Eurasian Development Bank

Manager of the Eurasian Fund for Stabilisation and Development Resources

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Review of the Report by the Ministry of Finance of the Republic of Belarus on Compliance with Conditions of the Second Tranche of the EFSD Financial Credit

The conditionality of the second tranche of the EFSD financial credit to the Republic of Belarus (hereinafter the RB) aims at:

a) bringing the inflation down and progressively building up the country's gross international reserves through consistent implementation of tight monetary and fiscal policies in the context of the improved exchange rate flexibility; and

b) further liberalisation of the economy through structural reforms focused on eliminating barriers for market pricing, improving the performance of state-owned enterprises, and creating an enabling environment for their subsequent privatisation, as well as improving the business environment to step up the private sector development.

By 1 June 2016 (the control date for the second tranche review), all the conditions for the second tranche had been met, except for one indicative target, envisaging mobilisation of new loans in an amount not exceeding 50% of the annual public debt repayment needs. The actual public borrowing in January-May 2016 made 83% of repayments.

Based on the results of the review, the Manager recommends disbursing the second tranche of the EFSD financial credit to the Republic of Belarus in the amount of US $300 million.

Main results of the country's economic development in January-May 2016

In January-May 2016, in the context of declining global oil prices and economic recession in Russia, Belarus gross domestic product (GDP) contracted by 2.8% in real terms (compared to 3.1% in the same period of 2015). The need for budget consolidation, high interest rates, and accumulated disbalances resulted in lower investment activity. The net state programme financing was -1.6% of GDP[1], budget fixed capital investment, having significantly contracted in the first five months of last year[2], dropped by additional 1.8% in the reviewed period, while private investments shrank by nearly one fourth in Q1.

In spite of the liberalised prices for socially important goods and increased utility and transportation tariffs (the share of controlled goods in the consumer price index (CPI) went down from 31.3% to 20.5%)[3], the inflation decelerated against the background of tight economic policies followed by Belarus' authorities, including compliance with all the monetary thresholds set in the Matrix. As at end-May, the average annual growth of consumer prices was 12.4%,

[1] At the programme exchange rate for 4 months of 2016.
[2] By 33% compared to the same period of 2014.
[3] The calculation is based on the CPI basket weights approved by Belstat for inflation calculation in 2016.

compared to 15.8% in the same period of last year. However, the current level of inflation is still above the target for 2016 (12%).

As at end-May, the official unemployment rate practically doubled compared to the same period of 2015, although still remaining at an unnaturally low level—1.2% of the workforce—if we both look at the main partner countries and take into account the significant size of excessive employment at state-owned enterprises estimated by the Manager at 20%.[4] The launched reform aimed at commercialising state-owned enterprises, *inter alia* lifting mandatory volume targets, should help optimise employment at such enterprises. However, the extremely low unemployment benefits, which currently make about 4% of average wages, is one of the reasons for reduction of incentives of the workers losing their jobs to register with employment agencies.

The current account (CA) deficit increased significantly from 8.3% of GDP in January-April 2015 to 11.6% of GDP in January-April 2016. The external imbalance expansion is mainly caused by the deteriorating energy balance[5] and weaker external demand. However, some positive trend has emerged in trade in investment goods, whose export volume increased by 5.5%. That is explained by the low base effect, growth in some sub-sectors of agriculture in Russia generating higher demand for Belarusian investment goods, and the weakening real effective exchange rate (REER) of the Belarusian rubel by 8.6% against the background of depreciation by 35.3%[6]. The rate of growth of domestic prices is still much higher than that in partner countries that contained a more significant weakening of the REER. It again stresses the importance of further reduction of inflation in the RB.

The authorities managed to maintain the current level of gross international reserves (GIR) despite the significant foreign exchange debt service payments made by the NBRB and the Government. The supply exceeded the demand in the foreign exchange market that helped the NBRB become a net buyer of foreign exchange in the open market. This development was mainly a result of increased supply of foreign exchange in the market by households in the context of their attempts to maintain the current level of consumption on the background of lower real incomes[7]. In January-May, the GIR were US $4.3 billion that is US $96 million higher than at the beginning of the year and is compliant with the threshold set for the second tranche. The GIR replenishment resulted in some improvement of this indicator measured in months of imports—an increase from 1.5 as at end-February to 1.6 as at the control date—but the key contributing factor was the import decline due to weaker domestic demand and depreciation of Belarusian ruble amounted to 39% in January-May 2016 compare to the same period of 2015.

[4] The estimate of excess employment at state-owned enterprises is based on a comprehensive approach, including the one developed by the World Bank, which relied on comparative analysis of labour productivity at state-owned and private enterprises. The results of the World Bank study were published in the Country Economic Memorandum for the RB in 2012. To get more details on EDB's approach, please see an article at: http://www.tut.by/stat/media/download/?device=desktop&id=http%3A%2F%2Fuploader.tut.by%2FMirzoev_16_06_2016.docx.

[5] Lower global oil prices result in smaller decline in prices for crude oil imported by the RB from the RF compared to reduction in priced for oil products exported by the RB that stems from the mechanism of the tax manoeuvre implemented by the RF from end-2014. The tax manoeuvre involves gradual phasing out of the oil export duty in the medium-term perspective accompanied by increases in the mineral tax that leads to high costs of imports for the RB due to higher costs of Russian oil. While before the tax manoeuver, the export duty averaged at US $350 per ton of oil, the tax manoeuver has led to its gradual reduction to US $80 per ton of oil in the first half of 2016. At the same time, the RB still benefits from preferential crude oil prices, but the size of this benefit has significantly shrunk.

[6] April 2016 to April 2015.

[7] Most of this inflow was generated through declining household savings outside the banking sector.

The NBRB's interventions in the foreign exchange market did not result in base money growth owing to its operations in the open market to absorb liquidity, reduction of outstanding loans previously extended by the NBRB to support banks' liquidity, and growing deposits of the Government with the NBRB. In the context of its successful achievement of the base money targets and declining annual inflation rates (from 12.8% in February 2016 to 12.4% in May), the NBRB management took several decisions to bring down the refinancing rate and interest rates for providing liquidity to alleviate the debt burden of enterprises. As a result, the refinancing rate dropped from 25% as at end-March to 22% as at the beginning of June, while the interest rate for liquidity support declined from 30% as at end-April to 27% as at the beginning of June.

The Manager is of the opinion that decisions on changing interest rates should be based on the pattern of changes in external imbalances, as their expansion because of structural reasons, which is largely a result of weaker competitiveness of the economy, may lead to the increased depreciation expectations and a next round of tightening of economic policy. Efforts to lower enterprises' non-productive costs, including excessive employment, would help improve the competitiveness of the economy and bring down the external imbalance that, in its turn, would facilitate a sustainable reduction of interest rates and minimise risks to the macroeconomic stability. Steps to lower interest rates in the context of the CA deficit expansion, registered at 11.6% of GDP for 4 months of 2016 (compared to negative 8.3% of GDP in January-April of 2016 and 2015 respectively[8]), and continued high uncertainty in external markets, including Russia, may strengthen the negative impact of external shocks on remaining structural imbalances.

Status of compliance with conditions for the second tranche of the EFSD financial credit

The conditionality of the second tranche includes 24 activities[9], of which 7 are control targets. All the targets set for the tranche have been met, except for one, which is the indicative ceiling of the share of new loans in public debt repayment (target1.15(1)).

I. Macroeconomic stabilisation

This package of measures aims at bringing down the inflation and maintaining the gross international reserves through implementation of tight and balanced monetary and fiscal policies in the context of a flexible exchange rate regime.

Anti-inflation measures and price stability gain importance against the background of the two-digit inflation experienced by the RB over the last 5 years. High inflation—and, thus, high depreciation—expectations make the economy less efficient due to stronger overall uncertainty, extremely high real interest rates, and a high rate of dollarization[10].

Target 1.1. The gross international reserves (GIR) should be at least US $4.2 billion (equivalent to 1.6 months of imports) – a control target.

Status: met.

[8] The Manager estimates the sustainable level of the CA deficit at no more than 3% of GDP.

[9] Taking into account that activity 1.15 is treated as two conditions.

[10] The rate of dollarization of deposits is 75% as at 1 June 2016.

According to the analytical review prepared by the NBRB as at 1 June 2016, the GIR made US $4.3 billion or 1.6 months of imports (compared to 1.5 months of imports as at the beginning of March 2016).

Building up the GIR measured in months of imports is essential for improving the resilience of the RB to external shocks in the environment of a persistent CA deficit[11], decelerating capital inflow, high burden of external debt service, low GIR, and deep-rooted depreciation expectations.

The factors contributing to the GIR replenishment comprise the flexible exchange rate policies (including the NBRB's transition to the continuous two-way auction mechanism for setting the exchange rate) and the monetary targeting policies. That facilitates efficient external shock management with parallel replenishment of the GIR.

In January-May 2016, the GIR grew by US $96 million. The sources of their growth included, in particular, foreign exchange borrowings of the Ministry of Finance of US $1,106 million, of which US $500 million – under the EFSD credit, Government budget revenues in foreign exchange estimated at US $329 million, growing gold prices resulting in an increase in reserves of US $205 million, and lower NBRB's foreign exchange credit to the economy, which declined by US $171 million. The growth of reserves was contained by the high debt burden for the Ministry of Finance and the NBRB: the payments of the Ministry of Finance related to its foreign exchange debt repayment and service were US $1,636 million, while the NBRB's debt repayment and service was equivalent to US $515 million on the net basis. The increase in the relative indicator from 1.5 months of imports as at end-February 2016 to 1.6 months of imports as at end-May 2016 was mainly a result of declining imports against the background of weakening terms of trade and compression of domestic demand in the RB. As at end-May, the average monthly imports were 3.4% lower than at end-February, making US $2,596 million.

Target 1.3. The net domestic assets (NDA) (at the programme exchange rate) should be no more than BYR 73 trillion – a control target.

Status: met.

According to the analytical review prepared by the NBRB as at 1 June 2016, the NDA made BYR 65 trillion (against BYR 68 trillion as at 1 March 2016).

This measure focuses on maintaining tight and consistent fiscal and monetary policies with the aim to ensure balanced domestic demand.

Implementing tight and consistent economic policies gains importance in the environment of high inflation and depreciation expectations[12]. In the context of remaining risks of a sharp deterioration of the external economic conditions,—another drop in oil prices at end-2015 resulted in additional depreciation of the Belarusian rubel by 15% in January 2016—tight monetary policies remain essential for achieving the programme objectives.

Monetary policy tightening, *inter alia* through reduction of the NBRB's lending to commercial banks, accumulation of cash in Government deposits owing to the augmented state

[11] In 2010, 2011, 2013, and 2014, the CA deficit (in percent of GDP) was correspondingly 15%, 8.5%, 10%, and 7%, on average exceeding US $5 billion.

[12] In May 2016, the gap between term household deposit rates for rubels and freely convertible currencies with maturity of up to 1 year was 14.8%, while the interest rate for new household local currency term deposits of up to one year was 17.7%.

budget surplus of BYR 9 trillion in January-April 2016, combined with asset operations of the NBRB to withdraw excess liquidity from the economy, contributed to meeting the target.

Target 1.4. The reserve money (at the programme exchange rate) should be no more than BYR 46 trillion – an indicative target.

Status: met.

According to the analytical review prepared by the NBRB, the reserve money was BYR 39.3 trillion as at 1 June 2016 compared to BYR 41.5 trillion as at the start of March 2016.

Meeting this target helps reinforce the effect of the anti-inflation measures. This condition was met through containment of the NDA growth. The NDA level was below the targeted ceiling. However, on the control date for the second tranche, the rate of inflation was still somewhat above the target – 12.4% compared to 12%. The NBRB expects that the annual inflation will decelerate to the targeted level of 12% as at end-June, noting that the annual targeted level is exceeded largely due to utility and transportation tariff increases. The Manager estimates that these measures resulted in acceleration of inflation by about 1.9 percentage points.

The Manager welcomes the measures taken by the RB to limit the base money, noting, however, that to achieve the targeted level of inflation in 2016, the NBRB may need to resort to tighter containment of the base money growth in the context of price liberalisation, persistently high inflation expectations, and uncertainty in external markets. The Economic Policy Matrix envisages that over the period of the programme supported by the credit, the base money growth will be only a result of growth of required reserves for foreign exchange deposits due to Belarusian rubel depreciation.

Target 1.5. The broad money supply growth (at the programme exchange rate) should be no more than 0% – an indicative target.

Status: met.

The money supply has declined at the programme exchange rate by 3.4% (compared to 2.7% as at the beginning of Match 2016) since the start of 2016.

It is important to avoid excessive money supply growth as there is still a significant monetary overhang resulting from the accumulated gap between the rates of growth of real wages and labour productivity, high inflation and depreciation expectations, and declining demand for money against the background of recession. Over the last 5 years, the RB has had two-digit inflation that reflects persistent excess money supply. High and volatile rates of inflation distort price signals in the economy, strengthen the uncertainty risks, virtually fully setting off the effects of policy measures aimed at promoting economic growth, and bring down the country's investment attractiveness.

Target 1.6. No multiple exchange rate practices – an indicative target.

Status – met.

There are no multiple exchange rate practices. In 2015, some small differences between the exchange rates in the over-the-counter and cash foreign exchange markets and the official exchange rate were observed over the periods of high depreciation—in January, when the depreciation reached 30%, and in August, when the Belarusian rubel depreciated vis-à-vis the US dollar by 15%. Otherwise, the exchange rate differential did not exceed 2%. In 2016, exchange rates did not deviate from the official one by more than 2% in spite of the significant exchange rate depreciation in January (by 14%).

This measure aims at creating a level playing field for all market participants and is an important prerequisite for reducing depreciation expectations and accumulating the GIR.

In the past, the RB periodically faced multiple exchange rates. For instance, over most of 2011, the NBRB maintained a fixed exchange rate and made no interventions to support it that resulted in a big difference between the official and the cash exchange rates. In 2013, the IMF also noted significant deviations of the over-the-counter exchange rate from the official one that was a result of restrictions on the amount of foreign exchange that could be sold in the over-the-counter market – no more than US $1,000. Multiple exchange rates were also observed at end-2014, when the legislation fixed a 30% fee on foreign exchange purchases.

This measure has been implemented by means of discontinuing various restrictions on foreign exchange conversion. The Manager stresses the importance of having no multiple exchange rate practices in future.

Target 1.7. Granting to economic entities access to purchases/sales of foreign exchange at the Belarusian Currency and Stock Exchange through banks – an indicative target.
Status: met.

On 21 March 2016, economic entities were granted access to trading in the exchange currency market through banks of the RB. This decision was approved by Resolution of the Board of the National Bank No. 106 of 1 March 2016.

This measure aims at improving the domestic foreign exchange market mechanisms and liberalising this market that would promote a more flexible rubel exchange rate. Better foreign exchange policies will help eliminate imbalances in foreign trade by generating adequate price signals in the foreign exchange, money, and commodity markets.

The two-way auction mechanism was introduced on 1 June 2015 that helped create a platform for transition to the floating exchange rate regime and reduce interventions to support the exchange rate. Thus, the NBRB was able to purchase foreign exchange in the amount of US $426.4 million on the net basis during the first 5 months of 2016. Resolution No. 106 lifted the ban—introduced by Resolution of the NBRB No. 323 of 26 May 2015—on purchases of foreign exchange by economic entities at the Belarusian Currency and Stock Exchange and limiting their participation in exchange trading to required surrender of part of their foreign exchange proceeds starting from 1 June 2015. Some analysis shows that at the moment economic entities continue buying and selling foreign exchange mainly in the over-the-counter market, while over 90% of their engagement in the exchange market is related to sales of their foreign exchange proceeds.

The Manager welcomes transition to the flexible exchange rate policies, noting, however, that the capacity of this regime would be fully utilised on condition of mainly market-based pricing in all the other markets. At the moment, the exchange rate is still above its equilibrium level[13] and is supported with high real interest rates that is largely explained by continued

[13] The Manager estimates that it is overvalued by 7-12%.

significant subsidised directed lending, in spite of some progress in reducing its stock over the period (-1.6% of GDP as at 1 May 2016 compared to the same period of 2015).[14]

Target 1.8. A fully functioning framework of bank liquidity regulation instruments consistent with the monetary targeting regime is in place – an indicative condition.
Status: met.

On 13 May 2015, the NBRB switched to the monetary targeting regime in implementing its monetary policies. In this framework, the key instrument of achieving the inflation target is control over money supply using an established money supply growth objective.

This measure will help improve the efficiency of fighting inflation, which is still one of the core challenges of the economy of the RB, while maintaining the necessary level of liquidity at commercial banks.

The NBRB regulates the money market by changing the volume of its operations of regulating liquidity in the banking system. The level of interest rates both in the money market and in auctions of the NBRB is determined by market factors taking into account the liquidity available to banks.

Introduction of this instrument has had a positive effect from the point of view of inflation deceleration in 2015. In 2016, this instrument is successfully used to withdraw excess liquidity generated through purchases of foreign exchange by the NBRB in the open market.

Target 1.9. A decision should be taken on changing the refinancing rate taking into account the actual pattern of interest rates in auctions of the National Bank[15], interest rates in the interbank market and with the objective of minimising interventions to support the exchange rate – an indicative target.
Status: met.

At the beginning of 2016, the NBRB brought down the refinancing rate by 3 percentage points – from 25% to 22%. The decision to reduce the rate was taken in the context of some improvement of the external economic environment emerging in the first half of the year—primarily oil price growth—that was accompanied by supply of foreign exchange in the domestic market exceeding the demand for it. Thus, the NBRB was able to increase the volume of liquidity provided to the economy by purchasing foreign exchange in the market. Saturation of the economy with liquidity brought to lower interest rates in the interbank market and auctions that served as a basis for the NBRB to take a decision on bringing the refinancing rate down.

This measure aims at containing the pressure of the monetary overhang on inflation and exchange rate, and reducing the volume of directed lending. The high share of directed lending results not only in pressure on the balance of payments, but also in a higher cost of credit resources for other market participants and lower efficiency of the interest rate channel of monetary policies.

The NBRB has initiated another reduction of the refinancing rate to 20% from 1 July 2016. The Manager is of the opinion that this decision is premature. Although the interest rate remains positive in real terms, the Manager believes that interest rate reductions should follow descending external risks that were the cause of the interest rate growth. Core interest rates

[14] At the programme exchange rate.
[15] The NBRB's operations to provide liquidity.

should not be going down when the CA deficit is expanding—for 4 months of 2016 it was at the level of 11.6% of GDP compared to negative 8.3% of GDP in January-April 2015,[16]—continued risks of financing the balance of payments, and high uncertainty in external markets, including Russia, as initially those were external shocks that caused the interest rate growth.

Target 1.10. Liquidity support should be provided to banks by the NBRB performing its lender of last resort function at interest rates not lower than the refinancing rate of the NBRB – a control target.

Status: met.

According to the information posted on the website of the NBRB, the interest rates for operations of providing liquidity were maintained above the refinancing rate throughout 2016. The spread has been 5 percentage points since the beginning of the year.

This measure ensures proper performance by the NBRB of its creditor of last resort function. As many interest rates for long-term loans and deposits are linked to the refinancing rate, maintaining the refinancing rate at a level above the interest rates for providing liquidity could result in distorted price signals in the banking sector. In particular, that can result in excess bank incomes from long-term loans or setting the price of long-term deposits at a level above the rate for liquidity management instruments. While the lender of last resort rates should continue to be the highest as its ability to credit the economy is limited only by demand.

This measure has helped the NBRB efficiently exercise its liquidity management functions, avoiding a situation of distorted price signals in credit and deposit market.

Target 1.11. The republican budget should be formed with a surplus equivalent at least to the amount of export customs duties from crude oil and selected oil products exported from the territory of the RB outside the customs territory of the Customs Union – an indicative target.

Status: met.

Under Law of the Republic of Belarus No. 341-Z of 30 December 2015 *On Republican Budget for 2016*, the republican budget surplus should be BYR 17.2 trillion. Under Article 14 of that Law, the amount of export customs duties from crude oil and selected oil products exported from the territory of the RB outside the customs territory of the Customs Union should be used to make payments in foreign exchange related to public debt repayment and service.

According to the Ministry of Finance, in January-May 2016, the republic budget received BYR 5.5 trillion of export duties while the republican budget surplus was BYR 7.5 trillion.

This measure primarily aims at maintaining the GIR and improving the country's debt sustainability. Export duties on oil products produced from Russian oil, which used to be transferred to the budget of the RF, have been retained in the budget of the RB since the start of 2015 and are used exclusively for the purposes of public debt service. The Manager sees that as a step in the right direction. This decision also facilitates budget consolidation, reduction of the augmented budget deficit, and optimisation of domestic demand to slow down inflation. However, strict compliance with this condition calls for an augmented general government budget surplus equal to at least the amount of export customs duties from oil and oil products.

[16] The Manager estimates the sustainable CA deficit at no more than 3% of GDP.

Target 1.14. Amendments aimed at reducing tax preferences should be introduced to the tax legislation – an indicative target.

Status: met.

In 2016 to date, there have been decisions taken to shift a number of tax preferences. For instance, the VAT preferences for electricity and gas supply to households was eliminated. According to the Ministry of Finance, this measure could potentially generate BYR 900 billion of additional budget revenues for the year. VAT preferences were also shifted for sales of vehicles for urban, suburban, and intercity passenger transportation, and for services of urban and suburban passenger transportation. According to the Ministry of Finance, the overall effect of the latter measure could be estimated at BYR 400 billion. Profit tax preferences for sales of own products were abolished[17] for companies in most agricultural subsectors and producers of laser optic equipment.

In addition, it should be noted that in order to support budget revenues, the measures to shift tax preferences were accompanied by increases of some tax rate. For instance, the VAT rate was raised on 1 April from 20% to 25% for telecommunication services. According to the Ministry of Finance, that can generate additional BYR 1 trillion for the budget. Excise tax rates were also raised for tobacco products, petrol, and diesel fuel.

This measure aims at strengthening the budget sustainability in the context of deteriorating external economic conditions and weakening economic activity.

Target 1.15 (1). Unconditioned implementation of the Public Debt Management Strategy of the Republic of Belarus in 2015-2020, including:

- the annual mobilisation of non-project related government loans[18] normally not exceeding half of the annual need of public debt repayment – an indicative condition.

Status: not met.

This measure included into the Public Debt Management Strategy of the RB for 2015-2020[19] aims at bringing down the level of the country's public debt and improving its external investment position.

In January-May 2016, the Government of the RB borrowed domestically BYR 15.2 trillion, and raised external non-project related loans of US $500 million[20] (equivalent to BYR 10.1 trillion). Domestic debt repayments made BYR 24.6 trillion, while external debt repayments were US $302.3 million (equivalent to BYR 6.1 trillion).

The ratio of new borrowings to public debt repayment was 0.83—that for external debt being 1.6 and for domestic debt – 0.62. According to the Ministry of Finance, in 2016 the amount of borrowings can make at least 95% of the public debt repayment needs, and such high borrowings are partially explained by issue of domestic debt obligations to support state-owned enterprises. In 2015, securities were issued in the amount of US $1.4 billion in order to restructure bad debts of state-owned enterprises, this year the size of such securities issues have

[17] On 1 January 2016, sub-paragraphs 1.6 and 1.12, paragraph 1, Article 140 of the Tax Code, were abolished thus eliminating the profit tax preferences.

[18] For the purposes of this document, non-project related loans signify loans not associated with implementation of investment projects with a significant import component.

[19] Approved by the RB Government on 17 March 2015.

[20] The first EFSD tranche.

been not so big so far – about US $300 million[21], but if relevant decisions are taken to expand the domestic debt for these purposes, it would have an even greater negative effect on compliance with this indicator in the Matrix.

To avoid further build-up of the debt burden for the budget, the Manager urges to execute the budget with an augmented surplus sufficient to implement the public debt management strategy.

Target 1.15 (2). Unconditioned implementation of the Public Debt Management Strategy of the Republic of Belarus in 2015-2020, including:
- using the export customs duties from crude oil and selected oil products exported from the territory of the RB outside the customs territory of the Customs Union to make payments in foreign currency related to public debt repayment and service – an indicative target.

Status: met.

The Manager estimates that in January-May 2016, the export customs duties received by the budget from oil and oil products were BYR 5.5 trillion (US $0.26 billion or 1.5% of GDP). The non-augmented republican budget surplus for that period was BYR 7.5 trillion.

II. Goods and services market reforms and reduction of state support.

This package of reforms is aimed at developing market pricing mechanisms, while taking into account the degree of monopolisation in the economy, to ensure more efficient use and allocation of commodity, financial, and labour resources and improve the competitiveness of the Belarusian economy. Specific measures to meet the objective include price liberalisation, raising utility and transportation tariffs for households to achieve the level of full cost recovery in the medium-term perspective, as well as reduction of the share of directed lending in total bank lending as its scale is a fundamental factor of structural imbalances distorting pricing in the money, foreign exchange, and commodity markets. Elimination of price distortions would enable more efficient use of resources, including financial resources, in the economy by allocating them to competitive projects.

Target 2.1. A Conceptual Framework of establishing an independent antimonopoly authority on the basis of the Ministry of Trade is agreed – an indicative target.

Status: met.

Decree of the President of the RB No. 188 of 3 June 2016 *On Anti-Monopoly Regulation and Trade Authority* provides for establishing the Ministry of Anti-Monopoly Regulation and Trade on the basis of the Ministry of Trade on 8 September 2016.

This measure aims at preparing the ground for creating an independent anti-monopoly authority with its core functions including facilitation of formation of market relations based on developing competition and entrepreneurship, prevention and restriction of monopoly activity and unfair competition, *inter alia* through controlling monopoly prices, and state control over compliance with the anti-monopoly legislation.

[21] Of which US $210 million are to be transferred to the newly created Asset Management Agency created to resolve bad debts of agricultural enterprises.

Target 2.2. Declaration of ex-factory prices for nitrogen fertilizers in the domestic market is abolished and price formation is based on a formula depending on the external market situation – a control target.

Status: met.

The Ministry of Economy of the RB adopted Resolution No. 11 of 23 February 2016 abolishing declaration of ex-factory prices for nitrogen fertilizers in the domestic market and initiating transition to formula-based pricing depending on the external market situation.

This measure aims at linking the domestic prices for nitrogen fertilizers to changes in the global market trends that would help the economic entities holding a dominant position in commodity markets of the RB for the commodity item "nitrogen fertilizers" respond to changes in the economic situation, as well as monthly form a fair market price in the domestic market, including a fair piece for agricultural producers of the RB.

Until Resolution No. 11 came into force, the activity of economic entities had been regulated by the Ministry of Economy through declaration of ceilings of ex-factory prices for nitrogen fertilizers produced and sold in the domestic market of the RB.

Under the Resolution, every year, during the period of 1 May-30 September, the domestic market price is to be set at the level of global prices converted at the official exchange rate of the NBRB and adjusted to transportation costs. In the remaining part of the year, the domestic price can be 10% below the global price, with this discount being reduced by 5 percentage points every year. This means that in two years after the Resolution is adopted, the domestic price will approach the world price.

The Manager welcomes implementation of this measure in the framework of abolishing the practice of administrative price controls and setting relative prices based on market signals. The impact of this measure can be assessed based on the volume of nitrogen fertilizer sales in the domestic market, which reaches US $0.2 billion (0.4% of GDP) or 45% of domestically produced nitrogen fertilizers. Implementation of this measure is expected to have a positive effect on the financial position of nitrogen fertilizer producers and strengthen the importance of price signals in economic decision-making. In April-June 2016, prices for nitrogen fertilizers in the domestic market tended to follow the pattern of global prices.

Target 2.3. The level of cost recovery through utility tariffs for households should be at least 40% as at end-April 2016 – a control target.

Status: met.

As at end-April 2016, the level of cost recovery through utility tariffs for households was estimated at least at 40% that is consistent with the level registered as at end-February 2016. The cost recovery level was maintained throughout the period owing to appreciation of the nominal exchange rate in March-April 2016, optimisation of utility production costs, especially in the part of heat production, and reduction of the unit cost of natural gas[22].

This measure, involving a gradual increase in utility tariffs for households to the full cost recovery level, aims at optimising utility consumption, consolidation of budget expenditures

[22] In February-April 2016, utility tariffs were raised by 1.1%, data on the cost patterns were not made available to the Manager. However, indirect factors show that the costs of imported gas went down: the nominal exchange rate appreciated in the period by 8.1% while the import gas price remained at US $136 per thousand m3.

through cutting budget subsidies to the utilities sector, and improved competitiveness of Belarusian enterprises owing to elimination of cross-subsidisation.

The low level of cost recovery through utility tariffs for households has a number of negative effects for the Belarusian economy and complicates achievement of macroeconomic stabilisation. Tariffs for households are maintained at a level significantly below the cost recovery one—that leads to unsustainable utility service consumption—by means of setting excessively high tariffs for industrial consumers that boosts their costs and weakens their competitiveness. Another tool of off-setting low tariffs for households is budget subsidies to utility companies. In 2015, they amounted to around BYR 8.1 trillion or 0.9% of GDP against BYR 8.7 trillion or 1.2% of GDP in 2014.

Target 2.5. A Decree of the Head of State is adopted providing for bringing the Development Bank of the RB into the framework of bank regulation of the National Bank. Prudential requirements are set for the Development Bank of the RB – a control target.
Status: met.

The Decree of the Head of State providing for application of banking supervision legislation to the Development Bank was adopted on 31 May 2016. The NBRB drafted a regulatory legal act defining the specifics of application of banking supervision legislation, *inter alia* in the part of prudential requirements, to the Development Bank. The regulation is to come into force at the same time as the Decree – on 1 August 2016.

This measure aims at improving the transparency of banking statistics in the RB and reducing risks in the banking system. Application of prudential supervision measures will bring down the banking risks for the Development Bank, for example by limiting the share of one borrower in its loan portfolio, while including statistical data on the Development Bank into the banking survey would enable preparation of more objective estimates of credit to the economy and share of directed lending. At the same time, the prudential requirements applicable to the Development Bank, taking into account the specific features of its activity, differ somewhat from those applied to commercial banks. In particular, the threshold for the large exposures to capital ratio is higher for the Development Bank, there are no immediate liquidity requirements, and no limitations as to participation in the authorised capital of other organisations. In addition, since the Development Bank cannot take household deposits, there is no threshold for the ratio of funds attracted from households to assets with limited risks.

If implemented, this measure will enable provision of more accurate data to the Manager on compliance with the conditions set for tranches 4 and 7 and regulating the share of directed credit to the economy. Implementation of this measure will also strengthen the soundness of the banking system of the RB.

III. Commercialization / privatization of state-owned enterprises and strengthening social safety nets

The measures in this section are aimed at creating an enabling environment for privatisation of state assets, transition of state-owned enterprises to commercial principles of operation, and strengthening of social safety nets.

Target 3.3. Formation of reserves in local budgets to finance expenditures on non-cash housing subsidies is ensured. The mechanisms of targeted state social support are strengthened, *inter alia* through revision of the size of social benefits – an indicative target.

Status: met.

Decrees of the President No. 78 of 23 February 2016 and No. 174 of 19 May 2016 provide for formation of reserves in the 2016 republican budget of BYR 8 trillion and in local budgets of BYR 796.7 billion to finance social safety nets. In the context of the planned increases in utility tariffs to the full cost recovery level in the medium-term perspective, a Decree of the President of the RB was drafted providing for introduction from 1 October 2016 of a system of non-cash housing subsidies to be provided to socially vulnerable categories of the population to cover part of their utility bills if the latter exceed a certain threshold share of their total household income.

In the environment of real incomes of the population declining in January-April 2016 by 6.9% compared to the same period of last year, a number of measures were taken to increase certain thresholds used for calculation of various social benefits, including the subsistence budget and the basic unit. The basic unit, for instance, grew from BYR 180,000 to BYR 210,000 compared to 1 January 2016. At the same time, the subsistence budget was raised from BYR 1,591,300 to BYR 1,699,400 as at 1 May.

Tis measure in the Matrix aims at strengthening the social safety nets in the environment of recession, declining real incomes of the population, rising utility and transportation tariffs, and growing unemployment.

Owing to the basic unit increase, the average unemployment benefit went up in January-March 2016 to BYR 261,300, however, its average amount was only 16.3% of the subsistence budget or 4% of average gross wages in that period. The Manager notes that in view of the potential release of excess employment and structural transformation of the economy, it is extremely important to raise the unemployment benefit as soon as possible to the level of the subsistence budget.

Target 3.5. A resolution is adopted by the Government on setting the initial selling price of enterprises as asset packages, shares (stakes in statutory funds) of business entities in republican and municipal ownership exclusively based on the market (not balance sheet) price – an indicative target.

Status: met.

Decree of the President of the RB No. 78 of 23 February 2016 establishes that the initial selling price of enterprises as asset packages, shares (stakes in statutory funds) of business entities in state ownership should be established based on the market price. The draft Resolution[23] presented for consideration by the Government of the RB on 6 May 2016 provides that the market price of enterprises as asset packages, shares (stakes in statutory funds) of business entities should be determined in line with the legislation on valuation activities.

[23] Draft Resolution of the Council of Ministers of the RB *On Amendments and Addenda to Resolution of the Council of Ministers of the RB No. 1929 of 31 December 2010.*

These amendments to the legislation enable setting the initial selling price of privatised assets relying not on the balance sheet price, as it was done in the past, but based on 3 market valuation mechanisms—comparable, discounted cash flow, and cost-based.

This measure is part of the package aimed at promoting privatisation through transition to market pricing of assets offered for sale and reduction of the role of the state in the economy. For instance, according to the Ministry of Economy and Belstat, in 2014 the share of the state-owned sector in assets of the economy was 67.5% and that in employment was 60.5%, while its share in gross added value made only 49.9%.**Target 3.6. A draft decision of the Head of State approving the procedure of fast decision-making by local governments on transfer into trust management of enterprises as asset packages in case of persistently insolvent municipal agricultural enterprises is prepared and presented to the Government – an indicative target.**

Status: met.

On 31 May 2016, the State Property Committee prepared and presented to the Council of Ministers a draft Decree of the President of the RB *On Trust Management of Enterprises as Asset Packages in Case of State Unitary Enterprises and Making Amendments and Addenda to Decrees of the President of the RB.*

This draft legislation says that decisions on transfer into trust management of enterprises as asset packages in case of persistently insolvent municipal agricultural unitary enterprises, including such transfer with the right to subsequent purchase of such asset packages by the trust manager, who has properly implemented the terms and conditions of the trust management contract, are to be taken by chairpersons of rayon / town executive committees.

If adopted and implemented, this Decree will promote more efficient use of state assets and their privatisation.

IV. Business climate improvement / private sector development

The measures in this section are aimed at developing the legislative and institutional frameworks facilitating the private sector development[24].

Target 4.1. An updated directive on entrepreneurial initiative development and business activity promotion in the RB is adopted – an indicative target.

Status: met.

Directive of the President of the RB No. 4 *On Entrepreneurial Initiative Development and Business Activity Promotion* adopted in 2010 is a programme document focused on further liberalisation of the economy, empowerment of the business initiative, creation of an enabling environment for dynamic and sustainable development of the RB. Taking into account the long-felt needs to revise the provisions and update certain measures specified in the document, the Reform Matrix includes a condition related to approval of an updated version of this Directive. But at end-2015, after the Government had drafted amendments to Directive No. 4, Belarus' authorities adopted a range of legislative acts and drafted a number of laws, which incorporated most of the strategic provisions of the updated version of Directive No. 4.

[24] Other measures under the section serve as conditions for further tranches.

These documents include, first of all, Decree of the President No. 78 *On Measures to Improve Efficiency of the Social and Economic Complex of the RB* focused on ensuring the inviolability of property, strengthening the anti-monopoly legislation, accelerating the development of small and medium enterprises (SMEs), helping entrepreneurs develop production and create new jobs, mobilising foreign capital, promoting entrepreneurship, etc. Parallel to that, the state programme *Small and Medium Entrepreneurship in the RB* for 2016-2020 was adopted, defining the key activities of SME support, as well as their targets. In addition to the already approved documents, a package of legislative acts is currently at the stage of clearance by national state bodies:

- Decree of the President on introducing the regulatory impact assessment of newly adopted regulations in the economic sphere aiming at implementing the international practice of decision-making based on assessment of the social and economic impacts generated by such decisions.
- Resolution of the Government on the procedure of conducting the regulatory impact assessment of draft regulatory legal acts / individual provisions thereof, which impact the conditions of doing business, to detail the legal regulation of this mechanism.
- Decree of the President on creating an electronic register of administrative procedures aimed at improving the ease of doing business by expanding the access and improving the transparency of regulatory procedures.
- Amendments to the Law *On Technical Rate Setting and Standardisation* aimed at implementing the provisions of the EurAsEC agreement and harmonising the legislation.
- Decree of the President on tax consultancy, introducing the institute of tax consultants in the RB to improve the investment climate, the quality of tax services, and responsibility associated therewith, and the efficiency of taxpayer interaction with the tax authorities.

Belarus' authorities are of the opinion that the above package of legislative acts is consistent with the objectives of further entrepreneurship development and serves as an alternative to the new version of Directive No. 4. Sharing this position in general, the Manager stresses the fact that a number of provisions of the draft new version of Directive No. 4 have not been taken care of, while they are essential for the private initiative development. Those cover measures in the area of right to private property protection, including:

- Ban on forfeiture of property rights without a court decision;
- Limitation of action period for privatisation results to 3 years; and
- Providing lease-takers the priority right to purchase of leased state-owned assets

The key objective of this condition is the development of the private sector as a factor of sustainable economic growth in the RB.

As the legislative acts adopted and drafted cover the prevailing majority of the reforms incorporated in the draft updated version of Directive No. 4, the Manager is of the opinion that this condition is under implementation.

Target 4.2. Considering the need to establish the institute of the Ombudsman to protect the rights of entrepreneurs – an indicative target.

Status: met.

The need to establish the institute of the Ombudsman to protect the rights of entrepreneurs was discussed in the 17th Business Assembly held on 2 March 2016. It was noted that creation of the institute of the Ombudsman to protect the rights of entrepreneurs under the aegis of the President of the RB is provided for in the 2016 Belarus National Business Platform developed and adopted by the business community.

In the framework of this Platform, associations of Belarusian entrepreneurs took proactive steps, drafting Decree of the President of the RB *On Ombudsman under the Aegis of the President of the RB to Protect Rights of Entrepreneurs*. After the draft is discussed at the Ministry of Economy, it will be presented for consideration and proposals to government stakeholders. The draft decree defines the legal status of the Ombudsman, the procedure of his appointment, and his terms of reference. The launch of this institute is a condition for the fifth tranche.

This measure aims at improving the business environment and promoting the private sector development by establishing the institute of the Ombudsman to protect the rights of private entrepreneurs.

According to the Ministry of Economy and Belstat, the private sector, which controlled only about 32.5% of assets in the economy and accounted for 39.5% of employment, generated over 50% of the gross added value in 2014. In the context of prevailing resource allocation in favour of the state-owned sector, protection of rights of the most productive part of the economy is the most critical condition of achieving sustainable economic growth.

Target 4.3. Introduction of international financial reporting standards and mandatory independent audit of such reporting. Consideration of the practicability of expanding the list of companies required to prepare their annual reports based on the IFRS – an indicative target.

Status: met.

In December 2015, the Council of Ministers and the NBRB adopted a joint resolution on making effective on the territory of the RB, following the procedure established thereby, the International Financial Reporting Standards and Explanatory Notes thereto as adopted by the International Financial Reporting Standards Foundation (hereinafter the IFRS) as technical regulatory legal acts. When the IFRS are made effective, the specific features of their application on the territory of the RB are to be defined.

In May 2016, The Ministry of Finance and the IFRS Foundation signed an Agreement on Copyright Waiver on the territory of the RB. The Ministry of Finance is now drafting technical regulatory legal acts providing for making each of the IFRS effective on the territory of the RB.

To implement the IFRS, the training centre provided training for 960 people in 2015 and 180 people in Q1 2016. Starting from 2016, the IFRS-based accounting statements are to be prepared by insurance companies, as well as by all legal entities for consolidated report preparation. Entities in the banking sector switched to the IFRS-based reporting in previous years.

Application of the IFRS is an important step towards creating a favourable investment climate in the RB by furnishing superior bodies and potential investors with plausible and reliable information about the financial status of enterprises.