.1	0.0	0.0	0.0
<i>Other Goods&Services</i>	0.1	0.0	0.0	1.1	1.3	0.9
INTEREST	0.0	10.4	11.7	0.0	0.0	0.0
SUBSIDIES AND CURRENT TRASNFRS	9.7	0.0	0.0	98.9	98.7	99.1
<i>o/w transfers to the SPF</i>	0.0	0.0	0.0	0.0	0.0	0.0
CAPITAL EXPENDITURES	0.0	0.0	0.0	0.0	0.0	0.0
LENDING MINUS REPAYMENT	0.0	0.0	0.0	0.0	0.0	0.0

3.12 In the social and cultural sphere,⁴ wages are determined by a wage grid with variations in coefficients depending on agency and seniority. The grid consists of 27 categories, with each category defined as a multiple of the “first-grade wage”, ranging from 1 to 7.84.⁵ Changes in the first grade are determined by discretion and indexation, which automatically affect other grade wages. Since March 1, 2001, the structure of wages in the “power ministries and state administration” is determined separately. The Government’s Program on the Socio Economic Development in Belarus for 2001- 2005 calls for an increase in wages from an average of \$100 per month in mid-2001 to \$250 per month by end 2005. Average monthly wage in 2002 was \$107.

3.13 In addition to the basic wage, various fringe benefits are available. Total monthly cash benefits may exceed the basic wage by a significant amount (75 percent) for some levels of the wage grid. Such fringe benefits make it difficult to get accurate information on the full extent of employee compensation and may undermine transparency. Both wages and the benefits that go along with them are “protected” items.

3.14 There are a number concerns related to the rapid increase in wages in recent years. The sharp increase in wages has not been underpinned by increases in productivity. Wage increases have therefore put pressure on the financial position of enterprises, as reflected in shrinking profitability and concerns about increasing arrears that were discussed in Chapter II. Sharp increases in wages relative to Belarus’ main competitors also do not bode well for competitiveness (see Figure 3.1) In addition, they serve to increase the fiscal pressure of the budget.

Figure 3.1: Belarus and Russia: Real Average Monthly Wage, 1996-2001



In order to compensate for rising wages, the Government has cut other forms of expenditure, especially capital expenditure. Arrears with respect to wages and particularly the knock-on effect they have with respect to pensions are causing increasing problems.

⁴ The social and cultural sphere includes budget sector and state administration workers, excluding the “power ministries” (defense, security, police, and associated organizations such as the border guards) and state administration.

⁵ According to the Belarus’ legislation, labor remuneration is carried out on the basis of hourly or/and monthly tariff rates. The rates are set in the collective agreements or by employer, and for budget organizations – by the Government. From January 1st 2003 the tariff rate of the first grade employees was set at BYR 25,000. Minimum wage is used as a social guarantee of the labor remuneration and was set at BYR 40,670 from January 1st 2003. From March 1st 2002, some social allowances, ceilings on average wage for setting pensions for some categories, as well as taxes, fines and other payments are calculated using so-called “base rate”, set by the Government.

3.15 Overall, the practice of setting large, ad hoc wage increases based on a dollar wage target does not appear to reflect the best approach to wage policy for Belarus. Public wages need to be set in a systematic, transparent process that is fiscally sustainable and will support efforts to maintain macro stability. A shift to wage changes in line with productivity growth is essential.

3.16 *Purchases of other goods and services* averaged 10 percent over 1998-2000, but fell slightly in 2001 to 9.3 percent of GDP. This level is above most of the comparator countries in Table 3.1. These expenditures reflect the basic operating costs of government and are often an item in which economies can be found. From the data in Table 3.2, it is clear that local governments have significantly reduced expenditures on other goods and services (from 36.1 percent of total expenditures in 1999 to 30.1 percent in 2001), whereas for the Republican government they have increased in recent years (from 18.7 percent of total expenditures in 1999 to 22.8 percent). In order to preserve efficacy of expenditures, it is important to ensure that cuts are not focused on key material inputs. This is particularly true at the local level, which bears responsibility for delivery of critical services. For example, purchases of such goods as textbooks and medicines are essential to effective services.

3.17 *Interest expenditures.* As discussed in Chapter II, interest expenditures are very low in Belarus relative to those of other countries (Table 3.1). Most interest is owed to the NBB and bondholders, and less to external lenders. Taking the low level of interest expenditures into account suggests that public expenditure in Belarus is even higher compared to other countries. For example, in Table 3.1, Hungary and the EU-15 average come closest to Belarus' level of expenditure. But both Hungary and the EU have much higher interest costs (7.1 and 4.2 percent of GDP, respectively). Considering primary expenditures only (which exclude interest expenditures), suggests that Belarus level of expenditure is about 5 points of GDP higher than all countries in the sample, and is about 13 percentage points of GDP higher than in Russia. This is critical as Belarus approaches integration with Russia as the adjustment required for effective convergence will be substantial.

3.18 *Subsidies and Other Current Transfers.* Subsidies and other current transfers, averaged 18 percent of GDP during 1998-2000 and increased to 20 percent of GDP in 2001. Such a level is on the high end of international experience. Poland and Slovenia had average transfers during the same period that were about 20 percent of GDP. EU countries averaged subsidies and transfers of almost 18 percent of GDP, whereas, that OECD countries excluding continental Europe had transfers and subsidies of only 11.6 percent of GDP. Russia's subsidies are averaged 14.3 percent of GDP, considerably less than those of Belarus.

3.19 The bulk of transfers and subsidies are paid out of the Social Protection Fund (about 12 percent of GDP in 2001) and the Republican budget (6.3 percent of GDP in 2001). About a third of Republican expenditure goes to this category. Transfers are made at the local level but the magnitude is smaller (about 2 percent of GDP and a tenth of their overall budget). Allocations to transfers and subsidies have also been increasing in recent years.

Table 3.3: Subsidies and Transfers, 1999-2001

	as a percent of GDP:		
	1999	2000	2001
Total Subsidies and Current Transfers	18.6	18.8	20.0
of which:			
Republican Budget			
Total Subsidies and Current Transfers	7.6	6.7	6.3
Subsidies	2.1	1.8	1.1
To public enterprises and organizations	0.6	0.3	0.2
Losses of enterprises and organizations	0.1	0.1	0.1
Other subsidies	1.4	1.4	0.8
Current Transfers	3.3	2.8	3.1
Mutual settlementsw/other levelsof gov't.	0.2	0.1	0.2
Housing Construction(to local budgets)	0.1	0.1	0.1
Targeted transfers to local budgets for maintenance	0.1	0.0	0.0
Support of administrative and territorial units(local)	2.7	2.5	2.5
Transfers to the Social Protection Fund	0.3	0.1	0.0
Transfers to Minsk for functions of the capital	0.0	0.0	0.2
Transfers on free meals of schoolchildren	0.0	0.0	0.0
Transfers to the Population	1.7	1.7	1.9
Pensions and benefits	0.6	0.7	1.0
Scholarships	0.2	0.1	0.2
Non-cash housing subsidies	0.0	0.0	0.0
Other transfers to the population	0.9	0.9	0.7
Foreign Transfers	0.3	0.3	0.3
Local Budget			
Total Subsidies and Current Transfers	1.7	1.9	1.8
Subsidies	4.3	4.2	4.1
To public enterprises and organizations	2.1	1.6	1.5
Losses of enterprises and organizations	1.0	1.0	0.9
Other subsidies	1.1	1.6	1.7
Current Transfers	-3.3	-2.7	-3.1
Mutual settlementsw/other levelsof gov't.	-0.2	-0.1	-0.2
Housing Construction(to local budgets)	-0.1	-0.1	-0.1
Targeted transfers to local budgets for maintenance	-0.1	0.0	0.0
Support of administrative and territorial units(local)	-2.7	-2.5	-2.5
Transfers to the Social Protection Fund	0.0	0.0	0.0
Transfers to Minsk for functions of the capital	0.0	0.0	-0.2
Transfers on free meals of schoolchildren	0.0	0.0	0.0
Transfers to the Population	0.4	0.4	0.7
Pensions and benefits	0.0	0.0	0.0
Scholarships	0.0	0.0	0.0
Non-cash housing subsidies	0.0	0.0	0.0
Other transfers to the population	0.4	0.4	0.7
Social Protection Fund			
Subsidies and Current Transfers	9.7	10.4	11.8

Source: Ministry of Finance and SPF.

3.20 The largest component of Republican subsidies and transfers (about 50 percent of the total in 2001) goes to current transfers to other levels of Government. This includes support of the administrative and territorial units, mutual settlements with local governments, transfers for housing construction as well as for housing maintenance. In 2001, the City of Minsk also received a transfer from the Republican government. Current transfers also include transfers to the Social Protection Fund. Transfers to the population are the next largest component of Republican budgets transfers. These include pensions and benefits, scholarships and other transfers. Of a similar magnitude, are subsidies that the Republican budget provides to support public enterprises and organizations, as well as to cover their losses. “Other subsidies” are a significant portion of this category.

3.21 While local budgets are the recipients of significant current transfers from the Republican budget, they also provide significant subsidies in their own right. Indeed, the subsidies that they provide to public enterprises – for general support and to cover losses – are at least two times as large as those provided by the Republican level. “Other subsidies” are a significant portion of local subsidies. Local governments also provide direct transfers to the population, although they are not large relative to subsidies.

3.22 Overall, current subsidies and transfers comprise a significant portion of the government’s budget (42 percent of consolidated general government expenditures in 2001). Given their magnitude, it would be a sensible strategy for Belarus to undertake a detailed analysis of the full range of subsidies and transfers, identify those that are truly meeting objectives, and elaborate options for reducing and slimming down the balance that are only partially achieving objectives. As will be discussed below, it is important to ensure that subsidies and benefits are focused and well targeted – otherwise the government may be spending resources for , at best, limited economic effect. This is particularly the case with respect to subsidies provided to loss-making enterprises and to public enterprises that are not able to operate on commercial terms. There is no economic rationale for continuing such expenditures.

3.23 *Capital Expenditures:* Relative to other countries, Belarus allocated a very high share of its expenditures to capital investment during the 1998-2000 period (Table 3.1). The average for those three years was 9 percent of GDP, almost three times higher than that of the EU, OECD, and a number of other countries including Russia and Ukraine. However, in the past three years, there has been a precipitous decline in capital expenditures in Belarus, from 10.7 percent of GDP in 1999 to 6.5percent in 2001 (from 22 percent of total consolidated general expenditures to 14 percent). The adjustment appears to have taken place at both the Republican and local levels in response to increasing wage and transfer requirements.

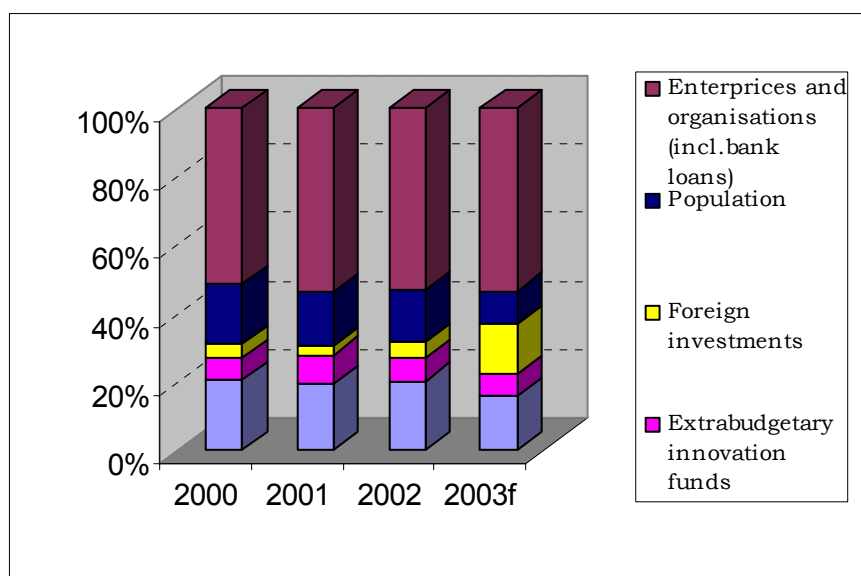
3.24 Capital investment expenditure goes into construction and major repairs. Capital transfers constitute a range of allocations to other budgets, to public enterprises, to financial institutions and “other transfers.” Capital transfers also include an “overseas” component to cover purchases and reconstruction of properties, “other transfers” and “other costs”. What remains unclear from the presentation of the budget is the degree to which capital expenditures are truly focused strictly on investment, or whether they include a variety of the accompanying expenditures of projects such as wages of the workers and other current transfers that are tied to

investment projects. The decline in investment may be more precipitous than aggregate data reveal.

3.25 Given the blurriness of borders between public and private in Belarus, assessing an appropriate level of public sector investment is difficult. Typically transition countries reduce the share of public investment as a share of GDP. Centrally-planned economies were characterized by exceptionally high levels of capital spending. After adjustment to initial transition shocks, an increase in total capital expenditures would be expected, with a shift in composition towards a robust public-private mix. Unfortunately, the data give no evidence of such a shift in Belarus.

3.26 The structure of total capital investments (public, private and those made by public enterprises) in Figure 3.2 suggests a number of points. First, the share of government in financing investment is still substantial, though decreasing. Second, the share of foreign financing is extremely low. The official 2003 projection of an increase in the share of foreign financing to about 15% of total capital investment is based on an extremely optimistic assumption of foreign capital inflows of \$412m. Third, extrabudgetary innovation funds play an important role in financing investment. The share of innovation funds in total capital investment in 2001 was higher than that of the consolidated budget. Finally, the major contributors are enterprises and organizations. Given that the Belarusian economy is still dominated by public enterprises, this implies both that public investments (in the broad sense) continue to prevail and are indeed much larger than suggested by the consolidated general budget.

Figure 3.2: Total Capital Investment by Major Source of Financing
(percent of total)



Source: Ministry of Economy.

3.27 Given the variety of funding sources for what essentially constitutes public expenditure on investment, a key question arises as to the process for allocating public investment resources to achieve greatest impact. Processes need to be put into place to ensure that investments made

through the budget and through public entities are prioritized according to highest rate of return. In addition, recurrent costs need to be separated out of the investment budget, and included in the current component of the budget. Effectiveness of public capital expenditure will depend on the stringency of analysis supporting the process for allocating these resources. Official estimates indicate Belarus needs US\$37 billion of investments during 2002-2010 to meet the targets envisaged in the *Main Directions of the Socio-Economic Development of Belarus till 2010* and the *Program of Socio-Economic Development of Belarus for 2001-2005* (i.e. 5-year plan). Developments in the enterprise sector suggest that increases in investments by enterprises and organizations is highly unlikely in the short-run, due to worsening financial positions. Under current circumstances, no significant foreign investments will enter Belarus. With increases in wages, subsidies, and transfers, resources available for investment will continue to be compressed. It is therefore especially critical to assure that the resources which are allocated to investment meet priority needs and are utilized effectively.

Box 3.1: Government Priorities for Capital Expenditure

There is not a clear pattern of strategic prioritization evident in the Government's investment program. According to the Public Investment Program for 2002, capital investments are aimed at achieving the following objectives:

- Continuation of the construction of the republican social facilities financed from the Republican Budget in 2001;
- Implementation of the activities within the framework of the program for minimization and mitigation of the Chernobyl impact and implementation of flood-control priority activities at flood-lands of the rivers Goryn and Pripyat;
- Support to agricultural and industrial sectors in implementing government targeted programs on food supply, including initial development of individual farms;
- Government's participation in financing production facilities - mainly those related to export and import substitution and productions employing new and high technologies – through allocation of budget funds on a tender basis with the purpose of attracting the own and borrowed funds of ent
- Addressing a number of the nationwide tasks including the tasks stipulated by the instructions of the President and the Government of the Republic of Belarus which cannot be funded from other sources.

drastic cuts during periods of revenue shortfalls. However, dedicating such a large share of public resources to such a wide variety of expenditures can potentially distort allocation of resources. Ministries may well seek to maximize protected resources – as opposed to maximizing outcomes. Similarly, resources applied to protected items may not be used as efficiently as possible. Every effort should be made both to evaluate the effectiveness of protected expenditures in meeting their objectives and to reduce protected expenditures to as low a level as possible (in absolute and percentage terms).

Table 3.4: Protected Expenditure Items, 1999-2001

	1999		2000		2001	
	Republican	Local	Republican	Local	Republican	Local
Wages and salaries	63428	111018	207451	338542	475808	790236
Extra charges on wages and salaries	11619	35001	38071	112184	87808	259547
Foodstuffs	12044	27500	33670	75452	89505	134071
Pharmaceuticals and dressing	7802	25270	27365	68760	56111	105219
Transfers to the population	52678	12527	159777	36781	319305	128742
including:						
Pensions and benefits	19089	43	62638	167	168035	426
Scholarships	4743	930	13287	2673	31079	5714
Cashless housing subsidies	0	42	0	82	0	228
Other transfers to the population	28846	11511	83852	33859	120191	122374
Total budget expenditures	659296	591067	1723175	1786861	3246150	3350897
Percentage of the protected items in the total	22	36	27	35	32	42

Source: Ministry of Finance.

The Allocation of Budget Expenditures: Functional Classification

3.29 The functional classification of public expenditure provides an indication of the allocation of expenditures across sectors. Table 3.5 shows the functional composition of total general expenditure compared to other countries.⁶ Expenditures in several categories, such as general public services, defense, public order and safety and recreation and culture appear to be in line with those of other countries. The composition of Belarus' expenditure stands out in a few ways. Expenditures on education and particularly on economic services appear to be relatively high. Expenditure on education in 1998-2000 averaged 6.4 percent of GDP relative to an average of 5.1 percent in the CEEs and 5.3 percent and 5.5 percent of GDP in the EU and OECD countries respectively. Expenditure on economic services is well above that of other economies and is approximately twice that of Russia and Ukraine. This reflects the government's continued involvement in the productive sphere of the economy, whereas other countries have significantly reduced such expenditures.

⁶ In order to make comparisons with other countries this table draws on the IMF, GFS database as well as other databases, therefore the categories used are not exactly those reflected in the Government's functional presentation of its budget that will be discussed below.

Table 3.5: Selected Countries' General Government Expenditure Avg. 1998-2000: Functional Classification
(percent of GDP)

	TOTAL PUBLIC SERVICES	GENERAL DEFENSE AND SAFETY	PUBLIC ORDER AND SAFETY	EDUCATION	HEALTH	SOCIAL SECURITY AND WELFARE	HOUSING AND COMM. AMENITI	RECREAT. AND CULTURE	ECON. SERVICES	INTEREST	Miscellaneous (incl. statistifical adjustment)
BELARUS	45.6	2.0	1.3	6.4	4.6	11.1	2.6	1.0	9.2	0.7	5.2
RUSSIA	36.1	2.2	1.6	3.2	2.2	9.1	3.2	0.6	4.5	4.5	2.3
UKRAINE	37.5	2.1	1.5	4.0	3.1	14.8	1.1	0.6	4.3	2.4	2.2
LITHUANIA	35.4	1.6	2.1	6.0	4.6	11.2	0.8	1.0	4.0	1.5	1.4
LATVIA	41.3	3.3	0.9	6.5	3.9	15.1	2.2	1.3	5.3	0.9	-0.4
ESTONIA	39.6	3.1	1.5	6.6	5.7	11.6	1.3	2.3	4.3	0.5	0.3
CZECH	42.5	2.4	1.8	4.3	6.7	14.5	3.5	1.0	6.2	1.1	-0.9
POLAND	43.1	2.4	1.5	5.7	4.3	19.2	3.2	0.8	2.9	3.0	-1.7
ROMANIA	34.9	1.4	1.8	3.2	3.4	10.6	1.8	0.5	4.9	5.0	0.7
HUNGARY	47.0	3.9	1.1	4.8	4.4	15.0	1.4	1.2	5.0	7.1	1.5
BULGARIA	39.0	3.5	2.9	4.1	3.8	13.1	1.7	0.8	4.8	4.2	-2.2
SLOVENIA	44.1	4.0	1.1	5.6	5.8	17.9	1.6	1.2	5.2	1.4	-1.3
SLOVAK	41.8	3.2	1.8	3.9	5.6	13.7	2.0	0.9	6.7	3.1	-0.9
Av. CEEs	40.9	2.9	1.5	5.1	4.8	14.2	1.9	1.1	4.9	2.8	-0.3
Cohesion countrie	42.5	2.0	0.8	5.0	5.1	10.1	1.3	0.6	3.8	5.3	6.1
EU	49.0	2.8	1.0	5.3	6.6	18.3	1.8	0.8	3.8	4.7	1.9
OECD	42.5	2.7	1.3	5.5	5.7	16.1	1.7	0.9	3.5	4.0	-1.0
OECD, ex. Cont. 1	34.7	2.4	1.4	5.5	5.4	11.3	1.6	0.9	2.8	4.5	-3.0

Source: IMF(GFS), European Commission General Government Data (ESA95), OECD Government Finance statistics, World Development Indicators 2001

Note: Cohesion Countries, EU, and OECD are for 1995-2000 unless otherwise noted.

*EU-EMU AND Cohesion group average health expenditure of 1990-1998

* EU-EMU and Cohesion group education and defense expenditure of 1997, % of GNP

* Hungary and Romania- total expenditure includes net lending

*Av. OECD, excl. Continental Europe (8 COUNTRIES, Iceland- not available)

3.30 Two areas in which Belarus' expenditure as a share of GDP appear lower than other countries are in health and in social security and welfare. At 4.6 percent of GDP, health expenditures are just under the average for CEEs and about 2 percentage points lower than expenditures in Europe and the OECD. They are, however, twice the expenditure on health seen in Russia. The government has set an ambitious target of expenditure on health reaching 7.5 to 8 percent of GDP by 2005. Such an increase would take Belarus' public expenditure on health well above that of most countries. Therefore while some increase could potentially be warranted, an increase of the magnitude proposed by the government's program may not be necessary. For social security and welfare, at 11.1 percent of GDP, Belarus' expenditure on in a middling range. The highest share of GDP devoted to these expenditures is in Poland at 19.2 percent of GDP. The lowest is at 9.1 percent of GDP in Russia.

3.31 In a more detailed presentation of the composition of general public expenditure in the last few years, it becomes clear that as a share of total expenditures, expenditure on social security and welfare has increased from 26.6 percent in 1999 to 32.4 percent of total expenditure in 2002 (Table 3.6). This is at least in part due to the knock-on effect of the increase in wages on social protection payments. The table also shows that expenditures on economic services has also fallen as a share of total expenditures.

Table 3.6: General Government Expenditure as a Share of Total Expenditure (percent)

Source: Ministry of Finance, WB Staff calculations

	1999	2000	2001	2002 Prel
General Public Services	6.8	7.0	7.2	7.0
Defense	2.1	2.1	2.3	2.2
Education	13.0	13.4	13.8	14.9
Health	10.5	10.9	10.9	10.9
Social Policy & Welfare	26.6	28.3	31.4	32.4
Housing & Utilities	5.7	5.9	5.6	5.3
Industry	2.4	1.7	1.5	1.3
Agriculture	5.6	9.1	7.8	6.4
Infrastructure	7.2	6.5	6.2	5.9
Conservation	1.3	1.3	1.5	1.9
Culture	1.4	1.5	1.5	1.5
Economic Services	10.8	5.0	4.1	5.1
Other	6.5	7.3	6.0	5.5
Total General Expenditure	100	100	100	100
Total General Expenditure (in billions of rubles)	1,432	4,190	8,039	11,655

3.32 It is clear from Table 3.6 that expenditures on education, health, and social policy and welfare come to over 50 percent of total general expenditures. They have increased from 50.1 percent of the total in 1999 to 58.2 percent in 2002.

Assessing Public Expenditures: Principles

3.33 While comparative analysis of economic and functional budgetary allocation is useful for observing expenditure trends and patterns, it cannot answer the most significant question, which is performance-related. Are the allocation and subsequent use of resources achieving desired outcomes for the least cost possible (i.e. efficiently)? The question that clearly arises in Belarus is whether, given the large allocation of resources that are provided to the social sectors, the government is achieving its objectives and providing services effectively.

3.34 Considerable progress has been made, over the last twenty years, in understanding how to analyze public budget processes and assess performance of public sector expenditures. There is widely shared understanding, at this point, that governments are not restricted to traditional *ex post* program evaluation (which is very costly) in order to gauge whether public resources are achieving desired outcomes – and at the least cost possible. Current understanding is based on a clear set of principles, that must be systematically applied in order to show results. This section reviews these principles, and the following section uses them to review social expenditures, based on the information currently available.

3.35 *Strategic planning.* In order to meaningfully assess performance, governments need to know in very specific terms what results or outcomes they are trying to achieve – both in aggregate for the country, as well as in more detail in individual sectors. Formal articulation of goals is essential, typically requiring input from relevant constituencies. The question of goals, as well as the question of means of achieving goals must both be asked. Once goals in terms of outcomes are specified, the question regarding options for getting there – and the relative costs associated with different alternatives – drives decisions on resource allocation. Taking the health sector as an example, the first-order question is what are the goals in the health sector? The strategic objective might be to achieve or maintain a healthy population. It is not a meaningful objective to spend ‘x’ percent of public resources on public health, as it would be possible to devote substantial resources to the health sector, and not achieve the strategic objective – e.g. by not serving the neediest segment of the population, by over-building hospitals and under-building clinics.

3.36 *Performance measurement.* A necessary complement to a strategy is an adequate mechanism for collecting relevant performance information. In the ‘best case scenario’, this entails a robust set of outcome indicators and performance measurement instruments for tracking progress – that are used throughout the public budgeting process. At a minimum, governments must specify how they will measure and track progress in meeting specified goals. For example, if the objective in the health sector is to achieve a healthy population, outcome indicators such as life expectancy and malnutrition might be tracked. Alternatively, if the objective is to maintain a healthy population, the incidence of infectious disease and maternal mortality might be used as outcome indicators. Definition of selected outcome indicators must be coupled with capacity to collect, verify and interpret data.

3.37 *Connecting resource decisions with desired results.* Having a goal, and even a set of measures or ‘indicators,’ is not enough. Outcome information must be combined with resource use information, in order to allow meaningful performance assessment. If a country is moving towards its health objective, but spending much more on health than another country with equal progress, this is important performance information. A recent survey of 27 OECD countries indicated that three-fourths of them routinely show performance information in budget documentation.

3.38 Using performance information for allocation of public resources implies knowledge – as opposed to conjecture – about the connection between application of a marginal level of resources, and a marginal level of results. There are at least two subcomponents of this process. First, appropriate measures of cost must be available – i.e. governments need to know how much inputs cost, and what production options are available for combining inputs to produce a unit of government output. Second, there must be capacity to gauge the relative contribution of government outputs to the achievement of desired results – i.e. the connection between output and outcome (or result). In the health sector, patient hospital days are outputs. Patient health is the outcome. Those managing public resources must be able to monitor the relation between levels of resources expended and levels of results achieved. This understanding is the core of the intensifying international focus on assessing development results.

3.39 The combination of clear objectives, performance indicators and an understanding of the links between expenditures and results, enables government to improve the allocation of resources among competing objectives (e.g. health versus education versus transportation). However, in order for a government to really make best use of performance information in allocating (and monitoring) public resources, certain pre-requisites must be in place, such as: adherence to the rule of law, adherence to an agreed-upon budget, political commitment to effective resource use, accessibility of transparent information, a functioning accounting system, as well as developed capacity for audit and evaluation. Information on the relation between resources and results is always valuable. However, expectations about reform efforts to include performance information in allocation of public resources need to be tempered in countries without the basic prerequisites.

Performance of Social Expenditures

3.40 This section takes stock of components and impact of social expenditure in Belarus. As seen above, social expenditures are currently running at about 60 percent of total expenditures and a considerable portion of GDP. This share is larger if other non-budget expenditures are included. Social expenditures have been on the increase (as seen between 2001 and 2002 in Table 3.6). The picture that emerges by combining these data with sector outcomes is that the country needs to sharpen the objectives of social expenditure, and seek efficiencies in implementation, as currently these expenditures are highly dispersed and may mask inefficiencies. Belarus has not yet made the transition to a market economy, and the country is likely to face additional tasks to protect the most vulnerable in the future, which would imply higher levels of public expenditures that the country can hardly afford. To prepare the country for the times to come, it would appear reasonable to streamline and sharpen the focus of current social expenditure.

3.41 *Poverty in Belarus.* A simple way of assessing the impact of social expenditures is to inquire about the poverty situation in a given country. The picture on poverty in Belarus is ambiguous. By international standards, poverty is low, and the country appears to perform strongly on the Millennium Development Goals (see Box 3.2). But, this may not be a relevant standard, at least not relevant to the government and population. In fact, the government has set itself higher and criteria to evaluate the

Box 3.2: Millennium Development Goals in Belarus

Statistics in Belarus reflect that several of the key MDGs have largely been met. This includes fulfilling targets under the 2nd, 3rd, 4th and 5th goals. (see

- Goal 1. Eradicate extreme poverty and hunger
- Goal 2. Achieve universal primary education
- Goal 3. Promote gender equality and empower women
- Goal 4. Reduce child mortality
- Goal 5. Improve maternal health
- Goal 6. Combat HIV/AIDS, malaria and other diseases
- Goal 7. Ensure environmental sustainability

However, there appears to be some deterioration in health indicators over time (life expectancy, diabetes). the goals

welfare of the population, than those that arise from international standards.

3.42 By domestic standards, the poverty rate has been relatively high at least on an episodic basis. Thus, while in 1998, less than 2% of the population fell under the international poverty line of less than US\$2 per day (WDR 2002), and the PPP value of GNI was US\$7,550 per capita, according to Belarusian criteria, 42% of population fell under the poverty line at some point over the course of the year in 2000. In 2001, the poverty survey estimated that overall, 28.9% of the population fell below the national minimum standard of living (monthly average, disposable resources per family member).⁷

3.43 Even if the poverty experienced is only temporary and the domestic poverty threshold is too high, these numbers reflect substantial economic vulnerability in the population. That is, small changes in the levels of income can drive a significant percentage of the population below the poverty threshold. This level of vulnerability is worrisome, given the economic challenges to which Belarus is currently exposed. Further, there is significant spatial variation in the poverty picture. For example, the 2001 figure of national average of population falling below the minimum standard of living (i.e. 28.9%) disaggregated between Minsk City and rural areas comes out to 13.0% and 33.6%, respectively.

3.44 Indicators of decreasing health of the population, fertility, and relatively high incidences of at least transitory poverty reflect an ample scope for effective Government action. In the present circumstances, it is fair to ask why high levels of current expenditure have not yielded more visible reductions in economic vulnerability. To better understand the relation between the relatively high incidence of poverty and the current expenditure system, it helps to examine various expenditure programs more closely. The objective is not to understand sectors, but to understand the practical relation in Belarus between public sector resource allocations and outcomes achieved.

Social Assistance and Social Security Expenditures

3.45 It is apparent through budget allocations that the Government of Belarus places a high priority on protecting incomes of, and social services for, the populace. What is not clear is whether there is congruence between the volume of resources expended and the outcome achieved. Social assistance and social security expenditures in Belarus are financed inside and outside the budget. The Budget includes a chapter on social policy and a large percentage of the expenditures to mitigate the effects of Chernobyl go for social benefits. Outside the consolidated Republican budget, there are the SPF, tax benefits mandated by law, and social expenditures carried out by enterprises. Overall this is a highly extended system of benefits.

3.46 The most striking characteristic of the current system of social protection is that it covers a broad percentage of the population. The extensive system of implicit and explicit benefits provides the majority of the population with access to a wide range of cash and in-kind 'privileges'. The system includes about 300 types of various benefits, applied to defined categories of citizens at varying rates. The system is archaic, opaque and inefficient – both in administration and outcome. Table 3.7 shows estimates of the transfers to the population as a percentage of disposable resources, using results from household surveys. These estimates show that in 1999 this ratio was roughly similar for all the income quintiles in the population. The situation continued to be virtually the

⁷ The significant disparity in rates between the two years is likely to be at least partially attributable to the wage and pension increase mandated at end-2001.

same in 2001. The results from the household survey confirm the presumption that the overall system of social assistance and protection is not well targeted.

**Table 3.7: Transfers to the Population, as a Share of Disposable Resources
(by income quintile of population)**

	Lowest	Second	Third	Fourth	Fifth
1999	2.1	2.5	2.5	2.6	2.0
2001	2.0	2.2	2.7	2.9	2.6

Source: Minstat.

3.47 Other sources confirm this result. Over 4 million people (or more than 40% of total population – and according to some estimates this share is substantially higher, up to 90%) are recipients of various benefits, subsidies and privileges. Estimation of the costs of privileges is a complicated task, and a clear accounting is simply not possible under current systems. Privileges – both direct and tax expenditure – are pervasive. Actual direct spending on the whole range of privileges provided outside the budget appears to be on the order of between 2% and 3% GDP. However, a full estimate would need to take into account additional costs: abuses and inefficiencies arising in connection with providing the benefit, tendencies to over-consume the good, or under-supply it (or to worsen the quality of good or service).

3.48 In 2001, on average, “social benefits” (including pensions) represented 25% of average family cash income. The figure reached 35% in rural areas. Aside from spatial biases, the distribution of social benefits (excluding pensions) are clearly not equitable – although there has been some slight leveling of the discrepancy over the past three years.

3.49 Not only is the system untargeted, but to-do receive far more poor in absolute terms. the objective of the assistance has been to needy on a priority present system is not that goal. International experience shows that protection systems, in be both financially and actually cushion effects of transition on households, must be to the most vulnerable

3.50 Another characteristic of the system is the dispersion of social into many programs provisions. This distorts expenditure and confounds the of public expenditure efficiency, because accounting of these not transparent. To transparency, it is to classify and group privileges by type and

decide on the scope of the privileges and the method of targeting. Experience of other transition economies shows that a broad range of privileges can be eliminated with very little difficulty. In some cases although the overall level of benefits (and costs to the government) may be high, the privileges themselves represent a small amount for the individuals/households.

3.51 Two tasks would then appear to be a priority: grouping of privileges and targeting. The World Bank has been in dialogue with the government for several years on the need to improve efficiency in the delivery of assistance to the population. The Ministry of Labor and Social Protection has piloted a program for targeting benefits (Unified Targeted Social Assistance Program pilot). No system of targeting is perfect. There can be errors of both inclusion and exclusion – covering too many or missing legitimate beneficiaries. However, as long as administrative overhead in the system is not excessive, introduction of any mechanism for moving away from universal

Box 3.3: Targeting Social Assistance

Experience with reform of social assistance and broader benefits (i.e. privileges) in the Former Soviet and other Eastern European countries is instructive.

- The challenge of rationalizing social protection expenditures remains huge. For this, benefits must be adjusted to affordable levels and strictly limited to target groups, while aiming to minimize errors of inclusion and exclusion. Even in these poorer economies, targeting of cash benefits can be achieved through several instruments, including through life-line tariffs, self selection approaches, geographic and community targeting, as well as through indicators of income or income proxies. De-institutionalization in some instances, where family and community support structures are intact, may also be beneficial. Ultimately, cost efficiency measures will help but not overcome the problem of under-funding, which must be redressed through reallocation of public funds.
- Reform of social protection schemes often provokes political opposition. Flattening of social benefits, for example, is often seen as unfair by those who have contributed more from their incomes to the consolidated fund, as Georgia's recent experience has shown. Hence, managing the political opposition, and maintaining adequate support to politically sensitive schemes, is a constraint that many governments in the region face. Governments will need to strengthen technical capacity for actuarial forecasts of pension expenditures and revenues, auditing of pension funds, and analysis of fund collection problems in order to reduce the risks of faulty design and weak implementation.

Taken from: [A Decade of Fiscal Transition](#) (Asad Alam & Mark Sundberg, The World Bank, May 2002). See also [Poverty Correlates and Indicator-Based Targeting in Eastern Europe and the Former Soviet Union](#) (Christiaan Grootaert & Jeanine Braithwaite, The World Bank, July 1998) for more detailed discussion of targeting.

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coverage is likely to reduce expenditure burden and substantially increase efficiency of social assistance expenditures in Belarus.

3.52 *Social expenditures of enterprises.* Most SOEs, and even some transformed enterprises, have retained their social sphere (kindergartens, summer camps, polyclinics, etc.). Social expenditures of enterprises fell only marginally – from 2.5% GDP in 1999 to 2.1% GDP in 2001 (see also paragraph 2.17). Given the importance of social assistance expenditures, the degree to which these expenditures are effective has a significant impact on overall government efficiency. Although the Belarusian Government started to transfer these expenditures from enterprises to the local governments, the process is slow and far from complete.

3.53 *Managing the social impact of transition.* In most of transition economies (especially CEEs) the restructuring of enterprises has generated increases in unemployment, in turn requiring an increase in public spending on unemployment benefits and various active labor market schemes. Given the limited restructuring of enterprises in Belarus, the share of expenditures for unemployment benefits accounted for a negligible share of total expenditures (less than 0.5%). Registered unemployment is low (2.3% of economically active population in 2001 and 3.0% as of end- 2002).⁸

3.54 However, it is likely that Belarus will have to face such challenges in the future. SOEs restructuring may mean shedding of excess labor and direct social expenditures. In order to avoid significant levels of social dislocation, an orderly system for shifting delivery patterns of social services would be required. The net result for the public budget would be a more transparent accounting for resources spent on social policy expenditures. Unemployment benefits and related expenses would increase.

3.55 *Tax Benefits.* Direct benefits to individuals are only part of the system. There are a range of indirect or implicit benefits and privileges, that while not directly social assistance, do play a role in the unfocused nature of the system. Tax exemptions and similar privileges include privileges and exemptions on customs duties, tax exemptions and privileges for legal entities and individuals, granting of postponing for payments of tax arrears to the budget (often, by Presidential Decree), granting of tax credits, arrears on budget loans. The cost of these type of privileges in 2001 accounted to Rbl 415.5 bn, or 2.4% GDP.

3.56 There appears to be movement towards rationalizing the system of privileges – largely because of economic relations with Russia. Two steps have recently been taken which imply some degree of commitment to controlling the growth of non-transparent social support transfers. First, Presidential Decree #207 from April 15th 2002 rules that financial support to individual enterprises will be provided through budget subsidies. Although this does not imply that there is a move to increase efficiency in use of public resources, it does imply that compared to the granting of individual tax exemptions and other privileges, the process likely to become more transparent. Second, Presidential Edict #11 from April 19th 2002 revokes individual privileges (tax, charges, customs duties) to legal entities and sole-traders. Revocation of the individual privileges was a precondition for introduction of Russian tariffs for energy resources and cargo transportation in Belarusian territory (effective May 1, 2002). However, the same Edict not only revokes individual privileges but also sets the conditions and procedures under which these individual privileges can be

⁸ Even given the limited reform in the Belarusian economy, it is possible that this figure understates actual unemployment. Individuals have little incentive to register, as the procedure is cumbersome and the level of unemployment benefits is low. For example, an average size of unemployment benefit per person accounted to 6% of average monthly wage in the economy in December 2001 and about 9% at end- 2002.

granted. Given the extensive dependence on privileges within the economic structure, it remains to be seen how revocation will play out in practice.

3.57 *Chernobyl Expenditures.* Within the total estimated “direct” costs of providing social privileges, the share of privileges granted to the Chernobyl-affected population in total costs is the highest – about 31% of total in 2001. This is followed by the costs of subsidized rent and utilities tariffs (18.8%), free or discounted travel services (16.5%), privileges granted to interior services (12.7%), privileges in education sector (11.4%) and supply of medicine free of charge or at discounted price (7.2%). Although a special subset of social assistance expenditures, the Chernobyl system of benefits offers a good illustration of the complexities and distortions prevailing in social expenditures in Belarus, as well as the degree to which the system can be made more effective by improved targeting.

3.58 The Chernobyl nuclear accident had dramatic human and ecological consequences for Belarus. It also imposed a significant financial burden on the country. Although Chernobyl expenditures declined over the 1993-2001 period, in absolute and relative terms, they still take a substantial part of public resources. The recently-prepared Chernobyl Study showed that budgetary resources spent on Chernobyl-related activities in general, and on providing various social privileges to Chernobyl-affected people has been used ineffectively.

3.59 Most of Chernobyl expenditures are financed from the republican budget by tax revenues from the earmarked emergency payroll tax⁹ (about 70% of total expenditures) and by allocations from different lines of republican and local budgets (such as “prevention and liquidation of emergency situations and natural calamities” (over 95% of this budget line), budgets of Ministries of health and education, etc.). The share of Chernobyl-related expenditures in total budget consolidated republican and local expenditures fell from 16% in 1993 to 6.1% in 2002.

3.60 The system of social benefits and privileges granted for “Chernobyl victims” is extremely complex. It includes more than 160 types of benefits with different levels of entitlements depending on factors such as the degree of exposure to radiation, disability, area of residence, etc. In addition, it also includes a wide range of special privileges for various categories of recipients. More than 20 categories of benefits have less than 10 recipients.

3.61 Chernobyl expenditures fall into the following three major categories:

- (i) Capital expenditures (resettlement, housing construction, construction of educational and health facilities in affected areas, etc.);
- (ii) Social expenditures (various benefits and privileges for Chernobyl victims envisaged by the special Law: health recuperation, free meals for children, free medicine, etc.);
- (iii) Expenditures for special targeted activities and programs (production of clean food, research and information, decontamination of environment, waste disposal, etc.).

3.62 Between 1994 and 2001 the mix of resource distribution across these three major categories changed. The share of capital expenditures fell from 56.4% to 18.4%, and the shares of social expenditures and expenditures for special programs increased from 38.2% to 64.1% and from 5.4%

⁹ The tax was set at 18% of the payroll fund, but lately had been reduced to 4%. In ABL 2002, it had been further reduced to 3.75%. This tax represents a burden on enterprises, increasing their costs and hence worsening their competitiveness.

to 17.5% respectively. For 2002 further reduction in the share of capital expenditures is planned – to 14.4%. In addition, marginal reduction in the share of social expenditures is planned (to 62.2%). There is to be a corresponding increase in the share of expenditures for special programs – to 23.4%.

3.63 A review of social protection measures for Chernobyl victims confirms that many entitlements are not related to actual impacts of radiation on health. Rather, they are primarily socio-economic in nature. Benefits are distributed even to those who were exposed to low levels of radiation, or who continue living in relatively mildly contaminated locations. This reality highlights a key source of distortion and inefficiency in social expenditures in Belarus. Many of the poor or most vulnerable receive no support, while others have access to multiple programs. In many, especially remote, areas, the poor may not be familiar with the scheme or do not receive any entitlements since transport costs might exceed the amount of assistance. The net result is that significant expenditures are made – but the intended outcome is not achieved.

3.64 Special Programs in the Chernobyl area cover various activities, and as noted above, consume an increasing share of the total Chernobyl-related expenditures. The most important activities are special agricultural protective measures, removal of contaminated radioactive materials, burial of waste, and research. In 2000 they accounted to 29%, 16.8% and 16.2%, respectively, of total expenditures for special programs. In 2001, the major emphasis was on special agricultural programs, which alone took over 80% of total expenditures for special programs. While the programs are viewed by the government as important, and are based on extensive scientific research, there is no economic assessment of the efficiency of these programs. Given the increasing share of resources devoted to these special agricultural programs, an efficiency analysis and monitoring are necessary of existing programs, as well as appraisal of new programs before their launching and implementation.

3.65 Belarus spends a considerable amount of resources on social assistance and social security programs and experience suggests that these resources are not being used as effectively as they might. The wide dispersion of programs both direct and indirect pursue just as wide a variety of objectives, making it hard to identify the overall objectives of the various programs and their effectiveness. What is clear is that programs to date have not been terribly effective at reaching the poorest of the population and, to the contrary, have been allocated to the benefit of the broad range of society.

3.66 In order to assure that the resources allocated to social assistance is effectively used a few key steps are required:

- Objectives of the system of social assistance and social protection must be identified.
- Programs must be reduced and organized around meeting those objectives. Privileges must be reduced and assistance must be better targeted.
- Efforts need to be made to measure and monitor outcomes of the programs, in addition to the allocation of resources.
- Regular assessments are required of programs to assure that they are meeting objectives and to understand the link between use of resources and successful programs.
- Resources should be focused on those programs that are demonstrably meeting objectives.

Health

3.67 Historically, the levels of health care services publicly-delivered in Belarus have been well above a ‘minimum basket’. The country inherited an extensive network of healthcare, and a population in relatively good health. However, a significant deterioration in health status has occurred. The population is declining, avoidable mortality and morbidity are considered to be high, there is a high incidence of cardiovascular disease, and there are emergent epidemics of TB and STD.¹⁰ The health status of the population is an issue of great sensitivity in Belarus. There are three factors which contribute: self-perceptions associated with the reputation for quality of life acquired during the Soviet years; the level of public anxiety about health consequences of the Chernobyl accident; and social perceptions of emerging epidemics (e.g. HIV/AIDS). The prevailing level of sensitivity makes it difficult to discuss delivery of health services with an eye to streamlining costs and improving performance in the sector.

3.68 Delivery of health services in Belarus has historically focused largely on curative as opposed to preventive or primary care, with responsibility distributed across local and national levels. There was an extensive legacy network of well over 5,000 medical installations – and over 150,000 trained doctors and nurses. However, there were, and remain, significant unevenness in spatial distribution of medical professionals. The ratio was estimated at 1.3 per 1,000 population in some areas and 7 per 1,000 population in others.

3.69 The prevailing inefficiencies in system were highlighted in the 2001 – i.e. inadequate primary care base, failure to shift to cost-conscious clinical decision-making, and insufficient effort translate international evidence into Belarusian clinical protocols. Belarus high per-patient cost indicators (see Box While not surprising in a system which is almost exclusively supply-driven, it is not situation which Belarus can continue to afford.

3.70 Belarus has fairly extensive data available on input costs and output units. are employed in the norms that are used sector budgeting. There is no analysis available, however, that links expenditures and outcomes (i.e.

performance data). At a more basic level, there are apparently no data that link expenditures and actual (as opposed to normative) outputs. This reflects absence of the habit of assessing and more formally evaluating resource use. For example, the obvious question – ‘if health expenditures have remained stable as a share of functional expenditures (Table 3.6, above) why are health outcomes (life expectancy, rate of communicable disease infections) deteriorating?’ – has apparently not factored in to discussions on health sector budgets.

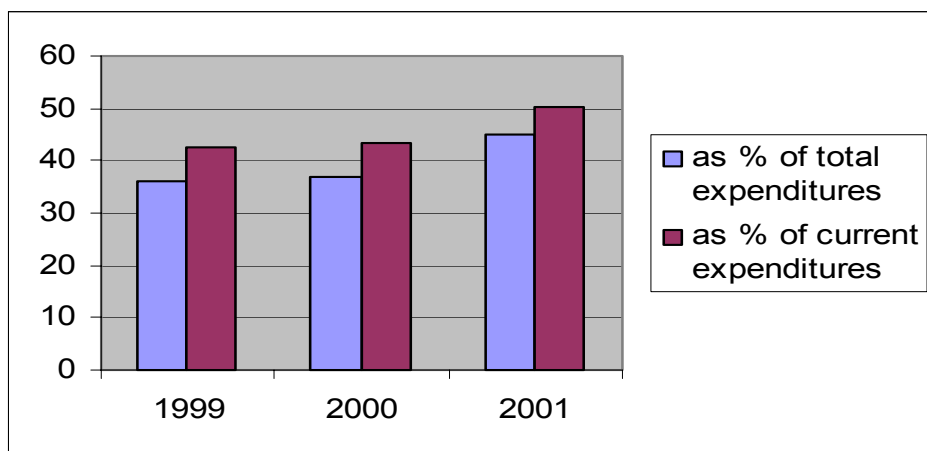
3.71 At least a partial answer is certainly embedded in economic classification of sectoral expenditures. General public health expenditure, as a percent of total general expenditures, was

<p>Box 3.4: Health Expenditures and Output Measures</p> <p>Per-patient health cost indicators in Belarus are relatively high compared to both OECD and CEE countries.</p> <p>For example, the average length of acute care hospital stays in Belarus (1996/97) was 14.6. The same indicator was 16.3 for Russia, but it was only 12.5 in Latvia, 10.3 and 10.4 in Estonia and Poland (respectively), 9 in the Czech Republic. It ranged between 5 and 8 for the EU.</p> <p>Similarly, inpatient care admissions per 100 people (1998) were 28 for Belarus, 21 for Russia, with the EU average at 18.</p> <p><i>Source:</i> <u>Belarus Health Policy Note</u>, World</p>	<p>the study</p> <p>to</p> <p>has 3.4).</p> <p>a</p> <p>These for</p>
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¹⁰ See Belarus Health Policy Note (2002) for extensive treatment of sectoral organization and performance issues.

10.5% in 1999, and 10.9% in 2001. While expenditures on health have remained stable, the required expenditures on wages have increased, thereby leaving less in the way of resources to procure other necessary inputs (See Figure 3.3).

Figure 3.3: Expenditures for Wages and Extra Charges on Wages in Health



3.72 The level of expenditures translates into just under 5% of GDP over the last three years. This level is below the government’s target of 7.5% of GDP (2005). However, the efficiency justification of the Program’s target is not self-evident. Nor does the target shed light on the government’s strategy for prioritizing across the numerous health challenges facing the population – which would be important for developing a baseline against which to gauge future performance. Regardless of prioritization within the sector, given findings of the 2001 study, it is probable that there would be greater health outcome returns to a focus on improving efficiency of resource use within the current allocation than to expansions in the envelope.

3.73 As in other sectors, budgets are set using norms, which has crowded out strategic planning and has left weak incentives for efficiency in the system. Under Decree #1225 (8/10/00), a pilot effort to improve efficiency in delivery of health services was initiated (in Vitebsk). The Vitebsk pilot was an important step, in that it was designed to improve incentives for efficient delivery of health services. Its objectives were to test reform approaches in the areas of expanding primary health care (i.e. outcome-focused) and reducing dependence on line-item budgeting (incorporating service utility data in resource allocation). The pilot was to be expanded beyond Vitebsk after the first year.

3.74 It appears that the process of identifying objectives, assessing performance and testing reform has begun in the health sector through the pilot. Further steps, as outlined in the Health Policy note, are required to improve the effectiveness of health spending. It will be particularly important to monitor the impact of increased wages on service delivery and the ability to secure the other necessary inputs for improving health outcomes.

Education

3.75 It is difficult to assess the quality of education in Belarus. The completion level of teachers is high at all levels of education. At the same time, there is no evidence of the quality of their knowledge and effectiveness of pedagogy (i.e. outcome data). There is no interpretable evidence of

the quality of learning, compared to international standards, as the necessary standardized tests have not been administered in Belarus.

3.76 Belarus, like other former Soviet republics and Central-East European countries, traditionally benefited from very high standards in elementary education. The situation is less favorable in the sphere of secondary, tertiary and special education. There is much to be done to implement new education methods and equip classes with computers, especially in rural areas. Otherwise, the education gap between various groups of population (urban-rural, low-income-high income families, etc.) will widen, with negative implications for the society and economy.

3.77 An increase in educational resources in transition economies does not necessarily translate into the creation of new opportunities for all. Rather, it could actually increase inequality, especially for those in rural areas, low-income families or those without “connections.” In some countries the educational gap among various youth groups has widened. Belarus needs to guarantee access to quality education (consistent with international standards) to avoid a widening of the educational gap between Belarusians and their counterparts in OECD, which would have a very negative effect on technological skills and the potential for economic growth.

3.78 Belarus inherited high levels of literacy and enrolment from the USSR. In 1999, the UNDP education index¹¹ for Belarus was 0.92, which is marginally higher than the Eastern European and the CIS average (0.91) and comparable to the OECD (0.94). However, in spite of impressive historical indicators of education outcomes, the educational system in Belarus is facing tremendous challenges. They are pervasive, encompassing the system from providing a sustainable system of facilities through training of teachers through creating new curriculum to computerizing classrooms. Restructuring is imperative, in order to provide the population with skills and knowledge essential for a modern market economy.

3.79 In spite of the development of a nominal private sector presence in education, the state retains the major role as educational services provider. The state (including through enterprises) is virtually the sole producer of primary education services. The same is true for secondary education. Private sector involvement is more substantial on tertiary level of education. As of the 2000-2001 academic year, there were 57 (43 state and 14 private) higher educational establishments in Belarus.

3.80 Education expenditures are financed both from Republican and local budgets. Higher and post-graduate education, as well as special programs, are financed from the Republican budget. The bulk of expenditures for pre-primary, primary and secondary education are financed from local budgets. Some educational establishments have off-budget funds, raised from the provision of paid services (there are 29 types of such services offered by establishments of the Ministry of Education).

3.81 Public expenditures for education in Belarus accounted for 6.4% of GDP in 1998-2000 and increased in 2001, which as seen in Table 3.8 is higher than many other countries. The new Law on Education adopted in 2002 sets the target of increase in public expenditures for education to the level of 10% of GDP. Notably, decision rules in use for allocation of public resources within this envelope to various levels of education services are unclear.

¹¹ This is one of the three indices, on which UNDP human development index (HDI) is built. It is based on the adult literacy rate and the combined primary, secondary and tertiary gross enrolment ratio

3.82 Data on the breakdown of the consolidated budget between the different levels of education are not available. However, a notional sense of Belarus' relative efficiency in the use of resources can be obtained by using data from international sources on expenditures per student, disaggregated by the level of education in different countries. It is possible to draw clear relations between the rate of expenditure and service outcome across the various levels. For example, given the data in Table 3.8, it is obvious from that Belarus has a very high rate of expenditures per student at primary level. It is well above that for other countries listed. Because of lack of performance data available, it is unfortunately not possible to make a complementary comparison on the dimension of results.

Table 3.8: Expenditures per Student as % GDP per Capita, 1997

	Primary	Secondary	Tertiary
Belarus	45,8	28,6	17,7
Belgium	8,5	13,5	17,6
Bulgaria	29,6	..	16,7
Czech Rep	13	20,8	33,7
Denmark	24,1	34,2	49,2
Finland	21,9	26,2	43,5
France	15,8	28,6	27,6
Hungary	17,9	17,6	30,4
Latvia	..	51,3	33,1
Lithuania	..	27,8	41,9
Netherlands	14,1	20,6	45,8
Poland	16,7	15,9	25,4
Slovak Rep	21,8	9,7	29,3

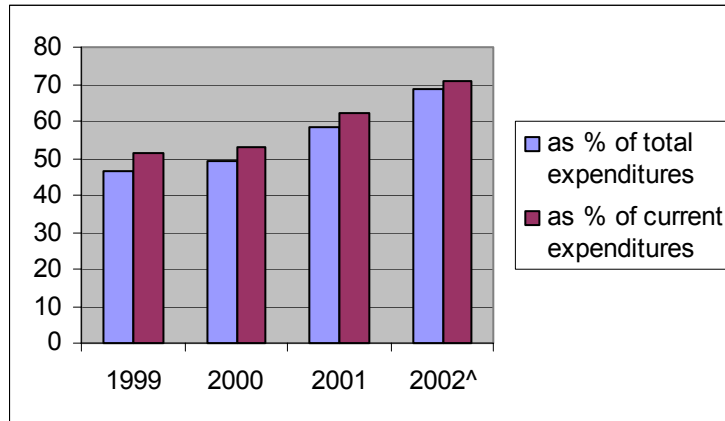
Source: WDI 2002, pp86-88.

3.83 Although there are likely to have been some changes since 1997, there is no reason to expect that there has been a dramatic reallocation of the expenditures towards secondary and/or tertiary education. While there is no internationally accepted 'guideline' for distribution of total public expenditures between different levels of education, evidence is widely accepted that there are greater initial positive externalities associated with investments in primary education (i.e. achieving universal literacy and numeracy). From this perspective, the pattern of expenditures is not notable. However, given that Belarus (as most countries of the region) has a highly literate and numerate population – and a pressing need to retool for a modern economy – one would anticipate that the share of public resources being devoted to tertiary and higher education might be more akin to that of countries committed to transition (e.g. Lithuania, Poland).

3.84 There is clearly room for efficiency improvements in delivery of education services. This is true on both the 'hardware' and 'software' sides. Student-teacher ratios, fixed costs, indicators of performance as well as effectiveness of capital stock and investments warrant attention. For example, based on data available for secondary schools, although the pupil-teacher ratio in Belarus is lower than in most other countries, this ratio fell further from 11.9 in 1992 to 10.1 in 2000 (from 15.1 to 12.2 in urban areas and from 7.5 to 6.9 in rural areas.) There may be room for this ratios to increase through a reallocation of resources.. Unfortunately, what is not evident from available data is the interaction of this factor with educational outcomes – i.e. are students learning, and learning what they need to know?

3.85 Another area of concern is adequacy of facilities. Current expenditures represent the bulk of education expenditures, and their share in total education expenditures of the consolidated budget increased from 90.6% in 1999 to 93.6% in 2001. It is set at 97.3% in 2002. This bias towards current expenditures – increasingly devoted to wages and associated extra charges (see Figure 3.4) – can hardly be viewed as sustainable. Over 50% of current expenditures on education were devoted to personnel costs in 1999. This figure has risen to over 70% in 2002. (Other important items of current expenditures on education are utilities, foodstuffs and transfers to population – all part of the privileges that are not means-tested.)

Figure 3.4: Expenditures for Wages and Extra Charges on Wages in Education*



*Actual 1999-2001, projected for 2002.

3.86 There is little logic evident in distribution of the low level of resources that are devoted to capital expenditures for education. Given the way that utilities are paid for in Belarus – through a system of cross-subsidies from sectoral ministries and enterprises – quality of capital stock (i.e. schools, classrooms) interacts substantially with fixed operating costs. Energy – and budgetary resources – are wasted in heating and lighting poorly designed and maintained facilities. These resources could be used for more direct performance-related purposes, such as books and needed equipment. Given the intention of the government to eliminate cross-subsidization, the burden of utilities bills is expected to be ease. However, without elimination of the inefficiency in the consumption of utilities, this gain will be short-term.

3.87 Efforts are being made to address inefficiency at the school level. Based on results of a pilot in Brest, the Ministry of Education is taking steps to rationalize the system of facilities (e.g. consolidating some schools in rural areas).¹² At the same time, the World Bank is working with the government on a Social Retrofitting Project (which includes energy retrofitting in schools and medical facilities, as well as technical assistance and training aimed at reduction of energy consumption in Belarus' social infrastructure by utilizing up to date methods and equipment, by reviewing and revising energy-related standards, etc.).

3.88 While these measures are important, there are clearly some fundamental flaws in incentives in the system for distributing resources in the education sector that must be addressed. The Ministry of Education reports great need in the basics for local level education – e.g. facility maintenance, curriculum development. At the same time there is substantial new capital investment in elaborate facilities at the national university. While not conclusive in isolation, this dissonance provides one of many pieces of evidence that resources for education in Belarus are not yet being distributed with an eye towards performance of public resources.

Allocating Sector Expenditures: Summing Up

¹² Thus, 179 schools in rural areas were closed during the 2000/2001 academic year.

3.89 The brief review of social expenditures shows that there is a wide range of opportunities to improve the efficiency of public expenditures, both in terms of the allocation of the resources across sectors as well as application of resources within sectors. It would appear that Belarus can achieve far greater progress towards strategic objectives (i.e. outcomes, results) for a given level of resource outlays than it presently does. In order to move in this direction, the government must begin instilling a results focus and culture of performance assessment. Using the principles outlined at the beginning of the chapter, specific areas for attention are summarized briefly below.

3.90 *Strategic Objectives.* The current system has evolved as a result of the amalgamation of various historical initiatives, each of which may have had its own individual justification. The result, as this review clearly shows, is that the public expenditure system in Belarus lacks a clear statement of strategic goals. This is true at both the aggregated national and sectoral levels. Recent reviews of Chernobyl expenditures provide a good example of the need to redefine expenditure objectives. This is directly related to another essential shift in approach highlighted in recent reviews – i.e. the need to move from a benefit approach to an economic development approach in the affected areas. Work on social assistance also shows that there is not a clear statement of objectives covering the multiplicity of programs and initiatives. Likewise in health, there not clearly stated goals in terms of outcomes, as opposed to intermediate inputs (i.e. number of beds, hospital facilities, doctors) that are embodied by norms. Moreover, stakeholders are not customarily involved in developing sector strategies or action plans.

3.91 The government has substantial advice that has been made available to it over the past several years in terms of options available for improving sectoral efficiency – in the enterprise sector, agriculture, health, social assistance, and Chernobyl. The challenge is to make the strategic decisions, and carry through despite short-run costs (social, political or economic) that may arise. The practical path is for the government to revisit the ‘plan’, and develop a complement that identifies a very limited set of outcomes for each sector. Once priorities are defined primarily in terms of outcomes – reflected in a very limited set of indicators – it will be possible for the government to discuss, and follow through on, meaningful cross-sectoral allocations.

3.92 *Performance Measurement.* The lack of clear strategic objectives has clearly hindered the development of sectoral monitoring indicators and related performance information. The country needs to identify outcome measures related to strategic objectives—i.e. performance indicators. But this in itself is not enough. It is essential that the government begin: to collect relevant data on the selected indicators; to develop a baseline against which to judge future performance; and to instill a culture and build capacity for assessing performance across sectors.

3.93 Belarus already has a very active program of collecting statistics. A next step would be for the government to focus on taking actions to make – and allocate resources based upon an understanding of – connections between user preferences, input mix and cost, and service performance. In addition to assessing the relevance of sectoral statistics collected, the government should focus on developing capacity to audit and verify performance data within sectors – both at the ministry and local levels.

3.94 The country, has an abundance of information regarding expenditures that provides a point of departure from which to build performance measurement systems. Hence, Belarus is in an optimal position to begin using performance information in managing sectoral expenditures. This base of information can be immediately incorporated into the budget cycle, in a variety of ways. Substantial returns stand to be captured by any effort, however modest, from relating user input and expenditure plans (at the planning stage) all the way through to assessing and

evaluating actual public resource outlays and outcomes (at the execution and evaluation stages).

- 3.95 *Connecting inputs and outputs.* Perhaps the greatest handicap to developing a proper understanding of the links between inputs and outputs is the use of norms. Although norms are empirically developed, they do not represent a proper assessment of the relationship between inputs and outputs. The recently completed Chernobyl study made the point that often budgetary allocations are made following certain understanding of their impact on reducing radiation intake, but these assumptions are often not tested. Also, although information available about costs, this information is not used in the selection of programs.
- 3.96 *What incentives do policy-makers and executing units have for improving performance?* While any economic transition meets with resistance from those with vested economic interests, over the medium to long-term the economy and population stand to benefit from a more balanced, transparent and strategic use of resources. As the government begins to make strategic trade-offs, however, it will be imperative for the government to communicate clearly with the population about goals – and progress towards those goals. Public sentiment typically serves as a key incentive for policy-makers. Thus, government has an incentive to articulate goals (the rationale behind them) – and transparently demonstrate progress towards those goals through use of performance data. Developing an explicit communication strategy to share the logic and benefits of reform with the public – as well as government and enterprise employees particularly – will be critical to success of any reform.
- 3.97 At the level of ministries and local levels, the government might wish to consider financial incentives. Ministries or local levels should be recognized for application of performance information in resource allocation. For example, some small percentage of budgetary resources could be reserved to an incentive fund to reward ministries with some nominal budgetary allocation (not for achieving results, just for adopting a results orientation). Alternatively, the Council of Ministers could provide limited managerial flexibility (freedom from narrowly specified personnel or other rules) to ministries in exchange for their being held accountable for results.

Priority Areas for Action

- 3.98 This chapter has provided a broad overview of the allocation of expenditures and its effectiveness. A number of priorities for the government's attention can be drawn from the discussion. These include the following:
- The government is currently following a wage policy that is likely to lead to a multitude of problems. Not only is the rapid increase in the level of wages putting financial pressure on budget institutions and firms, it is also quite likely to negatively affect the competitive position of Belarus relative to its neighbors. *Wage increases should be determined in a systematic way that is closely aligned with increases in productivity. They should not be based on a foreign currency target. Getting wages increases under control will also allow for a more effective distribution of inputs in the delivery of services.*
 - Subsidies and transfers from a particularly large part of the government's expenditure. *Subsidies to public enterprises and especially to loss making firms need to be phased out. Objectives need to be set for transfer programs and the number of programs rationalized and more effectively grouped. Efforts to improve targeting are also critical for improving the effectiveness of these expenditures.*
 - Capital expenditures by the public sector are under pressure due to the rise in wages and in subsidies and transfers. Capital expenditure funded by public enterprises is likely to fall given the financial deterioration these enterprises face. *A comprehensive mechanism for*

evaluating, prioritizing and allocating investment resources should be developed. It should focus on investments that are critical to the public sector and that will provide the highest social rate of return.

- A good portion of expenditures in the budget are protected. While it is important to assure that social needs will be met in the event that there are revenues shortfalls the current extent of protected items in the budget appears excessive. The extent of protected expenditures distorts the incentives of budget institutions and reduces the flexibility of budget management. *A careful evaluation of protected expenditures should be undertaken with an eye to reduce protection to those expenditures that are truly vital.*
- The review of functional expenditures suggests that the amount of resources dedicated to economic services may be excessive relative to the experience of other countries. As Belarus moves forward on its transformation to an economy integrated with the world, it will be necessary to reduce the scope of public sector involvement in economic activities that are not geared towards the provision of public goods. *Over time the involvement of the public sector in the provision of economic services should be considerably reduced.*
- The sectoral allocation of expenditures in Belarus is heavily oriented towards the social sectors. In principle, there is no “correct” sectoral allocation that applies to all countries. Rather what is needed is to focus on the effectiveness of expenditures in terms of the services delivered and outcome attained through an expenditure allocation. Belarus has until recently paid relatively little attention to the outcomes of expenditure and virtually none to performance (i.e. assessment of the effectiveness of resources use). *In order to move forward in this important area, in each sector the government needs to: i) identify strategic objectives; ii) develop a system for measuring performance; iii) connect resource allocations with desired outcomes; and iv) create incentives for policy makers to pursue the effective use of resources.* Only then will it be possible to fully understand the trade-offs in resource allocation between sectors.

3.99 The combination of clear objectives, performance indicators and an understanding of the links between decisions and results, enables government to improve the allocation of resources among competing ends. However, in order for a government to really make best use of such an approach, certain pre-requisites must be in place, such as: adherence to the rule of law, adherence to an agreed-upon budget, political commitment to effective resource use, accessibility of transparent information, a functioning accounting system, as well as developed capacity for audit and evaluation. The fundamental institutions of budget management are a prerequisite for both effective allocation of resources and maintenance of fiscal sustainability. The next chapter turns to a review of these public budget institutions in Belarus.