

**DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT**

STRATEGY FOR BELARUS

As approved by the Board of Directors at its Meeting on 20 July 2004

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ABBREVIATIONS

BAS	Business Advisory Service
BEEPS	Business Environment and Enterprise Performance Survey
BYR	Belarusian Rouble
bcm	Billion cubic metres
CAS	Country Assistance Strategy
CBR	Central Bank of Russia
CCF	Country Cooperation Framework
CEC	Central Election Commission
CIS	Commonwealth of Independent States
CPI	Consumer Price Index
CSO	Civil Society Organisation
DIF	Direct Investment Facility
EC	European Commission
ECE	Economic Commission for Europe
EHU	European Humanities University
EU	European Union
FDI	Foreign Direct Investment
FIAC	Foreign Investors Advisory Council
GDP	Gross Domestic Product
GEF	Global Environmental Facility
IBRD	International Bank for Reconstruction and Development
ICDF	International Co-operation and Development Fund
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
MSE	Micro and Small Enterprise
NBB	National Bank of Belarus
NEAP	National Environment Action Plan
NGO	Non-Governmental Organisation
ODIHR	Office of Democratic Institutions and Human Rights
OECD	Organisation for Economic Co-operation and Development
OGC	Office of the General Counsel
OSCE	Organisation for Security and Co-operation in Europe
PACE	Parliamentary Assembly of the Council of Europe
PHRD	Policy and Human Resources Development Fund
PMU	Project Management Unit
RCA	Revolving Credit Agreement
RUR	Russian Rouble
RZB	Raiffeisen Zentralbank Österreich AG
SBA	Stand-by Arrangement
SDDS	Special Data Dissemination Standard
SDR	Special Drawing Right
SEEC	Southern and Eastern Europe and the Caucasus
SME	Small- and Medium-sized Enterprise
SMP	Staff Monitored Programme
TACIS	Technical Assistance for CIS Countries
TAM	TurnAround Management
TB	Tuberculosis
TC	Technical Co-operation
Tcm	Thousand cubic metres
TFP	Trade Facilitation Programme
UNDP	United Nations Development Programme
VAT	Value Added Tax
WB	World Bank
WTO	World Trade Organisation

EXECUTIVE SUMMARY

The Bank remains seriously concerned about the slow pace of transition to democracy and market economy in Belarus. During the last Country Strategy period there has been only limited progress in the authorities' commitment to, and application of, principles of multi-party democracy, pluralism and market economics in accordance with Article 1 of the Agreement Establishing the Bank. In some areas there has been backtracking. Given the lack of sufficient progress in reaching the benchmarks proposed in the previous Country Strategy, the Bank's operations will remain along the lines of the Baseline Scenario outlined in that Strategy.

In the period covered by the new Country Strategy, the Belarusian authorities will have an opportunity to demonstrate the political will to introduce substantive, concrete reforms in both political and economic spheres. In the meantime, given the current difficult environment in Belarus and to achieve the Bank's transition objectives, the Bank will continue to focus its activities to supporting private sector development, including through policy dialogue. This approach is consistent with the wish expressed by local NGOs, business representatives and others, for the Bank to stay engaged and to support reform.

The 2002 Strategy proposed three alternative scenarios as a graduated response to domestic circumstances, referred to as a Baseline, an Intermediate and a Regular scenario. This approach makes the degree and nature of the Bank's engagement in the country dependent on the course of action chosen by the Belarus authorities themselves and their demonstrated willingness to deliver verifiable improvements in the political and economic spheres.

Over the past Strategy period, the Bank has followed the Baseline Scenario outlined in the 2002 Country Strategy, which was further fine-tuned in subsequent Strategy Updates mainly as a result of developments in the banking sector. The Bank has continued to finance SMEs and micro-enterprises via the existing SME Credit Line through two private banks, expanded the use of these resources to working capital and leasing, increased the limit under the Trade Finance Programme (TFP), and arranged a syndicated facility, the first for a Belarus borrower, of US \$36 million to Priorbank. No new technical cooperation projects were approved.

Going forward, and in the absence of any significant progress in the political and economic spheres, the Bank will continue to operate in the country according to the Baseline Scenario presented in the last Country Strategy. With some refinements detailed below, the Bank will have sufficient flexibility under this scenario to respond to new developments in the private sector. As in the previous Strategy, the Bank views this approach as the most appropriate way to further its enduring objectives to strengthen private entrepreneurship at the grassroots level, promote the growth of a middle class, and continue to build domestic constituencies for reform. All the Bank's operations under the Baseline Scenario must demonstrate that the investments are not effectively controlled by the state or state entities, and government officials will not personally benefit financially from such investments.

In the coming Strategy period, the Bank will focus on the following priorities:

- Portfolio management of existing investments in Belarus, including continued support to SMEs/MSEs through the existing sovereign SME Line of Credit approved in 1994 (which is fully committed and under which reflows are limited);
- Advisory services to SMEs via the Bank's TurnAround Management (TAM) and the Business Advisory (BAS) programmes, provided funding from donors will be made available;

- Selective direct investments in local and foreign private companies, including through the Direct Investment Facility (DIF) programme;
- Expansion of the trade facilitation programme to additional bona fide private banks;
- In accordance with the need to support private SMEs and MSEs, Foreign Direct Investment, as well as competition in the financial sector, the Bank will consider providing SME/MSE credit lines directly to individual private banks, and equity investments in private banks, together with related technical assistance, when the investments are small, particularly if this can be done alongside reputable international strategic investors, and the State has no control, including veto power over decision making.

The extent to which the Bank can put in place the types of transactions envisioned above will hinge on the overall investment climate in the country. With the objective of helping the authorities to improve the business environment and strengthen the financial sector, including identifying obstacles faced in these areas, the Bank will continue to cooperate actively with the authorities through policy dialogue, including participation in the Foreign Investors' Advisory Council (FIAC).

If Belarus were to make significant progress in transition towards democracy and a market economy, then the Bank would be in a position to conduct a broader range of operations as envisaged in the **Intermediate Scenario**. As in the previous Strategy, the Bank will employ a number of benchmarks that have been agreed by the international community in gauging progress in political and economic reforms.

- a) **Political benchmarks.** The United Nations Commission on Human Rights and institutions within the OSCE, European Union and Council of Europe have all stressed the need for tangible evidence of progress in the following areas:
 - Preservation of the right to freedom of expression and freedom of media;
 - Non discrimination against political opponents and the introduction of confidence-building measures, to include a full and impartial investigation in the cases of forced disappearance of several political opponents, in conformity with the country's commitments under the International Covenant on Civil and Political Rights; and
 - Compliance with the country's OSCE commitments under the 1990 Copenhagen Document for free, fair, equal, accountable and transparent elections. The upcoming parliamentary elections provide a clear opportunity for the current leadership in Belarus to demonstrate the political will needed to implement these commitments.
- b) **Economic benchmarks.** Business cannot function efficiently unless measures to dismantle the over-centralised system of economic management are in place. The Bank, together with the IMF and the World Bank, stresses the importance of:
 - Phasing out administrative interventions in the economy, particularly artificial restrictions on business;
 - Acceleration of the denationalisation and privatisation processes;
 - Putting in place measures to secure property rights and improve corporate governance.

Should evidence of significant progress emerge in these domains, the resultant improved investment climate would allow the Bank to consider, on a project-by-project basis and in consultation with the Board of Directors, further involvement in the Belarus economy.

The main operational priorities of this Intermediate Scenario could include:

- Participation in privatisation support for local private companies and foreign strategic investors, provided it can be shown that the proposed investments are not effectively controlled by the state or state entities and government officials will not personally benefit financially from such investments;
- Contribution to the commercialisation and privatisation of public utilities and services limited to provision of technical assistance;
- Encouragement of the privatisation and consolidation of state banks through the provision of technical assistance and very selective financing to the privatised banks.

If transition in Belarus were to proceed to the point that Belarus' commitment to democratic principles is demonstrably achieved and the domestic economy does not place constraints on EBRD activities in the country, the Bank would engage with Belarus according to a Regular Scenario with the normal range of its operations. In this case, the EBRD would be able to deploy the full range of its investment and lending facilities in Belarus, including financing for public sector projects and private-public partnerships. The Bank will continue to carefully monitor the political and economic situation in Belarus, and if the conditions for this Regular Scenario emerge, the Bank will propose a new Strategy for approval by the Board of Directors.

However, under current conditions, support for private sector development remains the most appropriate way for the Bank to advance the transition process in Belarus.

II. Country Strategy

1. THE BANK'S PORTFOLIO

1.1. Overview of Activities to Date

As of 31 March 2004, the Bank had signed a total of 11 investment projects covering energy, transport, telecoms, agribusiness, general industry and banking, for a total commitment of EUR 159 million. Four projects have been in the public sector, totalling EUR 111 million (70 percent) and seven in the private sector, totalling EUR 47 million (30 percent). Net portfolio was EUR 54 million, of which 92 percent had been disbursed. No new TC projects have been signed since year 2000.

Table 1: Commitments and Portfolio at 31 March 2004
(EUR million)

by Sector

Sector Name	COMMITMENTS					NET PORTFOLIO ¹		
	No. of projects	Total Project Cost	EBRD Funding	% of total EBRD	Disbursed	No. of projects	Portfolio	% of Portfolio
Financial Institutions	6	72.9	46.5	29%	39.8	5	32.0	59%
Infrastructure	2	122.1	74.5	47%	74.5	2	19.6	36%
<i>Energy</i>	1	31.4	31.4	20%	31.4	1	6.5	12%
<i>Transport</i>	1	90.7	43.1	27%	43.1	1	13.1	24%
Enterprises	3	42.5	37.5	24%	37.5	2	2.6	5%
<i>Agribusiness</i>	1	8.6	5.0	3%	5.0	1	1.7	3%
<i>General Industry</i>	1	2.3	0.9	1%	0.9	1	0.9	2%
<i>Telecom</i>	1	31.6	31.6	19%	31.6	0	0	0%
Country Total	11	237.5	158.5	100%	151.8	9	49.8	100%

¹ Details of net portfolio are provided in Annex 4.

1.2 Implementing the Last Country Strategy

New business

The Bank has followed the Baseline Scenario outlined in the last Country Strategy, and in subsequent Strategy Updates. In addition to the continued financing of SMEs through reflows under the Sovereign SME Credit Line (co-financed with Taipei China) via two private banks, i.e. Priorbank and Belgazprombank, which was expanded to allow for the financing of MSEs in 2001, and working capital and leasing in 2002, the only new operations to be signed since then consist of a ground-breaking syndicated facility of US\$ 36 million to Priorbank in 2003 (the first international syndication for a Belarus borrower) after Raiffeisen of Austria had acquired a controlling stake in the bank, and an increase of the TFP limit for Priorbank to US\$ 12 million.

Transition Impact

The SME Line of Credit has helped to finance 77 SME and over a thousand MSE projects. Under this facility, more than US\$ 50 million have been disbursed to local companies overall. The facility has supported institutional strengthening in currently participating banks, and improved their credit appraisal procedures.

The EBRD's support to Priorbank, including its equity investment, has enhanced international recognition of Priorbank's status as a private sector institution and a leading bank in Belarus, helped attract private sector investment and enhanced corporate governance.

The syndicated loan facility for Priorbank signed in 2003 represented the first international syndication to a local Belarusian borrower. As the first syndication it has a strong demonstration effect by setting out a model for a successful business dealing in Belarus. Furthermore, it has demonstrated to the rest of the banking sector the positive impact on business that a strong international reputable strategic investor can have.

The EBRD has conducted policy dialogue with the National Bank of Belarus and the central government authorities aimed at eliminating key obstacles to facilitate MSE lending. The Bank is also an active participant in the work of the Foreign Investors Advisory Council (FIAC).

1.3 Portfolio Performance

The portfolio disbursement ratio currently stands at 92 percent. There are no problems with repayments under current projects, except for delayed repayments of up to 2 months on one public sector project signed in 1993.

1.4 Lessons Learned

Reform constraints and policy dialogue linked to SME and MSE-finance operations. The Bank should seek to stay constantly engaged in policy dialogue with the relevant authorities in order to promote an insight into the benefits of continued reforms towards a market economy, including SME and MSE development.

Government thinking can be influenced through introduction of new concepts. The successful financing of the international component of a road project, through the introduction of collection of tolls in foreign currency from international road users, has demonstrated to the authorities the considerable advantages of the concept.

Risk mitigation. The Bank's approach to projects should be extremely cautious when it introduces a concept to a substantially unreformed sector of the economy where the progress in transition reform is of paramount importance to the financial viability of the project.

Even in difficult environments, the EBRD can play a pioneering role, e.g. as demonstrated through Raiffeisen's investment in Priorbank, a local private bank, where EBRD has been a shareholder since 1997. The Bank's involvement has played a key role in helping transform it into the largest privately held bank in the country, making possible the first syndication in the country (arranged by the EBRD), and introducing it to microenterprise lending.

1.5 Private/State Sector Ratio

Given the larger scale infrastructure projects signed in the initial years of Bank activity, the limitations imposed by recent country strategies on the EBRD's activities in Belarus, and the

difficult local business environment, the private/state ratio stands at 30 percent, even though in terms of the current portfolio, the private sector represents 61 percent.

2. OPERATIONAL ENVIRONMENT

2.1 General Reform Environment

Political Developments

During the past Strategy period, the political situation has remained difficult and continues to foster serious concern about the leadership's commitment to pursue democratic reforms. While the situation has improved somewhat in a few areas, it has worsened in others. The President's administration continues to be chiefly responsible for setting policy and resolving ideological and political matters, which are then carried out by the Government.

One positive step was taken at the end of 2002, when the mandate for the OSCE office in Minsk was renewed following a period of tension and disagreement over its remit. In June 2004, the OSCE Chairman-in-Office made the first high level visit to Belarus in six years and noted some positive developments in the political and ecological spheres. At the OSCE Parliamentary Assembly meeting in Edinburgh from 5-9 July, 2004, the Belarussian delegation signed a declaration with the OSCE Working Group on Belarus expressing their intention to meet OSCE standards for free and fair elections and promising to give opposition groups access to state-controlled media. Following this agreement, the Working Group head withdrew a harshly-worded resolution on Belarus from consideration. Also, the House of Representatives, the lower chamber of parliament, has shown some signs of heightened political relevance in shaping policy debates on matters related to the economy and democratic reform, though the number of pro-presidential deputies far outnumbers the fledgling reform group. Policy dialogue with the authorities in the Government has improved, and the Bank has taken advantage of this opportunity to raise issues regarding the need for greater democratic openness and improvements in the business climate at the highest levels. And the political opposition, while continuing to face numerous political obstacles, has begun to organise itself for the parliamentary elections due to be held in October 2004.

Despite these improvements, political conditions remain challenging. In the past year NGOs, non-state educational institutions and the independent media have experienced increased pressure and harassment by state authorities and, in several cases, have been forced to shut down. The emergence of a pluralist civil society was one of the few positive aspects of the presidential election of September 2001 noted by the OSCE, and these recent developments threaten to undermine that important step toward the creation of democratic political structures. The even-handed application of the rule of law is another important dimension of democratic governance, and on this score recent developments have not been encouraging. There have been accusations of politically motivated investigations of well-known opposition figures by the prosecutor's office and other state agencies, and courts are not viewed by independent monitors as politically neutral. The Council of Europe, together with the UN Commission on Human Rights, has also called for an independent investigation into the cases of four prominent "disappeared" persons whose cases remain unresolved.

For further details on political developments, see Annex 1.

Legal Environment

The legal system of Belarus is in the course of being transformed from one geared to an administrative/command economy to one based on market principles. Over the course of the past few years, fundamental market-oriented legislative reforms, including the adoption of a

new Civil Code in 1998, a Banking Code and new Bankruptcy Law in 2000, and an Investment Code in 2001, have been enacted. The business climate, however, continues to be adversely affected by a rigid and centralised system of economic management, state intervention, a largely stalled privatisation programme, and a banking system that is controlled primarily by the government. The consensus view is that the investment climate in Belarus is one of the most challenging in the CIS.

Some recent decrees of the President of the Republic of Belarus appear to represent a step back from the progress that has been made in enacting market-oriented legislation. Of these the most noteworthy is Decree No. 125 of the President of Belarus, dated 1st March 2004, “On the Special Right (“Golden Share”) of the State to Participate in the Management of Business Organisations”. Pursuant to this Decree, the state has the right to create in favour of itself a special right (referred to as a “golden share”) to participate in the management of business organisations, such as joint stock companies, which have been created in connection with the privatisation of former state enterprises. The Decree makes clear that the state is entitled to reserve to itself a golden share regardless of whether, at the time the decision to do so is made, the state owns any of the equity capital of the enterprise in which the golden share is to be instituted. It is therefore open to the state to institute a golden share even in a joint stock company which is wholly owned by private investors, provided only that the enterprise was originally created in connection with the privatisation of a former state enterprise. The circumstances in which the state acquires the right to institute a golden share are extremely vague. The Decree appears to give the state completely unfettered control over enterprises in which golden shares have been instituted. This Decree is a retrograde development which will likely render private sector investment, including foreign investment, even more problematic than it is already is.

Generally, since the previous Country Strategy, the pace of market-oriented law reform seems to have abated, with no major new commercial laws having been enacted. Furthermore, as indicated above, in certain respects the movement of reform has actually been away from the promotion of private enterprise.

The level of implementation of market based law reforms in Belarus appears to correspond broadly with the relatively low levels of economic and democratic progress made by the country, which suggests that all three of these pillars of transition are inter-dependent. Given the experience that in transition countries these pillars are mutually reinforcing, Belarus will only be able to achieve sustainable improvements in its investment climate if much-needed efforts to advance economically and politically are at least matched by a commitment to further market-oriented legal reform and the sensible and just implementation of the reforms that have already been enacted.

Social Conditions

Belarus ranks 62nd according to the UNDP Human Development Index for 2004, ahead of all other CIS member states but Russia, while lagging behind the advanced transition countries. The country’s relatively good performance on many social indicators is a result of Government efforts to retain the social infrastructure in education, health care and employment. However, many problems remain and recent trends in some spheres are a cause for concern. According to the 2003 UNDP national human development report for Belarus, demographic trends are a main area of concern. The population has been declining steadily for the past ten years, and the rate of decline has accelerated since 2002. UNDP defines the current demographic situation as “critical”. The birth rate has been declining since 1990, while the number of deaths per year has exceeded the number of births every year since 1994. The country’s aging population puts increasing pressure on working Belarusians, as the ratio of workers to pensioners declined from 2.2/1 in 1990 to 1.6/1 in 2002.

These trends are fuelled by a general decline in life expectancy, higher mortality rates and deteriorating health conditions. Life expectancy at birth fell from 71.1 years in 1990 to 68.5 years in 2000. In 2001, life expectancy increased to 69.6 years, but remains low by comparison with other central European countries. The shorter life span, especially for men, is caused in part by higher rates of morbidity from circulatory disease, accidents, murders and suicides. Incidents of respiratory and infectious disease are also at relatively high levels. These trends, in turn, stem from a decline in public health awareness and standards, including high rates of alcohol consumption and smoking. The rate of infection from HIV/AIDS is increasing rapidly, though the number of people registered with the disease is far lower than in some neighbouring countries. 915 cases were recorded in 2002 versus only 8 in 1995. According to UNDP, “deteriorating national health is a major obstacle to human development in Belarus,” requiring urgent measures of preventive healthcare and increased public awareness of healthy lifestyles.

Belarus’ score on the UNDP education index rose to .95 in 2003, outpacing most other transition countries and many developed countries in the West. While public spending on education has increased steadily, it remains insufficient to generate necessary upgrades in education quality and facilities in secondary schools and institutions of higher education. Private funding has remained flat in the past decade. Employment trends have been mixed. Belarus has seen a decrease in employment in industry and agriculture and a corresponding increase in employment in services. Some of this shift could reflect a positive, albeit socially painful, trend of enterprise restructuring in sectors that traditionally employed excess labour. Official unemployment was low at around 3 percent in 2002, although independent experts associate this with growth in hidden employment and the retention of redundant employees at many loss-making enterprises. Taking into consideration the number of people who do not register as unemployed, household survey data suggest that the true unemployment rate may be closer to 7.4 percent.

Poverty alleviation is an important objective of government policy. The main measures have included promoting real wage growth in the economy by stipulating wage targets in US dollar terms, as well as implementing more specific policies, for example a Comprehensive System of Social Protection Measures for the period 2002-05. These measures have contributed to the growth in real incomes in recent years and a decline in the share of the population with disposable incomes below the (government defined) subsistence budget. The share fell from a peak of 46.7 per cent in 1999 to 27.1 per cent in 2003, according to official data. The UNDP believe poverty is concentrated among large families dependant on the salary of one earner whose income is too low to support the other family members. A forthcoming assessment of poverty in Belarus by the World Bank for the period 1995-2002 largely confirms these trends. According to the preliminary estimates, poverty has declined owing to a combination of higher wages and social protection. However, given the concerns as to whether high wage increases can be sustained, the World Bank emphasise the importance of job creation as a means of providing a sustained response to the problem of poverty alleviation. Income inequality is low by international standards.

Environmental Situation

Despite the GDP growth, the environmental situation in Belarus has improved. For example, the cumulative amount of atmospheric air emissions has recently decreased by 2% a year on average and waste water discharge by 8%. The ambient air quality has become significantly better in such traditionally problematic cities as Mogilev, Vitebsk, Grodno, and Novopolozk. Environmental improvements have taken place as a result of increased environmental expenditures (accounting for up to 2% of the GDP) to finance the acquisition and installation of pollution abatement equipment, enlargement of designated protected nature territories and organisation of the environmental awareness public campaigns and training programmes.

These and other key directions of the country's environmental performance, such as improving administrative, economic and regulatory mechanisms of environmental protection, combating soil contamination, raising the energy efficiency levels, etc. are outlined in the current National Environmental Action Plan (2001-2005), which has been developed on the basis of the National Strategy for Sustainable Development (1997) and previous NEAPs (1990-1995 and 1995-2000).

The development of environmental legislation during the last two years – such as the revision of the framework Law on Environmental Protection(2002), new Laws on Flora (2003), introduction of additions and changes to the Laws on Environmental Taxation (1991), and on Waste of Production and Consumption (2002) – strengthens the state environmental control and monitoring functions, provides for an increased access of the population to environmental information, introduces the system of environmental certification and incentives, and reinforces the environmental impact assessment and compensation procedures.

In December 2003, Belarus joined the Stockholm Convention on Persistent Organic Pollutants and plans to implement a series of enabling activities with the support of Global Environmental Facility (GEF) and the World Bank in 2004.

In addition, in 2003, Belarus joined the UN ECE Convention on the Protection and Use of Transboundary Watercourses and International Lakes, which is particularly important for the country as all its large rivers are trans-boundary. Due to the fact that three of its neighbouring countries have recently become EU members, there are several EU TACIS and World Bank-funded initiatives within the country to harmonise its environmental legislation with the pertinent provisions of EC Directives, such as the EC Water Framework Directive. Other environmental legislation harmonisation initiatives in the country include the introduction of the system of integrated environmental permits based on the provisions of the IPPC Directive and the BAT approach.

2.2 Progress in Transition and the Economy's Response

2.2.1 Macroeconomic conditions for Bank operations¹

The main aims of government policy are to raise living standards, promote social development and limit the impact of reform on the population. This has resulted in a gradual approach towards economic reform as well as high levels of government spending to boost wages and support the state enterprise sector. In recent quarters this policy, combined with strong demand from Russia, has resulted in strong growth of industrial output. In 2003 both GDP and industrial output rose by 6.8 per cent, according to official estimates. In addition in 2003 the recorded fiscal deficit was modest, the current account deficit was only 2.9 per cent of GDP and the stock of external debt was low. The continued growth of demand, both from domestic sources and from Russia, has contributed to stronger growth in the first five months of the year with industrial output up by 14.4 per cent and GDP by 10.2 per cent (year on year). In the first quarter of 2004, stronger exports also resulted in a slowdown in the deterioration of the trade deficit and contributed to a modest current account surplus. There are however, doubts over the quality of some of the national accounts data. Belarus is expected to adopt internationally recognised methods of estimating industrial production by 2006 that could lead to lower growth rates. In addition there is almost certainly a large shadow economy, although by its nature it is difficult to estimate its size in relation to recorded GDP.

The economy has other characteristics, which affect the overall business environment in which the Bank operates. Belarus has one of the lowest shares of the private sector of any country in

¹ A more detailed review of macro-economic developments is contained in Annexes 2 and 3.

the region – EBRD's estimate was 25 per cent in 2003. It also has one of the highest shares of government revenue and spending at some 45 per cent of GDP. This, combined with an accommodating monetary policy, has contributed to Belarus recording one of the highest inflation rates in the region, although it is now on a downward trend. In addition, the access to external sources of funding is limited, partly a consequence of the failure to reach agreement with the IMF on a programme, but also because of the slow pace of privatisation which has limited flows of net FDI. A combination of greater macro-economic stabilisation and faster reform would improve the conditions for Bank operations.

Looking ahead over the period covered by this Strategy, there are at least three macro-economic issues that the government will need to address, the outcome of which will impact on the business environment. These are the fiscal burden, the need to adjust to higher import prices for gas and the implications of monetary union with Russia. The high share of government spending implies a high tax burden; most surveys of business conditions indicate that this is one of the main constraints on the growth of the private sector, a factor the government has recognised with cuts in both VAT and turnover tax from the beginning of 2004. Furthermore there is a considerable amount of off-budget financing through various means, including the innovation funds and directed lending. Such funds have been used in the past to clear wage arrears; they may also be used for additional investment. Thus, not only is the share of government in the economy higher than the figures show, but it also implies that many enterprises face soft budget constraints, thus enabling loss-making enterprises to survive. Both these concerns point to the need for fiscal tightening, with the emphasis on reducing spending in line with reductions in the tax burden.

There was some deterioration in the trade deficit in 2003 to 7 per cent of GDP, mainly because of higher gas prices and possibly the effects of some loss of competitiveness over time, for example as a result of the policy of ensuring large wage increase in US dollar terms irrespective of actual growth in productivity. The buoyant growth of exports to Russia and the surplus Belarus earned on transit and transport services ensured that the current account deficit was only 2.9 per cent of GDP in 2003.

However, Belarus now faces the prospect of significantly higher prices for its gas imports from Gazprom. In recent years Belarus has benefited from relatively cheap supplies from Gazprom (US\$ 30.1 per tcm, similar to the price of gas supplied to enterprises in western Russia). Following an agreement reached in June with Gazprom, the latter will charge Belarus US\$ 46.7 per tcm for the remainder of the year. Some of this price increase will be partially offset by higher transit fees, but the net impact will be to increase the trade deficit by up to 0.6 per cent of GDP. It could also have an impact on competitiveness in view of the dependence of Belarus industry on gas supplies. Thus some policy tightening may be required to address the pressures on the trade deficit.

The terms of monetary union with Russia, in particular the rate at which the currency is pegged to the Russian Rouble, ahead of the introduction of the Rouble as the common currency, is critical. Negotiations on monetary union have slowed and recent government statements indicate that it is now unlikely that a common currency will be introduced at the beginning of 2005, as originally intended. It is apparent that further progress will be required in the negotiations on the amount of compensation that Belarus is requesting from Russia for the necessary fiscal harmonisation. Although there could be advantages for Belarus in a peg to a stronger currency in terms of the downward pressure on inflation, there are also risks. The latter

include the possibility of the Rouble appreciating if oil prices remain high, the disparity between the respective inflation rates at present and the resulting implications for competitiveness.²

Thus the overriding conclusion is that despite some of the progress that Belarus has made with respect to raising growth rates and lowering inflation, a tightening of fiscal policy is required. This ought to result in a lower tax burden, ease the adjustment to a period of higher gas prices and provide more favourable conditions for an eventual peg to the Russian Rouble. The improved macro-economic stability would also create more favourable conditions in which the Bank could operate.

2.2.2 Progress in Transition

The pace of economic reform in Belarus has remained slow since the previous country strategy was completed in May 2002. During this period progress in foreign exchange liberalisation and developments in the banking sector were sufficient to warrant an upgrade in the EBRD's transition indicators for Belarus in 2002, while the cumulative progress with small-scale privatisation resulted in an upgrade in 2003. Nevertheless, by early 2004 both the estimated share of the private sector in the economy and the overall progress in transition remained among the lowest in the region. As noted above the main reason for this slow pace of reform reflects the authorities continuing desire to limit the adverse effects of faster reform on employment and social conditions. It has been achieved by the state maintaining ownership of an extensive range of assets as well as an ability to intervene in the economy, supported by accommodating monetary and fiscal policies.

2.2.3 Transition Challenges

Trade and Price Liberalisation

Further progress in trade liberalisation would strengthen competition in the economy. Negotiations on WTO accession have continued, combined with progress in lowering Belarus' average import tariff to 9.5 per cent at the beginning of 2004 (from 14 per cent in 1995). Following the fifth round of discussions in Geneva in January 2004, the WTO secretariat decided sufficient progress had been made to enable it to prepare a summary of the main steps the Belarus authorities need to take to harmonise domestic legislation with WTO requirements. Other major issues, which remain to be resolved, include the extent of agricultural support and the access of foreign banks to the Belarus financial services market. In addition, customs procedures will need to be strengthened. EU exporters to Belarus have encountered problems with the confiscation of merchandise at the border, on questionable grounds in their view.

However, given the close trading links with Russia, it is possible that the authorities may seek to co-ordinate the timing of the WTO negotiations with those of the Russian government. This may also depend on other factors including the progress of negotiations over the formation of the Single Economic Space (with Russia, Ukraine and Kazakhstan), as well as perhaps the long running aim of creating a free trade zone among the members of the Eurasia Community.

² According to the Belarus authorities, at a meeting of the Council of Ministers of the Union State in June 2004, consideration was given to the implementation of the Joint Action Plan. The latter is a set of co-ordinated measures for the introduction of the common currency, including the introduction of the Russian Rouble as the means of single legal payment and circulation within Belarus, before a single emission centre is created. The respective governments have also made some revisions to the Joint Action Plan in terms of the timing of the implementation of certain measures. Further decisions will be taken with respect to the timing of the introduction of the peg of the Belarus Rouble to the Russian Rouble and the introduction of the Russian Rouble as the single legal means of payment.

Further progress towards WTO accession will therefore partly depend on how the government determines its priorities in this area.

A reduction in the extent of state control over prices would provide greater incentives to producers. There have been some positive developments, including the government's announcement in October last year that it was reducing the number of food items on the list of goods subject to price controls. However, the majority of enterprise in Belarus (and especially those in the state sector) remain subject to price controls or limits on their margins. Towards the end of 2003, the government indicated it was preparing legislation that would transfer the responsibility for price formation of selected products (estimated to account for 30 per cent of prices) from government agencies to itself. Although this would not reduce the extent of state control, it is hoped that it will simplify procedures. In addition utility tariffs for consumers were raised in early 2003, which reduced the extent of cross-subsidisation by industrial consumers, although the authorities had to raise gas and electricity prices to industrial users in early 2004 following the sharp increase in the price of gas imported from Russian suppliers.

Privatisation

There is an urgent need to accelerate the pace of large-scale privatisation to assist with both the rationalisation of industry and to reduce the distortions that can arise from the provision of financial resources to support loss-making enterprises. The small share of the private sector is partly a reflection of the limited progress made with privatisation and the constraints on small business. Progress has nevertheless been made with small-scale privatisation, which the Ministry of Economy estimated to be at least 70 per cent complete by early 2004.

The emphasis of the large-scale privatisation programme has been on transforming state entities at both the republican and communal level into open joint stock companies and then selling shares to workers collectives and others via both auctions and tenders. At the beginning of 2004 it is estimated that a little over 1000 entities at the national level had been transformed (about 26 per cent of the total number) and some 2880 communal entities (39 per cent). Although shares have been sold in over 1580 state-owned enterprises to date, it is believed the state owns large shareholdings in over 500 of these and controlling stakes in some 300.

However, the number of large entities which have been successfully sold remains very limited. Of these, the majority were entities at the communal level with shares sold via auctions and tenders. The slow pace of privatisation may be seen from the trends in privatisation receipts. Proceeds amounted to just 0.1 per cent of GDP in both 2000 and 2001, before increasing to 1.7 per cent of GDP in 2002 (BYR 427 billion – US\$ 238 million), mainly due to the sale of the government's 10.8 per cent stake in Slavneft. Proceeds from privatisation were projected at BYR 430 billion in 2003, most of which was expected to come from the sale of 43 per cent of the government's stake in four petro-chemical companies. However, no bids were received and the government was forced to terminate the sale. By the end of the year privatisation receipts amounted to just 0.1 per cent of GDP (BYR 36 billion –US\$ 16.5 million), less than 10 per cent of the target, with most coming from the sale of entities at the communal level.

For 2004 the government aims to transform over 200 entities (both national and communal) into open joint stock companies and sell shares in 149 companies, with the aim of raising around BYR 120 billion in receipts for the budget. The sales could include the four petrochemical companies, the sale of some bank shares and a stake in the gas transit company Beltransgaz if agreement can be reached with Gazprom on the terms of the sale. However progress is likely to be partly dependent on the passage in coming months of a draft law on large-scale privatisation (which the President originally vetoed towards the end of 2003).

Enterprise Restructuring

Developing a stronger industrial sector should be a key aim if competitiveness is to be improved. Although this partly depends on appropriate macro-economic policies, for example the wages policy has almost certainly contributed to the increase in the number of loss making enterprises in recent years, a combination of low investment, little progress on governance and weak bankruptcy procedures have all held back rationalisation.

In March 2004 over 40 per cent of all industrial enterprises were classified as loss making while unsold stocks remain high. In addition there has been little reform in the agricultural sector and a large proportion of enterprise is dependent on subsidies to offset losses. According to the Belarus authorities, the persistence of the loss-making enterprises reflected shortcomings in the Bankruptcy law. Thus in November 2003, Presidential Decree N 508 "On economic insolvency (bankruptcy)" was adopted. The main aims are to prevent economic insolvency (bankruptcy) of organisations of different forms of ownership, strengthen the role of the state and increase of responsibility of companies' owners and managers. The Decree only took effect from mid-May and thus it remains too early to assess its impact. However, in the EBRD's view the Decree will not improve the situation as it limits creditor's rights and restricts the scope for applying bankruptcy procedures in certain groups of companies, especially of state owned companies.

According to data from the Ministry of Statistics and analysis of the results for 2003, output from small and medium sized enterprises rose by over 20 per cent in 2003, one of the fastest growing sectors in the economy, so that the share of the sector constituted 8.2 per cent of GDP. As of the end of 2003 there were 31,000 small enterprises in Belarus, of which 28,500 were private, and about 190,000 individual entrepreneurs with a strong concentration in trade and catering. By the end of 2003 more than 600,000 people were employed in this sector (taking into account individual entrepreneurs), some 13 per cent of all those employed in the economy.

The sector has benefited from government action, including from the Foundation for Support for Entrepreneurs (from 1992) as well as from the development of regional centres to support SMEs. More recently the Government adopted a Concept of State Support and Development of Small Businesses for the period 2002-05, intended to promote the sector. In recent quarters there have also been a number of decrees, both from the President and the Council of Ministers, which could also prove beneficial if they are implemented effectively. These include the presidential proposal, announced in July 2003 and enacted in November, to reduce the number of activities subject to licensing (from 165 to 49). In addition following a Resolution in December 2003 to Stimulate Business Development, the government announced other measures to promote the private sector including lower rent payments as well as tax holidays for small businesses.

Despite these measures the SME sector as a whole continues to suffer from excess regulation and arbitrary state interference. The introduction of restrictions on the numbers who may be employed by individual businessmen is an example of the latter. The main challenge is to reduce the burden of regulation, especially of licensing, given that a viable private sector depends on the ease of entry and exit. Among the most frequent comments of the Associations of small businesses in Belarus are the number of licensing requirements, the complex procedures and the fact that regulations frequently conflict with other legislation. The recent presidential decree on licensing is intended not only to reduce the number of activities requiring license, but also to streamline and simplify the process. How well the authorities implement the Decree is likely to have an important bearing on the growth of the sector.

Business Environment

The EBRD has conducted two surveys of the business environment among its countries of operation, in 1999 and in 2002³. According to the most recent survey, there was some improvement in the business environment in Belarus over this period, in common with most other countries. In 2002 the perception of the business environment was that it was better than in Ukraine, similar to that of Russia, but worse than the average of the Central European Countries. The burden of taxation was identified as the main constraint for most companies, while there were also concerns over the extent of regulation and the limited availability of sources of financing.

The conclusions were generally consistent with other assessments. For example the World Bank Group has conducted annual surveys of the regulatory environment for business in Belarus since 2001, covering some 600 enterprises, both state and private. Preliminary results from the latest surveys indicate that while there have been some improvements in licensing procedures, they remain a burden in terms of the time and cost; the tax burden is heavy, both with respect to the number of taxes that have to be paid and the internal arrangements that are required to meet the requirements of the tax inspections while the number and duration of official inspections in general increased significantly in 2003. The results indicate those areas where the authorities should concentrate their efforts to improve the business environment to stimulate the growth of the private sector.

Banking sector

A key challenge is to strengthen the sector. The banking sector is small and the six largest banks (four of which are mainly state controlled) remain prone to requests from government to provide credits to support loss making industrial and agricultural enterprises. The maintenance of the state's controlling stake in these banks (Belarusbank, Belagroprombank, Belpromstroibank and Belinvestbank) is a feature of the "Concept for the Development of the Banking System of Belarus, 2001-10", approved and implemented in mid-2002. According to the authorities, the rationale for these controlling stakes reflects the government's desire to ensure the banking sector guarantees deposit safety, and provides loans and other banking services to the population, and also provides strong financial support to industrial and agricultural enterprises, in support of the expansion of investment activities in Belarus.

Strengthening the sector could be achieved through a continuation of the current work by the National Bank of Belarus (NBB) to improve the implementation of supervisory policy, less state interference and a readiness to allow foreign banks to increase their operations in Belarus. Although the share of foreign banks in total bank capital at 7.5 per cent is well below the current limit of 25 per cent, greater participation by foreign banks is likely to strengthen the sector overall, both with respect to capital and lending operations, as has been found in many other transition countries.

Among the positive developments has been the acquisition of a majority stake in Priorbank, the largest private bank in Belarus and one of the main lenders to the private sector, by Raiffeisenbank at the end of 2002. The National Bank of Belarus has also continued to strengthen its supervisory policies, for example with the approval of new standards for financial accounting, intended to follow international standards, in October 2003. However, against a background of strong credit growth – over 50 per cent during the past year, there are a number

³ See the results of the Business Environment and Enterprise Performance Surveys in EBRD Transition Reports of 1999 and 2002. The number of firms included in the surveys in Belarus was 132 in 1999 and 250 in 2002.

of concerns. These include the decision to renationalise one of the larger banks (so that at least four main banks will remain in the public sector until 2010); a resolution from the Council of Ministers earlier this year that the main banks provide BYR 1.5 trillion of financing to enterprises in the real sector (as in 2003); and the “recommendation” from the NBB that commercial banks apply interest rates caps for lending to major enterprises.

The risks of such an approach include the serious distortions that are likely to arise in the allocation of credit, with loss-making large state-controlled enterprises benefiting at the expense of entities in the private sector. There are also implications for the overall credit quality of the loan portfolios of the main banks, while the provision of readily available credits to the enterprise sector inhibits the adjustment that is required for macro-economic reasons should the authorities seek to tighten fiscal policy. Overall, therefore the scale of lending to an unreformed enterprise sector almost certainly increases the risks for the banking sector.

The reduction in the rate of inflation during the first five months of the year has enabled the NBB to reduce the Refinancing rate to 22 per cent by end-May, which in turn has led to some reduction in interest rates more generally. In addition, a resolution of the NBB in February 2004 recommended to the banks, as a temporary measure, that the average interest rate on new credits in domestic currency should not exceed the level of the average monthly refinancing rate by more than three percentage points, and that the rate of interest on loans in foreign currency should also be lowered.

2.3 Access to Capital and Investment Requirements

Belarus’ financing and investment requirements are large, reflecting the limited extent of enterprise restructuring and the need to upgrade the infrastructure. However, external sources of financing have remained very limited. The failure to agree a programme with the IMF has meant there has been no IMF funding since the first tranche of the SBA was disbursed in December 1995. The result of the most recent Article IV mission in February 2004 was a statement by the authorities withdrawing their request for further negotiations on an SBA programme. In the absence of financial assistance, further co-operation with the IMF would concentrate mainly on technical assistance in a number of areas, including monetary policy and banking. Following the cancellation of a number of World Bank projects, lending from the World Bank group is also limited, although the IFC approved a loan for the banking sector towards the end of 2003. With the exception of the Russian government and Russian central bank, financial assistance from other bilateral donors remains at modest levels. However, the future volume of lending from official Russian sources is likely to be dependent on progress in resolving the various bilateral issues including gas supplies, Beltransgaz privatisation and monetary union.

To meet its own funding requirements this year the government will continue to borrow on domestic markets. It is also giving serious consideration to a bond issue on the Russian market. As the NBB has ceased to extend credit to the government from the beginning of 2004, state securities remain the main source of financing the budget deficit. Some consideration has also been given to the possibility of issuing a Eurobond, but a credit rating would first have to be obtained while the absence of an IMF programme would most likely mean that the terms of any issue would be less attractive than they might otherwise be, especially in view of the limited foreign exchange cover (less than one month of imports). Although the main external debt indicators are at low levels, indicating there is room to take on more external debt, the terms of any such debt issue (interest rate and maturity) will be crucial in view of the persistence of the fiscal and external deficits.

Belarus has attracted FDI in recent years, although much of this is accounted for by Russian contributions to the financing of the Yamal gas pipeline. After modest net FDI flows in both 2000 and 2001, net FDI amounted to US\$ 434 million in 2002, of which almost half was

accounted for by the sale of the government's stake in Slavneft. Gross flows of FDI were high in 2003, but were accompanied by large outflows so that net FDI was just US\$ 169 million. In 2003 the stock of net FDI (from 1989) was estimated at almost US\$ 2 billion, equivalent to US\$200 per head over this period. This is below the average for the CIS (of US\$ 290 million) and well below the average for the entire region (US\$830 million).

The prospects for a sustained increase in FDI depend on progress in privatisation and improving the business environment, as described above. A new Investment Code was adopted by the parliament in 2001 which provides the legal basis for foreign investment in Belarus. Amendments are currently under consideration to clarify aspects of the Code, including of the tax treatment for enterprises with foreign investment. In May 2002 the government announced a programme to boost FDI, mainly by lowering licensing requirements and simplifying tax regulations. Progress has also been made with the establishment of the Foreign Investment Advisory Council (FIAC) which has made a number of recommendations to improve the business environment to stimulate more investment from both domestic and foreign sources.

There may also be an opportunity to increase FDI flows as enlargement of the EU encourages some investors to consider investing in lower wage economies. However, one specific issue, which acts as a deterrent to potential foreign investors as well as domestic private investors, is the existence of the Golden Share, which was first introduced in November 1997. This measure allows the government to intervene in the decision making of any company in which the state had a stake, including the right to apply a veto in issues concerning the possible re-organisation and closure of a company. Although in practice it has only been applied in a few cases, the advice from both the IFIs and the FIAC has been consistent – that the measure should be abolished if Belarus wants to attract more FDI.

It is therefore of considerable concern that a Presidential Decree of March 2004 (to take effect in three months) has extended rather than abolished the concept of the Golden Share. The decree extends the application of the share to any company (including one wholly owned by private investors), which was once owned by the state and created as a result of privatisation or transformation into a joint stock company. Furthermore, the reasons for establishing a golden share are not that precise, ranging from a failure to pay wages for three consecutive months to more general concerns regarding the strategic interests of the state. In addition there is no limit to the duration of the golden share so that the state has the potential to exert considerable control over any company to which the golden share is applied.

2.4 The Economic Benchmarks

Four economic benchmarks were included in the 2002 strategy paper for determining whether the EBRD could move beyond the baseline scenario in its operations. The EBRD's assessment is that only moderate progress has been made towards meeting these benchmarks (although some progress has been made in other areas not covered by these particular benchmarks). The rationale is as follows:-

Phasing out administrative interventions in the economy, particularly artificial restrictions on business:

- The above review, supported by results of some business surveys, indicate that the extent of price control, regulation and intervention remain considerable. Some recent measures are encouraging, including the decrees to limit the number of activities subject to licensing and to promote business development, but it remains too early to assess their impact.

Acceleration of the denationalisation and privatisation process

- Progress has been made with both small-scale privatisation and with the policy of transforming former state owned enterprises into joint stock companies. However, the number of large-size entities which have been privatised, especially those where

a majority of the shares have been sold, remains very limited. This is especially true after the failure to sell stakes in the four petrochemical companies as well as the delays in approving the draft law on large scale privatisation in 2003.

Progress in securing property rights and improving corporate governance:

- There appears to have been very little progress in improving property rights in general. Evidence from OGC's 2002 Legal Indicator Survey, based on assessments from local law firms, described the bankruptcy law as "inadequate" (and the recent changes to the law are thought unlikely to have altered this assessment) while their perception of capital markets regulations was that they were "weakly conforming". More recent assessments of the compliance of corporate governance law and insolvency law in all the EBRD's countries of operation, conducted by OGC in 2003, placed Belarus in the category of countries described as "very low compliance" for corporate governance and "low" compliance for insolvency.

Transparency in the management of the Presidents' Fund:

- The President's Fund is included in each annual budget and for these purposes is treated no differently than any other item of government expenditure. In this sense this objective has been met. There are some suggestions that other Presidential funds exist, but there is no hard evidence that these funds exist.

3. STRATEGIC ORIENTATIONS

3.1 The Bank's Priorities for the Strategy Period

For the past several years, the Bank's activities in Belarus have been limited for reasons related to the Bank's Article 1 concerns and due to the natural constraints imposed by Belarus' slow progress in transition. In the strategy period, the Bank will remain engaged in Belarus and offer, as appropriate, a range of Bank operations. The future operational programme will depend largely on the government's concrete actions to promote the transition to a democratic, pluralistic society and market economy. In light of the concerns with Belarus' record on political and economic reform, the Bank proposes a graduated response to progress in transition in Belarus based on three alternative scenarios, referred to as a **Baseline**, an **Intermediate** and a **Regular** scenario. This scenario approach makes the degree of the Bank's engagement in the country dependent on the actions taken by the Belarus authorities and their demonstrated willingness to deliver verifiable improvements in the political and economic spheres.

If conditions remain as they are at present, with no significant improvement in reaching political and economic transition milestones, the Bank will concentrate on implementation of existing projects and new lending will be focused on private sector development only.

Accordingly, in the coming Strategy period the Bank will focus on the following priorities under the Baseline Scenario:

- Portfolio management of existing investments in Belarus, including continued support to SMEs/MSEs through the existing sovereign SME Line of Credit approved in 1994 (which is fully committed and under which reflows are limited);
- Advisory services to SMEs via the Bank's TurnAround Management (TAM) and the Business Advisory (BAS) programmes, provided funding from donors will be made available;

- Selective direct investments in local and foreign private companies, including through the Direct Investment Facility (DIF) programme; and
- Expansion of the trade facilitation programme to additional bona fide private banks.
- In accordance with the need to support private SMEs and MSEs, Foreign Direct Investment, as well as competition in the financial sector, the Bank will consider providing SME/MSE credit lines directly to individual private banks, and equity investments in private banks, together with related technical assistance, when the investments are small, and particularly if this can be done alongside reputable international strategic investors, and the State has no control, including veto power over decision making.

The extent to which the Bank can put in place the types of transactions envisioned above will hinge on the overall investment climate in the country. With the objective of helping the authorities to improve the business environment and strengthen the financial sector, including identifying key obstacles faced in these areas, the Bank will continue to cooperate actively with the authorities through policy dialogue, including participation in the Foreign Investors' Advisory Council (FIAC).

If Belarus were to make significant progress in transition towards democracy and a market economy, then the Bank would be in a position to conduct a broader range of operations as envisaged in the **Intermediate Scenario**. As in the previous Strategy, the Bank will employ a number of benchmarks that have been agreed by the international community in gauging progress in political and economic reforms.

a) **Political benchmarks.** The United Nations Commission on Human Rights and institutions within the OSCE, European Union and Council of Europe have all stressed the need for tangible evidence of progress in the following areas:

- Preservation of the right to freedom of expression and freedom of media;
- Non discrimination against political opponents and the introduction of confidence-building measures, to include a full and impartial investigation in the cases of forced disappearance of several political opponents, in conformity with the country's commitments under the International Covenant on Civil and Political Rights; and
- Compliance with the country's OSCE commitments under the 1990 Copenhagen Document for free, fair, equal, accountable and transparent elections. The upcoming parliamentary elections provide a clear opportunity for the current leadership in Belarus to demonstrate the political will needed to implement these commitments.

b) **Economic benchmarks.** Business cannot function efficiently unless measures to dismantle the over-centralised system of economic management are in place. The Bank, together with the IMF and the World Bank, stresses the importance of:

- Phasing out administrative interventions in the economy, particularly artificial restrictions on business;
- Acceleration of the denationalisation and privatisation processes;
- Putting in place measures to secure property rights and improve corporate governance.

Should evidence of significant progress emerge in these domains, the resultant improved investment climate would allow the Bank to consider, on a project-by-project basis and in consultation with the Board of Directors, further involvement in the Belarus economy.

The main operational priorities of this Intermediate Scenario could include:

- Participation in privatisation support for local private companies and foreign strategic investors, provided it can be shown that the proposed investments are not effectively controlled by the state or state entities and government officials will not personally benefit financially from such investments;
- Contribution to the commercialisation and privatisation of public utilities and services limited to provision of technical assistance;
- Encouragement of the privatisation and consolidation of state banks through the provision of technical assistance and very selective financing to the privatised banks.

If transition in Belarus were to proceed to the point that Belarus' commitment to democratic principles is demonstrably achieved and the domestic economy does not place constraints on EBRD activities in the country, the Bank would engage with Belarus according to a Regular Scenario with the normal range of its operations. In this case, the EBRD would be able to deploy the full range of its investment and lending facilities in Belarus, including financing for public sector projects and private-public partnerships.

The Bank will continue to carefully monitor the political and economic situation in Belarus, and if the conditions for this Regular Scenario emerge, the Bank will propose a new Strategy for approval by the Board of Directors.

Given EBRD's limited and potential investment portfolio in the country, the Bank's environmental focus remains on providing support and guidance on environmental, health and safety issues and environmental monitoring on existing projects. All future projects will undergo the environmental due diligence process to ensure full compliance with the Bank's Environmental Policy and Procedures.

3.2 Sectoral Challenges and Bank Objectives

3.2.1 Private sector development and support for SMEs/MSEs

In Belarus, the private sector accounts for one of the lowest shares of GDP and employment among all the transition economies. The Bank's relatively positive experience with the Belarus SME Line of Credit and other financing of private sector enterprises, illustrates the potential for SME/MSE development in the Belarus economy. Enterprise owners have demonstrated strong entrepreneurial skills and ability to operate efficiently in the difficult environment, although limited access to finance, vulnerability when dealing with the regulatory authorities and poor access to information impose serious constraints on developing their businesses.

The Bank has financed, under the Belarus SME Credit Line, via local partner banks, over 77 SMEs and 1,100 MSEs. More than USD 50 million has been disbursed to local companies overall. The syndicated facility for USD 36 million to Priorbank (arranged by EBRD), signed in September 2003 (EBRD commitment USD 12 million) is fully disbursed. As of end of April 2004, 64 sub-projects had been approved for USD 34.2 million. The Bank also has an on-going successful equity investment in Milavitsa, a women's lingerie manufacturer. The experience with the Belarus SME Line of Credit has helped identify impediments to efficient SME/MSE lending and encouraged the National Bank of Belarus and the Government to intensify concrete regulatory changes. The Bank joined the Foreign Investment Advisory Council (FIAC) at the end

of 2002, and has been actively participating in its work, focusing in particular on issues such as: phasing out administrative intervention in the economy, particularly artificial restrictions to business; elimination of the “golden share”; streamlining excessive licensing procedures; streamlining and efficient application of commercial legislation; elimination of restrictions on profitability, on pay scales, on maximum salaries, production quotas for domestic markets; and acceleration of the privatisation process.

Financing of private enterprise, particularly SMEs/MSEs, via eligible private financial intermediaries will remain an operational priority of the Bank under the Baseline Scenario. The Bank will continue to focus on the development of the SME and micro-enterprise sector as well as privatised or new firms, local or with foreign partners (including cross-border FDI). The main transition goals pursued by the Bank will be:

- to support the development of the SMEs and MSEs and thereby help the growth of the middle class;
- to provide objective feedback to the authorities on the status of the investment climate and the Bank’s views on preconditions for private sector development;
- to create an efficient working relationship with those NGOs representing the interests of private sector market participants.

Under the Baseline and Intermediate scenarios, the Bank will primarily focus on the following activities:

- lending through private banks to SMEs and MSEs;
- support restructuring, management and training needs of private SMEs and micro-enterprises through the Turnaround Management Programme (TAM) and BAS;
- seek to attract and support strategic investors by providing debt and/or equity financing to industrial private sector enterprises. Opportunities are likely limited but may be found in wood processing, agribusiness, ceramics, light industry packaging, services and machine building;
- carefully select private equity financing to SMEs through the Direct Investment Facility.

The Bank is currently considering a lending framework to Belarus private banks, which would not rely on sovereign guarantees, in order to reach out to SMEs, MSEs and individual entrepreneurs, including those who never previously had a bank account/used banking products. It is also planned to replace over time the existing sovereign SME Line of Credit, as well as to restrict in the interim any reflows to support of MSEs.

The Bank is currently considering one potential candidate for DIF and will continue looking for other opportunities for debt financing and investment, including via DIF, in the Belarus private sector. This can include small energy sector projects in the private sector, which are not substantially dependent on the state. The Bank also attaches great importance to policy dialogue on the investment climate within FIAC and will continue to participate in its activities.

The Bank has recently received from the authorities two sets of enterprise lists: i) companies planned for corporatisation and privatisation in 2004, and ii) open joint stock companies, both state and private sector controlled, whose shares are offered for sale to the EBRD. With regard to the former, most companies included could benefit, following privatisation, and subject to sound banking criteria, from the new SME Facility currently under consideration. With regard to the latter, under the Baseline Scenario, the Bank will not be in a position to purchase shares of the government in local enterprises. Some of these enterprises could potentially be considered for debt financing once these have been privatised. However, insofar as all the above enterprises

are concerned, the issue of potential application of the golden share would first need to be resolved.

3.2.2 Financial sector

Despite the small number of eligible private banks, the Bank's experience with two of these, Priorbank and Belgazprombank, has been successful, particularly in terms of financing of SMEs and MSEs. The Bank is actively seeking other private banks as channels to meet the demand for financing from the private sector, and increase competition in the banking sector.

The existing sovereign SME Line of Credit, or "SME I" (USD 30.0 million in two equal tranches) was signed in 1994 with an aim to support Belarusian SMEs and to strengthen a core group of commercial banks, particularly in developing their credit skills. The line is channelled through the National Bank of Belarus (NBB). It currently has a final maturity date of 2012. Both tranches were disbursed and the first tranche, USD 15 million, was prepaid in 2000 after the Russian financial crisis. SME I is co-financed in an amount of USD 7.5 million by ICDF. The amount outstanding under the second tranche was USD 6.4 million as of 31 March 2004. Five banks have been accredited under the SME Line of Credit and have benefited from technical assistance accompanying the project. Currently only Priorbank and Belgazprombank remain eligible for borrowing from the recycling account. The use of proceeds available under the SME I was expanded to allow for MSE finance in 2001 and for leasing/working capital finance in 2002.

Technical assistance provided to the local banks and the NBB under the SME I initially included assistance to the participating banks in the areas of institutional building, such as credit and related procedures, asset/liability management, accounting and staff training; and to the NBB in establishing the Project Management Unit (PMU) responsible for the Project's overall accounting and monitoring. The technical assistance was financed under the TACIS Programme (total of ECU 1.5 million over 1994-1996); further financing was provided by the Taipei-China (total USD 540,000 over 1996-2003) as well as by the Republic of Belarus and participating banks (ECU 400,000).

Through its equity participation in Priorbank since 1998, the Bank has played a major role in strengthening and restructuring the bank. At the end of 2002, Raiffeisen Zentralbank Österreich AG ("RZB") through its wholly owned subsidiary Raiffeisen International Beteiligungs AG ("RIB") acquired 50% of Prior's capital via a capital increase of EUR 30.6 million thus becoming Prior's main investor after EBRD with its 13.5% (diluted from 27% prior to the capital increase). Under Belarus legislation, RZB made a public offer to all minority shareholders at the capital increase subscription price per share which further increased RZB shareholding in Priorbank to over 61%. Following RZB's investment, Priorbank has become the leading private bank in Belarus, in terms of corporate services, its financial position and its management quality.

EBRD then arranged in 2003 the first international loan syndication for a Belarusian borrower in a transaction that channelled USD 36 million to Priorbank to provide urgently needed short- and medium-term loans to the private sector in Belarus. This also represented the first financing to a Belarusian commercial bank on a stand alone basis (without recourse to the state). The syndicated portion was provided by banks from Austria, Germany, Portugal and Russia. The funds have been fully disbursed to Priorbank.

The Trade Facilitation Programme (TFP) with two local banks, Priorbank and Belvnesheconombank, was signed in January and March 2000, but is currently only active with the former. The programme aims to maintain and increase foreign trade within the EBRD's countries of operations and with the West and to provide liquidity to the trade system. The project has an impact on the transition through institution building within client banks,

demonstrating new ways of financing trade, new products and processes, and developing skills in the country. In 2003 the EBRD increased the limit on its Trade Facilitation Programme (TFP) facility with Priorbank to USD 12 million.

In 2003, the EBRD carried out an extensive environmental monitoring visit, which comprised site visits to a number of the financial intermediaries' subprojects and environmental training/discussions with the clients' personnel in charge. The projects' environmental performance, including compliance with the applicable national environmental, health and safety regulation, adherence to EBRD's Environmental Exclusion List and submission of annual environmental reports to the Bank, has been fully satisfactory.

Over the last two years, there have been areas of progress in the banking sector. The most notable has been the majority investment in Priorbank (see above) by a reputable international strategic investor, RZB of Austria. Policy dialogue with the NBB and the central government has yielded some progress in terms of elimination of barriers to MSE lending. At the same time the banking system continues to be dominated by state owned largely unreformed banks. Belpromstroybank was renationalised in 2003, and the authorities have postponed the privatisation of four large banks to 2010. The golden share issue is also not resolved.

In light of the above, the key transition goals for the Bank are:

- to stay engaged in the sector and to help safeguard further reform to encourage a competitive and sound banking sector, which commands the confidence of the population and meets the needs of the real economy;
- to focus on institutional strengthening by supporting the better private banks in the country; and
- to continue with projects designed to enhance the intermediation of selected banks with the goal of increasing the sector's capacity and developing new credit delivery vehicles to meet the financing needs of micro, small and medium sized enterprises and the emerging private sector in general.

Under the Baseline Scenario, financing of SMEs/MSEs via eligible private financial intermediaries will remain an operational priority of the Bank. The Bank will also seek to increase competition among eligible private sector banks in the sector. The Bank could also give consideration to the establishment of an MSE financing bank, if it excludes state participation and if sufficient equity capital and funding can be mobilised as well as the technical assistance that may be needed, although preference will be given to channelling MSE funding via private local commercial banks. The Bank will continue working to identify new eligible partners for TFP. Equity investments in private banks could be considered, particularly alongside quality international strategic investors, as long as the State has no control, including veto power, over decision making. Finally, mortgage financing may be given consideration, although exposure levels to individual eligible private banks, the needs for SME/MSE lending and the regulatory framework may constrain EBRD's activity in the sub-sector.

The Bank is currently considering a new lending framework for SMEs and MSEs via Belarus private banks to be provided on a stand-alone basis (without state guarantees in an amount to be potentially supplemented by cofinancing from IFC). This framework would also replace over time the existing SME I facility which is a sovereign loan, thus reducing the exposure of the state in EBRD financed operations, while restricting further use of reflows under the latter to MSEs.

While currently there are very few potential private banks that could be eligible for EBRD financing, the Bank will continue to actively seek new potential partners. Apart from one larger

bank, the new partners for the EBRD are likely to be in the group of smaller banks. Some of these banks have recently started to work more actively with private SMEs/MSEs and expressed interest in cooperation with the EBRD. Privatisation of four state-owned banks was postponed by the authorities to 2010; therefore cooperation with Belarusbank, Belagroprombank, Belinvestbank and Belpromstroybank (renationalised in 2003) will not be possible in the near future. In the medium size banks group all banks, but Belgazprombank, do not meet EBRD criteria due to the state control in some of them, high concentration of assets/liabilities, integrity issues, or overall financial position.

The new credit lines to local banks will require technical assistance, particularly for institutional strengthening in new participating banks and as well as credit training and streamlining of procedures for MSE lending in new participating banks. Despite the scarcity of available grant funds from donors, the Bank will continue to explore various sources of funding and will also consider partial funding where feasible from the participating banks themselves.

Under the Intermediate Scenario, the Bank may consider encouragement of privatisation and consolidation of state banks through the provision of technical assistance and very selective financing to the privatised banks.

3.2.3 Public Utilities and Services

Since independence, capital investment in infrastructure, public utilities and services has been minimal primarily as a result of lack of structural reform, which has curtailed investment flows. The breakdown of the operating norms under the traditional system and the growth of arrears have not only stifled investment, but also reduced revenues to a fraction of the requirements needed for sustainable operations, resulting in a deterioration of both operating service and infrastructure itself. The major transition challenge over the next several years will be to ensure genuine restructuring to eliminate capital and operating inefficiencies and to promote long-term sustainability of operations in this sector.

The Bank's main transition goals in the infrastructure sector will be oriented toward:

- Policy dialogue to assist in preparing a framework for commercialisation, increased private sector participation, regulatory reform, and other structural reform of utilities and services traditionally operated by the state or municipalities; and
- Modernisation and improvement of efficiency and. Where feasible, involvement of the private sector.

In the Baseline scenario the Bank will achieve these transition goals through the management of the existing portfolio. Under the Intermediate scenario, technical assistance will be provided to prepare for structural reforms.

4 CO-OPERATION WITH IFIs AND OTHER INTERNATIONAL ORGANISATIONS

The Bank cooperates closely with the other IFIs. In particular, cofinancing is planned with the IFC in the context of the SME/MSE lending framework for private banks currently under preparation. The Bank cooperates closely with the IFC on investment climate issues considered in the FIAC. There are close consultations with the IMF and the World Bank on issues pertaining to assessments of economic developments and reform.

IMF: The IMF and the Belarusian authorities have long disagreed about appropriate macroeconomic policies and the assumptions underlying them, and thus the Fund has made no

disbursements to Belarus since late 1995. A Staff Monitored Programme was implemented during 2001. The results were mixed and there was no agreement as to whether the outcome warranted a resumption of financing. During the Article IV consultations in early 2004, the authorities withdrew their long-standing request for discussions on a stand-by arrangement. Foreign exchange liberalisation, modest disinflation and increased energy sector cost recovery levels have been welcomed by the IMF. However, it has indicated that wage policies remain unsustainable, quasi-fiscal activities are widespread and structural reforms have stalled. The IMF considers the authorities' macroeconomic projections for 2004, including GDP growth of 9-10 percent, to be unrealistic. At the same time, the authorities have shown a keen interest in technical cooperation with the IMF. Recent technical assistance missions have advised the Belarusian authorities on monetary and exchange rate management, tax policy, technical aspects of currency unions, and balance of payments statistics. The authorities have also announced their intention to subscribe to the IMF's Special Data Dissemination Standard (SDDS).

IBRD: In the context of its March 2002 Country Assistance Strategy (CAS) covering 2002-2004, IBRD has been focusing on the preparation of the following lending projects:

- a) The TB/AIDS project which has been under preparation since 2000 was recently withdrawn by the authorities, just prior to loan negotiations, leading to IBRD suspending preparation of the proposed Post Chernobyl Recovery Project until the authorities' commitment to that project would be confirmed.
- b) Post Chernobyl Recovery project – still in preparatory stage; preparation temporarily suspended per a) above.
- c) Social Assistance (learning and innovation loan) – rejected by the authorities.

IBRD is now planning an evaluation of the CAS as a backdrop for a new country strategy. In addition to continued IFC activities, the authorities have indicated that they prioritise the Chernobyl and environmental projects, and would like to continue dialogue on social sector reforms. (More information is contained in Annex 6).

IFC: The IFC has been providing various technical assistance to the private sector; recently the IFC extended a US\$14 million to Priorbank. IFC is considering further lending operations for SME/MSE through a local private bank as well as, reportedly, a few selected investments into private sector enterprises.

United Nations Development Programme (UNDP): The UNDP's Second Country Co-operation Framework (CCF) for Belarus (2001-2004) was approved in early 2001. The CCF is focused in two interrelated and mutually reinforcing programme areas: economic development through strengthening democratic governance, and environmental conservation and management.

Taking into account that by the end of 2003 UNDP's programme priorities in Belarus had not changed, it was agreed with the government in early 2004 that the current CCF would be extended for one year. The resource mobilisation target for 2001-2004 is USD 9.3 million, of which USD 8 million had been mobilised as of May 2004. The target for 2005 is USD 3.0 million.

The projects implemented by UNDP in Belarus address a wide range of problem in the spheres of civil society development, poverty reduction, business development, energy and environment, information and communication technologies, Chernobyl and trans-boundary cooperation.

EU-TACIS: In 2000-2003 two National programmes for Belarus were approved for an area of co-operation that was limited to Institutional, Legal and Administrative reform. Within this area

of co-operation, TACIS will concentrate its activities in particular on the support to civil society, to assistance in the fields of education and training and in the field related to the Chernobyl catastrophe. The overall allocation for the years 2000-2003 is EUR 11 million. The Commission has recently approved a Country Strategy Paper / National Indicative Programme on TACIS assistance for the period of 2005-06. The document foresees EUR 10 million for support to civil society and democratisation, higher education and alleviation of problems related to the Chernobyl catastrophe. The assistance planning is in line with the General Affairs Council Conclusions of 1997, which set restrictions on EU assistance to Belarus.

In addition, Cross Border Co-operation continues to operate in Belarus especially in the field of environment, and projects to upgrade border posts in the Brest area (EUR 16 million) and to demarcate the border between Belarus and Latvia (EUR 2.0 million) are now being initiated.

Under the regional and nuclear safety programmes Belarus has participated in an environmental project (EUR 5 million) and Chernobyl related projects (Belarus' share about EUR 3.8 million). In the area of Justice and Home Affairs, Belarus has received support for improving border management (1997 budget, EUR 0.45 million and 2001 budget, EUR 3.5 million). In 2003, additional EUR 9 million have been allocated for strengthening border management in Belarus. A project against trafficking in women (2000 budget, EUR 0.9 million) is under implementation as well as a project to combat drug trafficking (2001+2002 budgets, EUR 1.5 million). In addition, a project to strengthen the asylum system in Belarus (2002, EUR 0.365 million) is foreseen.

Political Assessment

Compliance with Article 1

The Bank remains seriously concerned about the slow pace of transition to democracy and market economy in Belarus. During the last Country Strategy period there has been only limited progress in the authorities' commitment to, and application of, principles of multi-party democracy, pluralism and market economics in accordance with Article 1 of the Agreement Establishing the Bank. In some areas there has been backtracking.

Political Accountability

According to the present constitution, the President of Belarus holds a wide range of powers, including the right to appoint and dismiss most key political and judicial officials and the right to issue decrees. Checks and balances on executive power are weak. The parliament has limited statutory powers, and in practice is dominated by forces loyal to the president. The judiciary is independent, according to the constitution, however in practice the courts have been accused of political bias by international rights monitors. According to an opinion rendered by the European Union's Venice Commission in 2003, many provisions in the constitution "fail to respect the traditional notion of separation of executive, legislative and judicial powers." A delegation from the EBRD's Board of Directors visited Minsk in May 2004 and reported that the President's administration is chiefly responsible for setting policy and resolving ideological and political matters, which are then carried out by the Government. Presidential decrees, the report noted, cover a wide range of issue-areas and contribute to an unpredictable policy environment.

Starting with the 1996 national referendum, elections in Belarus have not met OSCE commitments for democratic elections and Council of Europe standards. The electoral code currently in force was adopted in February 2000 and then amended in June 2000, following several rounds of consultations with experts from the OSCE Office of Democratic Institutions and Human Rights (ODIHR). However, even following these amendments, an OSCE/ODIHR assessment made in Warsaw in July 2000 concluded that "the Electoral Code fails to ensure democratic elections in Belarus." The main issues outstanding relate to problems with transparency in the ballot counting process, the procedures for forming central and local election commissions, excessive campaign regulations, and provisions for early and mobile voting. According to the authorities, some of the provisions recommended by international experts were contrary to the Belarusian Constitution or fell outside the purview of the Electoral Code. The Code currently in force corresponds to the "Convention on standards for democratic elections, electoral rights and freedoms of the member states of the CIS." Observers from the CIS countries have tended to view electoral processes in Belarus more favourably. After his visit to Belarus in June 2004, the OSCE Chairman-in-Office issued a press release which, among other things, urged the authorities to "interpret and implement the Electoral Code in a way that allows for genuinely democratic elections."

Although there have been discussions between ODIHR officials and the authorities in Belarus on reforming electoral legislation, no progress has been made to date. Some Belarusian authorities insist that the existing code fully corresponds to international standards for democratic elections, while others blame the absence of reform on the slow response of international experts to their requests for technical assistance. A small group of legislators in the House of Representatives, known as "Respublika", proposed a debate on the Electoral Code which was resisted by the parliamentary leadership. In June 2004, three members of this group went on hunger strike to protest the leadership's unwillingness to put Respublika's draft bill on amending the Electoral Code on the parliamentary agenda. They remained on strike for nearly

three weeks, attracting attention from various domestic sympathisers and from the international community. The strike ended on 22 June, when the House of Representatives agreed to debate the draft bill, which was rejected with 71 votes against and 8 in favour. On 1 July, the leader of Respublika, Valery Frolov, was attacked by unknown assailants and his briefcase stolen immediately following his return from a visit to Moscow.

The local elections held in March 2003 suffered from some of the same shortcomings evident in earlier elections. Opposition groups and independent NGOs complained of their lack of access to seats on district election commissions, rejection of registration requests from some opposition candidates and last-minute removal of others, harassment of opposition parties and restrictions on their campaign activities, limiting opposition access to mass media, and manipulation of the early voting procedures, and falsification of election results in some districts. 25,805 candidates were registered by the Central Election Commission (CEC) for 24,012 seats in the local Councils of Deputies, meaning that in more than 90% of the districts a Government-sponsored candidate ran unopposed. ODIHR did not formally observe the election, but the OSCE office in Minsk did organise a small team of experts to monitor the campaign. The brief report noted some positive aspects of the election, including high turnout, but also referred with concern to the unusually high number of votes cast in the early voting period – 20 percent – which left the door open for ballot manipulation, and the fact that five opposition candidates in the Minsk area had their candidacies withdrawn after early voting had already begun.

At the time of the last presidential election in September 2001, despite the critical assessment of the conduct of the election, the international community welcomed the active participation of civil society groups in the electoral process and the emergence of greater political pluralism in Belarus. While these groups continue to function and a political opposition continues to exist, several have come under increasing strain in the past Strategy period in large part due to Government-sponsored harassment. More than fifty NGOs were closed in the past year alone, some as a result of miniscule technical violations. Two groups that played a leading role in monitoring recent elections – the Belarusian Helsinki Committee and the Human Rights Centre “Viasna” – came under especially heavy pressure. “Viasna” was charged by the Ministry of Justice with various infractions in 2003 and finally liquidated by Supreme Court order in October because of violations linked to their observation of the presidential election in 2001. In March 2004, the Belarusian Helsinki Committee was charged with tax evasion on proceeds from EU grants under the TACIS programme dating back to 1995. The Committee maintained that TACIS grants are tax-exempt under Belarusian law, but the tax authorities demanded back taxes and penalties of 155 million rubles (US\$ 73,000). In a move that was welcomed by NGOs and the international community, the Minsk Economic Court in July 2004 ruled in the Helsinki Committee’s favour and ordered the Tax Ministry to pay 190,000 rubles to compensate for the Committee’s legal expenses.

It has been encouraging to see the formation of a small but vocal group of independent legislators in the House of Representatives, known as “Respublika”, take up important reform initiatives and foster debate in the legislature. Similarly, the opposition, which boycotted the last parliamentary election in 2000, has begun to form electoral blocs in the run-up to the parliamentary election due to be held in October 2004. One such group is the Popular Coalition Plus Five, a bloc of opposition parties and like-minded NGOs formed to contest the upcoming parliamentary election on a pro-reform platform. Another opposition bloc called European Coalition Free Belarus promotes the idea of deeper European integration and cooperation with the European Union. Nevertheless, the opposition remains on the fringes of political discourse, partly due to their past inability to organise and coalesce behind a core group of leaders, but also due to their limited access to the media, legal constraints on their ability to organise meetings and demonstrations, restrictions in the Electoral Code (as noted above) and harassment by the authorities.

In June 2003, the Belarusian House of Representatives approved implementing legislation for a Presidential decree that allows the authorities to ban a political party, trade union or other organisation if it is guilty of a single violation of the law during a rally. In March 2004, the Prosecutor General's Office opened a criminal case against a prominent opposition leader, Anatoly Lebedko of the United Civic Party, on charges of slander of President Lukashenko. If convicted, he could face a five year prison term. In May 2004, Mikhail Marynich, a former Government minister and ambassador who switched to the opposition and challenged President Lukashenko in the 2001 election, was arrested by the State Security Committee (KGB). He is charged with criminal possession of classified Government documents and firearms. When he was apprehended, he was also found with US\$ 90,000 in cash which the authorities say came from Russia and was meant to finance illegally the opposition election campaign.

The October 2004 parliamentary election is an opportunity for the Belarusian authorities to demonstrate the political will to hold free and fair democratic elections in accordance with their OSCE commitments under the Copenhagen 1990 agreements. However, the inhospitable political climate created for opposition parties and independent NGOs in the past year does not send a positive signal regarding their intentions. A documentary programme shown on Belarusian state television in May 2004, in which prominent opposition figures were linked to fascism and accused of plotting assassinations and a violent coup with foreign backing, was described as "open slander" by the OSCE head of office in Minsk. In a statement issued after the broadcast, the OSCE office interpreted the content of the programme as "a clear attempt to undermine the political opposition in the lead-up to the parliamentary election." All told, this is not conducive to creating conditions for a multiparty democracy and political pluralism.

Rule of Law

The constitution provides for an independent judiciary; however, the executive's right to appoint judges at all levels, granted under the constitutional changes introduced by referendum in 1996, raises doubts regarding the independence of the judiciary in Belarus. The President appoints six out of twelve members of the Constitutional Court, the head of the Supreme Court and the Supreme Economic Court, and all district and military judges. Judges are paid low salaries and are heavily dependent on the executive for bonuses and other perks making them susceptible to corruption on the one hand and coercion on the other. The practice of "telephone justice", by which executive and local authorities can influence decisions in trials where they have a direct interest, is believed to be widespread.

Several cases of unexplained disappearances by members of the political opposition and media in recent years have raised questions of abuse of power. The disappearances of former Minister of Internal Affairs Yury Zakharenko in May 1999, former Chairman of the 13th Supreme Soviet Viktor Gonchar and his associate Anatoly Krasovsky in September 1999 remain unresolved. The case of Russian reporter Dmitri Zavadsky, who disappeared in July 2000, led to several arrests and prosecution, but his body was never found and questions have been raised about the integrity of the investigation. In April 2004, the Parliamentary Assembly of the Council of Europe (PACE) adopted a resolution (No. 1371) calling for an independent investigation into these four cases and the resignation of the current Prosecutor General who was alleged to have orchestrated the disappearances and participated in a cover-up. The resolution, based on a January 2004 report by Christos Pourgourides, the PACE Committee on Legal Affairs and Human Rights rapporteur, also stated that the Belarusian parliament's special guest status in PACE would remain suspended until such investigations and a parliamentary committee of inquiry were launched.

The United Nations Commission on Human Rights also adopted resolutions in 2003 and April 2004 expressing its "deep concern" over credible reports implicating senior officials in the Belarusian Government in the forced disappearance of political opponents. Endorsing the Pourgourides report, the 2004 UN resolution called for an independent investigation and the

dismissal of law enforcement officers and public officials implicated in the disappearances and their alleged cover-up. The resolution insists that Belarus cooperate with various existing mechanisms of the Human Rights Commission – including the Working Group on Arbitrary Detention and the Special Rapporteur on Torture among others – and appointed a Special Rapporteur to examine the human rights situation in Belarus. The Special Rapporteur will report to the Commission on Human Rights at its 61st session in spring 2005.

The Belarusian authorities reject the allegations made in the Pourgourides report and the PACE and UN Commission resolutions, maintaining that the PACE rapporteur exceeded his mandate and made improper and politically-charged assessments. The UN resolution, they claim, is the result of pressure from the United States and the European Union rather than consensus opinion among the members of the Commission. Nevertheless, to demonstrate their cooperation with the Commission, the authorities have issued an invitation to the Working Group on Arbitrary Detention to visit Belarus in the coming year. At the same time, they have questioned both the need and the financial wisdom of appointing a Special Rapporteur on human rights conditions in Belarus.

Civil and Human Rights

The constitution as amended by the 1996 referendum guarantees all basic rights and freedoms, including freedom of speech, press, association, assembly, religion, and movement. However, rights groups report that many of these rights are not fully protected in practice.

Belarus has an independent press where the views of the political opposition are occasionally expressed, but the legal framework for the creation and maintenance of independent media remains difficult. For example, according to the current Law on Mass Media it is a punishable offence to defame the president or other senior Government officials, effectively creating a legal ground for official censorship. The law also empowers the Ministry of Information to suspend publication of a newspaper or periodical without a court ruling for 3 months and can invalidate the organisation's registration. There are more than one thousand non-state press outlets in the country and the number is growing, although the Government retains influence over all print media through its near monopoly of production and distribution networks. Internet usage is increasing in the country, which is a positive development, but the draft law on mass media (discussed below) extends its legal reach to web-based mass media and international media experts have warned that this could, if implemented, result in undue restrictions on the operation and content of both internet service providers and website publishers.

In the past Strategy period, several cases of pressure on media organisations have drawn international attention. The most recent developments in this regard were the temporary suspension of one of the country's leading private newspapers *Belaruskaya Delovaya Gazeta* over alleged repeated violations of laws regulating media activities, the temporary closure of Russia's NTV office in Minsk over a dispute concerning their coverage of the funeral of Belarusian writer Vasily Bykov, and the decision not to renew the accreditation of the Minsk office of IREX, the US media-promotion and academic exchange organisation. In April 2004, the PACE adopted a resolution on Persecution of the Press in the Republic of Belarus (No. 1372) pointing the "systematic harassment and intimidations carried out by state officials, in particular the Ministry of Information, against journalists, editors and media outlets which are critical of the President of the Republic or the Government of Belarus." In June 2004, the OSCE Representative on Freedom of Media expressed his serious concern about a decision by the State Security Committee to deport a Ukrainian journalist from the independent newspaper *Vremya* for his allegedly biased reporting on political and social developments in Belarus. The deportation was criticised for having taken place outside the judicial process and without the right of appeal. The OSCE Media Representative said the deportation was part of a pattern intended to "silence critical voices in the media."

In each of the cases noted above, the Belarusian authorities have defended their actions as consistent with the law and/or the need to protect its citizens from erroneous and harmful information from foreign sources. Nevertheless, the Government and elected officials have not shown a strong willingness to cooperate with international bodies monitoring press freedom. For example, in August 2003, the OSCE Representative on Freedom of the Media and his senior adviser were denied a visa to enter the country for consultations in the OSCE Minsk office and with independent journalists and media NGOs.

In 2003, the Government prepared amendments to the Law on Press and other Mass Media. The OSCE Representative on Freedom of the Media received a copy of the new draft law and requested an analysis from the independent NGO Article 19: Global Campaign for Free Expression. In a memorandum issued in November 2003, Article 19 noted some positive features in the draft law, including guarantees for freedom of opinion and expression and a prohibition of censorship, but on balance the memorandum emphasised the “very serious concerns” Article 19 experts have about the draft law. A number of provisions were interpreted to impose “significant restrictions on freedom of expression.” Most importantly, the system for registration, licensing and accreditation of media organisations, overseen by bodies not independent from the Government, “represents an excessive exercise of State control over the media, inconsistent with international guarantees of freedom of expression.”

It is of course important to perfect the legal framework for mass media, and to ensure that the scope of law is not too wide so as to allow room for politically motivated harassment of independent media organisations. The authorities’ willingness to consult with the OSCE on the draft law is certainly positive. However, adoption of recommendations from international expert bodies is the true test of cooperation and commitment to upholding the country’s obligations relating to freedom of expression under various international human rights treaties and institutions to which it is a signatory. A recent initiative by the President to establish a state ideology and to use the media to transmit official ideology and “immunise society from internal and external threats” does not suggest a full commitment to these principles.

Aside from media, educational institutions are also expected to serve as conduits for the state ideology, which places restrictions on academic freedom. President Lukashenko, in announcing his policy to establish a state ideology, described the role of teachers as “active propagandists” and called for the removal of teachers who do not support government policies. In this connection, the independent European Humanities University has run into difficulties with the Education Ministry in recent months. The rector of the university has faced pressure to resign, based on the Ministry’s objection to the high number of foreigners hosted by the EHU, and its application for a license renewal in May was delayed for several weeks forcing the administrators to cease all financial operations and cancel classes. The license was ultimately granted for a five-year period, and academic and financial operations have resumed.

According to Belarusian officials, 52 trade unions currently operate in the country. However, rights monitors and the International Labour Organisation have criticised the Government for interference in the activities of independent trade unions. In 2002, the Belarusian Federation of Trade Unions, which had produced the leading opposition candidate in the 2001 presidential election, was effectively taken over by the state when its leader was removed and a senior official within the Presidential administration was appointed to replace him.

Belarus is a country of origin for trafficking in persons, especially women and children. According to the US Department of State, Belarus is a Tier 2 country in the matter of trafficking, meaning that the country does not fully comply with the minimum standards for the elimination of trafficking but it is making significant efforts to do so. A report issued in July 2004 states that more remains to be done in the sphere of protection and assistance to victims, but “the Government of Belarus has demonstrated its political will to combat trafficking in persons.”

External Relations

According to the Ministry of Foreign Affairs, Belarus pursues a “multi-vector” foreign policy. However, foreign relations are dominated by the ongoing process of integration with the Russian Federation. The Union Treaty, which was signed by presidents Boris Yeltsin and Lukashenko and ratified by the legislatures of both countries, came into effect in January 2000. In the two years, disagreements have arisen between the two sides regarding the implementation of currency unification, the privatisation of the Belarusian gas transport network Beltransgaz, and the price of gas delivered by Russian gas monopoly Gazprom. There have also been disagreements on the larger question of the goals and modality for unification. These disagreements have led to delays in meeting key milestones in creating a Union State. In June 2004, some steps were taken to resolve issues of gas delivery prices, valuation of the gas transport network and the timing of currency unification.

With the enlargement of the European Union on May 1 2004, Belarus and the EU became direct neighbours. The EU is one of Belarus’ largest trading partners and a destination for more and more Belarusian tourists and businesspeople. The EU’s Wider Europe initiative, contained in a Communication adopted by the European Commission in March 2003, set out a new policy framework for relations with Europe’s new neighbours. The thrust of the initiative is to link the promise of closer cooperation with the neighbouring countries to the establishment of common democratic values and the implementation of the requisite political, economic and institutional reforms that would make that cooperation possible. However, a follow-up to the original Communication issued in May 2004 pointed to several shortcomings in the political sphere in Belarus and therefore excluded the country from those with which it is jointly developing Action Plans to integrate them further into the European market. According to officials in Brussels, [in the framework of the European Neighbourhood Policy \(ENP\), the EU will reinforce its lasting commitment to supporting democratic development in Belarus.](#) However, under current political circumstances, it is not yet possible to offer the full benefits of the ENP to Belarus. The first important milestone for Belarus in the ENP framework will be the parliamentary elections this autumn. If and when fundamental political and economic reforms take place, it will be possible for Belarus to be fully involved in the ENP. The Belarusian authorities have stated their interest and willingness to establish a joint Action Plan if an official invitation is issued.

The authorities profess a wish to strengthen ties with the United States, but relations remain strained and the US Government has made improvement in bilateral relations dependent on concrete and measurable steps by the Government of Belarus to make progress toward democracy, respect for human rights and freedom of speech. The Belarusian authorities welcomed the US decision of 3 June 2004 to suspend temporarily the 1974 Jackson-Vanick amendment in respect of Belarus. That will enable Belarus to make use of the Normal Trade Relations regime with the United States for an additional year.

Macroeconomic Developments

Demand and Output

GDP grew by 6.8 per cent in 2003. It reflected an increase in consumption (although real wage growth at some 3 per cent was lower than a year earlier), an increase in public investment as a result of strong credit growth as well as strong demand for exports, especially from Russia. The latter was stimulated by the real depreciation of the currency against the Rouble for much of the year, as well as the imposition of trade restrictions by Russia against third countries, from which Belarus benefited. In response to this demand there was a broad based response from the **industrial sector** with output up by 6.8 per cent overall, with large increases from machine building, chemicals as well as construction. After a poor first half, agricultural production recovered and output rose during the year as a whole (also by 6.8 per cent).

These trends have largely continued into the early months of 2004, with the economy growing by 10.2 per cent in the first five months of the year (year on year), driven by strong industrial output (up by over 14 per cent) while agricultural output rose by 5.5 per cent. The Belarus authorities target GDP growth at between 9-10 per cent this year.

There are, however, doubts over the precise accuracy of the output **data**. The IMF has indicated that if the national accounts data were compiled according to international standards, then real growth (especially in the industrial sector) would be lower. The Belarus authorities have recently agreed that the national accounts should be based on these standards by 2006.

In addition, the strong output performance bears little relation to the financial position of enterprises within both industry and agriculture. Over the past year between 30 and 45 per cent of large enterprises have consistently been reported as loss making, while the pressure to boost output has contributed to large unsold stocks. The lack of reform in the agricultural sector has meant that some two-thirds of all agricultural enterprises (mainly collectives) are loss making and dependent on budgetary subsidies.

The size of the economy is probably larger than shown by the official data, owing to the existence of the **shadow economy**. The size of the sector is difficult to estimate with any precision, but one recent official source argued it was between 17-18 per cent of the recorded economy. However, in view of the extent of the tax and regulatory burden, some private estimates suggest that it could be comparable to the size of that of some other countries in the region – perhaps about 40 per cent of recorded GDP.

Inflation

The rate of inflation, as measured by the CPI, has fallen from the very high levels recorded in 1999/2000, but at over 28 per cent (annual average) in 2003, it remains the highest in the region. The relatively high inflation rates in earlier quarters reflect the loose stance of monetary and fiscal policy and the policy of ensuring large wage increases (in US dollar terms). There has been some moderation in the rate of CPI inflation in the first five months of this year, although at an annual rate it currently remains slightly above the government's target of lowering inflation to between 14-18 per cent by the end of the year.

The current **wages policy** was first introduced in 2001 and is designed to boost incomes and living standards. The targets are to raise wages from US\$ 141 per month at the end of 2003 to US\$175 per month by the end of this year and to US\$250 by end-2005. The policy, which applies in the state sector, and which the private sector is meant to adopt as well, has delivered strong wage growth. Thus Belarus, one of the slowest reforming countries in the CIS, recorded

a (nominal) GDP per capita income of US\$1768 in 2003, well above that of Ukraine (at US\$1020) but below that recorded in Russia of US\$2992. Although the average growth of labour productivity in industry exceeded that of real wage growth in 2003 (7.7 per cent compared with 3 per cent), at the enterprise level wage growth bears no necessary relation to productivity growth and is likely to have contributed to the losses many large enterprises have recorded since 2001. Such enterprises then require financial support, either in direct subsidies, off-budget financing or directed lending from the larger banks to enable them to continue operating.

Fiscal Policy

The recorded **fiscal deficits** in Belarus have always been at modest levels – the outturn was 1.4 per cent of GDP in 2003. However, the fiscal position remains of concern for three main reasons. First, the share of revenue and expenditure in GDP (at around 45 per cent) is among the highest of any country in the region and is thus a reason for the large tax burden on industry, a factor identified in most surveys of the business environment as a major impediment on growth.

The Ministry of Finance has recognized the problem and aims to lower the share of revenue in GDP by 1.3 per cent in 2004 (and a further 2 per cent in 2005), commencing with **cuts to VAT** (from 20 per cent to 18 per cent) and **turnover tax** (from 4.5 per cent to 4.15 per cent) from the beginning of 2004. However, with the need to lower the tax burden over time, most of the necessary fiscal adjustment will have to come from lower spending, where better targeting could contribute. It is, however, evident that one of the fastest growing elements of spending is the wage bill – its share is projected at 25.5 per cent of spending in 2004, almost double that of five years ago.

Secondly, the actual share of government spending in GDP is almost certainly larger than reported owing to the existence of substantial **off-budget financing**. In a recent report the World Bank estimated that the share of total spending was probably closer to 50 per cent of GDP, implying that the actual fiscal deficit may be higher than recorded. The main economic implication is that budgetary constraints on many industrial and agricultural enterprises are soft, since enterprise managers can reasonably assume that there is a good chance that any excess spending on their part will ultimately be met either directly or indirectly from the budget.

Finally, the government has limited options for **financing the deficit**. In 2003 the government aimed to fund the deficit mainly through borrowing and privatisation receipts. Tax revenues were buoyant in 2003, but the failure of privatisation to meet its target left the government with no option but to cut back spending by BYR 1 trillion, including that of capital items, to limit the deficit. For 2004, the budget deficit is projected at around 2 per cent of GDP (having been amended in the first quarter of 2004 to accommodate additional spending on housing), based on a projection of GDP growth of 10 percent and a gas price of US\$ 50 per tcm. On these projections BYR 925 billion is to be financed, with around BYR 120 billion from privatisation receipts, BYR 373 billion from net domestic borrowing and the remainder from external funding. There are, however, concerns as to whether the latter is realistic in view of the absence of large-scale funding from the IFIs.

Monetary and Exchange Rate Policy

The growth of both the **money supply and domestic credit** has remained strong, with both aggregates increasing by over 50 per cent during 2003, rates which have been sustained during the first months of 2004. However, some of the growth in credit reflects decisions by the government and the President's Administration that the main commercial banks should provide credit to support larger enterprises. Some of the growth has been supported by a comparable growth in deposits. The refinancing rate has also been lowered, falling from an average of 38

per cent during 2002 to 23 per cent by May 2004. The average lending rate (for loans in domestic currency) has steadily declined, and was some 30 per cent for short-term loans to enterprises in March. Although the comparable rates for long-term loans were lower, real rates remain positive, as most loans are short-term.

The National Bank intends to lower the growth of the main aggregates during 2004 in order to meet the **inflation target** of 14-18 per cent. Whether the growth of the monetary aggregates can be slowed depends on several factors including the amount of directed lending and whether the agreement that the NBB should cease its direct funding of the budget (of some BYR 255 billion in 2003, equivalent to – 0.7 per cent of GDP) is adhered to.

Whether the inflation target can be met will also depend on movements in the **exchange rate**. To date the NBB has been successful with its policy of allowing a gradual monthly depreciation of the currency against the Russian rouble, although in practice the link was to the US\$. The high rate of inflation between 2001 and early 2003 meant that the currency appreciated in real terms against both Russian rouble and the US dollar, which is likely to have affected the competitiveness of exports during this period.

However, some strains to the policy emerged during 2003 as the US dollar weakened and the Rouble strengthened. The net result was that the currency is estimated to have depreciated in **real effective terms** by some 7 per cent, the result of a strengthening (in real terms) against the US dollar but a fall against both the Rouble and the Euro, thus providing a boost to exports to both these markets. These trends have continued in the first five months of 2004, with the nominal depreciations against both the Rouble and the Euro contributing to greater price competitiveness of exports. For 2004 the NBB's intention was to allow a modest nominal decline against the Russian rouble in the first half of the year (up to 6 per cent), followed by greater stability.

The future of the current exchange rate regime is of course bound up with the progress of the negotiations on **Monetary Union** with the Russian authorities, and in particular the intention to introduce the Russian rouble as the common currency from the beginning of 2005. Although progress has been slower than originally intended, negotiations have continued on all the main issues. These include the claim of the Belarus authorities for US\$ 2.1 billion, part of which reflects the authorities claim for compensation to offset the fiscal costs of bringing tax rates closer to Russian levels, an amount the Russian authorities regard as excessive. Secondly, there are issues relating to the responsibility for the implementation of monetary policy. Although it has been agreed that Belarus should have two seats on the CBR Board of Directors, President Lukashenko subsequently stated that the responsibility should be shared. In addition issues relating to customs duties between the two countries remain to be resolved. As a result, two important events – the proposed introduction of the Russian rouble for non-cash settlements (originally to be introduced in July 2003) and the peg to the Russian rouble (from early 2004) – have been delayed. Furthermore, during June this year the authorities acknowledged that the plans to introduce a single currency in Belarus and Russia from the beginning of next year would probably be delayed.

The level of the exchange rate at which the Belarus currency is **pegged to the Russian rouble** is a crucial step in the negotiations, especially given the dominant role of Russia as a trade partner for Belarus. There are risks in pegging a currency to one that could easily appreciate, given the importance of oil and gas revenues to the Russian economy, especially when there remains a disparity in the respective inflation rates. There could also be benefits in terms of exerting downward pressure on inflation, although the more limited scope to apply monetary and fiscal policy in a currency arrangement implies that where adjustment is required, it has to come through greater flexibility of domestic prices, wages and employment in order to maintain competitiveness.

Balance of Payments

The **current account** deteriorated slightly during 2003 to 2.9 per cent of GDP. The decline is mainly due to a sharp deterioration in the trade deficit, which at over US\$ 1.2 billion, was a third higher than a year earlier. It is evident that there is a marked seasonal pattern to the trade deficit in Belarus, mainly the result of higher energy imports, and the trade deficit in the fourth quarter of 2003 accounted for over 40 per cent of the trade deficit for the year as a whole. Belarus traditionally earns a surplus on its services, especially for transport and from transit fees, and these rose by 29 per cent in 2003 (amounting to US\$ 557 million), offsetting some of the decline in the trade account. During the first quarter of this year export growth has remained strong, resulting in a reduction in the trade deficit and a small surplus on the current account, which amounted to US\$ 97 million.

Two further related features of the Belarus trade position, in common with some other CIS countries, are that it is dependent on **imports of energy** and is also highly dependent on **Russia as a trading partner**. Despite a strong performance from exports during 2003 (which rose by 26.7 per cent in the year), the immediate reason for the decline in the trade deficit was the higher cost of gas imports. Imports of energy (oil, oil products and gas) account for about 25 per cent of total imports, although Belarus exports some oil products so that the value of trade in oil and oil products is broadly balanced. These imports of energy also represent a large share of imports from Russia, which accounted for 67.2 per cent of all Belarus imports in 2003. However, as with many CIS oil importers, the high cost of energy imports is partly offset by the resulting strengthening of demand in Russia (which accounted for 48 per cent of Belarus exports in 2003).

From the beginning of 2004 Belarus will pay significantly higher price for its **gas imports**. For a number of years Belarus has imported 18.5 billion cubic metres (bcm) of gas from Russian suppliers. Gazprom supplied 10.2 bcm at US\$ 30 per thousand cm, the price at which it supplies gas to industrial enterprises in western Russia. The balance was imported from other suppliers at slightly higher prices, so that for example in 2003 the average import price for all gas imports was US\$ 36.9 per tcm. At the beginning of 2004 upward pressures on gas prices led Gazprom to indicate that it was only prepared to supply 10 bcm of gas to Belarus at much higher prices. Negotiations broke down over the exact terms and Gazprom suspended deliveries from the beginning of the year, leaving Belarus to import all its gas from other Russian suppliers at prices over US\$ 45 per tcm. The authorities eventually reached an agreement in June whereby Gazprom will supply gas to Belarus for the remainder of the year at US\$ 46.7 per tcm. After allowing for some increase in the transit fees for gas exported through Belarus to Western Europe (from US\$ 0.55 to US\$ 0.75 per tcm per 100 kms), Belarus is likely to face a higher import bill of up to 0.6 per cent of GDP in 2004.

Other policy initiatives could also have some influence on the trade accounts. Belarus has signed the agreement on the **Single Economic Space** (with Russia, Ukraine and Kazakhstan). However, the precise trade benefits to Belarus from such an arrangement are unclear given that such a large proportion of trade is already with Russia and covered by an existing trade agreement. However, the new agreement might provide scope for an early resolution of trade disputes.

In addition there are some concerns that **EU enlargement** will have a negative impact on exports as bilateral trade agreements with individual accession countries are scrapped. One published study has reviewed the likely implications for imports from selected CIS countries

(including Belarus) into the four main Central European countries⁴. While acknowledging many of the uncertainties, it concluded that the overall impact on trade volumes for the CIS countries could be quite small. Although bilateral trade agreements would end, nevertheless in some central European countries there could be more opportunities to export as domestic protection was lowered to the level of the Common External tariff. Furthermore the authors anticipated greater prospects for FDI (for the CIS countries) over the medium term.

The absence of funding from the IFIs in recent years has meant that the growth of **foreign exchange reserves** has been highly dependent on export growth, supported by the 30 per cent surrender requirement. At the end of 2003, foreign exchange reserves were estimated at US\$ 495 million, equivalent to less than one month of imports of goods and services. However, the improved trade performance in the first quarter of this year has resulted in an increase in reserves to over US\$ 550 million by the end of May.

External Debt

The stock of **external debt** is modest, mainly the result of the absence of IFI funding and the inability to borrow on the main international markets. The stock of external public debt was US\$ 1,089million by the end of 2003 (just 6.2 per cent of GDP). A little over two-thirds of this amount represented the medium and long-term obligations of the public sector. By the beginning of April this amount had fallen to US\$ 708 million (of which guaranteed loans to enterprises accounted for 52 per cent and direct government loans the remainder). Almost 80 per cent of the public debt is from bilateral sources (especially Germany and Russia), with multilateral debt accounting for the balance (the World Bank is the largest creditor in this category). Although there is discussion of issuing bonds on the Russian market and possibly a Eurobond, on present trends the external debt stock would decline further in both 2004 and 2005 as repayments are made.

Belarus does, however, have a substantial amount of short-term debt that has risen steadily to US\$ 2.2 billion at the end of last year. This is comprised of trade credits (US\$ 660 million), arrears to energy suppliers (US\$ 350 million), liabilities of the banking system (US\$ 280 million) and other unspecified debts.

Repayments on public external (medium-term) debt amounted to US\$ 200 million in 2003 (a **debt service ratio** of just 2.1 per cent) and are projected to be at similar levels in both 2004 and 2005. The debt service ratio is therefore low and estimates of the total debt service (including some of the short-term debt) suggest it is no more than 4-5 per cent. Furthermore it is evident that one consequence of the decline in external debt has been the need to tap the domestic debt market for funding purposes. Thus by the end of 2003, the outstanding stock of domestic debt, at BYR 2 trillion, was almost 6 per cent of GDP.

⁴ Economic Commission for Europe “The accession of Central European Countries to the European Union: the Trade and Investment Effects on Belarus, the Russian Federation and Ukraine. Occasional paper No 2 by Elizbieta Kawecka-Wyrzykowska and Darius Rosati, UN, Geneva, 2003.

Annex 3

Belarus - Selected Economic Indicators

	1996	1997	1998	1999	2000	2001	2002	2003 Estimate
Output and expenditure <i>(Percentage change in real terms)</i>								
GDP	2.8	11.4	8.4	3.4	5.8	4.7	5.0	6.8
Private consumption	4.5	11.4	14.1	9.5	8.0	17.9	11.4	11.1
Public consumption	0.0	6.8	6.3	5.5	5.8	3.1	0.3	2.5
Gross fixed capital formation	7.2	15.9	6.9	-16.0	14.7	1.9	2.6	12.0
Exports	27.1	23.9	-3.4	-2.3	na	na	na	na
Imports	26.5	24.9	-1.2	-8.6	na	na	na	na
Industrial gross output	3.5	18.8	12.4	10.3	7.8	5.9	4.5	6.8
Agricultural gross output	2.4	-4.9	-0.7	-7.0	8.8	1.6	3.1	6.8
Employment <i>(Percentage change)</i>								
Labour force (end-year)	0.1	-4.1	0.0	0.3	-0.1	-0.4	-1.3	-1.0
Employment (end-year)	-1.0	0.1	1.1	0.6	0.0	-0.5	-1.7	-1.0
<i>(In per cent of labour force)</i>								
Unemployment (end-year)	3.9	2.8	2.3	2.1	2.1	2.3	3.0	3.1
Prices and wages <i>(Percentage change)</i>								
Consumer prices (annual average)	52.7	63.9	72.9	293.7	168.6	61.4	42.6	28.5
Consumer prices (end-year)	39.3	63.4	181.7	251.3	107.5	46.2	34.8	25.4
Producer prices (annual average)	35.0	86.5	73.5	355.8	185.6	71.8	40.4	38.0
Producer prices (end-year)	29.0	89.0	200.0	245.0	168.0	39.0	43.0	29.0
Gross average monthly earnings in economy (annual average)	60.5	87.3	104.2	322.4	200.9	108.8	53.8	34.0
Government sector <i>(In per cent of GDP)</i>								
General government balance	-1.5	-0.7	-1.0	-2.0	-0.1	-1.9	-1.8	-1.4
General government expenditure	40.7	46.2	45.4	47.3	45.9	46.8	44.7	46.1
General government debt	9.8	11.6	11.5	14.7	15.0	11.6	10.6	10.5
Monetary sector <i>(Percentage change)</i>								
Broad money (M2, end-year)	52.4	111.4	275.1	133.2	210.9	66.1	50.3	56.3
Domestic credit (end-year)	58.5	115.5	297.4	143.2	181.4	67.4	53.7	68.9
Broad money (M2, end-year)	14.3	15.8	30.9	16.7	17.2	15.2	15.0	17.1
Interest and exchange rates <i>(In per cent per annum, end-year)</i>								
Refinancing rate	35.0	42.0	48.0	120.0	85.0	48.0	38.0	28.0
Deposit rate (1 year) ¹	32.4	15.6	14.3	23.8	37.6	34.2	26.9	21.0
Lending rate (1 year) ²	62.3	31.8	27.0	51.0	67.7	47.0	36.9	32.0
<i>(Belarussian roubles per US dollar)</i>								
Official exchange rate (end-year)	15.5	30.7	106.0	320.0	1,180.0	1,580.0	1,920.0	2,156.0
Official exchange rate (annual average)	13.2	26.0	46.1	248.8	876.8	1,390.0	1,790.9	2,052.3
External sector <i>(In millions of US dollars)</i>								
Current account	-516	-859	-1,017	-194	-338	-435	-378	-505
Trade balance	-1,149	-1,407	-1,501	-570	-884	-807	-914	-1,234
Merchandise exports	5,790	6,919	6,172	5,646	6,641	7,334	7,965	10,092
Merchandise imports	6,939	8,326	7,673	6,216	7,525	8,141	8,879	11,326
Foreign direct investment, net	105	350	201	443	119	96	453	169
Gross reserves, excluding gold (end-year)	469	394	703	309	357	359	457	495
External debt stock ³	950	976	1,011	886	812	817	991	1,089
<i>(In months of imports of goods and services)</i>								
Gross reserves, excluding gold (end-year)	0.8	0.5	1.0	0.6	0.5	0.5	0.6	0.5
<i>(In per cent of exports of goods and services)</i>								
Debt service	2.3	1.6	1.9	3.9	4.2	3.4	4.1	4.6
Memorandum items <i>(Denominations as indicated)</i>								
Population (end-year, million)	10.2	10.2	10.1	10.1	10.0	10.0	9.9	9.9
GDP (in millions of Belarussian roubles)	191,800	366,830	702,161	3,026,064	9,134,000	17,173,200	26,138,000	35,930,000
GDP per capita (in US dollars)	1,419	1,385	1,503	1,207	1,039	1,237	1,468	1,768
Share of industry in GDP (in per cent)	34.6	34.3	33.4	31.9	30.1	29.9	30.1	30.0
Share of agriculture in GDP (in per cent)	16.0	15.4	13.9	14.6	14.2	11.9	10.9	9.5
Current account/GDP (in per cent)	-3.6	-6.1	-6.7	-1.6	-3.2	-3.5	-2.6	-2.9
External debt - reserves, in US\$ millions	480.9	582.3	308.2	577.0	454.9	457.6	534.4	615.5
External debt/GDP (in per cent)	6.6	6.9	6.6	7.3	7.8	6.6	6.8	6.2
External debt/exports of goods and services (in per cent)	14	12	14	14	11	10	11	9

¹Data refer to weighted average interest rates on new one-year deposits in commercial banks. ²Data refer to weighted average interest rates for one-year loans by commercial banks. ³Total debt including medium and long-term public and publicly guaranteed debt and an estimate of private debt.

International Monetary Fund (IMF)

Belarus joined the IMF on July 10, 1992, and first borrowed in 1993, receiving SDR 70 million under the systemic transformation facility (STF). Another SDR 70 million was disbursed under the STF in 1995. A stand-by arrangement for SDR 196 million was approved in December 1995, but only the first tranche of SDR 50 million was drawn. The stand-by agreement expired in September 1996 with no further funds disbursed, as Belarus did not meet programme targets and conditions. In the wake of the Russian financial crisis in mid-1998, the IMF and Belarus began negotiations regarding financial support under the compensatory and contingency financing facility (CCFF), a programme designed to assist countries suffering from external price shocks. These negotiations were inconclusive, however, as programme agreements were again not met.

In 2001, the Fund staff reached agreement with the Belarusian authorities on a six month staff-monitored programme (SMP), which did not involve any borrowing from the IMF. The SMP was intended as a confidence-building measure to build a track record of positive macroeconomic policies leading to negotiations on a new stand-by arrangement. The SMP incorporated monetary and fiscal performance targets, as well as structural measures in the areas of price and foreign exchange liberalisation, banking sector reform, privatisation, and improving the business environment. Performance under the SMP was mixed, as quantitative performance targets on monetary policy were met while those on the budget deficit and government tax and expenditure arrears were not. A number of structural reform measures were also not implemented. The Belarusian authorities continued to express interest in an SBA after the SMP expired in 2001. However, since then the staff and the authorities have been unable to agree on macroeconomic policies and projections. As a result, in early 2004, the authorities withdrew their request for discussions on an SBA.

Despite the lack of agreement on macroeconomic policies, Belarus has benefited from IMF technical assistance and training in the areas of monetary and fiscal policies, statistics, and anti-money laundering legislation. IMF technical assistance between 1992 and early 2004 amounted to more than 19 person-years, with a cost of more than \$3.5 million. Also, from 1993 to early 2003, more than 350 Belarusian officials received IMF training, either in Washington or at the Joint Vienna Institute. Finally, the authorities have indicated their intention to subscribe to the IMF's Special Data Dissemination Standard and have begun to take steps to enhance the dissemination of national statistics.

Relations with the World Bank

The World Bank Group Strategy

1. Belarus joined the World Bank in July 1992 although the World Bank Group programme in Belarus was rather limited during the period 1995–2000. Under the 1999 CAS, liberalisation of the exchange rate was set as a trigger for moving to a *low case* lending (one project per year) scenario. Unification of the exchange rate in September 2000 led to an improvement in the quality and intensity of the dialogue between Belarus and the Bank and allowed the Bank to proceed with the preparation of a \$22.6m Social Infrastructure Retrofitting Project, approved on June 5, 2001.

2. The current CAS for 2002–04 was approved in 2002 to advance cooperation with Belarus in critical areas, help the country open up its economy and society, minimize social and environmental risks, and address global public good concerns. CAS implementation, however, has been neither smooth nor satisfactory and has recently encountered a major setback with regard to project lending when the authorities informed the Bank of its intention to withdraw its request for Bank financing for the TB prevention project. Given that the TB project was under preparation for over three years and invitation for loan negotiations had been issued, the Bank has temporarily suspended preparatory activities for the next project in the pipeline, the proposed Post Chernobyl Recovery Project, until the authorities' commitment to this project can be confirmed. The CAS centers around the following issues:

- Advisory activities on reform, particularly with regard to business environment and social policies, and to nurture involvement of civil society;
- Lending is concentrated in three areas: (i) global public goods; (ii) mitigation of social risks, including the consequences of the Chernobyl disaster and the lack of greater social inclusiveness; and (iii) fostering private sector development through a better business and investment environment.

3. The CAS has two lending scenarios—a *low case* and a *base case*. Under the *low case* scenario, lending would be concentrated essentially on global public goods (i.e., TB/HIV prevention, environmental protection) and projects directly targeted to the poorest segments of society, and is limited to \$140m (excluding grants from the Global Environmental Facility). Under the *base case*, lending would reach up to \$270m for the three-year period. Lending under the base case would only commence after the government has accumulated a one-year track record in improving the business environment and fiscal transparency. Belarus is currently in the low case.

4. To date, loans to Belarus total \$190.6m. (on a commitment basis), and \$15m. has been provided in the form of grants. The IBRD Belarus active portfolio has one ongoing operation—*Social Infrastructure Retrofitting Project* totaling \$22.6m. The project aims to assist the rehabilitation of the heating system, thermal insulation and lighting in over 450 public buildings across the country. Project implementation is satisfactory, and so far \$2.3m has been disbursed.

5. Non-lending activities include grants and analytical work. Among the most recent studies have been the Chernobyl Review (*Belarus: Chernobyl Review*, Report No.23883-BY, July 15, 2002), which identified the key problems caused by the Chernobyl accident and made recommendations for strengthening the programmes of both the government and the donor community. A Public Expenditure and Institutional Review (*Belarus: Strengthening Public Resource Management*, Report No.26041-BY, was completed in June 2003) A Poverty Assessment Update (*Belarus Poverty Assessment: Preparing for the Future*, Report No.27431-

BY, being finalized). The objective was to assess the reasons for the evolution of poverty, assess the impact of various public subsidies and provide policy recommendations.

6. Other activities have included the commencement of a dialogue with the authorities on Pension Policy in late 2003. The aim of the review is to analyze the current pension system and discuss the options for reform. There is a PHRD Climate Change pilot project (supported by the Japanese Climate Change Initiatives Grant), approved in 2003. The aim of this pilot project, which is associated with the ongoing *Social Infrastructure Retrofitting Project*, is to demonstrate the opportunities for greenhouse gas emission abatement through energy efficiency and greater utilisation of renewable energy sources. A Global Environment Fund grant to support “Enabling Activities related to the Implementation of the Stockholm Convention on Persistent Organic Pollutants” also recently received approval.

7. One of the key objectives of the current Belarus CAS is to help the *development of civil society* through information dissemination, dialogue with the government and involvement of the civil society organisations (CSOs) in Bank supported activities. The Bank maintains the ongoing dialogue with CSOs on the CAS priorities. The Bank also implements a number of civil society capacity building programmes, such as the annual *Small Grants Programme* and *Development Marketplace*, aimed at empowering small communities development, encouraging the inter-sector partnership, establishing basic mechanisms for cooperation of CSOs with local authorities to be improved over time and used as best practices.

8. With respect to future activities, the preparation of *Country Economic Memorandum* is planned for FY 2005. The joint World Bank-IMF Financial Sector Assessment Programme (FSAP) will be launched in the Autumn of 2004. Both institutions have agreed in principle to carry out the review and consideration is currently being given to the appropriate timing.

9. The IFC activities in Belarus. The IFC strategy for Belarus is to foster the private sector development through technical assistance and lending operations. The IFC began its work in Belarus with technical assistance to the government in devising and implementing an auction based privatisation model in the retail sector in 1993. The IFC facilitated the privatisation of more than 1,100 enterprises in 35 cities and regions of Belarus. To assist the newly-privatised businesses at the initial stage of their operation, it launched a *Post Privatisation Project* in 1995, under which local business support centers were created.

10. Since 1997 Belarus has halted the process of privatisation and restructuring of industrial property. Private business in the country is represented mainly by small and medium enterprises (SMEs). IFC technical assistance efforts are aimed at creating an enabling environment for SME growth. To this end, in 2002 the IFC started a two-year *Business Associations Capacity Building project*. The project focuses on improvement of business associations management and strengthening their lobbying and advocacy capacity. The IFC also interacts directly with government and local administrations to improve policies and legislation affecting the SME sector and investment climate in general. The corporation is a founder and active participant in the Foreign Investment Advisory Council, an advisory body to the Council of Ministers of Belarus. As of January 2004, the IFC has implemented five technical assistance projects totaling \$9.4m. In the banking sector, the IFC provides long-term funding to local banks to strengthen their balance sheet and to help them better meet the needs of SME sector in Belarus. In June 2003 the IFC extended a five-year \$14m loan to Priorbank for on-lending to private enterprises.

11. Given the recent problems in the CAS implementation and attaining agreed objectives, the Bank has communicated to the Belarus Authorities that it will prepare the Strategy Completion Report in early FY05 and will attempt to identify possible areas for cooperation in the nearest future.

Legal Transition

COMPARATIVE ASSESSMENT OF BELARUS'S COMMERCIAL LAW

Belarus' commercial laws were characterised as barely adequate by the EBRD 2002 Legal Indicator Survey⁵, which placed it on a par with Ukraine and the Russian Federation. The reasons for such an evaluation of the commercial laws of Belarus derive from substantive deficiencies in the corpus of commercial law and from frequent and often arbitrary interference of state authorities in commercial transactions.

LEGAL SECTOR ASSESSMENT

Bankruptcy

Bankruptcy and insolvency are governed by the “Belarus Law on Economic Insolvency” 2000, as amended (the “Bankruptcy Law”). The law scored as “low compliance” in the EBRD's 2003 Sector Assessment Survey on bankruptcy and insolvency and scored poorly due, in part, to its ambiguous way of addressing certain key issues.

The Bankruptcy Law applies to all businesses other than state treasury-owned enterprises. Although the criteria for commencing insolvency proceedings are set out, these criteria are somewhat vague and confusing. Proceedings can be initiated by both debtors and creditors but the process for a debtor to initiate its own reorganisation proceedings are somewhat tortuous and require, among other things, notice to be provided to creditors. It is also not clear that a debtor could initiate such proceedings in *anticipation* of being insolvent.

Creditors are given ample opportunity to participate in both liquidation and reorganisation proceedings relating to bankrupt debtors. The position of secured creditors is comparatively weak. In a bankruptcy liquidation, claims of secured creditors rank behind claims of wage and tort claimants as well as fiscal claims. This stands in sharp contrast to the position of secured creditors in Russia, where tort and wage claims can only rank ahead of secured claims if they arose prior to the creation of the security and fiscal claims rank behind claims of secured creditors.

Pursuant to Decree No. 508 of the President of Belarus, dated 12 November 2003, “On Certain Matters relating to Economic Insolvency (Bankruptcy)”, the Belarus law regulating enterprise bankruptcy was amended. Among the more noteworthy features of the Decree is a provision to the effect that, unless otherwise provided by the President of the Republic of Belarus, legal entities and individual entrepreneurs who have obligations for the supply of goods or the rendering of services to the state or who are obliged to perform transactions, including foreign trade transactions, which benefit from a sovereign guarantee of the Republic of Belarus, are not subject to bankruptcy liquidation. This provision, which has no counterpart in Russian

⁵ From 1997 to 2002, the EBRD has conducted a Legal Indicator Survey each year to measure the progress in legal reform in Central and Eastern Europe, the Baltic States and the Commonwealth of Independent States, as viewed by local lawyers and academics. The results of such survey are based on responses to the questionnaire sent out to lawyers practising in any given country. The survey represented their perception of the country's legal system and, in particular, the degree to which key commercial and financial laws have reached internationally acceptable standards (extensiveness) and to which extent these laws are implemented and enforced (effectiveness). The survey is based purely on local lawyers' perception of their own country legislation and does not represent EBRD's own view on these legal systems. In addition, it must be noted that each respondent is asked to answer the questionnaire for his/her country only, and not on a comparative basis.

bankruptcy law, is peculiar and may in practice operate to impede debt collection and restructuring efforts of creditors of the foregoing class of debtors. The Decree also authorises the court to institute a so-called “defence period” for up to 3 years to enable any extra-judicial rehabilitation efforts to be completed before a decision whether to liquidate the debtor needs to be made. This is a significant departure from the position under the Bankruptcy Law, which limits the duration of the “defence period” to three months following the acceptance by the court of a bankruptcy petition. During the “defence period” there is a stay on creditor enforcement action and the debtor’s ability to conduct its business operations is restricted in a number of respects. The Decree provides that the Bankruptcy Law is to be applied subject to the provisions of the Decree and other legal acts of the President of Belarus.

Capital Markets

The primary legislation governing the securities market includes the Law on Securities and Stock Exchange and the Law on Depository Activity and Central Depository of Securities. The former was adopted in 1992 and was amended in 1996 and 2002, while the latter came into force in 1999 and was subsequently amended in 2002 and 2003. The principal regulator for the securities market is the Committee on Securities of the Council of Ministers of the Republic of Belarus. The chairman of the Committee on Securities was appointed by the President of the Republic of Belarus and the vice-chairman by the Council of Ministers.

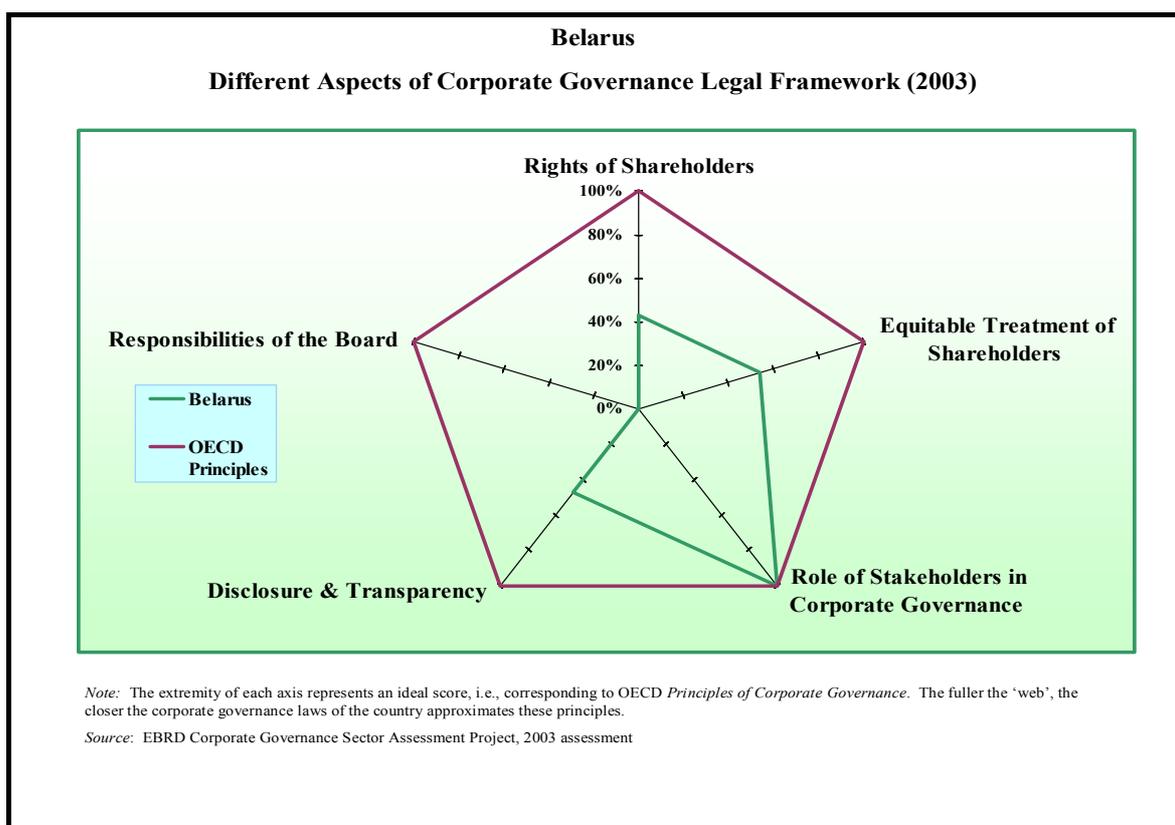
Generally speaking, the capital markets of Belarus are still at a very early stage of development with the exception of the market for state securities. The policy of the Government of the Republic of Belarus has effectively increased the volume of placed state promissory notes and improved the terms of their issue and circulation over the years. Under the existing law, non-residents are permitted to acquire certain types of state securities. However, so far as overall financial market development is concerned, banking reform remains the priority and hence the focus of the Government.

Despite the amendments adopted in recent years as indicated above, the legal framework governing the securities market remains deficient in several respects. For example, the operational independence of the Committee on Securities is not assured by the law. The staff of the Committee on Securities is not legally protected from lawsuits arising from the actions taken when duly discharging their duties. The enforcement and sanction powers of the Committee on Securities are weak. In addition, in the case of a change in corporate control, there are no mandatory disclosure rules in place. The rules governing the qualification requirements for professionals operating collective investment schemes (“CIS”) in Belarus and the rules governing the offering documents of CIS are inadequate. Also insufficient are the requirements for CIS to disclose information about its operations on a regular basis. The rules regulating the activities of market intermediaries need to be strengthened. Lastly, financial reporting standards are not in line with international standards.

Company Law and Corporate Governance

The Law on Joint Stock Companies, Limited Liability Companies and Additional Liability Companies came into force in 1992 and was most recently amended in 1998. This law sets forth the basic framework for the formation and operation of companies in Belarus.

According to the results of the EBRD’s 2003 Corporate Governance Sector Assessment, Belarus is a country whose existing corporate governance related laws (i.e., “law on the books”, not how the relevant legislation is actually being implemented) when compared to the OECD *Principles of Corporate Governance* were rated among the “very low compliance” countries. A reform priority for countries in this category is to overhaul their outdated or seriously deficient laws by bringing them into line with international standards (see chart below).



Basically, the existing corporate governance legal framework of Belarus is deficient in several aspects. As shown from the attached chart drawn based upon the findings of the EBRD Corporate Governance Sector Assessment in 2003, the rules governing the responsibilities of the board of directors in a company fall substantially short of international standards. In addition, the rules for protecting minority shareholder's rights are rather weak. For example, in terms of newly issued shares of a company, the pre-emptive right of existing shareholders is not assured by the law to prevent their existing percentage shareholding in the company being diluted. The minority shareholders in a company have no right to appoint an auditor to examine the books of the company if necessary. Furthermore, there is no disclosure requirement with regard to related-party transactions; nor are there rules dealing with corporate transactions where there are conflicts of interest concerns. The overall disclosure rules under the existing corporate governance legal framework are inadequate.

Concessions

Belarus does not have a single general framework concessions act *per se*. However, the 2001 Investment Code (the "Investment Code") contains fairly detailed provisions relating to concessions which constitute a legal basis for the award of concessions.

Generally, the Investment Code seems to cover basic elements of concession granting standards. Although the part of the Investment Code relating to concessions may only be regarded as barely adequate when compared to modern international best practices, there are a number of positive features, e.g., rules and definitions such as publicity, reference to "equal rights and obligations" for all parties, possibility to contest and limitation of final negotiations..

A concession is defined as a contract between the Republic of Belarus and a concessionaire, on the transfer, on a compensation basis and for a specified time period, of the right to perform, on

the territory of the Republic of Belarus, a particular form of activity, subject to the exclusive right of the state to use the relevant property. According to the Investment Code, the maximum duration of a concession is 99 years.

The Investment Code is unfortunately not clear in many respects, leaving gaps and adding uncertainty as to its application. It does not, for example, identify the public authorities that are empowered to award concessions and enter into project agreements. Instead, it non-specifically refers to the Republic of Belarus, represented by the Government or by the “republic administrative body authorised by the Government”. The Investment Code, seems implicitly to allow both domestic and/or foreign persons to be shareholders of the concessionaire. The Investment Code leaves, however, the possibility for the Government to restrict tender to domestic investors only or to foreign investors only.

Many aspects of the Investment Code should be further developed and specified in more detail. The latter concerns the very scope of the application of the Investment Code and the identification in the Investment Code of the sectors and/or types of infrastructure and/or services in respect of which concessions may or may not be awarded. The former relates particularly to clauses on a project agreement and financial aspects including those of governmental involvement. The Investment Code does not specifically provide for concessionaire compensation’s rules or mechanisms. The Investment Code does not provide the lenders with “step-in” rights in the event of concessionaire defaults. Other aspects of the Investment Code that will deter potential investors are that it does not provide for a restrictive list of termination events; and neither does it give an option for the lenders and the concessionaire to choose the applicable law to govern their finance relations. Furthermore, it does not permit the contracting authority to enter into a project agreement that is governed in whole or in part by foreign law.

On a more positive note, the Investment Code permits the contracting authority to enter into agreements that are subject to international arbitration. This, coupled with the fact that Belarus has ratified both the New York Convention on Recognition and Enforcement of Foreign Arbitral Awards (1958) and the Washington Convention on the Settlement of Investment Disputes (ICSID) should be noted as a plus.

Secured Transactions

The provisions of the new Civil Code, dated 7 December 1998, relating to security interests take priority over the 1993 Pledge Law (the “Pledge Law”). The Pledge Law does, however, still apply in so far it does not contradict the Civil Code. Because both sets of provisions have not been harmonised, uncertainty for the market will exist until the Pledge Law is either repealed or amended.

The regime for secured transactions is similar to the one found throughout the CIS, which has quite serious shortcomings:

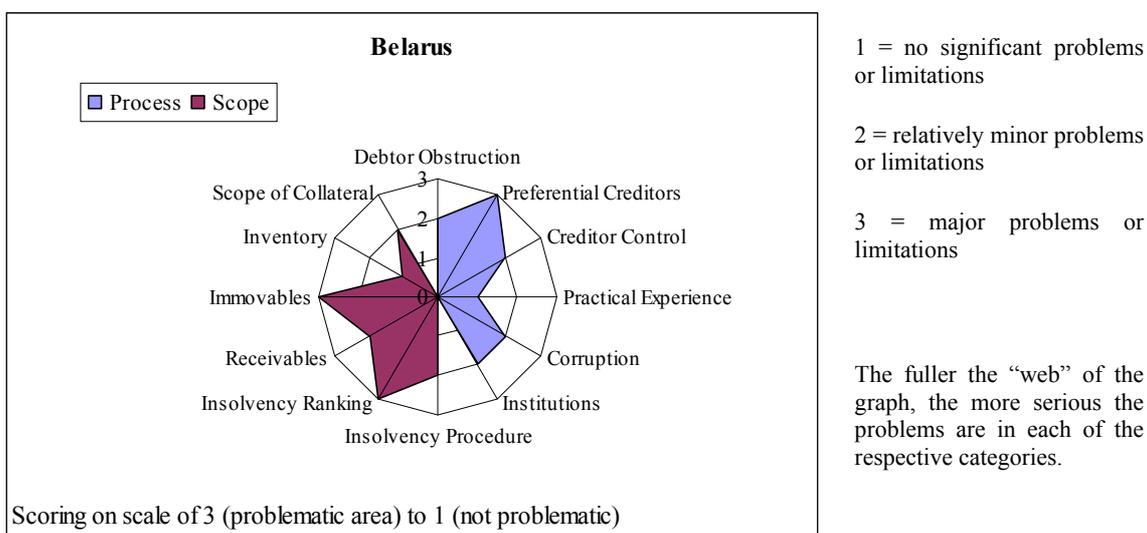
1) There is no general registration system, in which all charges over movable property would be recorded. The borrower, if a legal person, is required to keep a record of all pledges on its books. However, as this rule does not seem to be respected in practice, there is *de facto* no way a creditor can be certain that the security it takes would have a first ranking.

2) The regime would not withstand any level of sophistication by which the parties would wish to take security over a fluctuating pool of assets, or indeed would want to secure a credit line. The Civil Code only allows for charges over goods in circulation and processing. It does not seem to cover other types of property, which may also be subject to constant change, such as accounts receivable.

3) Enforcement, despite the above comments, has been found to function relatively efficiently. In a survey conducted by EBRD in the summer of 2003, Belarus was found to provide a regime and practice of enforcement which would allow a creditor to recover relatively swiftly a secured debt through enforcement of its security and realisation of the collateral. Belarus ranked higher in this respect than Russia, and just after Ukraine. However, it is difficult to draw general positive conclusions as the debtor could severely obstruct the proceeding (for example, by requiring the court to suspend the procedure to allow him time to acquire the money needed to satisfy the debt). Also, secured creditors would rank after employee claims for injuries, as well as employee wages and the tax office claims (see chart below which highlights preferential creditors as one of the serious issues in the enforcement of security in the country).

Belarus has taken some positive steps toward adopting modern principles of secured transactions law as contained in the EBRD Model Law on Secured Transactions. However, further reform will be required before tangible benefits to secured creditors can be generated.

Qualifying factors in the charge enforcement process



Process factors	Scope factors
<p>Debtor obstruction: The possibility for the debtor to prevent, slow down or otherwise obstruct the enforcement proceedings to the detriment of the chargeholder. Legitimate exercise of right of defence or appeal is not included.</p> <p>Preferential creditors: The impact of claims of other creditors (other than prior-ranking secured claims) on the satisfaction of the secured creditor’s claim.</p> <p>1. Creditor control: The ability of the creditor to control or influence the conduct of the enforcement procedure.</p> <p>2. Institutions: The reliability of the courts and other institutions necessary to support the enforcement process.</p> <p><i>Practical experience: The general level of practical experience with the enforcement process in the country in question.</i></p> <p>Corruption: The impact of corruption within the court system on the enforcement process.</p>	<p>Insolvency procedure: The impact of the debtor’s insolvency on the enforcement process.</p> <p>Insolvency ranking: The priority of the secured creditor’s claim upon insolvency of the debtor.</p> <p>Receivables: An assessment of the simplicity and certainty of the enforcement process for a charge over receivables.</p> <p>Immovables: An assessment of the simplicity and certainty of the enforcement process for a charge over immovables.</p> <p>Inventory: An assessment of the simplicity and certainty of the enforcement process for a charge over inventory.</p> <p><i>Source: EBRD New Legal Indicator Survey 2003</i></p>

Telecommunications

The telecommunications sector in Belarus is currently governed by the Telecommunications Law of 1994 and is regulated by the Ministry of Posts and Telecommunications (the “Ministry”). There is no independent regulator and the Ministry acts as both policy maker and regulator for the sector. In essence, the structure of the economy has changed little from Soviet times, resulting in poor economic performance and burdensome government regulation.

While there is limited competition in data and Internet, the continuing fixed-line monopoly of state-owned Beltelecom currently prevents any meaningful private participation in the provision of fixed services. This situation is reflected in the low teledensity, particularly in rural areas. Beltelecom also maintains a stake in the mobile sector and all Internet Providers are required to connect through Beltelecom’s Internet operation. Privatisation of Beltelecom has been mentioned on a number of occasions since the late 1990’s but no serious attempt to bring the company to market has yet been apparent.

In the mobile market, analogue services have been provided since 1993 by Belcel, a joint venture with Beltelecom and a number of successive foreign operators. The first GSM licence was awarded in 1999 to a privately controlled company, MDC, another joint venture between Beltelecom, Belarusian partners and a private foreign operator. In addition, upon expiry of the three year MDC exclusivity, a second GSM licence was awarded, through an international tender in 2002, to MTS – yet another partly state-owned joint venture between Moscow-based MTS, Beltelecom and other Belarusian partners, with the state reportedly holding a controlling 51% interest.

While there is a competitive base in the mobile market and mobile penetration rates are growing, sector development is being stifled by the overpowering presence of the state in the market place. Similarly, the continuing fixed line monopoly of Beltelecom and state involvement therein, is seriously impacting upon sector development in terms of investment, modernisation and network build.

Accordingly, the government should, without delay, adopt a forward looking sector policy that would facilitate private investment, and thereby, development of the sector. The elaboration of such a policy should be followed up by adoption and full implementation of a new framework telecommunications law, reflective of international best practice. The EBRD assisted the government in drafting such a law in 1999 but, unfortunately, this matter has remained under discussion by the government with no apparent activity to adopt this legislation since. Among the specific policy initiatives which should be elaborated and implemented are; in the mobile sector, rationalisation of state involvement in all sector operators and, in the fixed market, an appropriately timed programme of liberalisation and privatisation. All these initiatives should be accompanied by the full implementation of a modern regulatory regime applying international standards in the areas of tariffing, interconnection, licensing and universal access, sufficient to support transition to an appropriately competitive market place.