



Progress Report on compliance with conditions for the third tranche of the Reform Program of Government and National Bank of Belarus Supported by EFSD Financial Credit
(prepared on the basis of the Report of the Ministry of Finance of the Republic of Belarus)

Implementation of the conditions of the third tranche of the EFSD financial credit to the Republic of Belarus aims at:

- a) reduction of the inflation and progressive build-up of the gross international reserves through duly coordinated tight monetary and fiscal policies;
- b) continued deregulation of the economy through structural reforms aimed at liberalizing pricing mechanisms, improving the efficiency of public sector enterprises and creation conditions for their subsequent privatization, as well as improving business environment to enable more proactive engagement of the private sector.

The qualification for the third tranche requires compliance by 1 September 2016 with 22 conditions, 9 of which are control targets. As of the date of this Report, 4 conditions have not been met, including 1 control target.

The said control target (see target 1.16 of Section II below) requires limitation of the annual non-project related public borrowing to no more than 75% of the total annual sovereign debt repayment requirement, and in case of exceeding the threshold, the amount in excess of 75% should be used exclusively to replenish the Government deposits. In fact, in January-August 2016 the amount of public debt in Belarus reached 103.4% of the repayment amount. At the same time, the foreign currency deposits of the Government have increased by USD 253 million instead of USD 574 million, as required by the condition.

One of the fundamental reasons of exceeding this threshold is the need for timely repayment of the debt liabilities in the context of expansion of the current account deficit, shortfall of the revenues and recession over the past two years. Moreover, the authorities use debt instruments to support public sector (state-owned) companies. In 2016 during the period under review, government bonds were issued for these purposes in the amount of USD 109.6 million and BYN 13 million.

The Manager notices that in fact the RB authorities had technical possibility to replenish their foreign currency reserves to the required level by converting the increase in the government budget deposits¹ recorded in January-August of the current year in a total amount equivalent to USD 582 million, of which 62% were denominated in BYN. The sources of these deposit increases were budget surplus (equivalent to USD 520 million) and net borrowing (USD 62 million).

¹ Including local authorities.

Given that the excess of the government borrowing threshold occurred in the context of expanded surplus and replenishment of the GIR beyond the minimum level, specified by the tranche conditions, the Manager recommends granting a waiver of compliance with this condition.

Failure to comply with three indicative targets was due to the delay in adoption of the following documents, which common objective was to encourage changes in the public sector, aimed at enhancing the effectiveness of public property management in order to maximize profits by efficient allocation and use of resources:

- *Strategy of improving efficiency of the management of state-owned organizations (Target 3.1)*

This strategy was announced by the RB authorities in 2015 as a key instrument outlining the guidelines, mechanisms and time boundaries for the proposed reform of public sector organizations. The Manager has the draft Strategy prepared by the authorities in consultation with the IMF. The said draft provides for implementation of a set of measures to enable transformation of the system of management of public sector enterprises, including separation of responsibilities of the owner and the regulator; introducing the corporate governance policies at all public sector enterprises, regardless of the government share in their equity; improving the system of monitoring fiscal risks generated by public enterprises, as well as the scope and effectiveness of public support; adoption of IFRS standards by all public sector companies; and improvement of the legislative framework as it relates to public property management. In implementing the above activities, an analytical and legislative base will be built for decision-making on public property management (including privatization, bankruptcy, reorganization and liquidation).

In general, the Manager considers that the draft Strategy is satisfactory, and concludes that its implementation will improve the efficiency of operation of public enterprises and enable favorable environment for the private sector development. The evolutionary nature of the Strategy aims at maintaining high quality of the social capital existing in RB. In the opinion of the Manager the adoption of this document will be considered as an important signal of the readiness of the RB authorities to reform the public sector management system.

- *Presidential Decree "On additional measures to provide social support for certain categories of unemployed" (Target 3.3)*

The purpose of this Decree is to increase unemployment benefits for certain categories of unemployed² till the subsistent budget. This will stimulate cost optimization of public sector enterprises through layoffs of redundant workforce, which, according to the Manager's assessment, may reach 20% in the public sector and about 14% in the economy nationwide. Despite the fact that in the current year the number of those laid-off in Belarus exceeds the number of newly hired, the Manager believes that the extremely low level of unemployment benefits (about 3% of the average pay) is a deterrent hindering further optimization of the numbers of the employed, especially in state-owned companies. Currently, according to the official statistics, the number of registered unemployed is about 1%, whereas the ILO estimates

² In particular, for workers, dismissed from enterprises under staff optimization.

show the unemployment rate at 4-5%³. In this context, strengthening of social safety nets for people laid off in the process of the enterprises' commercialization becomes essential precondition for the structural transformation of the economy of Belarus, because the proposed optimization of labor costs should enable release of financial resources and their overflow to more efficient and promising sectors.

- *Presidential Decree "On trust management of an enterprise as a property complex of the state unitary enterprise" (Target 3.6)*

This draft decree is designed to improve financially insolvent public sector enterprises, mainly operating in agricultural business. Out of the total number of agricultural organizations, over 60% are fully or partly state-owned. Despite substantial state support, their performance efficiency is pretty low, and in recent years, in the context of the ongoing economic recession and the downfall of global food prices, their condition has been exacerbated even more: at the end of 8 months in 2016 the share of farming units running at a loss accounted for nearly a quarter of the total number. The proposed draft requires that public sector enterprises must be transferred in trust to be managed on a competitive basis for max. 5 years, during which time the asset manager (legal entity of any form of ownership) should reach the agreed upon and formalized financial performance (cost-effectiveness and profitability). The draft decree includes an opportunity to buy-out an enterprise by a trustee. In the event of successful implementation of the contract, the current delay in the enactment of the Decree hinders the practical application of this instrument.

Given the importance of these documents for implementation of the structural reforms, the Manager recommends proceeding with disbursement of the third tranche of the EFSD financial credit to the Republic of Belarus in the amount of USD 300 million, subject to adoption of the relevant Presidential Decrees and the Strategy of improving efficiency of the management of state-owned organizations by the authorities of the country.

³ Data on this methodology are not published in RB.

I. Current macroeconomic situation in Belarus

Moderately tight macroeconomic policies, pursued by the RB authorities, contributed to reducing inflation below the target benchmark. As a result of recommendations provided by the EFSD, real interest rates set by the NB of Belarus for liquidity provision remain on a positive level⁴, despite their decline during 2016 from 30% in January to 23% in September. Reduction of the interest rates does not trigger off unbalanced increase of liquidity in the economy, and monetary aggregates are kept within agreed frame. Lower inflation was also facilitated by tough fiscal policies enabled by the surplus budget. In addition, the decline in global commodity and food prices amid a stable foreign exchange rate, contributed to further reduction of cost inflation.⁵ Another important factor, arresting inflation, was a drop in inflation expectations⁶, resulting from the stabilized slowdown of inflation rates, as well as consistent and transparent monetary targeting policy, carried out by the NB of Belarus. In October 2016, the consumer price inflation amounted to 11.0% per annum, i.e. below that of the previous year (11.5%) and the target benchmark of the NB for 2016 (12%).

Flexible exchange rate policies have provided support to the balance of payments and contributed to reducing the decline in GDP. More flexible exchange rate policies supported by the commitment of the NB of Belarus to the method of a two-way auction mechanism for determination of the foreign currency exchange rate allowed minimizing foreign exchange interventions using them, predominantly, to prevent abrupt ups and downs of the exchange rate. During the 9 months of the current year the exchange rate depreciated in real terms by 10.6%, whereas the gross international reserves (GIR) increased by USD 0.6 billion, reaching at the end of September 2016 the level of 1.9 months of imports (compared to 1.5 months in December 2015). The increased price competitiveness of the economy and the low baseline level of last year, along with the growing farming sub-sectors in Russia, promoted increased demand for non-commodity exports from Belarus, and constituted principal factors slowing down economic decline in the current year. By the end of nine months in 2016, the GDP of Belarus diminished by 2.9% in real terms, compared with -3.7% year-on-year in 2015.

The expanded surplus of the general government budget was formed due to reduction of the off-balance-sheet costs and despite the slowdown of tax revenues inflow. The budget of general government (including the off-balance-sheet transactions) for 8 months in 2016 was executed with an expanded surplus at 1.7% of GDP, compared to its deficit of 2.9% for 8 months in 2015. Such a tangible improvement in the fiscal position was achieved by means of significant reductions in off-balance-sheet spending: budget deposits earmarked for funding public housing construction projects dropped by a factor of 2.6 the previous amount, performance guarantee financing - down by a factor of 1.6 the previous level, and topping the authorized funds of public companies - cut by 50%. The fiscal parameters were somewhat improved due to the continued reduction of capital expenditures (-3.3%, against -25.8%), as well

⁴ i.e. about 11% in real terms.

⁵ This benefit is to an extent offset by the negative impact of low oil prices on the balance of payments of the Republic of Belarus. Primarily, Belarus is a net exporter of petroleum products, and low energy commodity prices undermine its net energy exports. Secondly, the decline in oil prices slows down the pace of recovery of the Russian economy and affects the demand of the RF for products from Belarus. Ultimately, these factors exert a pressure on the balance of payments, exchange rates and inflation.

⁶ According to the survey carried out by the NB of Belarus, the share of respondents that expect a slower or steady growth in prices, increased from 21.3% in the beginning of 2016 to 34% in October.

as a more moderate growth of current expenses (+16%, against +22%). The rate of growth of the consolidated budget revenue has decreased from 27.3% in January-August 2015 to 6.2% in the current period. The most important shortfall was recorded on revenues accruing from foreign trade activities (-13.3%, compared to +125.8% in January-August 2015), which is due to the decline in the global prices of oil and reduction of its supplies from Russia, as well as corresponding decline in the oil products' export. Net of export duties, which started to drip into the budget of the Republic of Belarus in 2015, the foreign trade revenue in the consolidated budget of Belarus in January-August 2016 decreased, as compared to YoY in 2015, by 16%. The rate of growth of other tax revenue proceeds also slowed down from 18% in January-August 2015 to 10% in the current period.

On the one hand, reduction in government lending programs, amid high interest rates, deters expansion of the loans and increases the number of bad loans; on the other hand, implementation of this policy created conditions for a more efficient allocation of resources in the economy. Given the high interest rates and overall reduction of directed lending⁷, the volume of loans to the economy issued by the banks is shrinking. In the context of the biggest problem of the banks, which in terms of prudential supervision is about single-client concentration⁸, stability of the banking system in Belarus continues to decline: the share of bad debts in September 2016 rose to 14.3%, compared to 6.5% one year back. It appears, that reducing inefficient lending investment schemes in the banking system lays the groundwork for its more effective operation in the medium term. Moreover, in the context of the more flexible exchange rate policies and decline in devaluation expectations, the 3rd quarter of 2016 saw inception of the BYN deposit recovery process and reduction of the hard currency deposits down to 72.1% from 79% in January 2016.

Expansion of current account deficit, at a time of reduction of foreign direct investment and increasing external debt, evidences about a negative impact of the accumulated structural imbalances on the economy. The current account deficit in January-August of 2016 amounted to 4.6% of GDP, compared to 2.2% of GDP in January-August, 2015, with concurrent reduction in foreign direct investment (3.1% of GDP, compared to 3.7% of GDP in the previous period), and growth of the external debt liabilities (27.7% of GDP, compared to 19.3% of GDP). The ongoing decline in productivity and deteriorating financial condition of enterprises (the net profit of the economy in the first six months of 2016 decreased by 20.7%, and the share of loss-making organizations in their total number went up to 22.8%, or by 24.8%, as compared to YoY 2015), reflect the existing structural problems in the economy, which may result in inefficient allocation of resources. Inflexible labor markets, enormous share and role of the government in the economy, as well as continuing price controls, constitute fundamental structural disparities, distorting resource allocation and pricing processes on monetary, foreign exchange and commodity markets.

Implementation of measures designed to improve the efficiency of management of public sector enterprises should contribute to resolution of structural problems and will

⁷ Net increase in loans issued by commercial banks and the Development Bank of Belarus in January-July 2016 amounted to -0.9% of GDP due to faster growth of repayment over lending operations.

⁸ The large banks fail to comply with this regulatory requirement, because their loan portfolios were built in the context of directed lending practices, therefore their risks, concentrated on a group of related borrowers, may exceed the level of safe level.

facilitate sustainable economic growth. One of the reform sets in a frame of the EFSD Program is aimed at further liberalization of the economy, and enhancing capacity for sustainable economic growth. In particular, adoption of a comprehensive strategy to improve management of public sector organizations requires unbiased assessment of the financial condition of public sector companies, implementation of corporate governance policies, as well as separation of responsibilities of the government, in its capacity of the regulator, and those of the owner. Along with the concurrent capacity building for development of the private sector, the Strategy will contribute to improving the quality of management decision-making by public sector enterprises, as well as attract investments for modernization and growth. The adoption of the Presidential Decree on the policy for transfer in trust of insolvent companies will create the conditions for expansion of financial "sanitation" tools to be used by public sector enterprises (mainly agricultural production units). Increasing the size of unemployment benefits to the subsistence level, as provided by one more draft Decree, will strengthen social safety nets for those laid off in the process of market orientation of enterprises and will enable release of labor and financial resources from the public sector and their cross flow to more efficient and promising sectors.

Belarus: Key Macroeconomic Performance Indicators

	2013	2014	1q 2015	2q2015	3q2015	4q2015	2015	1q 2016	2q2016	3q2016
<u>National Accounts and prices</u>										
Growth of real GDP, % (to corresp. Q of the previous year)	1	1,6	-2	-4,3	-4,4	-4,4	-3,8	-3,7	-1,4	-3,8
<u>Public finances (% of GDP)</u>										
Budget revenues and grants	40,3	40,3	43	43	53	44	42,7	43,6	43,8	54,6
tax revenue	25,4	24,3	26,6	25,2	34,5	26,3	25,6	24,2	26,4	36,1
Budget expenditures and net financing	40,1	39,2	40,5	39,4	50,0	55,7	43,9	40,8	42,2	39,2
current expenditures	33,4	33,9	38,2	35,7	45,9	49,5	36,3	38,7	38,6	34,2
capital expenditures	6,7	5,3	2,3	3,7	4,1	6,2	5,0	2,1	3,6	5,0
Budget balance	0,2	1,1	4,0	5,0	-0,7	-0,2	1,2	2,8	1,6	15,4
Budget balance (expanded)	-0,9	0,4	-1,9	0,2	-5,4	-5,9	-2,5	4,4	2,2	1,7
<u>External sector</u>										
Exports of goods and services, % (to corresp. Q of previous year)	-15,1	-1,7	-27,7	-21,5	-25,5	-22,1	-24,2	-16,7	-15,9	-5,1
Imports of goods and services, % (to corresp. Q of previous year)	-5,4	-5,6	-28,5	-24,0	-27,5	-22,0	-25,4	-26,7	-11,2	-8,1
Current account, % of GDP	-10,5	-6,9	-10,0	2,8	-0,5	-8,2	-3,8	-14,8	0,0	
Net foreign direct investments, % of GDP	51,7	-9,8	-10,0	0,1	-0,5	-1,0	-2,7	-10,3	1,7	
Gross reserves, in months of imports	1,9	1,6	1,4	1,5	1,6	1,5	1,6	1,6	1,7	1,9
Real effective exchange rate, % (to corresp. Q of previous year)	7,9	11,7	11,7	5	2,3	-4	-3,6	-8,4	-6,1	-6,5
Average BYN-USD exchange rate	0,9	1,0	1,5	1,5	1,6	1,8	1,6	2,1	2,0	2,0
<u>Information:</u>										
GDP, in BYN billion	63,7	77,8	18,7	21,7	23,1	23,4	87,0	21,3	22,9	25,1
GDP, in USD billion	71698,63	76118,42	12 766,86	14 782,84	14 102,54	13 130,51	54 681,02	10 300,26	11 587,11	12 764,89
Exports of goods and services, in USD million	44046,1	43311,9	7612,70	9102,90	8342,30	7779,50	32837,40	6340,60	7654,20	7915,00
Imports of goods and services, in USD million	46387,0	43794,7	7237,0	8678,8	8111,6	8635,7	32663,1	6358,1	7708,9	7452,0
Current account, in USD million	-7567,3	-5221,6	-1302,3	393,6	-73,7	-1091,3	-2074	-1552,0	-4,0	
Net foreign direct investments, in USD million	1 984	1 789	-1 280	18	-74	-130	1 466	-1 064	201	
Gross reserves, in USD million	7236,854	5716	4 561	4 621	4 628,6	4 176	4468	4 192	4315	
Population, in thousands of persons	9468	9481	9 481	9 485	9 494	9 499	9 498	9 498	9 500	

Sources: RB, IMF, Manager's assessments

II. Status of compliance with conditions of third tranche of EFSD financial credit.

The conditions for the third tranche require implementation of 22 measures by the deadline (1st September 2016). The evaluation identified failure to comply with 1 of the 9 control targets, which provides for annual non-project related public borrowing not to exceed 75% of the total annual sovereign debt repayment requirement. In fact, in January-August 2016 the amount of public debt reached 103.4% of the repayment amount. Out of 13 indicative targets 3 targets were not met. Three documents have not been adopted: (a) Presidential Decree on increasing unemployment benefits for people laid-off in the process of commercialization and optimization of enterprises; (b) Presidential Decree on the policy for decision making by local authorities to transfer insolvent enterprises in trust management; and (c) Strategy of improving efficiency of the management of state-owned enterprises.

The detailed assessment of compliance with each Performance Indicator for the third tranche is provided below.

I. Macroeconomic stabilization

These measures are aimed at reducing inflation and supporting gross international reserves through tight and balanced monetary and fiscal policies in the context of flexible exchange rate regime.

The importance of anti-inflation measures and ensuring price stability increases significantly amid the double-digit inflation, observed in Belarus in the last 5 years. High inflation (and hence devaluation) expectations hamper effective performance of the economy because they entail increasing overall uncertainty, high real interest rates and extensive

dollarization prospects⁹. The prevailing rate of inflation also draws on considerable accumulated gap between real wages and productivity (238% compared to 2000), and still widely used inefficient directed lending schemes. The resultant unbalanced increase of the share of unit overhead costs in the gross output, constitutes a fundamental factor, responsible for the decline of competitiveness of the Belorussian economy and for pressure on the exchange rate.

Target 1.1. The level of gross international reserves (GIR) is equal to at least USD 4.3 billion (equivalent to 1.6 months of imports) – a control target.

Status: met.

According to an analytical review the NB of Belarus, as of 01/09/2016, GIR amounted to USD 4.7 billion (1.9 months of imports), compared to USD 4.3 billion (1.6 months of imports) on the control date for evaluation of compliance for the second tranche (01/06/2016), and USD 4.2 billion (1.5 months of imports) - at the beginning of 2016.

Building-up of GIR is necessary to ensure improved resilience of Belarus to external shocks amid persistent manifestations of current account deficit¹⁰, reduction in capital inflows, heavy foreign currency debt service burden, low GIR and entrenched devaluation expectations.

A more flexible foreign exchange policy (including adoption by the NB of Belarus of the continuous two-way auction method to determine the rate of exchange) and monetary targeting policies serve as instruments promoting GIR build-up. These policies allow minimizing foreign exchange interventions and using them exclusively to prevent abrupt ups and downs of the exchange rate.

During eight months of 2016, GIR increased by USD 536 million. This growth was enabled as a result of foreign currency borrowings, carried out by the Ministry of Finance, in the amount of USD 1,952 million (of which USD 800 million was a loan provided by EFSD.), the foreign currency purchase interventions by the National Bank of Belarus (net amount equal to USD 1.06 billion), the increased price for gold, which added to the reserves USD 340 million, and the reduction of the NB foreign currency deposits in commercial banks by USD 212 million. The above growth of the reserves was offset by the outflow of foreign currency, which was due to the high debt service burden of the Ministry of Finance and the National Bank: foreign currency debt repayment and service liabilities of the Ministry of Finance during 8 months of the current year took up USD 2.2 billion, and net repayment and debt service by the National Bank - USD 878 million. The evolution of the reserves was also influenced by the foreign exchange earnings of the Government, generated by oil-related duties.

Target 1.3. Maximum level of net domestic assets (NDA) according to the program rate does not exceed BYN 66 trillion (BYN 6.6 billion, in denominated amount) – a control target.

Status: met.

According to an analytical review of the National Bank of Belarus, as of 01/09/2016 the NDA amounted to BYN 6.2 billion compared to BYN 6.5 billion on 01/06/2016, and BYN 6.87 billion at the beginning of 2016.

⁹ Dollarization of deposits as of 01/06/2016 - 75%.

¹⁰ According to the results of 2010-2011 and 2013-2014, current account deficit (in percentage of GDP) was equal to 15%, 8.5%, 10% and 7%, respectively, and, on average, exceeded USD 5 billion.

Compliance with this target aims at supporting stringent and coordinated fiscal and monetary policies in order to achieve a balanced domestic demand.

The importance of implementing the said stringent and coordinated economic policy is emphasized due to the persistence of high inflation and devaluation expectations. The gap in interest rates on BYN and foreign currency deposits of private individuals, observed in August 2016 was 13.1%, and the rate on new national currency term deposits of private individuals amounted to 15.3%. In the context of persistent risks of potential abrupt deterioration in the external economic environment, along with the high risks of national currency devaluation, tight monetary policies remain an important factor of stabilization of the Belorussian economy.

From the beginning of 2016, NDA of the National Bank of Belarus diminished by BYN 0.7 billion, as a result of the tight monetary and fiscal policies. NDA dropped because of the reduced lending to the economy in January-August down to BYN 0.8 billion, and due to the increase in liabilities to the government by BYN 0.9 billion, as a result of the budget surplus, which added to the deposits of the government and National Bank of Belarus. At the same time, utilization of the EFSD financial credit by the government for foreign currency debt repayment and service, has led to an increase in NDA by USD 579 million (BYN 1 billion), which is explained by the peculiarities of statistical accounting for this credit in the analytical balance sheet of the NB of Belarus¹¹. Despite the USD 800 million (BYN 1.4 billion), granted by the EFSD, the foreign currency deposits of the MF of Belarus increased during the 8 months only by USD 221 million (BYN 0.4 billion), because of the foreign currency debt repayment and service liabilities.

Target 1.4. Maximum level of monetary base (MB) according to the program rate does not exceed BYN 47 trillion (BYN 4.7 billion, in denominated amount) – an indicative target.

Status: met.

According to an analytical review of the National Bank of Belarus, as of 01/09/2016, the MB amounted to BYN 4.3 billion compared to BYN 3.9 billion at the beginning of June 2016, and BYN 4.5 billion at the beginning of 2016.

Controlling the MB level helps to consolidate the benefits of anti-inflation policies.

Compliance with this target was ensured by the National Bank of Belarus' withdrawal of liquidity from the economy (the amount of liquidity withdrawn since the beginning of the year increased by BYN 0.5 billion), by the reduction of lending to the economy (by BYN 0.8 billion, of which BYN 0.4 billion provided in the form of BYN loans), by accumulation of funds on deposit accounts of the government (BYN 0.9 billion, with BYN deposits increasing by BYN 0.5 billion). The reduction of the monetary base as a result of the above factors was counterbalanced by foreign currency purchase interventions of the National Bank of Belarus totaling USD 1,060 million (or BYN 1.9 billion).

The Manager welcomes the measures taken by Belarus to control the monetary base, but indicates that for sustainable reduction of the inflation, Belarus authorities will need to carry out structural reforms to improve the country's competitiveness on the global markets and to lower the CA deficit. The Matrix of Economic Policy provides that in the course of disbursement of the

¹¹ Statistical consideration: EFSD financial credit increases OIN precisely to the extent it reduces NDA due to the increase in deposits of the MF.

financial credit, growth of the monetary base should be contingent only on increase in the mandatory reserve fund for foreign currency deposits, due to the devaluation of the BYN.

At the end of 8 months the inflation was below the target level (11.8%, compared to 12%). In September and October the inflation rate continued to decline down to 11.2% and 11%, respectively. The Manager points out that some of the factors, slowing down the inflation, are exogenous and represent the dropping global commodity prices and the pressure on price growth in advanced economies. Therefore the National Bank of Belarus should carry on with its tough monetary policies to prevent increase in inflation beyond the target benchmark.

Target 1.5. Maximum growth of broad money supply according to the program rate is 0% - an indicative target.

Status: met.

Money supply, according to the program rate, decreased since the beginning of 2016 by 3.4% (compared to the reduction by 3.5% at the beginning of June in the current year).

The importance of avoiding excessive growth of money supply stems from persistence of an abundant monetary overhang, generated by the accumulated gap between growth of real wages and labor productivity, the high level of inflation and devaluation expectations, and the shrinking demand for money during recession.

During the last 5 years, the inflation in Belarus has retained a double-digit rate, which evidences about a chronic excess of money supply over demand. High and volatile inflation rates distort the price signals coming from the economy, increase the risks of uncertainty, practically wipe out the efficiency of growth stimulus policies and downgrade investment attractiveness of the country.

Target 1.6. No multiplicity of exchange rates – an indicative target.

Status: met.

Practice of multiple exchange rates is not observed. In 2015 minor deviations of the rate on the over-the-counter (OTC) and cash markets from the official exchange rate were registered at times of strong devaluation (in January, when the devaluation was 30%, and in August, when the BYN-USD rate dropped by 15%). In other periods, the rate deviations did not exceed 2%. In 2016, the variation of the exchange rates compared to the official rate was within 2%, despite a very serious devaluation in January (14%).

This measure is aimed at creating equal conditions for all market actors, and constitutes an important prerequisite for abatement of the devaluation expectations and building of GIR.

In the past, multiplicity of exchange rates was observed in Belarus on a regular basis. For most of 2011, the National Bank of Belarus fixed the exchange rate and did not undertake interventions to support it, which led to a large gap between the official and spot rates. In 2013, the IMF also observed significant deviations of the OTC exchange rate from the official rate, which were due to restrictions imposed on amounts of currency sold on OTC markets (no more than USD 1,000). The multiplicity of rates was also observed at the end of 2014, when the relevant legislation set a 30% commission on currency purchase transactions.

Implementation of this measure became possible thanks to scrapping of all administrative restrictions on foreign currency conversion. The Manager emphasizes the importance of exclusion of practice of multiplicity of exchange rates from all the future activities.

Target 1.7. Stock market trading mechanism in the mode of continuous two-way auction in operation – an indicative target.

Status: met.

Mechanism of the continuous two-way auction introduced since 1 June 2015.

This measure aims at improving the operation of the domestic foreign currency market and its liberalization, which will promote flexibility of the BYN exchange rate. Improvement of the foreign currency policy will facilitate elimination of foreign trade imbalances by generating articulate price signals on the foreign currency, money and commodity markets.

Introduction of the two-way auction mechanism, running since 1 June 2015, enabled creation of a platform for transition to a floating exchange rate and reduction of exchange rate support interventions, which proved instrumental in reaching net foreign currency purchases by the NB of Belarus, totaling USD 1,060 million in the first 8 months of 2016.

The Manager welcomes the move to flexible exchange rate policies, but points out that complete realization of the capacity of this vehicle will be possible in the context of market pricing on all other trading floors. At this point, the effective exchange rate remains above the equilibrium value¹² and is supported by high interest rates in real terms, which is largely attributable to the persistence of considerable levels of subsidized directed lending, despite the progress in reducing their volume during this period (-0.9% of GDP as of 1 August 2016, compared to YoY last year).¹³

Target 1.8. Operational system of liquidity management tools compliant with the monetary targeting policy in place – an indicative target.

Status: met.

In January 2015, the NB of Belarus adopted a policy of monetary targeting as part of its overall monetary policy, with money supply control, based on a preset target for its growth, as its principal tool for achieving the inflation rate benchmark.

This measure improves effectiveness of anti-inflation policies, to address this key economic problem, and maintains the required level of liquidity in commercial banks.

Since 13 May 2015, a system of liquidity management tools compliant with the monetary targeting policy has been in place and running. Money supply management is carried out by the NB of Belarus by modifying the volume of its liquidity control transactions for the banking system. Interest rates, both for money markets and auctions, are determined by the NB of Belarus on the basis of market factors, with due account of available liquidity.

Implementation of this tool had a positive impact on decelerating the rate of inflation in 2015-2016. In 2016, this tool was also actively used for removing excess liquidity, resulting from currency purchases by the NB of Belarus on the market.

Target 1.9. Changes in refinancing rates, subject to achieving the inflation target, actual dynamics of interest rates for auction transactions of the National Bank¹⁴, interbank interest rates, status of the current account of the balance of payments and minimizing exchange rate support interventions – a control target.

Status: met.

¹² According to the assessment of the Manager, by 7-12%.

¹³ According to the program rate.

¹⁴ Provision of liquidity by the NB of Belarus.

In the beginning of 2016, the NB of Belarus lowered the refinancing rate by 7 percentage points from 25% to 18% as of 1 September 2016. Decisions on cutting the rate were made in the context of some improvement in the external economic conditions observed in the first six months (primarily in respect of the increase in oil prices), which contributed to the faster growth of foreign exchange supply in the domestic market compared to the demand side. This allowed the NB of Belarus to solve the problem of liquidity shortage observed in the beginning of the year by foreign currency purchases on the market. Saturation of the economy with liquidity led to the reduction of rates on the interbank market and for auction transactions, and in view of the above, the NB of Belarus decided to cut the rate of refinancing. Furthermore, the NB of Belarus justified its decision to reduce the rate by the decline in inflation.

This measure is aimed at curbing the monetary overhang pressure on inflation and foreign exchange rates, as well as at reducing directed lending practices. The high volume of directed lending generates pressure on the balance of payments, and also raises the cost of loans for other market actors, as well as reduces effectiveness of caps and floors for the monetary policy.

The Manager believes, that lowering interest rates should be carried out, subject to the trends of external imbalances, since they are largely the result of loss of competitiveness of the economy, due to inefficient utilization of resources, including labor. Reduction of overheads at enterprises, including redundant employment, will enhance competitiveness of the economy and reduce external imbalances, which, in turn, will promote further cuts of interest rates. Rate cutting at a time of expansion of the current account deficit, recorded in the results of 7 months in 2016 at 5.6% of GDP (compared to minus 2.8% of GDP for January-July of 2015)¹⁵, and the persisting uncertainty in external markets, including Russia, carries high risks of potential negative impact of external shocks. Although the results of 8 months show a decrease in the current account deficit down to 4.6% of GDP, and the inflation continued to subside, the Manager indicates that this is largely due to seasonal factors and absence of external shocks.

Target 1.10. Liquidity support provided to banks by the National Bank of Belarus acting in its capacity of lender-of-last-resort is based on interest rates not below the level of its rate of refinancing – a control target.

Status: met.

According to the NB of Belarus the liquidity provision rates in 2016 were permanently maintained above the refinancing rate. The spread was 5 percentage points since the beginning of the year.

This measure ensures proper performance by the NB of Belarus acting as lender-of-last-resort. As many rates on long-term loans and deposits are linked to the refinancing rate, maintaining it at a level higher than that of the liquidity provision rate, may provoke generation of distorted price signals in the banking sector. In particular, they may display excessive earnings of banks coming from long-term loans, or incorrect pricing of long-term deposits, showing higher levels than the rates provided by liquidity management tools. Rates of the lender-of-last-resort should remain highest, because its economy lending capacity is contingent exclusively by demand.

¹⁵ According to the assessment made by the Manager, the current account deficit in its steady state does not exceed 3% of GDP.

Implementation of this measure enabled the National Bank to effectively manage liquidity and avoid distorted price signals on lending and deposit markets.

Target 1.16 Unconditional performance under the Strategy for 2015-2020, in respect of sovereign debt service, which provides for annual non-project related public borrowing¹⁶ not to exceed 75% of the total annual sovereign debt repayment requirement. In case of exceeding this level, the amount of borrowings in excess of the 75% threshold is allocated exclusively to replenish gold and foreign currency reserves – a control target.

Status: not met.

During 8 months in 2016, the volume of public borrowings amounted to 103.4%¹⁷ of the total repayment amount, including external debt - 143%, and domestic debt - 89%.

Compliance with this requirement should enable reducing public debt and improving the external investment position of the Republic of Belarus.

In the total amount of borrowing and repayment transactions of the government a foreign currency component was prevalent (about 89% and 86%, respectively), while the net repayment of domestic foreign currency credits (- USD 118.8 million) was performed by funds raised by means of external net borrowings (+USD 232 million).

On the domestic market the government of Belarus borrowed BYN 2.83 billion (of which amount the equivalent of BYN 2.34 billion represents foreign currency borrowings), while the required amount of repayment was equal to BYN 3.17 billion. External untied (unrelated) borrowings amounted to USD 800 million¹⁸, with the amount of repayment equal to USD 568 million.

Excesses over the threshold are in part attributable to government securities issued in support of public sector enterprises. In 2016, during the period under review, government bonds were issued in the amount of USD 109.6 million and BYN 13 million¹⁹ to support public sector companies.

In fact, the authorities of Belarus could replenish their foreign currency reserves to the required level by converting the increase in the government budget deposits, recorded in January-August of the current year in the National bank of Belarus and commercial banks, in a total amount equivalent to USD 582 million, of which 62% were denominated in BYN. The sources of the deposit increases were budget surplus (equivalent to USD 520 million) and net borrowing (USD 62 million).

Given that the excess of the government borrowing threshold occurred in the context of expanded surplus and replenishment of the GIR beyond the minimum level, specified by the tranche conditions, the Manager recommends granting relief from compliance with this Benchmark.

Target 1.17. The public debt-to-GDP ratio not to exceed 45% - a control target.

¹⁶ The unrelated (untied) borrowings are defined herein as financial credits that are not related to implementation of investment projects with a considerable import component.

¹⁷ According to the account of Belarus, the borrowing/repayment ratio amounted to 102.8%, the discrepancy of 0.6 percentage points should be attributable to the exchange rate difference. In particular, Belarus takes account of the domestic foreign currency borrowing at a rate, effective on the date of transaction, whereas the Manager does it based on the monthly average rate.

¹⁸ First and second tranches of the EFSD financial credit.

¹⁹ OAO "BMZ" and OAO "Automotive Components - USD109.6 million, OAO "Ivacevichidrev" - BYN13 million.

Status: met.

The level of public debt to GDP, as of 01/09/2016, stood at 38.3%.

Compliance with this requirement should enable increased debt sustainability and improvement of the external investment position of the Republic of Belarus.

Practice of raising funds through borrowing over and above the repayment requirement threshold resulting from, inter alia, significant amounts of government support of business entities in the context of sliding GDP and devaluation of the national currency, which led to non-compliance with public borrowing limits (see para 1.16 above), as well as had a negative impact on the level of sovereign debt of Belarus. Since the beginning of the year, the public debt rose by 5.8 percentage points of GDP, due to the increase of foreign debt liabilities from 22.5% to 27.7% of GDP, and the domestic debt - from 9.8% to 10.6% of GDP²⁰.

II. Reform of goods and services markets and reduction of government support.

Implementation of this set of measures is aimed at setting up market-oriented pricing mechanisms, effective use and distribution of the commodity, financial and human resources and improvement of competitiveness of the Belorussian economy. Specific measures to perform this task are price liberalization, raising housing utility and public transport tariffs with a view to enabling full cost recovery in the medium term, as well as reduction of public program lending by the banking system, since its scope constitutes a fundamental factor of structural disparities distorting pricing mechanisms on money, foreign exchange and commodity markets.

Target 2.1. Decree of the President on establishment of independent anti-monopoly authority – an indicative target.

Status: met.

The Decree of the President of the Republic of Belarus, dated 3 June 2016 # 188, "On authorities for anti-monopoly control and trade" makes provision for establishing a ministry for anti-monopoly control and trade on the basis of the Ministry of Trade, effective 8 September 2016.

Implementation of this measure is aimed at laying the groundwork for establishing an independent anti-monopoly authority, whose main objectives should be promotion of market relations on the basis of competition and entrepreneurship, prevention and restriction of monopolistic activities and unfair competition, including through price controls exercised on monopolies and state supervision over compliance with the anti-monopoly legislation.

Currently the Ministry is established and operates in accordance with the duly approved regulations.

Target. 2.2. Regulatory ordinances to establish prices and tariffs by the Government of Belarus and other public institutions, responsible for pricing in the economy, are limited to lists of goods and services contained in the Presidential Decree # 72 of 25/02/2011, and in the Resolution of the Council of Ministers of Belarus # 35 of 17/01/2014, as well as in other regulatory documents, insofar as they are not inconsistent with the EEU obligations of Belarus. The Government has prepared a plan of action to address non-market transfer pricing in vertically integrated holdings of public sector enterprises – a control target.

Status: met.

²⁰ In part the public debt to GDP ratio growth (disregarding the net repayment of domestic debt) may be due to the slowdown in GDP growth and BYN devaluation.

The Manager does not have evidence of administrative interference in the process of pricing in the consumer market in violation of the Presidential Decree # 72 of 25/02/2011 and Resolution of the CM of Belarus # 35 of 17/01/2014.

The plan of action to eliminate non-market pricing schemes in vertically integrated holdings of public sector enterprises # 30/210-240/304, was approved by the First Deputy Prime Minister on 23 September 2016.

Implementation of the above measure is aimed at abolition of administrative controls over producer prices, and at setting relative prices on the basis on market signals. Non-market transfer pricing practices adversely affect the financial condition of enterprises involved in such schemes, hamper evaluation of the financial sustainability of public sector enterprises, integrated in holdings, and their restructuring. Moreover such practices distort price signals required for economic decision-making.

The plan of action to eliminate non-market transfer pricing comprises the following measures: (i) review of legislation with a view to identifying regulatory requirements enabling prices, other than non-market ones, for transactions between entities, vertically integrated into holdings of public sector enterprises (deadline - end of 2016); (ii) drafting proposals on improvement of legislation based on the outcome of the above review (deadline - 01/04/2017); and (iii) adjustment of the taxable base in the event of identification of transfer prices, reducing tax liabilities (on a permanent basis). In the opinion of the Manager, the plan's exclusive focus on the impact of transfer pricing on tax collection, rather than on inherent economic benefits for public sector enterprises, diminishes the effectiveness of this plan.

In the process of preparation by the government of draft amendments to the legislation, the Manager will discuss with representatives of Belarus potential addenda to the Framework containing measures enabling the above amendments. Implementation of the comprehensive Strategy of enhanced efficiency of management of public sector organizations (see II, target 3.1 below), which requires all public sector enterprises to adopt policies of corporate governance and maximization of profits, will also stimulate market-based pricing both in holdings, and across the economy.

Target 2.5. Negative net growth of lending in the frame of the government programs and activities by commercial banks and the Development Bank of the Republic of Belarus in the first six months in 2016 from all sources of finance with maximum level of new lending at BYN 17 trillion (BYN 1.7 billion in denominated amount, according to the program rate) – a control target.

Status: met.

According to the NB of Belarus the net increase in lending of the government programs of commercial banks and the Development Bank in January-July 2016, was equal to -0.9% of GDP. This indicator resulted from the accelerated growth of repayment (BYN 1.5 billion)²¹ over lending (BYN 1.1 billion).

²¹ The amount of loan repayment is given net of repayments carried out by issuance of government securities in the amount of BYN 194 million.

Implementation of this measure is focused on stabilizing the macroeconomic environment by reducing inefficient investments and through fiscal consolidation by cutting interest rate subsidies.

III. Commercialization/privatization of public sector enterprises and improving social protection

The measures contained in this section, are aimed at optimizing the role of the government in economic activities and in consolidation of social protection of the population.

Target 3.1. Adoption of the concept of public sector property management for the period up to 2020 – an indicative target.

Status: not met.

The Council of Ministers of Belarus at its meeting 20 October 2016 endorsed the draft comprehensive Strategy of enhanced efficiency of management of public sector organizations (hereinafter: the Strategy) and instructed the State Committee on Property and the Ministry of Finance, in consultation with other government agencies, to finalize this draft before 15 December 2016.

The main purpose of this requirement consists in developing by the authorities of principles for reforming the system of management of public sector commercial property, which should facilitate maximization of profit from uses of this property in the interests of the government through efficient allocation of resources and setting up of interim framework for implementation of reforms.

The Manager has the draft text of the Strategy, prepared by the authorities of the Republic of Belarus in consultation with the IMF. The said draft provides for implementation of a set of measures to enable transformation of the system of management of public sector enterprises, including separation of responsibilities of the owner and the regulator and implementation of corporate governance policies by all public sector enterprises, regardless of the government share in their equity and the value of their assets. In particular, it is contemplated that all public sector enterprises of strategic importance, reporting to the national authorities, will be on a step-by-step basis (up to the end of 2017) handed over to the books of the State Committee on Property, whereas the sectoral ministries will focus on their respective industries by providing equal business development conditions for economic entities, and increasing competition on their markets. Incorporation of national enterprises, which requires further empowerment of the existing Boards of Directors, and establishment of such offices in the newly incorporated enterprises, should be finalized before the end of 2019. The activities of the Boards of Directors, whose members (including independent professional experts) will be elected on a competitive basis, will focus on developing strategic business objectives of the enterprise, monitoring progress toward their goals, including external audit, and management compensation policy, which should be based on financial results of their performance. The draft Strategy makes provision for a large-scale training program for Board members. Companies of non-strategic importance, mainly small and medium-sized businesses, will be transferred under the control of local authorities.

The draft Strategy envisages establishment within the Ministry of Finance of a specialized unit, responsible for monitoring fiscal risks, generated by public sector enterprises. It will provide a focal point for information on public sector enterprises with persistently poor

financial performance, undermining the sustainability of public finances by materialization of various fiscal risks; it will enable identification of the scope and types of budget burden and evaluation of the effectiveness of government support; work to improve the quality of forecasts on revenue and expenditures of the national budget; as well as create analytical framework for management decision-making on the areas of sanitation of these public sector enterprises, including through privatization, bankruptcy, reorganizing and liquidation.

The objectives of optimizing operation of public property will also consist in facilitating classification of all public sector enterprises in accordance with international standards set forth in the Guidelines on Public Finance Statistics (IMF). The said classification of enterprises by this method, which should be completed by March 2017, along with the results of fiscal risks monitoring, will determine the list of candidates for privatization and liquidation.

The proposed adoption of the IFRS standards, as envisaged in the draft Strategy will enable more unbiased due diligence of public sector enterprises, improvement of the quality of both operational and strategic decisions, including those made on investments for growth and modernization of public sector enterprises.

The draft Strategy is focused on improving regulatory and legal framework in the area of management of public property. In particular, the draft contemplates developing a public property management code, which should incorporate all disparate pieces of relevant legislation (with concurrent removal of existing contradictions). It is also expected that improvements will be made to the laws on privatization and bankruptcy and anti-monopoly legislation.

In the opinion of the Manager, obstacles hampering effective implementation of the Strategy may arise in the form of systemic risks, including preservation of significant price controls, especially on producer prices. Direct price controls, exercised on a certain level, distort price signals even on markets, where prices are market-based. Ultimately it means that the results of fiscal risks monitoring, based on which management decisions will be made on methods of "sanitation" of public sector enterprises, will also bear an imprint of these distortions. Continued redundancy in employment at public sector enterprises constitutes one more key obstacle to increasing structural flexibility of the economy and its systematic reform, because it leads to conservation of labor and financial resources by problem enterprises, holding up their cross-flow to more efficient and promising sectors. Identification of these problems in the Strategy and outlining ways of addressing them could significantly improve prospects for the proposed reforms.

In general, the draft Strategy is acceptable for the Manager. Compliance with this condition will be deemed acknowledged, subject approval of the Strategy in due process by the authorities of the Republic of Belarus.

Target 3.3. Adoption of the package of the documents to ensure adequate safety net for workers, laid off due to commercialization and optimization of enterprises - an indicative target.

Status: not met.

Out of the agreed package of the documents, Presidential Decree "On additional measures to provide social support for certain categories of unemployed" has not been adopted. The draft Decree was initially filed for approval by the Government in July of the current year, but so far has not been signed by the Head of State.

The bill, enabling amendments to the Law "On employment of the population of the Republic of Belarus", was signed by the President of Belarus on 18 July 2016. These amendments came into effect on 24 October 2016. The Law "On the national budget for 2017" was passed on 18 October 2016.

The above measure is designed to encourage public sector enterprises to proceed with optimizing the number of their employees as key to reducing extra overheads and improving competitiveness. According to the Manager's assessment, redundancy at public sector enterprises accounts for 20%, which is equivalent to unemployment of 14% of the active population. The official registered unemployment in Belarus at the moment is about 1% of the active population, compared to 5.1% in Kazakhstan, 5.3% in Russia and 19.6% in Armenia.

Given the urgent problems with employment, the average unemployment benefit in Belarus is currently only about 3% of the average salary. In this context, strengthening of social safety nets for people, laid off in the process of market orientation of enterprises, becomes an extremely important prerequisite for success of the proposed structural transformation of the economy of Belarus.

The draft Presidential Decree "On additional measures to provide social support for certain categories of unemployed" makes provision for increased unemployment benefits for people, laid-off as a result of optimizing the number of employees at enterprises or undergoing skill upgrade training, up to the level of 100% of the average per capita subsistence budget (hereinafter - SB) (24.2% of the average wage in January - September 2016) for the first 13 weeks following dismissal, and up to 80% (19.4% of the average wage) for 13 more weeks. Payments to all other categories of those, laid-off on grounds of redundancy, will increase to 50-20% of SB (12.1% - 4.8% of the average wage).

The amendments made to the Law "On employment", require employers to notify the Ministry of Labor and Social Protection about the proposed dismissals two months in advance, and provide for engaging the Ministry in organization of training and skill upgrade courses for professional staff, who may be laid off as redundant in the process of optimization of public sector enterprises.

The Law "On the national budget for 2017" provides possibility for increased funding of the Social Security Fund (by cutting down budget deposits) to enable partial reimbursement of costs incurred in payment of unemployment benefits and scholarships to citizens attending vocational training, retraining or skill upgrade courses upon assignment of the relevant authority on labor, employment and social protection.

The government is currently working on implementation of an insurance system for unemployed. It is expected that in 2017 a set of regulatory framework documents will be developed to provide regulatory support for mechanisms of formation and operation of insurance funds, and in 2018 these regulations will be enacted (as the above insurance funds proceed with financing unemployment benefits in 2021).

The Manager will acknowledge compliance with this condition, subject to approval of the Presidential Decree in due process.

Target 3.4. The results of 2015 show that the share of public sector in gross value added (GVA) is no more than 47% - an indicative target.

Status: met.

According to the annual bulletin of the Belstat (Statistical committee) "National Accounts of the Republic of Belarus" for 2015, the share of public sector enterprises in the formation of gross value added (GVA) accounted for 46.3%.

This measure is focused on optimization of the role of public sector in the economy of Belarus.

The Economic Policy Framework requires that as a result of deregulation efforts in the economy, including measures supported by the EFSD financial credit, the input of public sector enterprises to the formation of GVA by the end of 2017 should drop down to 41%.

Target 3.5. Participation in EBRD-sponsored assessment of needs of "Belinvestbank" in institutional capacity building and preparation of institutional development program. The National Bank of Belarus adopted a plan of exit from the list of shareholders of OAO "Bank Moscow-Minsk". To conduct evaluation of the current privatization legislation (transfer of property ownership) insofar as it relates to public sector property, for compliance with transparency, operational flexibility and efficiency requirements; to introduce proposals for updating the legislation to the Government - an indicative target.

Status: met.

Institutional development needs assessment has been completed for OAO "Belinvestbank" in cooperation with EBRD. The plan of action of the NB of Belarus for transfer of its shares held in OAO "Moscow-Minsk Bank" is approved by the Resolution of the Management Board of the National Bank of the Republic of Belarus of 31/05/2016 # 288.

With a view to enabling implementation of the relevant provision of the Presidential Decree # 78 of 23 February 2016, which prescribes valuation of the initial sales price of privatization targets at their market value, the Resolution of the Government was adopted (# 639 of 16 July 2016).

This measure is aimed at encouraging the process of privatization of public sector properties, including by providing clearly defined privatization procedures and determining fair prices for property put out for sale.

In accordance with the plan of action for the implementation of the Memorandum of Understanding between the Government of the Republic of Belarus and the EBRD, implementation of the institutional development program, developed jointly by OAO "Belinvestbank" and the EBRD, should get underway in September 2016. As agreed, the EBRD will hire a consultant on institutional development, who will work with the staff of "Belinvestbank" to upgrade their capacity in areas defined by the program.

As required by the plan of action of the NB of Belarus for transfer of its shares held in OAO "Moscow-Minsk Bank", approved by the Resolution of the Management Board of the National Bank of the Republic of Belarus of 31/05/2016 # 288, the proposed privatization of the said bank will be completed before the end of 2019.

For the purpose of implementation of the relevant provision of the Presidential Decree # 78 of 23 February 2016, the Committee on State Property, in cooperation with other government departments, performed an assessment of legislation, insofar as it relates to privatization of public sector property, for compliance with transparency, operational flexibility and efficiency requirements. The said assessment provided the groundwork for adoption of the Government Resolution # 639 of 16 July 2016, approving the Regulation on procedure for determining initial

sales prices for privatization targets. According to this Regulation the initial sales price of the privatization target should be equivalent to its market value. Valuation of public sector property should be performed by organizations specialized in such activities, and whose government shareholding in the authorized capital is over 50%²². According to the Committee on State Property, previous privatization practices in Belarus showed that valuation of properties on the basis of their book value provided prices that could be significantly higher (by more than 30%) than their market value, which greatly reduced investment attractiveness of property offered for sale.

The Manager welcomes this measure, as it can launch and promote privatization processes, which will contribute to improving competitiveness of the economy of Belarus.

Target 3.6. The decision of the Head of State on the decision-making procedures of the local authorities to proceed with transfer of insolvent local utility and farming units in trust management is adopted and in force – an indicative target.

Status: not met.

The draft Presidential Decree "On trust management of companies as property complex of public sector unitary enterprises" was initially filed for review by the Government on 16 September 2016, but was returned for finalization to the Committee on State Property in accordance with the recommendation of the Committee for State Control and the General Prosecutor's Office. At this point in time, the document has not been approved by the Head of State.

This measure is designed to address financial insolvency of public sector agricultural units by means of a mechanism, enabling their property transfer for trust management.

Out of the total number of agricultural organizations, over 60% are fully or partly state-owned. Despite substantial public support, their performance efficiency is pretty low, and in recent years, in the context of the ongoing economic recession and the downfall of global food prices, their condition has been exacerbated even more: agricultural produce sales in 2015 decreased by a factor of 11 (a drop from 5.5% in 2014 to 0.5%), the share of units running at a loss, rose almost 3-fold (up to 35%), and their losses increased by a factor 2.5 to BYN 4.7 trillion. All across the agricultural sector, financial liabilities as of the beginning of the year, amounted to BYN 85 trillion, BYN 36 trillion of which amount were loans and credits, and BYN 48 trillion were outstanding payables.

During the period under review in 2016, the national authorities passed a number of legislative acts aimed at enabling financial recovery of agricultural enterprises, such as the Presidential Decrees # 251 "On amendments and addenda to decrees of the President of the Republic of Belarus" and # 253 "On measures to ensure financial recovery of agricultural enterprises". They are designed to improve efficiency of the agricultural sector as a whole and require more extensive application of tools of pre-judicial recovery and bankruptcy, as well as additional incentives for managers of farming enterprises and investors.

The adoption of the Presidential Decree # 253 required amendments to be made to the draft Presidential Decree "On trust management of companies as property of public sector unitary enterprises", already approved by the government. According to this draft, trust

²² However, a potential investor may provide an independent assessment of the property value and negotiate with the government valuator to make a deal on their valuation results if they are spaced too wide apart.

management may be considered not only for agricultural enterprises, but also for any other public sector enterprises with an option for buy-out on the basis of successful performance during the trust term. Transfer in trust will be carried out on a competitive basis for a maximum of 5 years. Trust will be granted by the current supervising authority (Council of Ministers, regional governments or district executive committees), based on the outcome of the competitive bidding process. The trust agreement will contain relevant terms and conditions, such as limitations on uses of trust property, size and form of compensation of the trustee, trust property performance (profitability and profit) and the term of contract. Provision is made for a buyout option in case of successful performance under the trust agreement.

The draft Decree stipulates that agricultural enterprises opting for a pre-judicial recovery program will be transferred in trust without competitive bidding, and in that case the final decision will rest with relevant local executive committees. In addition, the draft also authorizes the above local executive committees to expropriate land parcels of loss-making agricultural enterprises, and transfer them to efficient companies without any auction sale or charging any price for the said land.

Compliance with this condition will be deemed acknowledged, subject to approval of the said document in due process.

IV. Improvement of business environment and development of private sector

Measures, provided herein, are aimed at development of legislative framework and establishment of institutions enabling development of private sector²³.

Target 4.1. The government has adopted a resolution to proceed with implementation of the Directive on development of the entrepreneurial initiative; implementation of activities, contained in the Directive, has started – an indicative target²⁴.

Status: met.

The President's Directive # 4 "On development of entrepreneurial initiative and stimulation of business activity in Belarus" since 2010 has been a policy document promulgating further liberalization of the economy, empowerment of business initiatives, creation of favorable conditions for vibrant and sustainable development of Belarus. In the process of review and approval of this Plan of Action, the Directive # 4 was presumed to be updated in view of the pressing issues requiring modification of its provisions and measures. However, at the end of 2015, after the government filed draft amendments to the Directive # 4 for review and approval by the authorities of Belarus, a number of legislative acts were adopted, which comprised most of the policy provisions of the new version of the Directive # 4.

The key document among them is the Presidential Decree # 78 "On measures to enhance effectiveness of social and economic sector of the Republic of Belarus", aimed at

²³ Other measures contained in this section, constitute conditions to qualify for the next tranches.

²⁴ In view of the adoption of several laws aimed at promoting entrepreneurial initiatives, including the Presidential Decree # 78 and the State Program "Small and medium-sized entrepreneurship in the Republic of Belarus" for 2016-2020, which incorporate most provisions of the new version of Directive # 4, adoption of the said directive is no longer relevant. Therefore, this measure follows the progress of implementation of the Plan of Action for the current Directive # 4 (Resolution of the CM and the NB of Belarus of 28/02/2011 # 251/6) and the Plan of Action for implementation of the relevant provisions of the Presidential Decree # 78 (approved by the First Deputy Prime Minister of Belarus on 04/03/2016 # 11/100-59/49).

safeguarding the integrity of property, strengthening the anti-monopoly laws, accelerated development of SMEs, promoting proposed development of production facilities and creation of new jobs, attracting foreign capital, supporting publicity for business initiatives, etc. At the same time, the State Program "Small and medium-sized businesses in the Republic of Belarus" for 2016-2020 was adopted to define the key activities in support of SMEs, as well as their target benchmarks.

In October 2016, amendments were made to the law on technical regulation and standardization to ensure implementation of the provisions of the EEU Treaty, and on harmonization of legislation, as well as the Resolution of the Council of Ministers of the Republic of Belarus of 5 October 2016 # 802 was adopted, which seeks to strengthen the role of public advisory councils, based in government institutions, in identifying problem areas and providing solutions in carrying out business activities.

Along with the already approved documents, the government agencies are in the process of reviewing a package of draft legislative acts, including:

- Presidential Decree on establishment of a mechanism for assessment of regulatory effect of normative and legislative acts (provisions thereof) on business environment;
- Presidential Decree on setting up of electronic registry of administrative procedures for monitoring administrative impact on businesses;
- Law on tax consultancy, which provides a concept of community of tax consultants in Belarus, with a view to improving the current investment environment, increase quality of and responsibility associated with provision of tax consultancy services, as well as efficiency of communication between taxpayers and tax authorities.

In the light of the above, Belarus believes that the measures that have already been taken, and those contemplated for the nearest future, including laws and regulations, are consistent with the objectives of further development of entrepreneurship, and should be considered as alternative to the Directive # 4. Yet, the Manager hereby points out that there appears to be no further progress in work on the regulatory framework in respect of specific provisions of the new draft Directive # 4. These include: unambiguous ban on raising tax rates for 5 years and measures for protection of private property ownership rights:

- Prohibition on deprivation of ownership rights without a court order;
- Statute of limitation for privatization related cases - three years;
- Providing pre-emption buyout rights to tenants of rented public property.

The key purpose of this requirement consists in enabling private sector development opportunities as a driver of sustainable growth of economy of the Republic of Belarus.

Mindful of the fact that the adopted laws and draft legislation and regulatory documents incorporate overwhelming majority of the reforms listed in the draft Directive # 4, the Manager believes that compliance with this condition is in progress.

Target 4.3. Implementation of the International Financial Reporting Standards and mandatory independent audit of said reports. Consideration of rationale for extension of the list of companies, subject to mandatory IFRS compliance in preparation of annual financial statements – an indicative target.

Status: met.

In December 2015 the Council of Ministers and the National Bank of Belarus adopted a joint resolution, according to which the International Financial Reporting Standards and their Commentaries, accepted by the IFRS Foundation, entered into force in due process on the territory of Belarus as technical regulatory documents. In the process of enactment of the IFRS, specific peculiarities of their application in Belarus should be defined.

In May 2016 the MF and the IFRS Foundation signed an agreement whereby the IFRS Foundation waived its copyright privileges on the territory of Belarus. The joint Resolution of the Government and the National Bank of Belarus # 657/20 of 19 August 2016, enacted 42 IFRS and 25 Commentaries on the territory of Belarus as technical normative legal acts, effective 1 January 2017.

As part of the IFRS enactment requirements, beginning from 2016, accounting statements are prepared by insurance companies, as well as all legal entities, responsible for compiling consolidated financial statements. Banking institutions adopted IFRS in previous years.

Adoption of the International Financial Reporting Standards is a major step forward toward enabling favorable investment environment in Belarus by providing to supervisory authorities and potential investors reliable high-quality information on the financial condition of enterprises.