



ICEG EUROPEAN CENTER

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# **NEWS OF THE MONTH**

*February 2007*

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## REGIONALLY CONSIDERABLE HUNGARIAN OUTWARD FDI

Hungary seems to be the most important FDI source in the region. It realized almost two times higher Outward Foreign Direct Investment (OFDI) stock as any other country among new EU members. At the end of 2005 Hungary had an FDI stock of USD 6.6 billion<sup>1</sup> that is USD 660 in per capita terms. (UNCTAD)

### OPENNESS OF THE ECONOMY

Hungary is an opened economy both in terms of trade and capital movements. This is in the context of globalisation from one side a must, from other side is a favourable process.

As concerns the openness of country for international trade, Hungary improved considerably. Total exports and imports measured as a share of GDP have increased from 35% and 40% in 1995 respectively to the level of 76% and 77% in 2006. That means that the contribution of international economic activities to the GDP and its growth is considerable.

At the beginning of transition, trade liberalisation was the main engine of economic integration process. In the second half of nineties however Inward Foreign Direct Investment (IFDI) became the most impulsive force of development. The development of foreign trade has strong relation to FDI, as foreign investors are responsible for decisive part of exports and imports, but also for considerable part of Value Added.

### INWARD AND OUTWARD FDI

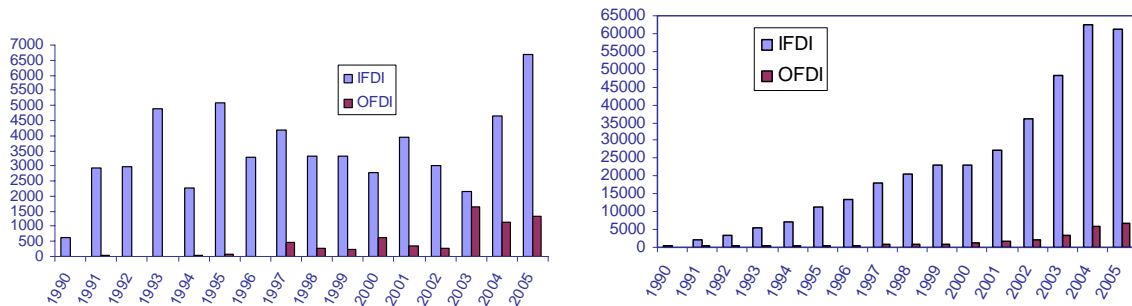
Hungary possesses illustrious position in attraction of IFDI. In 1991-2005, in average USD 3.7 billion arrived per annum and it was never less than USD 2 billion. By the end of 2005 the FDI stock has reached USD 61 billion, in per capita terms USD 6100. It is sizeable if having compared for instance with Poland that though has USD 94 billion, but only USD 2400 per capita.

As of OFDI, its development does not show such bright performance if comparing with IFDI. But if looking on its own and in comparison with other countries in the region, the picture is much more sophisticated. One can speak about considerable changes related to OFDI only from 1997 when the first measurable amounts of capital outplacements happened. 2003 brought the record high USD 1.6 billion outflow and this happened in the following two years with some moderation, USD 1.1 billion in 2004 and USD 1.3 billion in 2005. 60% of OFDI stocked realized in 2003-2005. This way 2005 finished with USD 6.6 billion OFDI stock. In absolute terms, Poland had USD 4.5 billion OFDI stock in 2005.

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<sup>1</sup> The amounts measured in USD easily can be transformed to amounts measured in EUR, if calculating by 2005 yearly average USD/EUR 0.8024 exchange rate of National Bank of Hungary; one can multiply the USD sum with 4/5 getting the data in EUR.

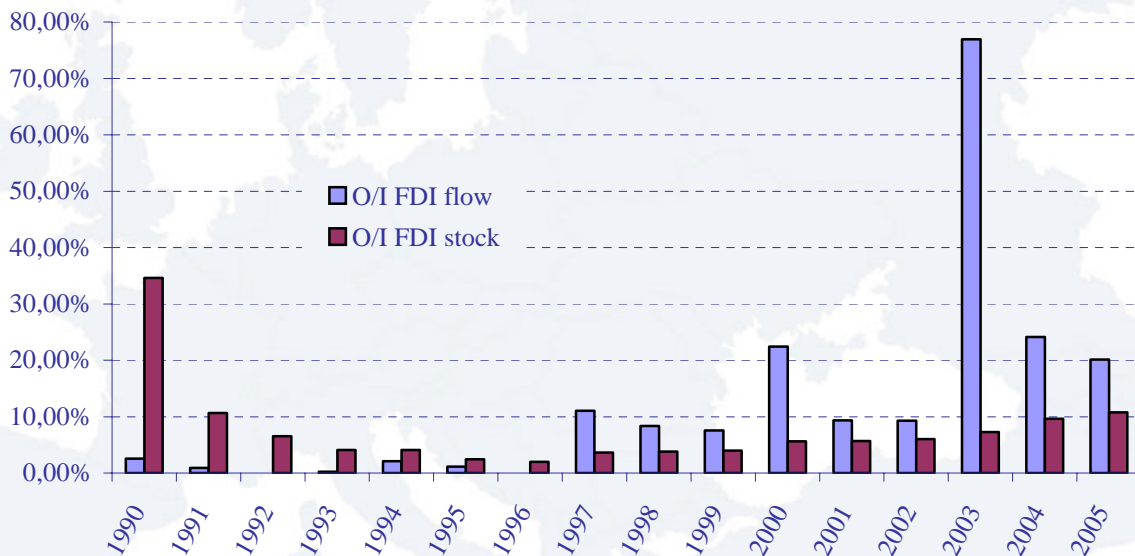
**Chart 1. Development of Hungarian Inward and Outward Foreign Direct Investments 1990-2005 (flow-left and stock-right)**



Source: UNCTAD

It is worth to have a look on the index of OFDI/IFDI. In 2005, calculated this for Hungary, the OFDI stock reached 10% of IFDI stock. The share of OFDI has increased dynamically, but it is still far from developed EU members. The EU average is 126% that means that the EU as a whole net FDI exporter. If comparing with Poland's 5%, Hungary has almost double high share.

**Chart 2. Development of the Share of Outward FDI in Inward FDI 1990-2005 (%)**



Source: UNCTAD, own calculations

If investigating the relation of FDI to Gross Domestic Product (GDP), only the more developed Slovenia and the small economy of Estonia show better data. See *Table 1* below. Hungary with its 6% of GDP OFDI stock leads the group of Visegrad countries.

**Table 1. Development of Indices of OFDI to Gross Domestic Product in NMS-8, 2000-2005 (%)**

	2000	2001	2002	2003	2004	2005
<b>Czech Republic</b>	1.3	1.9	2.0	2.5	2.9	3.4
<b>Estonia</b>	5.0	7.9	10.4	12.4	12.5	15.0
<b>Hungary</b>	2.7	3.0	3.3	4.3	4.5	6.0
<b>Latvia</b>	3.4	0.6	0.8	1.0	1.7	1.8
<b>Lithuania</b>	0.3	0.4	0.4	0.7	1.9	2.8
<b>Poland</b>	0.6	0.6	0.8	0.9	1.1	1.6
<b>Slovakia</b>	1.6	2.1	2.0	1.9	1.5	1.2
<b>Slovenia</b>	4.0	5.1	6.8	7.1	7.5	10.6

Source: UNCTAD

### SPECIALITIES RELATED TO HUNGARIAN OFDI

FDI realized by Hungarian resident companies are not so considerable, but their importance has been growing year by year. Small countries experience stronger inward capital flow at the beginning of development, later they orienting themselves in direction of increase OFDI.

In 1990-1997, forces of economic policy served the management of transformational difficulties, the convergence to EU standards, reorganization and privatization of state owned companies. Basically two reasons can be recognized behind the acceleration of OFDI: acceleration of globalisation and the other is the stepping of transformation into other phase.

The main target direction for Hungary is its neighbour countries, reflecting strong geographical determination. Crucial factors behind this are the direction of trade relations, common cultural and historical background, informal relations and the still not finished privatization processes. By 2004 data Slovakia (40%), Macedonia (9%), Croatia (9%), Poland (8%), Romania (5%) and Bulgaria (5%) are the main directions measured as a share of OFDI stock. The main target activities are the manufacturing (53%) - o/w fossil fuels processing (44%), services (42%) – o/w financial services (26%). (Source: National Bank of Hungary, own calculations) The role of green-field investments is not considerable, thus the outward FDI arrive mainly in acquisition of shares, particularly in the process of privatization. The role of reinvested earnings has started to increase in the last few years.

The OFDI is realized by relatively small number of companies, like MOL (oil and gas), OTP (banking) and T-COM/Matáv (telecommunication), Danubius (hotels), Graphisoft (ICT), Richter Gedeon (pharmacy), Synergon (ICT), TriGránit (estate, construction), Videoton. Practically they cover more than 90% of OFDI stock. Companies of importance can be divided into four groups. The first group consists of those affiliates of foreign multinationals that are not able to reinvest their earnings in Hungary by the former profitability (Axel-Springer, Hamburger, T-COM etc.). The second group represents those big companies operating on stock exchange that tries to get markets and the title of regional multinational company (OTP, MOL, Richter Gedeon etc.). The third group includes those Hungarian owned medium and big size companies that particularly seek opportunities to decrease costs (Videoton etc.). The last group deploys small and medium size with the aim of starting internationalization for cost reduction and market expansion.

## **CURRENT SITUATION OF PRIVATE HEALTH INSURANCE SYSTEM IN SLOVAKIA**

There is a wide dispute among countries under structural reforms about the ways to prove financing health care system. This is going to be a determining question in Hungary as well, where the government intends to introduce a multi-insurance health-care system. At Slovakia this system has been practiced for 13 years. In this analysis it is going to be shown how the Slovak system is built up, what were the main instruments of changing 2-3 years ago and what are the recent plans of the present government.

At first we have to clarify that the build-up of a health insurance system is just a small part of the whole health care. Adjudication of a country's system has to be based on the availability and quality of health care goods and services, the state of health of population and the satisfaction of the people. In addition the efficiency and the proper financing of the system have priority. The question of operating a private or a state-owned health insurance system is just secondary. It should be subordinated to the aforementioned aspects.

### **BUILT-UP OF THE SYSTEM**

Private health insurance system was set up in 1994. Initially 10 health insurance companies entered the market, later the number of them rose to 12. Today – in consequence of mergers and extinctions – there are 6 health insurance companies in Slovakia, 2 of them are state-owned (VšZP and SZP) and the others are private. The system which was formed in 1994 based on a central redistribution fund which was used as common budget. State- and privately owned companies paid contribution to the fund and the aggregated assets were redistributed among the health-suppliers. Problems came to light when amounts of contribution of insurance companies became incontrollable. Especially the payments of the state-owned companies were not traceable – there was no motivation to be concerned with costs because the state compounded debts towards health care providers every year.

In the evolved situation the previous government decided to pass some basic changes. Instead of central redistribution fund a new redistribution matrix has been introduced which made monetary movements clearer and more transparent. A managed competition has been built in the system which allowed the insurance companies to compete for the patients. Evading the discrimination of that part of the population which is “bad risk” for the companies – namely children, chronic ill patients and elderly people –, the government decided to set up a new system which compensates health insurance companies for insuring “bad risk” people. Rate of compensation depends on the age and gender of patients. Functioning of health care suppliers and insurance companies used to be supervised by the Ministry. Since 2005 an independent supervisory authority controls the system.

The profit-making rules are not as permissive as in the case of other private companies. At first insurance companies cannot draw out money for their own interests until all the debts are not paid to the health-care providers. In addition 3 % of total turnover have to be reserved as a minimum margin requirement for maintaining the solvency.

Health insurance companies have to find other aspects of competition. First of all they can restrict their expenditures with more efficient use of health-care services. If decision-makers feel the responsibility, they will not willing to pay unnecessary medical examinations. Another field where insurance companies can experience rivalry is the services they give.

Here we shouldn't think about different qualities of serviced medical attendances, rather it is about the specified health care-packages which contain services for an aimed group of the population: elderly people, prenatal care, specified care for chronic ill, etc. The third and easily measurable item is how much time insured persons have to wait for health care rendering (treatments, operations etc.).

There is a huge gap among privately-owned and state-owned health insurance companies. According to indicators of *Table 2* we can observe that private companies operate more effectively. Although the two private companies still insure 56 % of the population, notwithstanding the number of waiting insured persons at Sideria and Apollo is remarkable. Solvency rate of the companies also depict the divergence and the affects of dissimilar quality of paying health care services. After all not surprisingly more then 500 thousand people left the two state-owned insurance companies since reforms started.

**Table 2. Indicators of Health Insurance Companies in Slovakia**

<i>Health insurance company</i>	<b>Number of insured persons waiting for health care rendering</b>	<b>Net balance of arrivals and departures of insured persons on January 1, 2007</b>	<b>Solvency rate on December 12, 2005</b>
<b>Sideria*</b>	0	-79 401	11.90 %
<b>Apollo</b>	0	-26 924	13.11 %
<b>Dovera*</b>	76	+85 168	30.51 %
<b>EZP</b>	-	+74 607	-
<b>Union</b>	-	+462 460	-
<b>SZP (state owned)</b>	1 391	-81 564	6.40 %
<b>VŠZP (state owned)</b>	9 739	-434 346	4.12 %

\* *Sideria and Dovera have been conjugated*  
Sources: Health Policy Institute, Slovakia

Taking advantage of free choice of health insurance companies, Slovak people had remarkable movement among insurers. Special actions – e.g. delivering defined amount of money in case of persuading other people to change to Union –, additional preventive examinations which the insurance-packet includes and the international extension make Union insurance company – which is just for one year on the market – more attractive than even some other private health insurance companies (HIC). This contributes to substantial migration.

### **PLANNED ALTERATIONS OF THE GOVERNMENT**

Although the present government plans to implement actions which restrict latitude of private health insurance companies, this means nowise that private insurance system is under collapsing.

Basic principles of the government why they insist on changing the present system are that the health insurance system doesn't function suitably because it causes indebtedness of healthcare providers – however it's arguable if the insurance companies can be blamed for it. In addition they claim changing of legal status to joint-stock companies hasn't been rational and hasn't resolved the long-standing conflict between resources and needs in the health care system.

According to the position of the Health Ministry the system requires basic alterations: health insurance companies shouldn't officiate as owners, their assignment should be more

emphasized in the field of managing spending of social security contributions and regulating the accessibility of medical attendance. The government's proposal intends to restrict companies' possibilities in profit-making from financing health services. With this step they would abolish the business-opportunity in health insurance system. The Ministry doesn't look upon it in that light: in their opinion companies will have the remaining opportunity to make profit by providing additional services in the framework of additional voluntary insurance.

At the moment all the insurance companies operate as joint-stock companies. The government's proposal contains the idea of conjugating the two state-owned insurance companies and transforming them again into public institutions. By implementing this measure the two mentioned companies would lose their independence and control would be shifted to the Health Ministry – as it was before. According to expert reports this alteration would be particularly dangerous in respect of controlling the system. Regulations of financial sector – including the rules for joint-stock companies – are more elaborated than the regulations of public sector which can result in unequal rights of market-participants. In addition the phenomenon of “soft budgetary constraint” would again resurface. In the field of health insurance system we talk about soft budgetary constraints when the insurance company or companies doesn't really have to care about their occurring deficit because it is complemented from state budget. This system is not sustainable in a long run and leads up to ineffective distribution of sources.

Noticeable plan of the government is to obligate some groups of insured – children, elderly people, unemployed, students, etc. – to choose one of the state health insurance companies. With a provision like this they could achieve that the market share of the state-owned companies would be raised from 56 % to 86 %. In addition state would be able to control the highest proportion of resources because the risk index – which multiplies the redistributed amount according to the insured age and gender – is higher considering children and elderly people. If size of risk-indexes is overestimated than the truly realized risk-rates state-owned companies may be able to make additional profit of it.

The further proposal of the government about establishing a special fund for compensating extremely cost procedures is also criticized by some professionals. Firstly it would partly depreciate the responsibility of providers for their results. Secondly it is quite difficult to determine which treatment should be rated as “extremely cost”. Positive discrimination of selected patients could cause non-transparent classification of insured persons.

### **FUTURE OPPORTUNITIES**

Since 2004 there are fewer obstacles for the insurance companies to enter on the health insurance market. The former limit of minimum 300 thousand insured people has been abolished. From this point of view it can occur that a couple of new insurance companies step into the Slovak insurance sector.

In that case the government carries their current plans into execution, market share of state-controlled insurance companies or company could be raised in a large measure which would lead to monopolization of the health insurance market.

### **PRIVATE HEALTH INSURANCE: DOES IT HAVE ANY SENSE?**

According to international practice what are the main characteristics of an operable private health insurance system? According to the statistics of OECD-surveys private health



insurance doesn't have real affect on cost-effectiveness and quality-improving in the majority of the countries. Nonetheless some advantages of the HPI-system can be mentioned: statistics show it has more positive contribution on the field of creating responsiveness and more choice of the consumers.

In the case of Slovakia roughly the same characteristics are observable. People have free choice at choosing health insurance companies – whereas the real differences of supply among health insurance companies are disputable. The responsiveness is hardly measurable but presumably its improvement based on e.g. that ensured can follow their flow of money by means of individual insurance accounts which are provided by the HICs.

Although the system of private health insurance varies regarding to the differences among countries, it is noticeable on the whole that building up a PHI system doesn't reduce costs and not really ameliorates health-care quality.



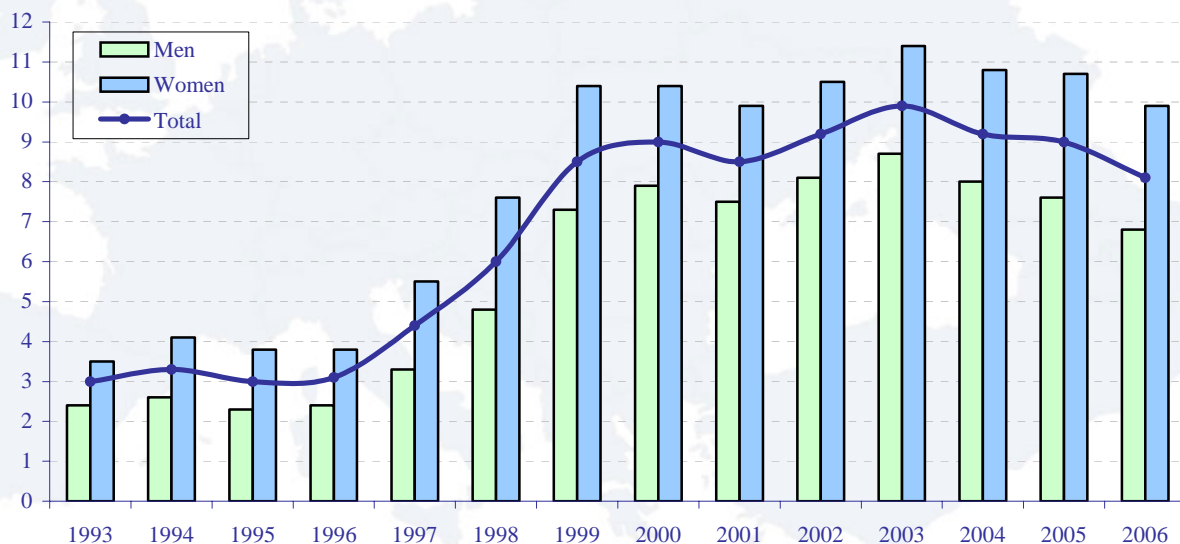
## FAVOURABLE DEVELOPMENTS OF CZECH LABOUR MARKET

The situation in the Czech labour market has improved in the previous year. Positive tendencies continued in 2006 due to increased economic activity resulting in a slight increase (0.8%) in the number of employed. During this period the yearly unemployment rate decreased by 0.9 percentage points to 8.1%. Real wages grew by 3.9% on average in 2006 while there was a 1.1 percentage points higher, however decreasing productivity growth in the third quarter of the previous year.

### TENDENCIES OF EMPLOYMENT AND UNEMPLOYMENT

Promising trends of 2005 continued in the previous year in the Czech labour market. The number of employed people reached 4866 thousand in the third quarter of 2006 and the total employment rate of persons aged 15-64 grew by 0.2 percentage points to 65.4% compared to the same period of the previous year. There have been two significant however contrary tendencies effecting the employment rate. The fast growth of the number of students at universities have pushed down the employment, while new, strong age groups entering the labour market have had a positive effect on the number of employed. Total employment rate of the Czech Republic exceeds the average employment rate of EU-25 by 1.8 percentage points. Concerning the structure of Czech employment, the secondary sector can still be considered as overweight (40% of total employment) and increased at a faster pace compared to the tertiary sector (56.1% of total employment) in the third quarter of 2006. The share of the tertiary sector was 12 percentage points lower than the EU-25 average.

**Chart 3. Unemployment rate in the Czech Republic 1994-2006**



Source: Czech Statistical Office

Concerning unemployment the Czech labour market was mentioned as a success story in the beginning of the nineties. Most people losing their job found a new one in the restructuring secondary sector or in the tertiary sector. Additionally one third of people losing job was already retired, or took part in an early retirement program, while many women exited the labour market as well taking care of family and household. The slow structural change and the economic recession period between 1997 and 1999 lead to three-times higher unemployment

rate. Since then the Czech labour market policy aims to facilitate structural changes and the creation of new employment.

In the third quarter of the previous year, the decreasing trend of unemployment started in 2005 continued, and the number of unemployed reached 365 thousand. According to *Eurostat* data the Czech unemployment rate was one percentage point lower than the average of eu-25 and 0.5 percentage point better compared to the average of old member states. Although the number of unemployed women decreased by 10.7 thousand more than the number of unemployed men, there were still more female job seekers. The share of female unemployed increased by 0.7 percentage points to 55% compared to the same period of the previous year.

The number of unemployed with primary education decreased by 10% since the third quarter of 2005, which was due to a general decrease of the number of people in the productive age with the lowest level of education. Concerning education level, the number of university graduates not having a job rose by the fastest pace (20%) to 22 thousand; however this group faces still much lower unemployment compared to people with lower education. Long term unemployment remained a problem in the previous year. Although the number of people being unemployed one year or more decreased by 8% since the third quarter of 2005, there are still only three EU member states struggling with even more severe long term unemployment (Germany, Poland and Slovakia).

### **WAGES AND LABOUR COST**

In the third quarter of 2006 average gross monthly nominal wage increased by 6.1%. Wages in the business sphere remained higher compared to the average wages in non-business workplaces, and the gap increased as nominal wages in the business sphere increased by 6.2% compared to that of 5.4% in the non-business sphere. As consumer prices went up by only 2.9% in the same period, real wages grew by 3.1%. The lowest wage level was registered in sectors such as agriculture, fishing and hotels and restaurants, while people working in the fields of financial intermediation, computer related services or electricity earned 4.5 times the wage of industries at the lower end of the wage range. As the GDP per person employed increased by 5% during the same period labour became relatively cheaper. The increase of labour productivity was slowing down falling 0.8 percentage points compared to the first quarter of 2006. Nominal labour costs increased by 6.4% in the third quarter of 2006 compared to the same period of 2005, while the deflated labour cost index amounted to 4%.

### **EXPECTATIONS**

The Czech labour market is on the way of recovery. However, governmental measures need to be taken in order to increase employment and decrease structural unemployment in the country. The national employment policy of the Czech Republic aims to solve labour market problems by increasing economic growth and competitiveness and by implementing an active employment policy.

In order to solve structural problems in the framework of an active employment policy, the low regional and professional mobility of employees should be increased (not only by creating new employment but also by improving transport and housing infrastructure), the reduced selective nature of the system of social benefits and the high tax burden on labour should be eliminated and the supply side of the labour market should be made more flexible by reforming the education system and promoting a life long learning system.

According to a Dutch forecast, the Czech labour market has another focal point besides structural problems. The country could lack 1.5 million workers in 2050 due to an aging population and an outflow of Czech, mostly well-educated migrant workers moving to more developed EU countries with higher wages. The government can choose between stopping the outflow of Czech labour force by financial incentives or attracting skilled labour from non-EU countries, not mentioning the importance of attempts has to be taken in order to improve demographic situation that can show its results only in the long-run.



## DEPENDENT BELARUSIAN ECONOMY AND INTERNATIONAL TRADE

In Belarus, trade has always played an important role, even during the period of Soviet era. At that time Russia was the main and most important market for the export of Belarusian producers, moreover the Belarusian import has been originated from Russia as well. This strong relationship remained; Russia is still the main trading partner of Belarus – among the CIS-countries (and also from the world). To strengthen and expand this “special relationship”, these two countries are about to establish the Union State that may reflect deepening of economic integration among two old relatives.

### RUSSIA'S ROLE IN THE FOREIGN TRADE OF BELARUS

Considering the trade, seemingly Belarus belongs to the open countries, as its trade turnover continuously exceeds the volume of GDP. The merchandise trade ratio compared to the Belarusian GDP (i.e. the openness of the country) has always been above 110% during 2001-2005 although smaller decrease in some years happened (*Table 3*). Data in the table shows Russian role in the foreign trade of Belarus. Russia is by far the most important and most influent trading partner of Belarus, and not only in the context of the CIS-countries, but also in that of the total export and import.

**Table 3. Indicators of Trade in Belarus, 2001-2006**

	2001	2002	2003	2004	2005	2006
<b>Merchandise trade turnover (% of GDP)</b>	127,38	117,25	120,63	130,78	110,57	-
<b>Export of goods (million USD)</b>	7451	8021	9946	13774	15979	19739
Share of Russia within CIS (%)	88,18	90,72	89,79	88,62	80,96	79,51
Share of Russia from total export (%)	53,19	49,58	49,06	47,08	35,77	34,70
<b>Import of goods (million USD)</b>	8286	9092	11558	16491	16708	22323
Share of Russia within CIS (%)	93,81	94,07	94,45	94,41	90,81	90,25
Share of Russia from total import (%)	65,63	65,13	65,77	68,03	60,56	58,61
<b>Trade balance (million USD)</b>	-835	-1071	-1612	-2717	-729	-2584
With Russia (million USD)	-1475	-1945	-2722	-4734	-4402	-6234

*Source: World Bank, Ministry of Statistics and Analysis of Belarus, own calculation*

Analysing the CIS-import, we can see that 90% of the import coming from these countries consists mainly of Russian products, furthermore the main export market of the Belarusian producers is also Russia: in 2006 almost 80% of the Belarusian export found market itself in Russia. This share can be experienced if we compare it to the total export and import.

On the other hand, one can observe a continuous decline – still in the year of 2001 the Russian share of the total import exceeded the 65%, by 2006 this share decreased by 7 percentage point; but in case of export the decrease during the same period is much notable: it nears the 20 percentage point. (*Chart 4*)

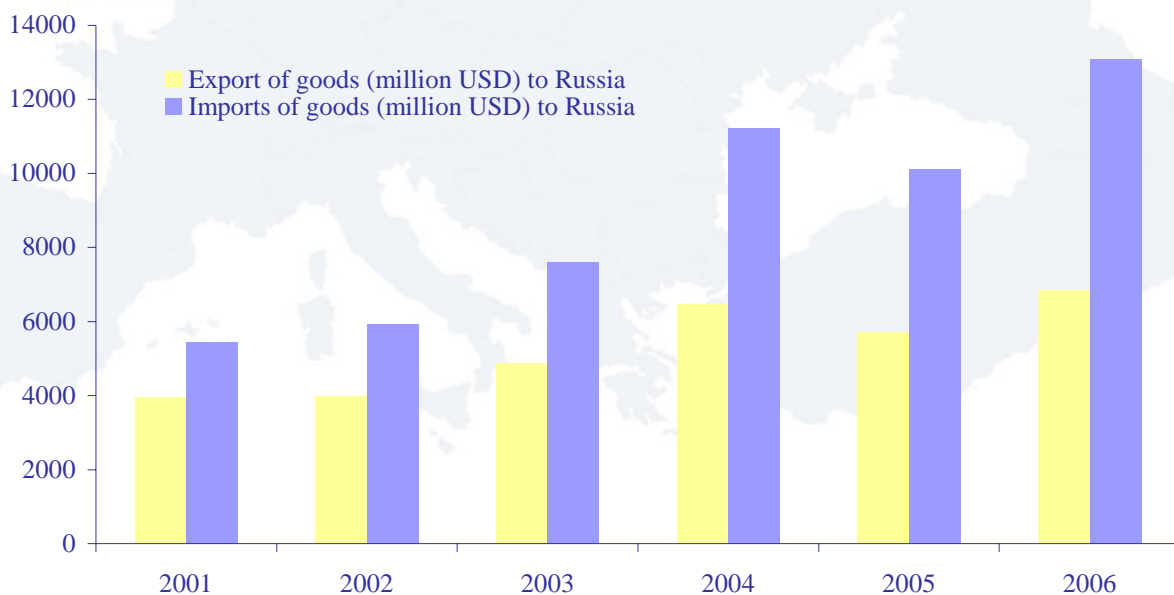
**Chart 4. Russia’s Share in Total Exports and Imports, 2001-2006**



Source: Ministry of Statistics and Analysis of Belarus

This decline seems to be very surprising, if we take into consideration that Russia and Belarus are “old” trading partners and they have accepted and signed different agreements in order to strengthen their relations and to abolish the trade restrictions. However, as it is seen in *Chart 5*, Belarus managed to expand its exports to Russia as well as the import coming from Russia increased by value. It may mean that Belarus increased its exports and imports on non-Russian markets, like the EU.

**Chart 5. Development of Exports and Imports, 2001-2006**



Source: Ministry of Statistics and Analysis of Belarus

## TRADE AGREEMENT OF BELARUS AND RUSSIA

The special relationship existing between the two countries can be described by the trade agreements and by politically led economic favours (offered mainly by Russia). The subject of one of these favours is the oil. As Belarus belongs to the net oil importers and produces resource-intensive products, the most important favour for the country is that Russia offers oil to Belarus at a lower price than any other state (still more favourable price than that offered for the other CIS-countries).

Because of the hard access to suitable data, only a World Bank analysis (issued in 2004) can give data (till 2003) to analyse this situation. In this document it is said that the difference between the export oil prices offered to Belarus and to other CIS-countries in the late 1990's exceeded the 25%, but the prices seem to convergence nowadays. In spite of this fact, two things are clear. On the one hand, Belarus is a more favourable country for Russia than the other CIS-countries. On the other hand, the export oil price offered by Russia to countries of former Soviet era is still lower than that of to the non-CIS-countries.

Beyond favourable oil price, Russia and Belarus are willing to strengthen their trade relations. The most common sign for that is the willingness of establishing a Union State. This would ensure a free trade area and customs union, and the final (ambitious) aim is to become a political union. These two countries hope the relation between them will be closer and the cooperation will deepen. In spite of these big aims, the integration process slowed down, and Russia and Belarus are not able to fulfil the deadline determined in the Treaty on the Creation of the Union State (1999). According to an analysis issued by World Bank, there are still problems need to solve, mostly in connection with the harmonization of different policies (e.g. energy, communication, taxation, transport).

Despite the unsolved problems, an achievement can be mentioned in the process of establishment the Union State: more or less, the customs union is built up and another three countries joined them: Kazakhstan, the Kyrgyz Republic and Tajikistan. But the customs union is described asymmetric, Belarus regularly uses not allowed barriers (e.g. quotas, licensing, import through warehouses only, duty stamps) to restrict the imports coming from Russia – and Russia does not always respond in kind. In spite of it, the barriers used by Belarus led to several disputes, e.g. the sugar dispute in 2004, but the last year's gas and oil dispute can be mentioned as well.

## CONCLUSION

The above mentioned data and trade agreement show that a unilateral foreign trade exists in Belarus; a special trade relationship describes the country's connection to the Russian Federation. For Belarusian producers Russia remained such a market, where they can sell their products. Also on the import side the connection is strong, most of the (energy) resources come from Russia. This is especially convenience for Belarus, because these resources are offered at a discounted price by Russia. Therefore producing the resource-intensive products does not mean any problem. Hence, this trade relation became a strong dependence on Russia – in case Russia decides not to supply the oil in given conditions, it can cause serious shock for the currently experienced economic prosperity. It is fair to mention however that Belarus is a transit country of fossil fuel trade coming from Russia to the West, making stronger its bargaining power.

Furthermore, the Belarusian government has realized that the budget revenues can be increased by the incomes coming from the trade of Russia. In 2005 the government decided to collect indirect taxes in trade relation with Russia on the basis of the country of origin, i.e. tax

is imposed on all the import coming from the Russian Federation. Remembering the fact that about 60% of the total Belarusian import comes from Russia, this revenue is enormous for the government budget. This measure could help to handle the deficit and to ensure the balance.

But there is a great disadvantage of it: if an economic decline or stagnation happens in the Russian Federation, consequently the Russian export (i.e. the Belarusian import from Russia) will decrease the Belarusian government will have to consider the unfavourable affects on the budget. Because of the unilateral trade relations, the Belarusian government should not think that the revenues coming from the rest of its trade partners could solve the problem. The other countries share in the trade of Belarus is very low – while Russia's share from the total Belarusian trade turnover nears the 50%, the second biggest trade partner, the Netherlands bear the 9% of the total Belarusian trade turnover, then come Ukraine and Germany with 6-6%.

These all refers to the fact that although the relationship with Russia is essential for Belarus, at the same time it could be very dangerous. If an economic crisis happens in the Russian economy, the Belarusian economy will feel it almost at the same time as it appears in Russia. Furthermore, this relationship makes Belarus be more closed from other – especially European – countries.

Belarus is on the way towards the World Trade Organization (WTO), and the customs union with Russia is a good “practice” for the country to learn how to behave in a liberalized world, at a global market full with competition. But there are still things to learn: Belarus has to learn how to fulfil the rules that are accepted in a treaty and not to hurt them. Joining the WTO is a great challenge for Belarus: so far this country has had almost one important trade partner, and after the WTO accession there could be much more, and the country will not be able to use any trade barriers without serious respond.

Additional challenges exist that can influence further development of economy, like underdeveloped and monopolized services sectors, unsustainable economic performance based on short-run gains in oil processing, metalworking, wood and paper manufacturing.