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BELARUS

Special Focus: Dimensions of Wealth Accumulation

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- *National Wealth is an important indicator of economic development—it shows if the national portfolio of assets is balanced to support GDP growth in the long-term.*
- *While Belarus has demonstrated a rapid increase in national wealth, the accumulation of physical capital has coincided with a deterioration in the country's net foreign asset position.*
- *Improvements in Belarus's net international investment position would require strengthening 'intangible' capital—economic institutions that improve the efficiency of available physical and human capital.*

The Changing Wealth of Nations

The annual income statement of a country—as summarized by its GDP—provides only a partial picture of sustainability of country's economic development. It is useful to think of GDP as a `return on assets'. GDP is calculated by looking back on the previous year's economic activity and is considered a flow measure. Wealth and its composition tells us if the portfolio of assets or stocks—produced, natural, human capital and net foreign assets—are balanced to support GDP growth in the long-term. In specific terms, a country's wealth includes: (i) produced capital and urban land—machinery, buildings, equipment, residential and non-residential land—measured at market prices; (ii) natural capital—energy (such as gas, oil, coal, various metals, agricultural land, forests and protected areas)—measured as the discounted sum of the value generated over the lifetime of the asset; (iii) human capital, measured as the discounted value of earnings over a person's lifetime; and (iv) net foreign assets—the sum of a country's external assets and liabilities.

The World Bank has spearheaded work on global wealth accounting for more than a decade. *The Changing Wealth of Nations 2018*—a third comprehensive volume of wealth estimates—tracks the wealth of 141 countries between 1995 and 2014. This new book improves estimates for natural capital and for the first time provides estimates of human capital. The construction of wealth accounts is guided by the concepts and methods of the System of National Accounts, while the approach to asset valuation is based on the concept that the value of an asset should equal the discounted stream of expected net earnings (resource rents and wages) that it earns over its lifetime.

Human capital was the main contributor to gains in wealth in all regions. However, natural capital is the largest component of wealth in low-income countries, constituting 47 percent of their total wealth in 2014. The share of natural capital gradually declines as countries graduate from low- to middle- and high-income status. At the same time, the share of produced capital doubles, from 14 percent in low-income countries to 28 percent in high-income OECD countries, and human capital reaches 70 percent of wealth in high-income OECD countries – not by reducing the amount of natural capital, but by adding more produced and human capital. However, stagnant wages and aging have been preventing the share of human capital in total capital from increasing further, especially in some upper-middle and high-income countries.

Global wealth grew 66 percent between 1995 and 2014, starting to spread among a larger set of countries. An overwhelming majority of countries increased per capita wealth between 1995 and 2014, with the fastest growth in the middle-income countries. These countries are catching up with high-income countries, largely due to the phenomenal rise of Asia, which has gone from mostly low- to middle-income status. Much of the convergence in wealth is due to the accumulation of human capital, which has benefited from massive investments to improve education and health outcomes. In the region of Europe and Central Asia (ECA) – along with Latin America and the Caribbean, and North America – the average annual growth rate in human capital per capita was less than 1.5 percent. These three regions also have comparatively higher levels of development, but more significant pressures from declining labor shares in GDP.

In more than two dozen countries in various income brackets, per capita wealth stagnated or even declined. These include several large low-income countries, some carbon-rich countries in the Middle East, and high-income OECD countries, affected by the 2009 financial crisis. Declining per capita wealth implies that assets critical for generating future income may be depleted, and the rents generated from natural assets depletion are not invested properly, a fact often not reflected in national GDP growth figures.

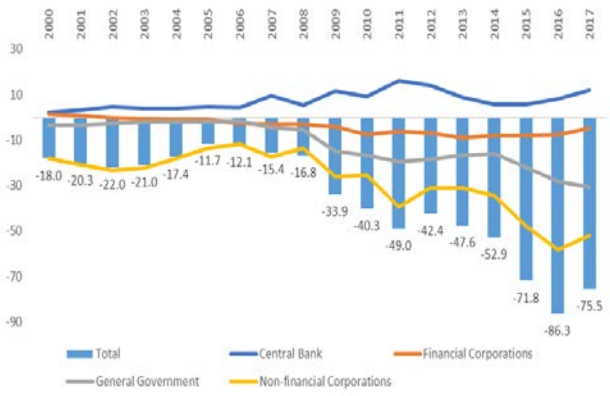
The Report does not estimate the intrinsic value of institutions, governance, and economic policies, nor their effect on the value of other assets. For example, social capital often refers to the trust that promotes cooperative behavior and can facilitate economic activities and ultimately increases well-being. In that sense, these estimates are not measuring forms of "intangible" capital. In the context of Belarus this is an important caveat, for example, the role of a well-functioning institutions and domestic financial system should not be underestimated. While domestic financial assets are not accounted as an element of national wealth, a well-functioning financial system plays an important role in an optimal distribution of accumulated capital among economic agents, including enterprises and households.

Wealth Accounting for Belarus

As in other ECA countries, human capital is the largest component of wealth in Belarus. The share of human capital in total wealth in Belarus is 49.2 percent, similar to Russia (48.1 percent) and Moldova (50.5 percent), but slightly higher than in Ukraine

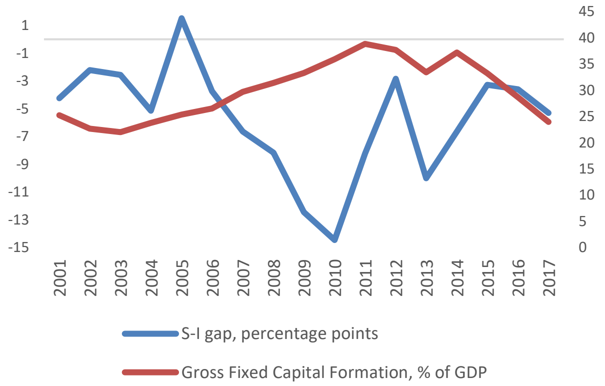
(33.8 percent), which derives its wealth from produced capital (44.9 percent vs. 33.5 percent in Belarus and 40.2 percent in Moldova). In contrast, the average share of human capital in total wealth in ECA countries is 61.8 percent, and even higher in Poland – 73.2 percent. In per capita terms, Belarus is ahead of Moldova and Ukraine, but lags behind its larger neighbors – Poland and Russia. Moreover, Belarus records a negative net foreign assets (NFA) position – US$4,588 in 2014, or 4.6 percent of GDP – almost three times higher than in Moldova and Ukraine, and the ECA region average. This figure indicates that that accumulation of wealth in Belarus has occurred at the expense of a build-up of external liabilities. The net international investment position has been deteriorating steadily since 2007, and by the end of 2017, it reached US$41.5 billion (Figure 1), one of the worst indicators in the ECA region.

Figure 1: Belarus's Net International Investment Position and its Selected Components, 2000-2017 (percent of GDP)



Source: World Bank Staff calculations based on National Bank data.

Figure 2: Savings-Investment Gap and Gross Fixed Capital Formation,2001-2017



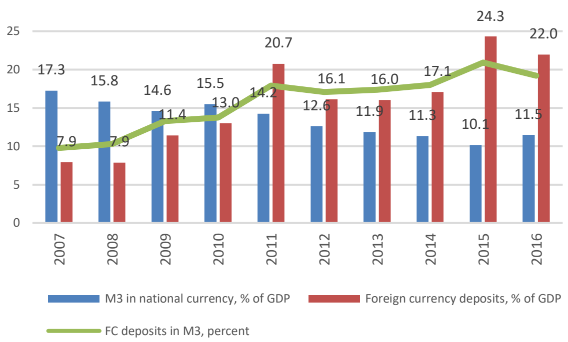
Source: IMF WEO Database, January 2018 and WDI Database.

Since 2005 Belarus started to accumulate sizable external liabilities to cover a shortfall in the savings investment gap needed to accumulate produced capital. The savings-investment gap (Figure 2) has been financed by debt flows, with limited FDI. Although the existence of a sustained savings-investment gap does not necessarily augur problems per se, these may arise if borrowing has been used to support to finance investments that do not have a rate of return as high as the cost of borrowing.

The build-up of external liabilities occurred in a heavily dollarized domestic financial system. The M3 to GDP ratio in domestic currency accounted for only 11.5 percent in 2016, declining from a 15.5 percent average during 2007-2015 (Figure 3). The ratio of broad money to GDP puts the economy of Belarus – 32.3 percent on average over 2010-2016 – in the group of low-income countries (31.5 percent). In contrast, in 2016, lower and upper MICs had ratios at 60.8 and 122.8 percent, respectively. These low indicators for Belarus are related to certain weaknesses in the financial system and a high degree of its dollarization (Figure 3).

Improvements in Belarus's net international investment position would require increasing the efficiency of capital and labor. Periodic stimulation of domestic demand in the past, including by the rapid expansion of credit at subsidized rates, especially in foreign currency to insufficiently-hedged borrowers, has contributed to falling returns on capital and growing rates of impaired loans in the banking system. However, the wealth diagnostic shows that Belarus has accumulated the necessary asset base – including human capital – for generating higher returns. To achieve this goal, it is critical to strengthen its *intangible* assets, including improved corporate governance mechanisms, hardened budget constraints, support for joint ventures with foreign investment, and an improved insolvency resolution framework. These measures would support a new growth engine and help the economy to reduce its dependence on external financing.

Figure 3: Selected Indicators of Domestic Financial Sector, 2007-2016



Source: World Bank Staff calculations based on National Bank data.

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