DOCUMENT OF THE EUROPEAN BANK
FOR RECONSTRUCTION AND DEVELOPMENT

STRATEGY FOR BELARUS

As approved by the Board of Directors at its meeting on 10 December 2009

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EXECUTIVE SUMMARY

Since 1996 the Bank's activities in the Republic of Belarus have been limited by the country's slow progress in democratic and market-oriented transition. Previous Country Strategies have highlighted inconsistencies in the Belarusian authorities' commitment to and application of the principles of multiparty democracy, pluralism and market economics, as contained in Article 1 of the Agreement Establishing the Bank. As a result of the difficult operational environment created by these inconsistencies, the Bank's engagement with Belarus has been constrained.

The Bank remains concerned about the slow pace of reform in Belarus. Elections are not fully free and fair and the development of political pluralism, free media and civil society has a way to go before meeting the standards of a mature democracy. The state continues to dominate the economy and the use of production targets, wage restrictions, price controls and directed lending remain common. However, towards the end of the last Strategy period there have been encouraging signs of progress on both the political and economic fronts that, if continued and intensified, would provide a basis for deeper engagement with the Bank.

During the course of 2008, Belarus implemented some democratic reforms, including the release of political prisoners, the partial liberalisation of print media distribution, and showed greater tolerance towards the political opposition.

There were also several economic reforms implemented in recent years. The golden share provision was abolished across all industries in 2008 and a number of privatisations via sales to foreign investors took place. In the financial sector, improvements in regulation and supervision have been accompanied by the removal of lending interest rate caps. The simplification of the taxation regime has benefited small and medium-sized enterprises as well as companies operating in small towns. Notable progress has been made in the area of deregulation. As a result, Belarus has made impressive progress on the World Bank's Doing Business indicators in recent years, rising from the 115th ranked country globally in 2008 to 82nd in 2009 and to 58th in 2010. Further advancement of privatisation and price liberalisation are among the key stated commitments under the IMF programme agreed in January 2009.

At the same time, the macroeconomic environment has become more demanding. The Belarusian economy grew rapidly in recent years, at 8.2 per cent in 2007 and 10 per cent in 2008. However, as an open industrialised economy, Belarus has been severely hit by the global economic crisis, primarily through the external demand channel. The economy has been simultaneously exposed to negative terms of trade shocks on both the import and the export sides: while the price of Russian gas continued to increase, the price of its key commodity export, potassium, fell sharply from its 2008 peak. As a result, economic growth slowed from 10 per cent in 2008 to 1.2 per cent in the first four months of 2009 (year-on-year), despite the rapid accumulation of stocks of unsold industrial output. Belarus is one of the few countries in the transition region still showing positive growth in 2009.

The Belarusian authorities have become more open to cooperation with the international financial institutions with regard to the development and implementation of market-oriented reforms. The combination of a positive direction of change and the greater willingness from the authorities to work with the international community on ways to address outstanding issues on the transition agenda is a basis for a modified strategic approach. By cautiously increasing its level of engagement, the Bank will seek to enhance the effect of programmes recently introduced by other organisations with a similarly strong interest in moving the Belarusian transition forward.

In its Strategy, the Bank will work together with private sector investors, the Belarusian authorities and other IFIs and donors to address the following key transition challenges:

- **Development of private sector micro, small, and medium-sized businesses**, in particular through enhanced access to finance for MSMEs located outside Minsk and the regional centres.
- **Implementation of a transparent privatisation programme** across various sectors of the economy, including further commercialisation of operations and privatisation of large state-owned banks.
- **Liberalisation of trade** and adequate provision of trade finance.
- **Improvements in energy efficiency** across various sectors of the economy, particularly in Belarus' large and highly inefficient manufacturing industry.
- **Commercialisation of municipal infrastructure** as well as **improvements in environmental standards.**

The Bank's activities in addressing these challenges will continue to be guided by its mandate and its adherence to the principles of Article 1. The focus in all its operations will be on finding private sector solutions and preserving market discipline. The operational priorities in the present Country Strategy build on the foundations laid in recent years on developing the MSME sector and attracting foreign investors to Belarus.

The Strategy therefore outlines **a calibrated strategic approach** that will allow the Bank to increase its engagement with Belarus on the basis of concrete implementation of sector-specific reforms designed to promote the further development of a market economy. The objectives in Belarus over the Strategy period will include the following, with certain areas of activity to be phased in as progress in meeting sector conditions is documented:

- Expansion of existing credit lines for **micro, small and medium-sized enterprises** via established privately owned partner banks, including the Belarusian Bank for Small Business. The Bank will also consider expanding its SME credit lines to commercially oriented state-owned banks with credible privatisation prospects in order to increase the geographical reach of its credit lines into the Belarusian regions and to support future privatisation efforts.
- Provision of technical assistance and, potentially, financial support to **pre-privatisation and privatisation** measures. These activities will focus in the first instance on technical assistance for the establishment of a Privatisation Agency and the pre-privatisation of a number of medium-sized and large state-owned firms, in line with Belarus' Stand-by Agreement with the IMF and Development Policy Loan with the World Bank.
- Promotion and financing of activities aimed at increasing **energy efficiency**, by working with local financial intermediaries to develop dedicated energy efficiency credit lines. The Bank will also work with private operators and foreign strategic investors to support the development of sustainable energy sources. The development of both energy efficiency credit lines and renewable sources of energy will require the Belarusian authorities to develop an appropriate regulatory framework to foster long term investments in this sector.
- Expansion of the Bank's **Trade Facilitation Programme** (TFP) to promote cross-border activities. TFP for existing Bank clients will be increased for on-lending to private sector clients. In addition, the Bank will consider the step-by-step expansion of the TFP programme to allow private sector partner banks to provide trade finance to selected state-owned clients and make TFP available to selected state-owned banks, with similar requirements in terms of commercial nature of operations and privatisation prospects as in the MSME credit line case for on-lending to private sector clients.
- Provision of support for the reform and technical upgrade of the **environmental infrastructure and municipal services** sector in cities and smaller urban areas to reduce pollution, improve energy efficiency, and improve standards for basic services including provision of clean drinking water, sustainable processing of waste and waste water, and enhancing energy efficiency of district heating and other urban infrastructure. Where possible the Bank will work alongside partners such as the NDEP, NIB and EIB to achieve these mutually shared objectives.

In view of proposed strategic approach and operational content, Belarus would be a full beneficiary of the ETC Initiative, with the benefit of optimising the development of the private sector and required institutions, including the provision of Technical Assistance from donors and the EBRD. In this context it is proposed, following Board adoption of this Strategy, to ask donors in the ETC Assembly of Contributors to consider including Belarus as a recipient of ETC fund resources for technical assistance.

An important dimension of the Bank's activities in the current Strategy period will be proactive **policy dialogue** with the authorities on the continuing need for acceleration of reforms and importance of enhanced political and economic openness. In that connection, the Bank will continue to closely monitor progress in these domains against a set of reform benchmarks.

In the political sphere:

- Further progress toward meaningful political accountability, including the strengthening of checks and balances in the political system, removal of impediments to NGO and opposition parties' active engagement in political life and even-handed application of the rule of law.
- Further progress in increasing media freedom and freedom of expression.
- Further progress in enforcing the human and civic rights protections guaranteed in the Constitution, including freedom from arbitrary arrest and detention.

In the economic sphere:

- Creating adequate space for private sector development and competition.
- Strengthening of market-supporting institutions and the legal and regulatory framework for private sector firms to enter and compete in the market.
- Significant reduction in arbitrary and distortionary state intervention in the economy, including through directed lending in state-owned banks, wage restrictions, price controls and production targets.

The Bank will actively and continually monitor developments against these benchmarks and report to the Board of Directors on an annual basis on progress/regress. This will further enable the Bank's management and shareholders to calibrate the appropriate strategic response to changes in the situation on the ground.

The Bank will continue to ensure that all EBRD operations in the Republic of Belarus meet sound banking principles, have transition impact, are additional and are subject to the Bank's Environmental and Social Policy and incorporate, where appropriate, Environmental and Social Action Plans. The Bank will continue and enhance its cooperation with other IFIs and international organisations through co-financing and policy dialogue, and will seek to mobilise donor grant financing from other multilateral and bilateral donors and, if available, the Early Transition Countries Fund to support preparation, implementation and grant co-financing of selected investment projects.

LIST OF ABBREVIATIONS

ATC	Assessment of Transition Challenges
BAS	Business Advisory Service
BEEPS	Business Environment and Enterprise Performance Survey
CIS	Commonwealth of Independent States
DIF	Direct Investment Facility
EBRD	European Bank of Reconstruction and Development
EC	European Commission
ENP	European Neighbourhood Policy
EU	European Union
EUR	EURO
EvD	Evaluation Department
FDI	Foreign Direct Investment
GDP	Gross Domestic Product
GEF	Global Environmental Facility
IBRD	International Bank for Reconstruction and Development
IFC	International Finance Corporation
IFI	International Financial Institution
IMF	International Monetary Fund
MSEFF	Micro and Small Enterprises Framework
MSMEs	Micro, Small and Medium Enterprises
NBRB	National Bank of the Republic of Belarus
NGO	Non-Governmental Organisation
ODIHR	Office of Democratic Institutions and Human Rights
OSCE	Organisation for Security and Co-operation in Europe
PPP	Public-Private Partnership
SBA	Stand-by Arrangement
SDR	Special Drawing Right
SMP	Staff Monitored Programme
STF	Systemic Transformation Facility
TACIS	Technical Assistance to CIS
TAM	TurnAround Management
TC	Technical Co-operation
TFP	Trade Facilitation Programme
UNCHR	United Nation Committee for Human Rights
USD	US Dollar
VAT	Value Added Tax
WB	World Bank

1. THE BANK'S PORTFOLIO

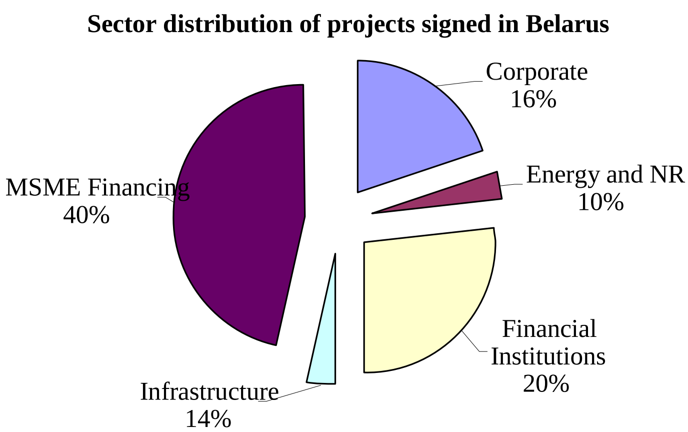
1.1. OVERVIEW OF ACTIVITIES TO DATE

The Bank's net cumulative business volume in Belarus was EUR 292 million as of July 2009. The cumulative portfolio increased by 58% or EUR 107 million from the previous Strategy period that ended in December 2006. From December 2006 to June 2009, the EBRD signed new projects in Belarus with a total commitment of EUR 67 million (including regional allocations). The Financial Institutions share of cumulative portfolio has increased from 33% to 60% as new financing was focused on local bank-intermediated MSME financing.

Table 1. Current Portfolio Stock (EUR million), including Regional (As of July 2009)

Sector Name	CUMULATIVE COMMITMENTS					CURRENT PORTFOLIO		
	No. of Projects	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	%
Financial Institutions	**23**	**217.2**	**175.2**	**60**	**101**	**21**	**59.7**	**84**
Infrastructure	**1**	**87.7**	**40.1**	**14**	**40.1**	**0**	**0**	**0**
Transport	*1*	*87.7*	*40.1*	*14*	*40.1*	*0*	*0*	*0*
Energy	**1**	**29.3**	**29.3**	**10**	**29.4**	**0**	**0**	**0**
Power & Energy	*1*	*29.4*	*29.4*	*10*	*29.4*	*0*	*0*	*0*
Corporate	**4**	**55.3**	**47.4**	**16**	**38**	**1**	**11**	**16**
Agribusiness	*2*	*25.2*	*18.7*	*6*	*9.3*	*1*	*11*	*16*
Telecoms Informatics & Media	*1*	*27.7*	*27.7*	*10*	*27.7*	*0*	*0*	*0*
General Industry	*1*	*2.4*	*1*	*0*	*1*	*0*	*0*	*0*
Country Total	**29**	**389.5**	**292**	**100**	**208.5**	**21**	**70.7**	**100**

Chart 1. Sector distribution of projects signed in Belarus



1.2. PORTFOLIO PERFORMANCE

The current EBRD portfolio in Belarus has a weighted project risk rating of 6.32, compared to 6.26 for the previous country strategy period in 2006 and the Bank average of 6.36 for CIS countries.

The portfolio disbursement ratio currently stands at 97% compared to 88% at the end-2006. There are no overdue outstanding repayments for the Bank in Belarus. Equity investments represent 22% of the portfolio, an increase from 11% at the end of the last strategy period, despite realising an exit from Priorbank.

Since the last strategy period, the Bank has exited from one equity investment by selling its minority equity position in Priorbank to a strategic investor – Raiffeisen group of Austria – realising a substantial gain on this investment. A new strategic investor has been attracted to one Bank investee company in Belarus, Olivaria brewery. BBH, a subsidiary of Carlsberg, Denmark, has entered into Olivaria at a substantial premium to the original Bank investment, thus allowing the Bank to book unrealised financial gain on the value of its equity stake in the company.

1.3. PROJECT PIPELINE

The Bank's 2009-2010 pipeline in Belarus is more widely diversified among various sectors than in recent years. In the financial sector, a number of smaller privately owned banks have been identified as potential new partners for SME/MSE financing. In addition to new facilities with local financial intermediaries to support their MSME lending activities through credit lines or equity investment, the Bank is also considering investments with privately owned corporates in food processing, retail, wood processing, logistics, property, general manufacturing and services sectors.

1.4. IMPLEMENTATION OF THE PREVIOUS COUNTRY STRATEGY

The Bank's Country Strategy for Belarus, approved in December 2006, established three 'scenarios' – baseline, intermediate and regular – which the Bank would pursue conditional upon progress in the implementation of democratic and market-oriented reform. Throughout the previous Strategy period Belarus has remained in the baseline scenario, which established the following strategic priorities for the Bank's operations:

- Portfolio management of existing investments, including continued support to MSMEs through approved Lines of Credit with privately-owned banks;
- Consideration of provision of MSME credit lines directly to individual private banks, and equity investments in private banks, when the investments are small and the Belarusian state has no control or veto power;
- Expansion of the Trade Facilitation Programme to additional bona fide private banks;
- Selective direct investments in local and foreign private companies, including through the Direct Investment Facility; and
- Advisory services to SMEs via the Turn Around Management and Business Advisory programmes.

In line with the baseline operational priorities, the Bank has focused its efforts on MSME financing. New SME/MSE facilities have been signed with two larger non-Belarusian state owned banks. A specialised framework approach has been pursued to facilitate more effective SME/MSE credit line administration in smaller amounts. The extension of the SME/MSE financing framework for USD 25 million has been fully utilised with four participating local banks. Additional extension of the Framework has been approved increasing both the amount to USD 50 million and the scope of the facility, which will now include other financial intermediaries such as leasing companies and new financing instruments such as equity investment, subordinated loans and all types of senior debt. One MSME credit line has been signed for USD 10 million with Minsk Transit Bank as part of this new Framework extension. In total, more than 15,000 MSME loans have been issued to date from the credit lines provided by the Bank in Belarus.

A specialised bank for MSME financing – Belarus Bank for Small Business (BBSB) – has been created in co-operation with other IFIs, bilateral development agencies, private sector partners and technical assistance donors. BBSB received a banking licence in October 2008 and since has since opened three fully equipped branch offices. By June 2009 BBSB had disbursed more than 430 loans to micro and small business clients in Belarus.

An equity investment, supplemented with subordinated debt and MSME line, has been extended to RRB bank, a relatively small privately owned bank focused on catering to small and medium size private sector businesses. An extensive Institutional Strengthening Programme is being undertaken at RRB as part of the investment package. Partner banks continue receiving support under the dedicated technical assistance programme enabling them to improve their MSE lending operations, to train staff and to broaden their MSE client base, particularly outside of the city of Minsk.

The Trade Facilitation Programme has been continued with private sector banks, and the number of participating banks has been increased from two at the start of the present Strategy to four banks as of June 2009 while the total TFP limit increased from EUR 7 million to EUR 42 million. From June 2009, partner banks also benefit from trade finance advisory services provided by the Bank consultants, which is expected to intensify the utilisation of the facilities already available by improving and widening the technical expertise in the country for these very specific instruments as well as spread the awareness among the banks and their clients of the benefits that TFP can bring particularly in such challenging times for cross-border trade and finance.

Donor funding mobilised in 2009 will allow the re-launch of TAM assistance to SME clients in Belarus. A consultant has been engaged to identify suitable new clients and specific project work is expected to start before the end of the year.

1.5. PORTFOLIO RATIO

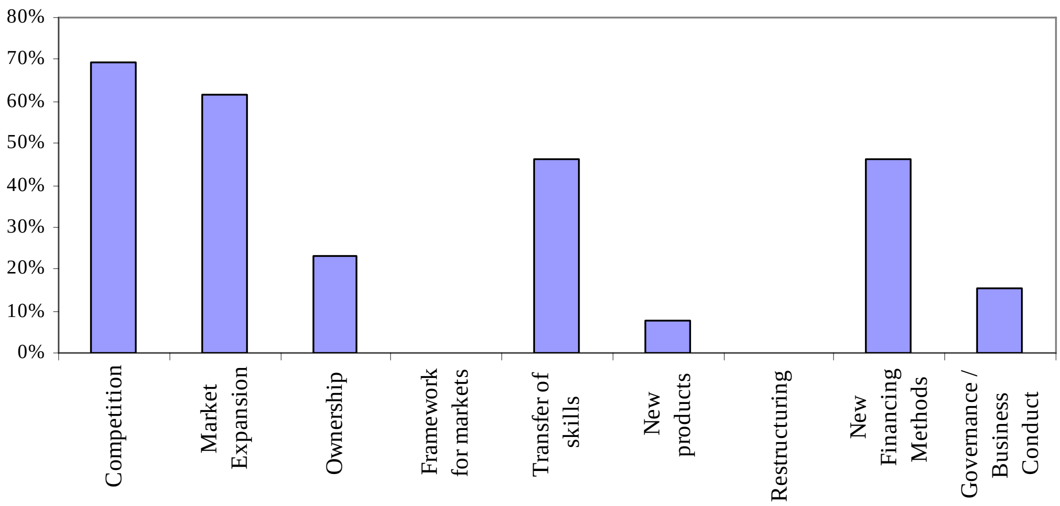
Financing of the private sector represents 100% of the current portfolio, as opposed to 93% in December 2006. The share of public sector financing has decreased over the years through repayment of earlier sovereign projects (Minsk Wholesale Market, Highway, and sovereign SME Line of Credit).

1.6. TRANSITION IMPACT OF THE PORTFOLIO AND LESSONS LEARNED

Transition Impact

All projects in Belarus approved over the last Strategy period were ranked “Good” or “Excellent” in terms of their transition impact potential. The financial sector accounted for approximately three quarters of projects, with a large contribution from credit lines for on-lending to micro, small, and medium-sized private enterprises. Consequently, the main transition objectives pursued by EBRD operations in Belarus were market expansion and competition (over 60 per cent of cases, see Figure 2), as well as transfer of skills and new financing methods. Most MSME credit lines have been supported by TC projects to assist partner banks to set up and expand MSME lending programmes.

Figure 2. Belarus: Share of Operations Pursuing Certain Transition Objectives



The projects performed strongly over the review period, which is reflected in the gradual reduction over time of assessed risks to transition impact, without changes to the assessment of transition impact potential.

In the agribusiness sector the Bank’s involvement with Olivaria, a brewery, successfully achieved most of the core transition objectives, including operational restructuring and technological improvements, staff training, advances in management practices, and improvements to corporate governance and standards of business conduct, thus cementing a strong positive demonstration effect of this transaction.

Newly approved projects in the corporate sector with excellent transition impact are aimed at expanding transition further into other sectors, firstly in wood processing and furniture manufacturing. The risks to transition impact of such projects remain high due to both state dominance in the sector and the regulatory environment, as well as the market risks related to the global and regional economic situation.

The overall transition impact of the Bank's portfolio in Belarus was assessed as *Minimal* at the time of adopting the previous Country Strategy. The increasing volumes, the involvement of new participating banks in the Bank's MSME lending facilities and new corporate sector projects have allowed for a gradual strengthening of the transition impact, particularly in the Financial Institutions sector. However, the Banking sector continues to be dominated by large state owned banks and no EBRD activities have taken place yet in Non-Bank Financial Institutions or Private Equity Funds. The Transition Impact within the Financial Sector is therefore rated as *Moderate*. Due to a very limited number of completed operations, the Transition Impact in the enterprise sector is considered to be *Minimal* while there were no projects in Infrastructure and the Transition Impact in this sector is rated as *None.* The transition challenges were most recently rated to be *Large* in each sub-sector.

The overall Transition Impact as in the previous Strategy period remained assessed as *Minimal*.

Lessons Learned

The Evaluation Department reviewed Olivaria brewery in July 2008. The Bank approved this operation in July 2005. It consisted of a loan and equity facility of USD 8 million. The purpose of the loan was the restructuring and expansion programme of the brewery which had been founded on the same location in 1864 and had been privatised in 1994 as a 100% privately-owned entity via a concessionary voucher privatisation scheme.

Evaluation Department assigned a *Successful* performance rating in acknowledgement of the well-timed investment by the Bank and the extremely successful competitive tendering process for finding the most suitable strategic investor. The transition impact was rated *Good* based on the excellent impact of the strategic investor. The environmental performance of the project was rated *Satisfactory*/*Good* and the extent of environmental change as *Substantial*/*Some.* The Bank's additionality was *Verified* in all respects. The Company's financial performance was rated *Satisfactory*. Many of the initiated improvements/restructuring efforts will contribute to improved performance when production can be further increased. The fulfilment of project objectives was rated as *Excellent*. Bank handling as well as the Bank's investment performance were rated *Excellent*. This project was a very good case study of what the Bank has been able to achieve in Belarus.

The financial sector is still evolving in a difficult environment and even though Prior Bank and a number of smaller banks are foreign-owned, their impact on the sector remains modest. A lesson learned from the Belarus SME Credit Line is to carry the policy dialogue ahead of the project.

2. OPERATIONAL ENVIRONMENT

2.1. GENERAL REFORM ENVIRONMENT

Over the last Strategy period, Belarus made some progress in structural reforms. Following the abolition in 2006 of the golden share provision—the right of the state to take over management of privatised enterprises—in the financial sector, the golden share was abolished across all industries in 2008. Alongside the ongoing programme of corporatisation of state unitary enterprises, a number of one-off privatisations took place, including the sales of two mobile telecom operators, a number of medium-sized banks, and a small number of medium-sized industrial enterprises to foreign investors. The commodity exchange, which opened in late 2005, has been expanding its operations gradually. A programme to simplify the taxation regime has benefited small and medium-sized enterprises in particular, as well as companies operating in small towns. In the financial sector, improvements in regulation and supervision were accompanied by the removal of lending interest rate caps.

Progress has been notable in the area of deregulation, with the streamlining of real estate registration rules in 2008 and the introduction of a one-day registration policy for enterprises and individual entrepreneurs from February 2009. As a result of these reforms, Belarus climbed 57 positions in the World Bank's Doing Business indicators, from 115th place in the 2008 survey to 82nd in 2009 and 58th in 2010, having achieved high scores in the categories "starting a business", "registering property", and "enforcing contracts". The government is committed to implementing further improvements to the regulatory environment, and further progress in the areas of privatisation and price liberalisation are among the key stated commitments under the IMF programme agreed in January and updated in June of 2009.

However, the Belarusian state continues to dominate the economy and the business environment for privately owned firms remains difficult. Production targets, wage restrictions, price controls and directed lending remain common, and affect both domestic and foreign-owned private firms as well as state-owned enterprises. Despite simplification of the tax regime, Belarus continues to be among the countries with the highest number of taxes and the highest tax burden in the world. Belarus also faces significant challenges with administrative corruption, as reflected in the country's score on both the World Bank's Worldwide Governance Indicator on 'Control of Corruption' and Transparency International's Corruption Perceptions Index. However, the latest EBRD-World Bank Business Environment and Enterprise Performance Survey, conducted in 2008, found that corruption was reported as a less significant obstacle to firms than crime, theft and disorder, and that the frequency of bribery in specific areas such as the courts and customs and import is lower than average for the CIS region, and has declined from 2005-2008.

2.1.1. Political Environment

Belarus' president, Alyaksandr Lukashenka, has dominated the Belarusian political landscape since his election in 1994. Since the beginning of 2008, however, the Belarusian authorities began a gradual process of political liberalisation leading to the implementation of a number of important steps in the field of democratic political reform. In recognition of these important steps, the European Union suspended the travel ban it imposed in 2006 for all but four of fifty persons on the travel blacklist, and the United States suspended the prohibition on the operations of two of the subsidiaries of the state-owned petrochemicals concern Belneftekhim. Nevertheless, despite these positive first steps toward political liberalisation, significant challenges remain to establishing Belarus firmly on the road toward multiparty democracy, pluralism and the protection of human rights.

Since 1994, regular elections to both the presidency and parliament have been held in Belarus. However, these elections have been neither free nor fair, as judged by international election monitors. In the most recent parliamentary elections in September 2008, the Belarusian authorities permitted seventy opposition candidates to register their campaigns, and many of them were granted limited access to the media. The Election Observation Mission from the OSCE's Office of Democratic Institutions and Human Rights concluded that minor improvements were evident in the conduct of the election, and that the cooperation extended to the Observation Mission was considerably improved. However, the OSCE concluded that the elections ultimately fell short of OSCE commitments for free and fair democratic elections. Particular shortcomings related to the overall election environment in Belarus, including restrictions on the rights to freedom of assembly and expression, which did not allow genuine political competition and equal treatment of election competitors by the Belarusian authorities. An international observation mission from the Commonwealth of Independent States (CIS) concluded that the elections had been carried out in generally democratic conditions and fully complied with both national legislation and international norms and standards. Of the seventy opposition candidates registered in for those elections, none were elected. Many opposition candidates alleged widescale ballot box fraud.

The most significant progress in the field of democratic reform in Belarus during the past year occurred in the human rights field. During 2008, all internationally recognised political prisoners in Belarus were released from prison, including the 2005 opposition presidential candidate, Alyaksandr Kazulin, after serving almost three years. Police and secret police crackdowns on opposition protests have become less frequent and less violent in the past year, although this might be attributable to the decline in attendance at such protests. Despite these positive developments, serious shortcomings in the protection of human rights in Belarus remain. For example, a number of the internationally recognised political prisoners released during 2008 remain under house arrest. The arrests of political activists continue periodically, and a number of youth political activists have been conscripted into the military despite claiming valid exemptions.

Some progress has been achieved in the area of pluralism and the strengthening of the constitutionally enshrined rights of citizens to form civil society organisations and to express their views openly. Important steps in this regard include the official registration in December 2008 of the social-political movement ‘For Freedom’ by the former opposition presidential candidate Alyaksandr Milinkevich. Nevertheless, significant challenges remain in the field of political pluralism. Opposition political parties as well as many independent civil society and non-governmental organisations continue to face difficult conditions, including the denial of registration on questionable ‘technical’ grounds. Most recently, the Belarusian Christian Democratic Party and the human rights organisation “Viasna” were denied registration for alleged irregularities in their registration documents. Furthermore, opposition political parties and civil society organisations that are registered continue to face obstacles ranging from difficulty obtaining premises to frequent and unjustified inspections by tax and other state officials.

Some progress has also been made in the latter half of the previous Strategy period with regard to liberalisation of the mass media. In November 2008 two independent newspapers, *Narodnaya Volya* and *Nasha Niva*, were granted distribution licenses with the state-owned Belarusian Post Office. Despite this important step, the mass media market remains dominated by state-owned television and radio stations and newspapers, opposition political parties and activists receive little domestic media coverage, and a further ten independent newspapers have been denied inclusion in the state-owned newspaper distribution system and are therefore able to work only from abroad.

Refer to Annex 1 for a more detailed assessment of the political environment.

2.1.2. Social Conditions

Belarus’ population, estimated at about 9.7 million people, has been declining in recent years (although the rate of decline has slowed), as the mortality rate exceeded the birth rate while net migration remained relatively low. At the same time, life expectancy at birth has been increasing steadily since the mid-2000s and reached 64.5 years for men and 76 years for women in 2007. Rural areas account for 35 per cent of the total population, down from 37 per cent in 2005, highlighting the urbanisation trend. In the UN Human Development Index Belarus is ranked 64th, a few positions below the GDP per capita ranking.

The official unemployment rate is low and continued declining despite the global economic and financial crisis to reach 0.9 per cent in May 2009. However, the crisis has led to an increase in the incidence of part-time work, which may not be fully reflected in the unemployment numbers. In addition, the Belarusian labour force also includes irregular migrant workers not accounted for in these data.

Belarus ranks highly on the Gender Development Indicator (15th out of 156 countries), as women tend to be economically active and account for 52.8 per cent of the total employment in the economy, including 45 per cent of employment in industrial enterprises. Women are also well represented in parliament (29 per cent). At the same time, the 2006 UN Special Report noted that women were particularly vulnerable to discrimination in recruitment and dismissal and were paid on average 20 per cent less than men.

Poverty alleviation has always been high on the policy agenda in Belarus. Extreme poverty (defined as income below the minimum consumption level estimated at approximately USD 3 a day in 2007 prices) declined from 42 per cent in 2000 to 7.7 per cent in 2007. The percentage of the population with income below the country-specific poverty threshold of approximately USD 4.5 a day ("minimum consumption budget") declined from 77 per cent in 2000 to 29 per cent in 2007. However, both indicators are likely to be negatively affected by the economic and financial crisis.

The Gini coefficient, a common measure of income inequality, increased in Belarus from 0.26 in 2006 to 0.27 in 2007 but remains remarkably low by international standards (for comparison, the corresponding value in Russia is 0.42). The average pension exceeded the official poverty threshold in 2006 for the first time in many years, and increased further in 2007 to USD 153 a month.

The state has largely maintained control over medical services, safeguarding the constitutional rights of citizens to free medical assistance. The infant mortality rate, at 4.5 deaths per 1,000 births, is relatively low by international standards.

2.1.3. Legal Environment

Over the course of the past three years, important new laws regulating the procedure for the registration of rights to property and establishing joint stock companies and other commercial enterprises have been adopted. New SME-specific laws have been introduced. On the one hand, the new laws made the rules applicable to individual entrepreneurial activity more restrictive by, for example, requiring that any business that has more than three employees who are not relatives of the entrepreneur be registered as a legal entity, and subjecting businesses to more stringent accounting, reporting, taxing and customs formalities. On the other hand, the procedure for registering a business entity was simplified in January 2009 by a Presidential Decree, pursuant to which it became possible (except for banks and non-bank financial institutions) to register by declaration on the day of application. In addition, another Presidential Decree issued in August 2008 made individual entrepreneurs working in rural areas exempt from income tax and, in some circumstances, from import duties and the value-added tax on imported manufacturing equipment, components and spare parts (with the exception of commodities imported from Russia). The latter Decree also expanded the range of businesses that enjoy preferences in rural areas.

Some changes have been introduced into banking legislation. In response to the worsening economic environment, the system of state guarantee for moneys deposited by individuals in accounts with commercial banks was introduced by Presidential Decree in 2008. According to such Decree, the state undertakes to compensate in full the total amount of monies kept on retail and deposit accounts with a licensed commercial bank should the Central Bank of Belarus revoke a banking license from such bank. Previously, the Belarusian state guaranteed deposits of up to EUR 5,000 and only in largest state-owned banks. By a Resolution of its Board, the National Bank of Belarus in October 2008 also increased the minimum required regulatory capital for Belarusian commercial banks taking retail deposits to EUR 25 million.

In April 2009, certain amendments were introduced into the bankruptcy legislation. The changes were made to clarify the role of bodies of the state administration in the context of a bankruptcy procedure, as well as the rights and powers of the owners and other stakeholders in the case a company is declared bankrupt.

Belarus has now adopted some basic elements of a governmental policy with respect to promoting Public Private Partnerships and developing a legal framework for their implementation. The country does not have a special Concessions Law; however, the Investment Code of 2001, as amended, contains detailed provisions regulating concessions. Nevertheless, substantial work remains to be done to enable an effective legal and regulatory environment for private sector investment into public utilities and services.

Belarus has started to adjust its privatisation regulatory framework in order to meet the benchmarks of the country's privatisation plan for 2008-2010. Certain regulations have been adopted to provide further guidance on reform of state property and the programme of denationalisation and privatisation of state-owned facilities. Such regulations, however, fall short of making any substantive changes to the cumbersome existing privatisation procedures. Although the state property management functions have been transferred from the Ministry of State Property Management to a more specialised agency, the State Property Committee, the latter has not been equipped with the requisite authority to develop and effectively implement privatisation projects and such mandate still requires involvement of various other ministries and state agencies. Following the recommendations of the International Monetary Fund, Belarus has undertaken to adopt a new Privatisation Law by February 2010.

2.1.4. Environmental Situation

Environmental and natural resource challenges present one of the most critical and complex areas in achieving environmentally sustainable economic growth for Belarus.

The land pattern of Belarus comprises arable land (27%), forests and woodland (38%), while marshland covers about 4% of the total area. Except for agricultural and forestry resources, Belarus is relatively poor in other resources. Peat is plentiful and is used as household fuel. In general, the local energy production, mainly oil, covers only 5% of the country's energy needs. Belarus also has deposits of potassium salt, limestone and phosphates.

Industrial activities are concentrated in urban zones where they discharge pollution into the air. Ambient air quality is a concern in Novopolotsk, Polotsk, Gomel, Svetlogorsk, and Vitebsk[1]. The biggest air polluters in these cities are chemical factories, power plants and manufacturing enterprises. Industry is the main polluter of the water through its waste water discharges. Another area of concern is biodiversity loss, especially in southern parts of the country in Polessie due to the poor irrigation practices of the past.

Although the environmental situation in Belarus has improved overall during the last few years, further challenges remain in the area of reducing air emissions from transport, industry and energy generation sectors as well as controlling and reducing water pollution, soil contamination and waste generation from industrial, agricultural and domestic sources. The majority of environmental improvements have taken place as a result of increased environmental expenditure (reported to be about 2.1% of the annual GDP) to finance energy efficiency, use of local resources, acquisition and installation of pollution abatement equipment and raising the level of environmental education and awareness of the public. Consequences of the 1986 accident at the Chernobyl nuclear power plant in Ukraine still affect the population, environment and economy of Belarus significantly. Twenty three years after, about 20% of the country is still contaminated with long-lived isotopes of caesium above acceptable levels. Environmental concerns are also raised by the recent plans to construct the country's own nuclear power plant in the north-western part of Belarus, with the two first reactors to be put in operation by 2016-2020.

Further environmental challenges are also being presented by climate change in such areas as agriculture, forestry and water resources and ecosystems management, and it has been recognised that Belarus will need to put forward adaptation measures to protect its social and economic systems from changing climatic conditions.

[1] UNECE Second Environmental Performance Review (2005)

The government of Belarus attaches high priority to environmental protection and management, and has adopted a number of key programmes and action plans, including the National Action Plan on the Rational Use of Natural Resources and Environmental Protection (NEAP[2]) for 2006-2010 and the National Strategy for Sustainable Development for the period to 2020 (NSSD[3]), and the National Programme of Measures to Mitigate the Consequences of Climate Change for 2008-2012. The overarching legislative document on environmental issues is the 1992 Law on Environmental Protection amended in 2002.

The challenges and opportunities in the environmental domain of Belarus will continue to be appraised and addressed by the Bank through its due diligence, monitoring and sustainability initiatives. Further information is provided in Annex 2.

2.2. MACROECONOMIC ENVIRONMENT

The Belarusian economy has been growing very rapidly in recent years, at the rate of 8.2 per cent in 2007 and 10 per cent in 2008. However, as a result of being an open industrialised economy, Belarus has been severely hit by the global economic crisis, not so much through the financial channel as through the external demand channel. Merchandise sales to Russia, Ukraine and other CIS countries have dropped sharply since September 2008. The economy has been also simultaneously exposed to negative terms of trade shocks on both the import and the export sides: while the price of Russian gas continued to increase, the price of its key commodity export—potassium—fell sharply from its summer 2008 peak. As a result, economic growth slowed down from 10 per cent in 2008 to 1.2 per cent in the first four months of 2009 (year-on-year), despite rapid accumulation of stocks of unsold industrial output.

Declining export revenues led the authorities to devalue the currency, which had been de facto pegged to the US dollar, by 20.5 per cent on 2 January 2009 and re-peg it to a basket consisting of the US dollar, euro, and Russian rouble in equal proportions. Pressures on the currency also forced the National Bank to limit liquidity injections into the banking system and raise the policy interest rate from 10 to 14 per cent. In January 2009 the authorities reached an agreement with the IMF on a USD 2.5 billion stand-by arrangement, which was augmented to USD 3.5 billion after the first review in June 2009, and may be complemented by further budget support from the World Bank. The first tranche of USD 800 million propped up the currency reserves, which at USD 4 billion cover around two months of imports. The package of measures agreed with the IMF includes fiscal discipline, in particular public sector wage restraint and a balanced budget in 2009, and moderation of directed lending through state-owned banks. As a sign of commitment to the programme, the authorities last December announced a 15 per cent nominal cut in government sector wages, almost entirely reversing the increase of 21 per cent granted in November. In addition, the 2009 budget foresees further public sector wage reductions in real terms.

Financing for the current account deficit, which is expected to rise, will depend on external borrowing by the sovereign from IFIs, Russia and China. The latter granted Belarus a three-year

[2] NEAP proposes broadening and strengthening international cooperation as a way to solve environmental problems effectively. The priority objectives are the implementation of agreements under the “Environment for Europe” process; implementation of international conventions, protocols and agreements to which Belarus is a Party; further development of bilateral and multilateral relations; attracting foreign investments for environmental programmes and projects. Overall NEAP sets to achieve reduction of anthropogenic impacts on the environment, improvements of environment and health of the population; rational and economic use of natural resources; biodiversity protection; development of resource-saving and resource-efficient low-waste technologies, industrial modernisation, re-use of resources and recycling.

[3] NSSD-2020, approved in May 2004, has been given high priority. It sets forth the principal guidelines for the transition to sustainable development in two main stages: 1) Stage one (until 2010) to further improve living standards based on the development and wise use of human capacity and a more efficient and competitive economy; and 2) Stage two (2011–2020) to lay the groundwork for a new post-industrial information society, with a new technological basis designed to ensure a smooth transition to resource-saving production.

ruble-yuan currency swap line of USD 2.9 billion equivalent, effectively a trade credit for imports of Chinese products. The Russian government has disbursed the second tranche of the second stabilisation loan (bringing the total of two loans to USD 3 billion) and is considering another request for USD 0.5 billion.

2.3. PROGRESS IN REFORM AND KEY TRANSITION CHALLENGES

Over the last Strategy period Belarus received a number of EBRD Transition Indicator upgrades in recognition of the recent implementation of some important economic reforms. The upgrades included banking, large-scale privatisation, enterprise restructuring, as well as an upward revision of the estimate of private sector share of GDP.

In the financial sector, following the abolition of the “golden share” provision in 2006, privately-owned banks have increased their presence, in particular in the MSME segment of the market. The quality of regulation and supervision has been gradually improving, lending interest rate ceilings have been suspended, the system-wide cap on foreign ownership has been increased to 50 per cent, and recently introduced universal deposit insurance levelled playing field between Belarusbank and other deposit taking institutions. At the same time, the pension system and the insurance sector remained largely unreformed, with state-owned companies continuing to enjoy monopoly rights to offer compulsory insurance.

Private sector activity has been gradually increasing in the corporate sector as well, helped by the simplification of administrative procedures, some streamlining of taxation, the recent abolition of the “golden share” provision, the launch of the commodity exchange, the gradual phasing out of restrictions on trade in shares of privatised companies, and a few privatisations with participation of foreign investors. At the same time, excessive regulation, including in the areas of certification and price setting, remains pervasive. There have been no major reform initiatives in the infrastructure sector, with private sector participation to date confined to urban transport.

Despite some progress, overall the economy remains dominated by the state and the transition challenges remain large across virtually all sectors of the economy, as reflected in the 2009 Assessment of Transition Challenges (see Annex 5). Indeed, Belarus is among the least advanced countries in terms of progress in transition (see Annex 6).

The key transition challenges include the development of micro, small, and medium-sized businesses; preparation of enterprises and large banks for privatisation and completion of privatisations; improvements in energy efficiency; liberalisation of trade; and commercialisation of municipal infrastructure alongside improvements in environmental standards.

- Despite some recent improvements in operational environment, **micro, small and medium-sized enterprises** face a number of constraints, of which access to finance is a very important one, in particular outside Minsk and regional centres (Brest, Gomel, Grodno, Mogilev, and Vitebsk). Reaching out to smaller towns remains a major challenge, which could be addressed either through expansion of office networks of banks that are active in the SME segment or by expanding commercial SME lending operations of large state-owned banks with extensive regional networks such as Belarusbank and Belagroprombank.

- In **the banking sector**, where four state owned banks account for 75 per cent of the assets of the banking system and face issues related to directed lending, an important transition challenge is to achieve substantial commercialisation of operations of the largest banks, for instance by means of setting up a Financial Development Agency that could take over administration of a significant part of state-sponsored subsidised lending programmes and to simultaneously undertake concrete pre-privatisation efforts to enhance the attractiveness of targeted state owned banks for strategic investors.

- Despite one-off privatisations, a significant number of medium and large-sized enterprises across various industries, and some large firms in the services sector remain in state ownership. **Facilitation of privatisation** of large enterprises and further commercialisation of operations and privatisation of large state-owned banks thus remain the key transition challenges. Pre-privatisation projects could be an effective way of helping to address this challenge. Such projects would include consideration of energy efficiency investment potential.

- **Trade facilitation** remains a major challenge, in particular in the current environment, in which trade flows have been severely disrupted by the global economic and financial crisis. More broadly, trade liberalisation needs to be pursued further by means of phasing out price controls (currently goods with administered prices account for over 10 per cent of consumer price index basket of goods and services) and liberalisation of price setting (for most other goods retail margin is capped at 30 per cent and other restrictions are in place).

- More generally, **energy efficiency** is a major challenge for Belarus, which inherited a highly industrialised economy with highly inefficient use of energy. Despite remarkable improvements over the last 15 years when energy intensity of output more than halved thanks to investment in modernisation of production and structural economic shift towards services, production in Belarus remains very energy intensive by international standards, with many inefficient and environmentally unfriendly technologies still in use and continues to lack the adequate institutional and incentive structure to adjust to a more sustainable path of energy use. The pricing of energy remains inadequate to incentivise efficient use and the non-price barriers to energy efficiency persist. Incentives for improvements in energy efficiency need to be strengthened through appropriate policies, including market pricing of energy and establishment of a clear framework for renewable energy. Improving energy efficiency will be an integral part of investment agenda in the private sector, pre-privatisation and selected public sector projects that are envisaged in this strategy.

- **Municipal infrastructure** requires both substantial investment and commercialisation to ensure its medium and long-term sustainability. A number of facilities are near-obsolete and present a substantial environmental hazard, locally and for the Baltic region more generally. At the same time, cost recovery in municipal infrastructure has been declining as prices of energy rose, with the cost recovery ratio currently standing barely above 30 per cent. Application of economically justified tariffs and improvements in efficiency of service provision, including energy efficiency, could help to achieve a substantial and sustained increase in cost recovery ratios combined with improved service quality.

2.4. ACCESS TO CAPITAL

The level of financial intermediation has increased notably over the last three years. Private sector credit-to-GDP ratio increased from around 25 per cent in 2006 to over 40 per cent at end-2008, of which consumer credit accounts for 7.5 percentage points. This is comparable to the levels of credit in Russia and Poland but is below levels observed in Central Europe and some CIS countries (Ukraine, Kazakhstan). Access to credit remains highly uneven across enterprises and sectors, with priority sectors such as agriculture and large industrial exporters enjoying easier access at preferential terms and often subsidised rates. Programmes of micro-lending and lending to small and medium-sized enterprises have been growing in size and outreach, but this segment remains largely underserved, in particular outside the capital and regional centres. In the 2008 Business Environment and Enterprise Performance Survey (BEEPS) around 10 per cent of firms named access to finance as a major obstacle for development, in the third place after taxes and level of human capital.

Effective lending rates have been largely stable, with some downward trend, but have increased with the onset of the financial crisis in late 2008. Around one third of loans by volume are denominated in foreign currency, mostly in US dollars, both in the corporate and in consumer segments.

In August 2007 Belarus obtained its first sovereign ratings from international credit rating agencies (long-term foreign currency B+ from Standard & Poor's and B1 from Moody’s). These ratings have been left unchanged since. Belarus has not yet made use of these ratings opting for bilateral loans from Russia and IFI financing (primarily a USD 3.5 billion stand-by agreement with the IMF signed in 2009). Sovereign rating has arguably facilitated access to syndicated markets for large Belarusian banks, such as Belarusbank and Belagroprombank enjoying explicit and implicit support of the Belarusian state, their owner. However, with the onset of the financial crisis international markets have been effectively shut for Belarusian borrowers. A few banks have strong international parents (Raiffeisen in the case of Priorbank, the third largest bank, Societe Generale in case of Belrosbank via Rosbank Russia, and major Russian banks in the case of Gazprombank and VTB subsidiaries).

FDI inflows have increased and averaged 3.8 per cent of GDP in 2007–08, up from 0.9 per cent of GDP in 2004–06. However, higher inflows largely reflect a few large deals and one-off privatisations, most notably a sale of a 50 per cent stake in Beltransgaz, a pipeline operator, to Gazprom for USD 2.5 billion in four instalments, of which three have been paid.

3. STRATEGIC DIRECTIONS AND OPERATIONAL PRIORITIES

3.1. BANK’S PRIORITIES FOR THE STRATEGY PERIOD

The Bank’s strategic and operational priorities in addressing the key transition challenges in Belarus will continue to be guided by its mandate and its adherence to the principles of Article 1 of the Agreement Establishing the Bank. The operational priorities in the present Strategy build on the foundations laid by the Bank in recent years, focused on developing the MSME sector and attracting foreign investors to Belarus. The Bank’s overriding priority during the Strategy period, as in past Country Strategies, will continue to be the provision of support for private sector development as a means to promote further progress in political and economic transition in Belarus.

The Bank will also work to identify new projects in general industry, agribusiness, property and tourism, telecoms, informatics and media sectors either with local private sector sponsors or foreign investors. A larger use will be made of Direct Investment Facility (DIF) for equity investments and Direct Lending Facility (DLF) or Medium-sized Loan Co-financing Facility (MCFF) for debt financing. Such ETCI instruments are tailored to facilitate financing of smaller companies and projects in the private sector in Belarus.

The Bank welcomes the greater openness of the authorities to working with the international community and the recent evidence of progress in some areas of structural reform in Belarus. This creates a new basis for the Bank to modify its strategic approach to take advantage of the evolving opportunities in moving transition forward in an environment where many serious challenges remain.

The Bank’s strategic approach will be carefully calibrated to increase its operational scope in a measured and incremental way, as the Belarusian authorities make further progress in political and economic reform. As such, it will monitor a set of political and economic benchmarks and continue to engage actively with the authorities in high level policy dialogue in those areas.

In the political sphere:

- Further progress toward meaningful political accountability, including the strengthening of checks and balances in the political system, removal of impediments to NGO and opposition parties’ active engagement in political life and even-handed application of the rule of law.

- Further progress in increasing media freedom and freedom of expression.
- Further progress in enforcing the human and civic rights protections guaranteed in the Constitution, including freedom from arbitrary arrest and detention.

In the economic sphere:

- Creating adequate space for private sector development and competition.
- Strengthening of market-supporting institutions and the legal and regulatory framework for private sector firms to enter and compete in the market.
- Significant reduction in arbitrary and distortionary state intervention in the economy, including through directed lending in state-owned banks, wage restrictions, price controls and production targets.

Positive developments in these areas will contribute to the creation of a more favourable business environment for the Bank's operations with private sector clients in a wider range of sectors in the economy and open up the possibility for working cautiously with state-owned entities. Thus, the second way in which the Bank will calibrate its strategic approach is by engaging with Belarus on the basis of the concrete and measurable implementation of sector-specific reforms designed to advance the market economy. In this respect, the calibrated strategic approach is based on explicit 'criteria' for each sector in which the Bank might undertake projects involving state-owned or public entities. These criteria include two forms of sector-specific policy reforms. The first are those that must be met *ex ante*, as a precondition for the Bank's engagement with state-owned or public entities in that sector. The second are those that would be implemented as a result of, and during the course of, any agreed project in that sector. This will enable the Bank to work closely with the Belarusian authorities as well as the other international financial institutions to maximise the transition gains from the Bank's operations in Belarus.

Building on the Belarusian authorities' increasing willingness to implement structural reforms, the Country Strategy for Belarus will focus on supporting the following priority areas:

- **Development of private sector micro, small, and medium-sized businesses**, in particular through enhanced access to finance for MSMEs located in the regions.

- Continued financing of **private sector enterprise** in Agribusiness, General Industry, Property and Tourism, Telecoms, Informatics and Media sectors. Widening the use of the instruments available to support private sector in ETC countries.

- **Implementation of a transparent privatisation programme** including further commercialisation of operations and privatisation of large state-owned banks with a view to prioritise those banks that are credible candidates for privatisation to channel MSME lines of credit as well as trade facilitation programmes.

- **Improvements in energy efficiency** across various sectors of the economy, particularly in Belarus' large and highly energy inefficient manufacturing industry. Depending on the results of an ongoing market demand study, credit lines for private SMEs and the residential sector could be considered, utilising the successful Sustainable Energy Financing Facility model.

- **Liberalisation of trade** and adequate provision of trade finance.

- **Commercialisation of municipal infrastructure** alongside improvements in environmental standards and energy efficiency.

The sector-specific criteria for engaging with state-owned or public entities in these sectors are described in section 3.2 below.

3.2. SECTORAL CHALLENGES AND BANK OBJECTIVES

The Bank's objectives for the Strategy period will focus on the development of MSMEs through enhanced lending, involving both private and state-owned banks, as well as technical assistance; support for the Belarusian authorities' stated intention to develop and implement an open, transparent and competitive privatisation programme, including pre-privatisation support as well as openness to the participation in privatisation of Belarusian enterprises and financial institutions of both domestic and foreign strategic investors; the provision of targeted financial instruments to improve energy efficiency and to develop the renewable energy sector in Belarus; the promotion of trade liberalisation and deepening through the expanded provision of Trade Facilitation Programme financing; and support for the reform and technical upgrade of environmental infrastructure and municipal services in cities and smaller urban areas.

Supporting reform and development in these key sectors will maximise the Bank's potential leverage to promote further progress in Belarus' transition to market-based principles and standards in the economy, as well as improving the overall operating environment for private firms and strengthening the investment climate to facilitate the acceleration of foreign direct investment in Belarus.

3.2.1. Micro, Small and Medium-sized Enterprise Development

The Bank will continue working with partner banks, exploring opportunities of engaging with non-bank financial institutions, and supporting the Belarusian Bank for Small Business (BBSB), particularly in its regional expansion phase, through debt and equity investment if required. Through BBSB and MSE lines of credit available to partner banks, the Bank has acquired, in aggregate, a leading position in the microfinance market. Its impact on the Belarus private sector remains, however, significantly hindered by the limited outreach of its primary distribution channel for MSME lines of credit only through privately owned banks that collectively account for less than 25 per cent of the overall banking market and an even smaller proportion outside the main cities. To supplement a limited capacity of privately owned banks, the Bank will seek to implement its MCFF product in Belarus through existing privately owned partner banks, including through co-financing existing clients. A major step forward can be achieved through granting MSME lines of credit to selected state-owned banks which have a much larger share of the MSME market than privately owned banks, particularly in the regions. The product portfolio could also be broadened by providing targeted loans for energy efficiency improvements through the introduction of the Sustainable Energy Finance Facility model, depending on the results of the forthcoming market study.

Criteria for engaging with state-owned or public entities

The facilities will remain available to majority privately owned MSMEs only and will include undertakings of new participating banks on improving their MSME lending capacity and actual volumes of MSME business with particular focus on rural areas. Selection criteria to widen the scope of partner banks to state-owned institutions will include the requirements that the Bank can be satisfied that there is a genuine government intention to at least partly privatise such institution and that the commercial nature of their operations is evidenced, in particular, by management's autonomy in respect of directed lending going forward and in adequately addressing any portfolio issues from such practices in the past. The Bank will work in close cooperation with other IFIs assessing and benchmarking progress with the commercialisation of operations of the majority state owned banks that aim to intermediate in MSME financing and other relevant products. The extent and depth of the coverage of MSME clients, both existing and prospective ones, will be a prerequisite in the selection process.

3.2.2. Privatisation

In line with the stated policy of the Government of Belarus and the requirements of the IMF, the Bank will seek to encourage and to the extent possible participate in the privatisation of relevant sectors of the economy. The rationale is to assist the government in its approach to an effective, transparent and economically beneficial privatisation policy to build confidence in the process and thus make it irreversible, and to support the overall package of policy measures agreed between the authorities and the IMF, in which the privatisation programme plays a prominent role. If and where appropriate, donors' contributions may be sought to assist in the capacity building of the privatisation authority to conduct the privatisation process in an efficient, transparent and competitive manner.

Criteria for engaging with state-owned or public entities

Any engagement by the Bank, whether in the pre-privatisation process or in the actual privatisation of a state-owned enterprise or bank, will require setting *ex ante* project-specific quantifiable targets and deadlines, including in respect of competitive tendering and transparency of the process. In addition, any project in this area must contain covenanted agreement on accelerating the Bank's exit on terms strongly motivating compliance of government agencies with the criteria, should the agreed objectives not be met. Willingness to commit to and implement improvements in corporate structure and governance practices, strict adherence to core activities, improvements in transparency and reporting standards and measures to enhance the investee company ability to attract strategic interest will also be among the key criteria. Policy dialogue will be undertaken to strengthen the capacity and empowerment of privatisation authorities in preparing, administering and completing the privatisation process. The engagement criteria for such projects will also include the compatibility with the relevant efforts of other IFIs with regard to the privatisation process and in particular with the country undertakings under the IMF Stand-by programme.

3.2.3. Energy Efficiency, Sustainability and Renewable Energy

The Bank will focus on utilisation of renewable, biomass and local sources of energy with specific and quantifiable contribution of each project to reducing the energy intensity of the economy. Private operators and preferably foreign strategic investors bringing advanced technology will be sought on a priority basis. Sustainable energy projects, including energy efficiency improvements, wider use of renewables, diversification of energy sources and better regional integration of transmission networks, will be undertaken on a commercial basis and will require an appropriate regulatory framework to foster long term investments on an economical basis, including progress in increasing energy tariff towards full cost recovery levels.

The Bank will also work with local financial intermediaries on developing dedicated energy efficiency credit lines to enhance availability of financing for medium and small scale energy efficiency and renewable energy investments, down to residential level, if possible. Supporting the creation or entry into Belarus of private sector Energy Service Companies (ESCOs) will also be considered on a priority basis. This will be combined with policy dialogue to create realistic business opportunities for private sector ESCO operations in the country, both in the private sector and on a Public-Private Partnership basis. Even in the absence of ESCOs however, the Bank will pursue investments and policy dialogue in order to increase the efficiency of the municipal utilities sector.

Criteria for engaging with state-owned or public entities

Prior to undertaking projects with any state-owned or public entities in this sector, an action plan will be agreed with the Belarusian authorities which facilitates wider private sector participation in energy infrastructure on a transparent, adequately regulated and sustainable basis. On a selective basis, the Bank may engage in public energy generation, transmission and other utilities, subject to an appropriate framework being put in place in line with the agreed action plan. The Bank will prioritise projects that have regional significance and where the efforts of other IFIs and international donors can be combined to achieve the above targets in a specific and measurable manner.

3.2.4. Trade Facilitation

In order to promote cross-border activities and widen the scope of intervention of the Bank in this respect, TFP and associated technical assistance available to existing partner banks will be expanded to satisfy private sector clients on a priority basis. It will also be made available through the existing and new private sector partner banks to publicly owned clients that operate as commercial entities in sectors clearly outside the Bank's exclusion list. Subject to a successful implementation of the Bank's strategy in respect of MSME lines of credit with selected public sector banks, Trade Facilitation will be gradually introduced as an additional facility available to these banks in order to reach out to a larger population of private sector companies engaged in cross border trade. The ability to act on a case by case basis in the extension of trade facilitation supports the granular conditionality of the modified Strategy.

Criteria for engaging with state-owned or public entities

Criteria to be met for the extension to public sector banks of the Bank's trade facilitation programme will be similar to those applying to the choice of state-owned banks with respect to MSME. In particular it will include addressing the directed lending concerns and evidence of a genuine government intention to at least partly privatise such bank. Regarding state-owned clients of privately owned partner banks, restrictions will be concerned with the nature and transparency of the trade involved, the corporate status of the client, its international trading track record and corporate governance.

The initial frame of the priorities and restrictions will also have a positive structural effect on the overall banking services market. At present, most of publicly owned entities do their banking business with state owned banks. By enabling private sector banks to provide TFP supported trade finance instruments to public sector companies while restricting the state owned banks to private sector only in this segment, the Bank will encourage broader competition across the ownership lines.

3.2.5. Municipal and Environmental Infrastructure

The Bank's priority is to support investments to improve municipal and environmental infrastructure and services and the reform process of the municipal utilities sector in cities and smaller urban areas. At this stage this mostly involves commercialisation of service provision through corporatisation, introduction of service contracts to improve the transparency and accountability of utility service provision and financial and operational sustainability which entails tariff setting in line with the cost of services while enhanced productivity is achieved through optimal use of labour and reduction of losses, operating and energy cost.

The primary target companies that the Bank will focus on will be publicly owned municipal utilities, although it is anticipated that the Bank will use a framework approach involving a sovereign loan or sovereign guaranteed facility to benefit several municipalities initially. The framework facility will require transition impact covenants agreed broadly within the framework but negotiated in more detail at the individual city or utility level taking into account local needs and priorities and may also need to reflect the special position of Minsk city among the municipalities. This approach will make the EBRD financing affordable while enabling the Bank to reach out to smaller municipalities and achieve real transition impact.

The Bank will seek to pursue such activities alongside regional initiatives such as the Northern Dimension Environmental Partnership (NDEP), bilateral donors and other co-financiers, potentially including the Nordic Investment Bank (NIB) and the European Investment Bank (EIB), to improve EBRD leverage and enhance the demonstration effects through wider scale operations. Specific investments to improve local environment conditions, and achievements in environmental consciousness and behaviour, will be an important part of the Bank strategy for engagement in the sector particularly in relation to co-financing with the NDEP.

Criteria for engaging with state-owned or public entities

Involvement with the municipal sector by its nature requires the Bank to engage both with publicly owned utility services and with municipal and regional public authorities. EBRD engagement will be conditional on credible commitments to substantially advance tariff setting consistent with the principles of cost recovery over the medium time horizon with adequate measurable intermediate targets, utilities will be commercialised *inter alia* through the introduction of service contracts and concrete cost control measures will be agreed with the clients and the relevant authorities as part of the project. EBRD engagement will also depend on ensuring that the government/municipality level administrative, legal and regulatory barriers to achieving utility level reform objectives will be addressed in a timely fashion to enable project implementation. Specific investments to improve local environment conditions and achievements in environmental consciousness and behaviour will be an important part of the Bank's strategy of engagement in the sector particularly in relation to co-financing with NDEP.

Supporting opportunities, if any available, for wider private sector participation through a transparent and sustainable regulatory framework and competitive tenders involving foreign strategic operators will be a priority in this sector for the Bank.

3.2.6 Transport and Power Infrastructure

In the early stages of this Strategy it is expected that the Bank will only consider projects in the transport and power sectors involving private sector partners, including public-private partnership (PPP) arrangements complying with the Bank's policy on concessions, where the infrastructure under consideration has regional significance in facilitating cross-border integration and there are evident broader policy dialogue implications with high transition potential. Subject to substantial and consistent progress in the other sectors listed above, and as evidenced in the annual reporting to the Board, it may be proposed to extend the Bank's operational priorities to supporting the development and commercialisation of other regionally critical transport and power infrastructure, particularly working alongside other IFIs. The Bank would then consider on a priority basis projects that support the development of key international road corridors potentially leading to wider sector reform and greater private sector participation and regional projects facilitating cross border power transmission and transit to promote more efficient energy generation capacity.

Criteria for engaging with state-owned or public entities

Projects in these sectors will require an even closer engagement with public entities and state authorities; therefore, even more comprehensive criteria will be required to be achieved before the Bank can consider any projects with state entities in this sector. In addition to demonstrated progress in achieving the criteria on projects undertaken in other sectors, projects will only be considered alongside other IFIs or bilateral donors such as the EC. Investment in these sectors with state-owned entities will be predicated upon effective policy dialogue on sector reform particularly focusing on advancing the commercialisation and private sector role in these sectors; on enabling independent market participants' access to the infrastructure; on enhancing incentives for renewable power and energy efficiency; compliance with internationally accepted standards for addressing the Environmental Impact of new facilities.

Demonstrating *ex ante* compliance with these criteria is expected to require considerable effort and time and therefore the Bank is not likely to be able to proceed with any specific investment in these sectors with majority state owned entities until the later part of the new Country Strategy period.

4. EARLY TRANSITION COUNTRY INITIATIVE

The process of transition appears to be gaining momentum in Belarus. However, the private sector share of GDP in Belarus, estimated at 30 per cent, is lower than in any other Early Transition Country Initiative recipient, transition gaps remain large across virtually all sectors, and there is substantial scope for deepening first-stage reforms related to privatisation and price and trade liberalisation as well as advancing second and third-stage reforms. Belarus scores below most ETC countries across all EBRD Transition Indicators, illustrated in the graphs in Annex 6.

These factors provide a solid rationale for employing a wider range of available tools to advance transition. The Early Transition Country Initiative is critical to providing support for the transition process in more challenging environments. Inclusion of Belarus in ETCI would provide a strong impetus to make full use of ETCI specific instruments for financing smaller projects through equity investment, co-financing with local banks and direct financing, all of which are very relevant in the Belarusian context. It may also facilitate access to technical assistance for projects that have high transition impact, but which need more intensive support for preparation, evaluation and execution, particularly for projects with smaller private sector firms.

5. CO-OPERATION WITH OTHER IFIs AND THE EC

The Bank will continue close co-ordination of its activity with other IFIs and bilateral financial institutions that are already active in Belarus or are preparing to start their direct work here (the World Bank, IFC, IMF and potentially EIB and Nordic Investment Bank) to increase the leverage of Bank projects and policy dialogue initiatives. In response to progress in economic reforms in Belarus, as well as the financial crisis, IFIs generally have stepped up their presence in the country.

The IMF has been approached by the Republic of Belarus in the last quarter of 2008 to provide crisis response related financing. A 15 month Stand-by Agreement was signed in January 2009 envisaging approximately USD 2.5 billion support; the programme has been reviewed in May-June 2009 and further augmented to approximately USD 3.5 billion. Two disbursements have been executed from this Agreement accounting for approximately USD 800 million. The second review has been completed in September and the decisions on the third disbursement are awaited in the near future. The IMF and the Bank continue close cooperation in assessing the main structural and reform challenges faced by Belarus and in coordinating the assistance approaches and instruments for achieving possibly broader and sustainable progress. Structural measures envisaged under the IMF stand-by agreement include transparent privatisations, commercialisation of lending practices of major state-owned banks, and further price liberalisation. The Bank will endeavour to support the implementation of these reforms, and in particular the privatisation process, through its work on the pre-privatisation projects or through other forms of engagement with state-owned entities such as the MSME credit lines or TFP facilities.

The World Bank had a very limited programme in Belarus for a number of years preceding the adoption of the new Country Assistance Strategy for 2008 – 2011, which was based on structural reforms undertaken by Belarus before the crisis. It envisaged up to USD 100 million sovereign lending a year primarily for public services, environmental and energy efficiency investment. With severe negative changes in external environment and resulting domestic effects, the World Bank has undertaken a mid-term review of the Country Assistance Strategy which is expected to significantly increase the volumes and scope of the World Bank lending activities in Belarus and in addition to financing individual investment projects, also to provide a development policy loan.

In October 2008 the European Council opened additional cooperation opportunities within the framework of European Neighbourhood Policy. It has five main components: Annual Action Programmes, Regional Action Programmes, Cross-Border Cooperation, Nuclear Safety Programme, the Trans-European mobility scheme for university studies. Other means of cooperation are budget lines and other instruments, including EU International Cooperation Programmes and External Programmes with EU Participation.

The EU is currently implementing projects within the framework of several annual action programmes. The annual Action Programme 2007 is aimed at supporting the Implementation of a Comprehensive Energy Policy for Belarus, the annual Action Programme 2008 is focused on Enhancement of environment protection through the revision of Belarus' environment policy framework; and the Action Programme 2009 is mainly dedicated to support quality control standards and infrastructure to improve food safety in Belarus.

Belarus takes part in three multilateral neighbourhood programmes - Poland/Belarus/Ukraine, Latvia/Lithuania/Belarus and the Baltic Sea Region.

The future cooperation is expected to focus more on economic development measures – specifically towards the improvement of the economy in the regions and support to small and medium towns. The new Eastern Partnership initiative offers to launch five flagship initiatives: Integrated Border Management Programme, SME Facility through technical assistance, financial intermediaries, risk capital and loans; improved energy efficiency and increased use of renewable energy sources; infrastructure initiative serving to diversify transit routes and sources of supply for the EU and its partners; Prevention of and response to natural and man-made disasters.

Inclusion of Belarus in the Eastern Partnership in May 2009 and progress in bilateral relations with the European Union may open the door for EIB operations in Belarus. It already resulted in EU Neighbourhood Investment Facility exceptionally approving (in March 2009) up to EUR 2 million of TC funds for Belarus aimed at assistance to EBRD’s FI clients facing financial crisis.

Active dialogue is continuing on Belarus joining the Northern Dimension Environmental Partnership to support environmental projects primarily on the Baltic see river basin that covers about a third of Belarus territory. The Bank will work to assist this initiative within the priorities and criteria mentioned above on the relevant sectors, primarily in the Municipal and Environmental Infrastructure and Energy Efficiency.

Belarus and the Nordic Investment Bank (NIB) have started negotiating a framework agreement that would allow the NIB to start lending operations in Belarus. Expected areas of focus for the NIB include the environmental and sustainable energy projects, where possible, under close cooperation with other IFI and international donors. Particularly strong opportunities for joint financing are expected in waste water treatment and solid waste management areas, where all potential projects would be assessed in close coordination between the relevant financing institutions as well as national and regional authorities in the country.

More detailed information on the development of IFI programmes in Belarus is presented in Annex 2 focusing on environment-related issues and in Annex 9 on more general assistance activity.

ANNEX 1: POLITICAL ASSESSMENT

Compliance with Article 1

Since 1996 the Bank's activities in the Republic of Belarus have been limited by the country's slow progress in democratic transition. Previous Country Strategies have highlighted inconsistencies in the Belarusian authorities' commitment to and application of the principles of multiparty democracy and pluralism, as specified in Article 1 of the Agreement Establishing the Bank. As a result, the Bank's engagement with Belarus has been constrained.

The Bank remains concerned about the slow pace of democratic reform in Belarus. However, in the past year there have been some encouraging developments related to the principles of multiparty democracy, pluralism and the rule of law and civil and human rights. During 2008, the Belarusian authorities began a process of gradual political liberalisation leading to the implementation of a number of important steps in the field of democratic political reform. The Belarusian authorities released all internationally recognised political prisoners, undertook some steps in relation to freedom of the media, and practiced greater tolerance towards the political opposition. In recognition of these important steps, the European Union suspended the travel ban it imposed in 2006 for all but four of fifty persons on the travel blacklist, the suspension was extended for another 12 months in November 2009 and the United States suspended the prohibition on the operations of two of the subsidiaries of the state-owned petrochemicals concern Belneftekhim in the United States.

Despite these positive first steps toward political liberalisation, significant challenges remain to establishing Belarus firmly on the road toward multiparty democracy, pluralism and the protection of human rights.

Political Accountability

Liberal democratic institutions that provide for political accountability are weak in Belarus. The institutional checks and balances on political power provided for in the Belarusian Constitution in practice do not constrain the power of the executive. Political power is concentrated in the presidency, and President Lukashenka personally oversees large areas of decision-making in both the political and economic realms, ruling through presidential decree rather than through the legislative process. The judicial and legislative branches of government are subject to extensive executive interference. The "power ministries" – the interior ministry, the police and secret police – play a pronounced role in political life.

Since 1994, regular elections to both the presidency and parliament have been held in Belarus. However, these elections have been neither free nor fair, as judged by international election monitors, and no opposition candidates are represented in parliament. Political parties exist, but they have only modest relevance on the political scene and are dependent on presidential approval. Attempts by opposition political activists and candidates to organise public gatherings have been routinely blocked by the authorities, and opposition candidates have received little or no access to the domestic media.

In the most recent parliamentary elections in September 2008, the Belarusian government declared its intention to conduct a "fully democratic" process, and the authorities permitted seventy opposition candidates to register. Many opposition candidates were granted limited access to the domestic media. The Belarusian government also issued a timely invitation to the OSCE's Office of Democratic Institutions and Human Rights to send an International Election Observation Mission to monitor the pre-election campaign period as well as the election process itself.

The OSCE found that the cooperation extended to the Observation Mission was considerably improved in relation to previous elections, and assessed that minor improvements were evident in the conduct of the election. However, the OSCE concluded that the "elections ultimately fell short of OSCE commitments for democratic elections" and that "further substantial efforts are required if Belarus is to conduct genuinely democratic elections in line with OSCE commitments." Particular shortcomings related to the overall election environment in Belarus, including restrictions on the rights to freedom of assembly and expression, which did not allow genuine political competition and equal treatment of election competitors by the Belarusian authorities. An international observation mission from the Commonwealth of Independent States (CIS) found that the elections were carried out in generally democratic conditions and fully complied with both national legislation and international norms and standards. Of the seventy opposition candidates registered for the elections, none were elected. Many opposition candidates alleged widescale ballot box fraud. In response to the OSCE Monitoring Mission's report, the Belarusian government indicated its willingness to enter into a dialogue with OSCE experts on reform of Belarus' electoral legislation. Following consultations between Belarusian and OSCE experts, the Belarusian National Centre for Legislation and Legal Research in May 2009 proposed a series of amendments to the country's electoral legislation which are under review by various state authorities in Belarus. The OSCE has yet to issue a formal assessment of the proposed legislative amendments' compliance with ODIHR recommendations or Belarus' OSCE commitments.

The Rule of Law

The rule of law in Belarus is weak, with extensive political interference in the judicial process and the promulgation of frequent presidential decrees serving as the key drivers of the legal system. While the members of Belarus' judiciary are generally well-trained and adequately resourced, the political impartiality of the courts cannot be relied upon when adjudicating cases of political significance – which includes a wide array of juridical cases, including commercial disputes, given the state's extensive involvement in the economy.

Administrative corruption is a problem for firms in Belarus. The country scores significantly below the transition country average on the two most geographically inclusive and methodologically rigorous 'meta-indices' available: the World Bank's 2008 Worldwide Governance Indicators, on which Belarus was ranked on the 24th percentile globally and 23rd of 30 transition countries on the 'Control of Corruption' indicator; and Transparency International's 2008 Corruption Perceptions Index, on which Belarus is ranked 151st out of 180 countries globally and 25th of the 30 transition countries.

On the other hand, "petty" or "administrative" corruption is not perceived by most Belarusians to be common, and by some measures the extent of administrative corruption in Belarus is lower than in many other transition countries. The 2008 EBRD-World Bank Business Environment and Enterprise Performance Survey, for example, found that corruption was reported as a less significant obstacle to firms than crime, theft and disorder, and that the frequency of bribery in specific areas such as the courts and customs and imports is both lower than average for the CIS region, and has declined from 2005-2008. There nevertheless remains a widespread perception among private sector firms that connections with the presidential administration are necessary to avoid arbitrary interference by regulators and the tax administration.

Civil and Human Rights

The most significant progress in the field of democratic reform in Belarus during the past year occurred in the human rights and media fields. During 2008, all internationally recognised political prisoners in Belarus were released from prison, including the 2005 opposition presidential candidate, Alyaksandr Kazulin, after serving almost three years. Police and secret police crackdowns on opposition protests have become less frequent and less violent in the past year, in parallel with a decline in attendance at such protests.

Despite these positive developments, serious shortcomings in the protection of human rights in Belarus remain. For example, a number of the internationally recognised political prisoners released during 2008 remain under house arrest. The arrests of political activists continue periodically, and a number of youth political activists have been conscripted into the military despite claiming valid exemptions.

Some progress has also been achieved in the area of pluralism and the strengthening of the constitutionally enshrined rights of citizens to form civic organisations, including trades unions, and to express their views openly. Important steps in this regard include the official registration in December 2008 of the social-political movement ‘For Freedom’ by the former opposition presidential candidate Alyaksandr Milinkevich.

Nevertheless, significant challenges remain in the field of political pluralism. Opposition political parties as well as many independent civil society and non-governmental organisations continue to face difficult conditions, including the denial of registration on questionable ‘technical’ grounds. Most recently, two political parties – the Belarusian Christian Democratic Party and the Freedom and Progress Party – and two NGOs – the human rights organisation “Nasha Viasna” and the “Assembly of Non-state Democratic Organisations” – were denied registration for alleged irregularities in their registration documents. Furthermore, opposition political parties and civil society organisations that are registered continue to encounter obstacles ranging from difficulty obtaining premises to frequent and unjustified inspections by tax and other state officials. Finally, while Belarus has ratified the eight core International Labour Organisation (ILO) conventions, the ILO deems Belarusian laws to be inconsistent with the principles of freedom of association and to impede trade union formation and worker organisation.

Media Freedom

Some progress has been made in the latter half of the previous Strategy period with regard to liberalisation of the mass media. In November 2008 two independent newspapers, *Narodnaya Volya* and *Nasha Niva*, were included in the state-run Belsoyuzpechat distribution network and the state-owned Belarusian Post Office’s media subscription system catalogue. In April 2009 a new independent weekly newspaper with a political orientation and a weekly print-run of approximately 1,000 copies, *Uzgorak*, was registered for distribution in three districts of Mogilev oblast.

Despite these important steps, the mass media market remains dominated by state-owned television and radio stations and newspapers, opposition political parties and activists receive little domestic media coverage, and a further ten independent newspapers have been denied inclusion in the domestic distribution and subscription system, making it virtually impossible for them to be sold in Belarus.

The internet is an increasingly vibrant source of news from independent and opposition journalists in Belarus, and internet penetration rates in Belarus are among the highest among CIS countries. The authorities have not attempted systematically to limit the growth or independence of the online media, although periodic ‘technical’ denial-of-service problems are known to affect critical opposition websites around politically sensitive periods, such as the annual Chernobyl Remembrance Day.

However, a new Law on the Mass Media which came into effect in February 2009 officially classifies online media as subject to the same provisions as apply to television, radio and print media, and obliges all journalists, including those working for online-only news sources, to register or re-register. The Ministry of Information has denied that it intends to use the new Law on the Mass Media to restrict the freedom of online news sources and has adopted a declarative principle of mass media re-registration. However, domestic and international critics assert that the sweeping powers in the new Law enable the authorities to close any media outlet, including online news providers, should they so choose.

In an effort to address concerns expressed by Belarusian journalists and the international community, in October 2008 the government established a Civic Coordination Council for Mass Media under the Ministry of Information. Independent journalists and journalists' NGOs (the Belarusian Association of Journalists) were invited to attend regular sessions of the Coordination Council. While this was a welcome step toward improving communication between the authorities and independent journalists, the Council has only an advisory function and meets infrequently.

ANNEX 2: ENVIRONMENTAL AND SOCIAL DEVELOPMENTS

EBRD's environmental and social approach in Belarus

EBRD's new Environmental and Social Policy entered into force on 12 November 2008. It establishes a set of 10 Performance Requirements (PRs) for the Bank and its clients so as to integrate environmental and social considerations in business operations. These requirements help EBRD's clients to introduce best practice for the management of environmental, occupational health and safety, labour and other social issues. In particular, the Bank adopts a rigorous approach to labour and working conditions issues which are one of the areas of concern in Belarus. Performance Requirement 2 covers assessment of such areas as labour conditions, fair wages, non-discrimination, gender equality, retrenchment policies, trade unions and collective bargaining practices. Stakeholder engagement is now a requirement for all projects and is expected to be carried out in a meaningful manner proportionate to the risks and issues involved.

All EBRD operations in Belarus are subject to the Bank's environmental and social appraisal and incorporate, where appropriate, Environmental and Social Action Plans into the legal documentation. Issues raised during due diligence, are thus able to be addressed, in line with the Bank's mandate to actively support environmentally sound and sustainable development through its investments. All these measures are intended to help guide companies' operations in Belarus towards better performance standards in line with the Belarus and EU environmental standards, ILO core labour conventions and other international best practice.

The Bank is facing many environmental and social challenges within the framework of its activities in Belarus and addresses those accordingly, making sure that appropriate safeguards are being built into every project to minimise any negative environmental and social impacts and to maximise potential benefits. The Bank is committed through its projects to help Belarus to abate air, soil and water pollution, to implement energy efficiency measures, to manage its natural resources in a sustainable way and to be in compliance with international environmental standards and best practices. In addition to that, significant environmental implications and opportunities are introduced in many other EBRD's initiatives and activities, including technical cooperation funds and training.

Apart from direct investment EBRD will pursue financing sustainability initiatives in different sectors of the Belarus economy. In accordance with the direction of Belarus state environmental policy there are potential opportunities for projects in many areas including municipal environmental infrastructure, energy efficiency, sustainable agriculture and forestry. The Bank will develop Technical Cooperation initiatives to support practical identification of the best environmental solutions and capture environmental opportunities within its projects. It will also support institutional capacity building and foster the development of economically viable and environmentally sustainable business opportunities.

Environmental legislative framework in Belarus

An overarching legislative framework on environmental issues in Belarus is the 1992 Law on Environmental Protection (last amended in 2002) that lists international cooperation in environmental protection both as a major principle of environmental protection and as a major aim of the national policy in environmental protection. Key directions of the country's environmental performance (such as improving administrative, economic and regulatory mechanisms of environmental protection and management, combating soil, air and water contamination and improving overall energy efficiency) are outlined in several documents, including the National Action Plan on the Rational Use of Natural Resources and Environmental Protection (NEAP) for 2006-2010 and the National Strategy for Sustainable Development for the period to 2020 (NSSD).

In past years Belarus made particular efforts to introduce the norms and principles of international environmental legal acts and commitments, striving to make its legislation EU-compatible. Updates of the national environmental legislation include the Law on Waste Management and the introduction of the Ecological Passport for enterprises in 2008. A Municipal Waste Management Programme (2007-2010) puts forward general principles and specific requirements related to methods of waste disposal which are consistent with comparable EU Directives and the country's international obligations. The overall objective is to prevent adverse environmental impacts, to promote separate municipal waste collection and recycling, and to maximize the recovery of valuable materials.

Since Belarus has borders with three EU countries, there have been several EU 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 legislative harmonisation initiatives in the country include the introduction of a system of integrated environmental permits based on the provisions of the IPPC Directive and the BAT approach.

The Law on State Environmental Review currently in effect does not cover all aspects of environmental impact assessment (EIA). The existing system of environmental assessment of economic initiatives comprises two interrelated processes: Environmental Impact Assessment (EIA) and State Environmental Review (SER). EIA deals with initiatives at the project level and does not address strategic documents, whereas SER deals with proposed projects, plans and programmes for socio-economic, sectoral and spatial development based on technical norms and thresholds. The importance of introducing mechanisms that would facilitate integration of environmental concerns into national decision-making has also been recognised, and Belarus has committed itself to introducing strategic environmental assessment (SEA). It is now in the process of building adequate institutional capacity for that purpose with assistance from the EU and the UNDP.

A National Programme of Measures to Mitigate the Consequences of Climate Change for 2008-2012 (NPMMCCC) has been prepared in order to fulfil the commitments of Belarus under the UNFCCC and Kyoto Protocol. The Programme includes the system of legal, financial, economic and organisational measures which are aimed at mitigation of the negative impacts on climate by encouraging GHG emissions reduction and increase of GHG absorption, support to national monitoring and assessment, wide implementation of renewable energy sources and energy-saving technologies.

Belarus and international cooperation in the environmental sphere

Belarus is a signatory of a number of international conventions and protocols related to environment protection. For example, the country acceded to the Stockholm Convention on Persistent Organic Pollutants (POPs) in February 2004. Belarus signed and ratified the United Nations Convention to Combat Desertification in 2001 and applies its provisions for sustainable management of degraded peat lands in the south of the country. Belarus also ratified the United Nations Framework Convention of Climate Change and Kyoto Protocol in 2005. In 2000 the country ratified the Aarhus Convention on access to information, public participation and access to justice in environmental matters and in 2005 became a signatory (by acceptance) of the Espoo Convention on environmental impact assessment in a transboundary context.

Environment remains the focus of many other organisations working in Belarus. The EU, UNDP, UNEP and the World Bank are all working closely with Belarus and contributing to the promotion of sustainable development in the area.

The **European Union** mainstreams its cooperation with Belarus on common challenges in the fields of environment, public health and social development through the Neighbourhood Programmes in the border areas of Latvia/Lithuania/Belarus, Poland/Ukraine/Belarus, and the Baltic Sea region. This includes promoting a cross sectoral dialogue and cooperation in common environmental and sustainability projects and initiatives. The new Eastern Partnership initiative will additionally enhance closer cooperation with Belarus in such areas as good governance and energy.

UNDP is pursuing a number of initiatives in energy and environment in Belarus. The current strategic focus is on capacity building for implementation of flexible mechanisms under the Kyoto Protocol, building capacity for Strategic Environmental Assessment and implementation of environmental conventions, as well as supporting sustainable development at the local level. UNDP is also developing a full –size GEF project aiming to support the reduction of transboundary industrial chemical pollution from small industries currently discharging through municipal waste systems. In the sustainable energy area it also implements a GEF project on removing barriers to energy efficiency improvements in the state sector in Belarus (USD 1.4 million), and another GEF project in sustainable land management, aiming at sustainable management of peatlands in Belarus to combat land degradation, ensure conservation of globally valuable biodiversity, and mitigate climate change (USD 1 million). In the area of biodiversity, UNDP is implementing a GEF project on catalysing sustainability of the wetland protected area system in Belarusian Polesie through increased management efficiency and realigned land use practices (USD 2.2 million).

The **World Bank / IBRD** maintains a close dialogue with Belarus on environmental initiatives, and its CAS objectives include ‘advancing a sustainable development agenda through support to environmental activities’. Ongoing projects include a Water Supply and Sanitation Project (USD 60 million) to improve the quality, efficiency and sustainability of water supply and wastewater treatment services in the six Oblasts of Gomel, Mogilev, Brest, Grodno, Minsk, and Vitebsk; a Social Infrastructure Retrofitting Project (22.6 million plus additional USD 15 million) to improve energy efficiency improvements and retrofitting in social sector buildings (schools and hospitals) across Belarus; and Post-Chernobyl Recovery Project (USD 50 million) to provide the population residing in the Chernobyl affected area with energy efficient and reliable heat and hot water services in order to improve their living environment. Most recently a USD 125 million energy efficiency project for Belarus has been agreed, aiming at improving energy efficiency in heat and power generation in selected towns in Belarus. This initiative will involve conversion of existing heat-only-boiler plants to combined heat and power plants at six sites. IBRD also has been pursuing enabling activities related to the implementation of the Stockholm Convention on POPs and a full-size GEF project of 5.5 million has been approved on POPs stockpile management and technical/institutional capacity building. Another initiative is a USD 60 million Belarus Solid Waste Management Project that is currently under consideration by IBRD for the development of an integrated Solid Waste Processing Facility in Grodno Oblast to support the country’s efforts to manage solid wastes according to international good practice, complemented with a GEF grant of USD 5.5 million to reduce environmental and health risks to the population from PCBs and POPs.

Belarus has been welcomed into the **Northern Dimension Environmental Partnership (NDEP)** initiative, and this cooperation will be a positive step towards reducing the pollution to the Baltic Sea. HELCOM has listed a number of Belarusian cities as environmental hot spots in its Baltic Sea Action Plan currently under implementation. The national nutrient reduction targets set for Belarus are 1,660 tonnes of phosphorus and 3,780 tonnes of nitrogen per year and equal to roughly half of Russia’s national targets. Although not directly at the Baltic Sea, Belarus still constitutes the 5th largest catchment area, and through its rivers, contributes to pollution of waters that are part of the catchment area of the Baltic Sea. There is also scope for achieving significant environmental benefits with cross border impacts through the implementation of projects in the agricultural/municipal solid waste and energy efficiency sectors. The current EU Strategy for the Baltic Sea Region sets out to develop cooperation with Belarus in the context of NDEP to improve the ecological state of the Baltic Sea.

EBRD’s environmental and social focus by sectors

The Bank places emphasis on supporting improvement of the environmental standards within **municipal environmental infrastructure and services** sector. Potential projects involve rehabilitation of water, wastewater and/or waste management facilities, as well as district heating. Along with the actual infrastructure improvements, in such projects the Bank is supporting institutional strengthening and improvements in management of the utility companies to further enhance their operational sustainability. Particular opportunities may exist in cooperation with NDEP to deliver significant environmental benefits and improvements for the Baltic Sea region as a whole.

In the **energy** sector the Bank is considering improvements in energy efficiency across various sectors of the economy, particularly in Belarus’ large and highly inefficient manufacturing industry. A major focus of the Bank's activities is the identification of energy efficiency opportunities as part of the Bank’s due diligence process. This can have significant environmental opportunities alongside with the financial benefits (e.g. carbon credits). These efforts are also supported by the ongoing Sustainable Energy Initiatives (SEI) I & II that is the EBRD’s specific contribution to address the climate change challenges, with a particular focus on energy efficiency and renewable energy. SEI Phase 2 (2009-11) will be focussed on climate change mitigation and adaptation issues.

In the **forest products industry** sector the Bank is considering support of forest industry investments that promote transition towards multiple use of forest resources, provision of socio-economic benefits and production of high value added processes and products based on legal and sustainable forest resource use. To that effect, the Bank requires its Belarusian forest industry clients to adopt and implement wood procurement procedures that are based on principles of sustainable forestry management so as to ensure that all wood will be of legal and sustainable origin. The Bank's clients are also expected to give preference to certified wood and, in a longer term, acquire a Chain-of-Custody certification in accordance with internationally recognised sustainable forest management standards. The Bank welcomes the Belarusian Government's ongoing commitment to enhance its forest legislation, enforcement and governance to address illegal logging. The Bank is in discussions with the Ministry of Forestry regarding possibilities to develop a TC-funded project in support of Belarusian efforts to eradicate illegal logging as well as to optimise the value of its forest resources based on sustainable forest management.

In the **agribusiness** sector the Bank is looking at projects in the food processing sector and is involved, for example, in brewing. Through those projects the Bank encourages improvements in the production techniques and efficiency, as well as promotes better environmental and social standards.

In the **financial** sector, the Bank continues to provide environmental and social (E&S) risk management training and guidance for its new and existing financial clients in the implementation of the EBRD’s environmental and social requirements. An e-manual has been developed to assist FIs with EBRD's environmental and social risk management procedures. This will ensure that the Bank’s financial intermediaries are capable of adopting more stringent environmental and social due diligence procedures and continue to report to the Bank on a regular basis. Recent participants of environmental and social risk management training in Belarus included six financial intermediaries: Belarussian Bank for Small Business (BBSB), Belgazprombank, Belrosbank, MTBank, Priorbank and RRB. The EBRD coordinates its efforts with other IFIs, UNEP FI and other initiatives to promote sustainable and responsible financing in the country, and will continue to support Belarussian FIs by providing further capacity building on environmental and social issues.

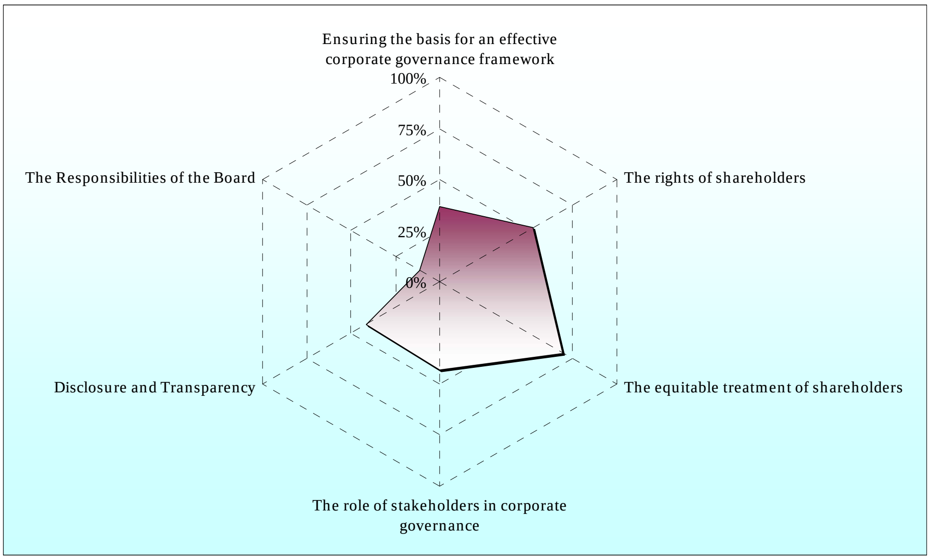
ANNEX 3: COMMERCIAL LAWS OF BELARUS

The EBRD has developed and regularly updates a series of assessments of legal transition in its countries of operations, with a focus on selected areas relevant to investment activities: capital markets, company law and corporate governance, concessions, insolvency, secured transactions and telecommunications. The existing tools assess both the quality of the laws "on the books" (also referred to as "extensiveness") and the actual implementation of such laws (also referred to as "effectiveness"). All available results of these assessments can be found at www.ebrd.com/law. This annex presents a summary of the results for Belarus, accompanied by critical comments of the Bank's legal experts who have conducted the assessments.

Company Law and Corporate Governance

The corporate governance framework is essentially regulated by the Law on Companies, which entered into force in December 1992 and was amended several times since then, most recently in January 2009. The law sets forth the basic framework for the formation and operation of companies in Belarus. There is no voluntary corporate governance code in the country.

Quality of corporate governance legislation – Belarus (2007)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to OECD Principles of Corporate Governance. The fuller the 'web', the more closely the corporate governance laws of the country approximate these principles

Source: EBRD Corporate Governance Sector Assessment, 2007 assessment

According to the results of the EBRD's 2007 Corporate Governance Sector Assessment[4] (see chart above) which assessed the quality of corporate governance legislation in force in November 2007, Belarus was found to be in "very low compliance" with the relevant international standards (the OECD Principles of Corporate Governance), showing a framework in urgent need of reform. When considering the effectiveness of corporate governance legislation, the 2005 EBRD's Legal Indicator Survey[5] highlighted a critical situation. A number of avenues are available by law to minority shareholders to obtain disclosure from a company but they are all complex. The time necessary to obtain disclosure is generally limited to 6-7 months but it is reported to be easy for the defendant to further delay the proceedings. In case of obstruction by the company, the procedure can be very difficult to enforce. When considering redress, consultants could not identify any really effective actions: they can all be complex, unpredictable and difficult to enforce. When looking at the institutional environment, the survey evidenced limited reliability of company information and lack of auditor independence, which further reduce the possibility of obtaining a successful disclosure. The survey also reported a lack of experience and competence of courts, prosecutors and market regulator in corporate law cases and their potential partiality, especially when the case is against a

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4 For more information see: http://www.ebrd.com/country/sector/law/corpgov/assess/index.htm
5 For more information see: http://www.ebrd.com/country/sector/law/corpgov/lis/index.htm

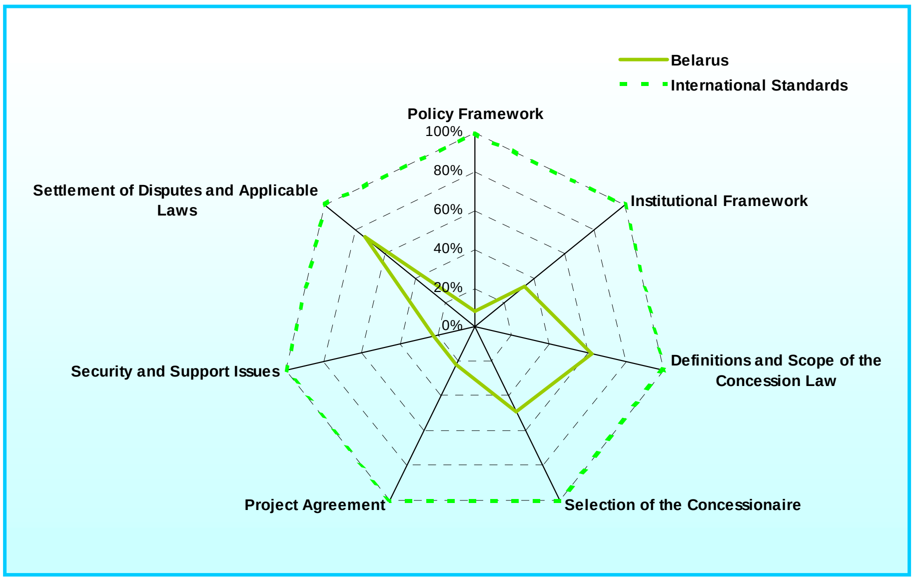
powerful defendant. As a matter of priority, the legislator should consider improving both the framework and the capacity of institutions to effectively implement the legislation.

Concessions

There is some reference to the promotion of public-private partnership and improving its legal environment in a few Governmental policy documents and economic development programmes in Belarus. Although substantial work remains to be done to enable an effective legal and regulatory environment for private sector investment into public utilities and services, clear signs are evident of the Government's intent to attract private sector investment into some municipal services as well as renewable energy projects.

Belarus does not have a specific concession law, but the Investment Code dated 2002, as amended, does contain detailed provisions regulating concessions (Section III-articles 49 to 76). It contains certain positive elements aimed at ensuring fairness and referring to "equal rights and obligations" of all participants, publicity of concession award, registration, review procedures. International arbitration is provided for although it is limited to foreign investors only. 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.

Quality of concession legislation – Belarus (2007/8)



Note: the extremity of each axis represents an ideal score in line with international standards such as the UNCITRAL Legislative Guide for Privately Financed Infrastructure projects. The fuller the 'web', the more closely concessions laws of the country approximate these standards.

Source: EBRD Concessions Sector Assessment 2007/8

However, the Investment Code is in serious need of improvement. It is silent on certain major elements relating to concessions and contains very few elements regarding government support and financial securities. This relates in particular to the rules governing its scope of application, the powers of the contracting authority, compensation provisions, non discrimination, as well as the Code's consistency with the Public Procurement Law, regulation of the project agreement and the provisions on the selection procedure, including the introduction of pre-qualification. Thus, despite certain favourable elements, the Investment Code does not constitute a sufficient legal basis for the development of PPP in Belarus.

As can be seen from the above graph, concession legislation in Belarus still falls short of international standards in many dimensions measured in the EBRD Assessment of Concessions Laws conducted in 2007/8.

Insolvency

Insolvency is governed by the "Belarus Law on Economic Insolvency" 2000, as amended (the "Insolvency Law"). The Insolvency Law's strongest features are its provisions relating to the avoidance of pre-bankruptcy transactions, clear rules on liquidation proceedings and on creditors involvement in the case.

The Insolvency Law's shortcomings include cumbersome commencement proceedings for debtor initiated insolvency and a lack of specialised courts to deal with insolvency cases. Moreover, there is an inadequate definition of the debtor's assets and a prohibition on set-off. The reorganisation proceedings are poorly reflected, the law failing to ensure full disclosure of information on the reorganisation plan to the creditors and provide for an independent analysis of the plan. The rules on the ability of creditors who approve the plan to bind the dissenting creditors to stick with it are vague and therefore inefficient. The law does not prevent termination of vital operational contracts for the debtor (e.g. supply of gas, electricity), nor does it provides for a continuous financing mechanism of the debtor during the reorganisation proceedings.

In April 2009, the President of Belarus signed into force an Ordinance aimed at streamlining pre-insolvency rehabilitation mechanisms. A state bankruptcy prevention commission was set up to help businesses assess their rehabilitation plans. Additionally, insolvency practitioners may upgrade their qualifications and receive state accreditation for participating in turnaround measures and provide an extensive range of services to companies in financial difficulty. Another preventive measure ensures raising the liability for company managers if they are found to have induced (by action or inaction) the company into bankruptcy. If not used carefully however, the latter could have a negative impact by preventing managers from taking good business decisions for fear of incurring liability.

The Insolvency Law was extensively amended in 2006-2007, introducing some innovative features, such as mandatory liability insurance for insolvency practitioners. The insolvency practitioners' profession was significantly strengthened by appointing a supervisory regulatory body for insolvency matters, setting requirements for education and examination, as well as licensing of insolvency office holders. Additionally, the amendments introduced clear rules of stay on all enforcement actions upon commencement of the insolvency proceedings. There are new rules on property of third parties held by the debtor and its exclusion from the insolvency estate. These changes should improve the efficiency of the law.

Secured Transactions

Taking security over property is governed by the provisions of the Civil Code, dated 7 December 1998. Security over movable property is also subject to the 1993 Pledge Law, which is meant to apply as far as it does not contradict the Civil Code provisions. Because both sets of provisions have not been harmonised, it creates considerable uncertainty for the market. A new Law on Mortgages entered into force in December 2008, together with some amendments to the provisions on mortgages in the Civil Code. The regime for security rights over movable property is similar to the one found in other CIS countries (especially Russia), with similar shortcomings:

1) There is no general registration system, in which all charges over movable property would be recorded. The borrower, if a legal entity, 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 his security would have 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 commodities 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. Specific identification of secured debt is also required.

3) Enforcement has been found to function relatively efficiently. In a survey conducted by EBRD in 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. 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.

Belarus has made some progress towards adopting modern principles of secured transactions law. However, it is necessary to continue working on key elements in order to bring economic benefits to the credit sector and the EBRD is urging the government to undertake such reform.

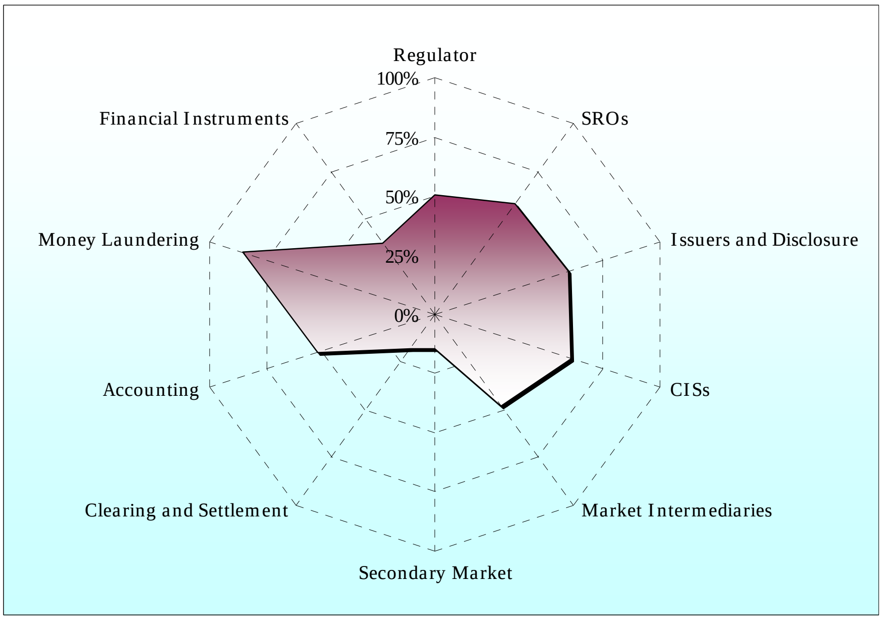
In contrast, recent progress was made on the regime for mortgages. In 2008, the Law on Mortgages was adopted, which provides a systematic regulation of mortgages (especially of residential real estate) and legal basis for long-term mortgage lending. Under the Law, a loan, sale-purchase agreement, lease, construction and other agreements may be secured by a mortgage. The main innovation introduced by the Law is the introduction of the ‘mortgage note’ instrument. The mortgage note indicates the actual amount of the debt, the description and location of mortgaged real estate, and other material information. Mortgage notes are subject to state registration, and are intended to be transferred and traded in order to encourage the development of a secondary mortgage market.

The Law on Mortgages entered into force on 26 December 2008. It is not clear how successful the reform will be, but the Mortgage Law makes an attempt to address some problems which had plagued commercial developments in the past. For instance, under the new provisions, the mortgage of a land plot will automatically confer to the creditor a mortgage of buildings and constructions located thereon.

Securities Markets

The legislation governing the securities markets in Belarus essentially includes the Civil Code adopted on 7 December 1998; the Law on Companies adopted on 9 December 1992; the Law on Securities and Stock Exchange adopted on 12 March 1992; and the Regulation on the Securities Department of the Ministry of Finance of the Republic of Belarus approved by the Regulation of the Council of Ministers No 982 adopted on 31 July 2006, all as amended. The Civil Code provides the general regulation on securities and on securities’ transactions; the Law On Companies regulates the activity of commercial companies in Belarus; the Law on Securities and Stock Exchange details the legal regime of shares and bonds and the Regulation on the Securities Department of the Ministry of Finance regulates the functions and the activities of the Securities Department of the Ministry of Finance, the securities markets regulator. The Ministry of Finance also regulates the insurance sector, while the National Bank of Belarus is in charge of the banking sector and the Population Protection Fund is the pension fund regulator.

Quality of securities markets legislation – Belarus (2007)



Note: The extremity of each axis represents an ideal score, i.e., corresponding to the standards set forth in IOSCO's *Objectives and Principles for Securities Regulations*. The fuller the 'web', the closer the relevant securities market legislation of the country approximates these principles.

Source: EBRD Securities Market Legislation Assessment 2007

In 2007, the EBRD benchmarked Belarusian securities markets legislation against the "Objectives and Principles of Securities Regulation" published by IOSCO.[6] The results demonstrated that the national legislation is in "very low compliance" with international standards showing a number of shortcomings in the majority of sectors under consideration (see chart above).

In order to understand how securities market legislation works in practice, in the same year the EBRD undertook a Legal Indicator Survey on securities markets.[7] Practitioners in the region were asked to comment on a hypothetical case study, advising an investor who lost his savings after buying shares in a national company's Initial Public Offering (IPO), misled by erroneous information in the prospectus. In particular, the Survey concentrated on effectiveness of prospectus disclosure requirements, private and public enforcement mechanisms and authority of the market regulator. The Survey found that IPOs are not common in Belarus. The law provides for some general requirements regarding information to be included in the prospectus but these are insufficient. Private enforcement mechanisms allow for some course of action but their effectiveness is limited. The securities markets regulator is not independent and its investigative powers and capacity are limited. Securities markets institutions are unable to provide the necessary support to court action while the experience of courts, prosecutors and securities market regulator in complex corporate law cases needs to be enhanced.

As a matter of priority, the legislator should carefully assess the compliance of national legislation with international standards and consider improving both the framework and the capacity of institutions to effectively implement the legislation.

6 For more information see: http://www.ebrd.com/country/sector/law/capital/assess/index.htm
7 For more information see: http://www.ebrd.com/country/sector/law/capital/survey/index.htm

Telecommunications

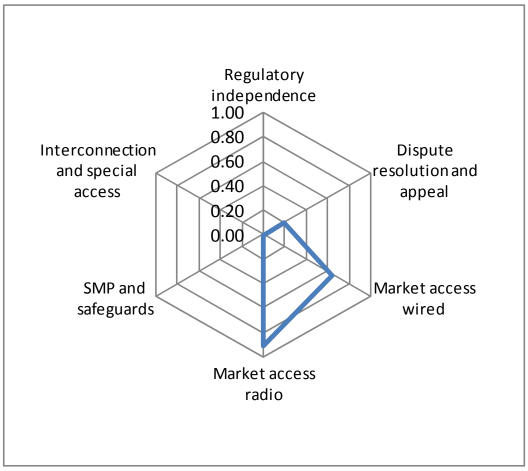
Institutional framework: The Ministry of Communications and Informatisation (the "Ministry") is responsible for regulatory as well as the ministerial functions in the telecommunications sector. The Ministry is a founder of the state-owned operator Beltelecom and exercises the functions of authorised regulatory body with respect to this enterprise. The Ministry also manages the state-owned shareholding in the statutory fund of the Belarusian Telecommunication Network. Shareholdings in the statutory funds of mobile operators MTS and BelCell belong to Beltelecom. Velkom, the only privately owned company, is wholly owned by Telekom Austria.

Regulatory independence: Since regulatory functions are carried out by the Ministry it is clear that regulatory independence, as it is understood in the WTO reference paper, does not exist in Belarus. A regulatory department within the Ministry was established and began working during 2007. In the case of Beltelecom, the privatisation process has not yet begun. Tariffs for residential local calls are below-cost. The government would like to maintain such low tariffs in order to ensure that fixed voice services are affordable for all. On the other hand, Beltelecom's prices for international calls are rather high, as are Internet access charges. This enables Beltelecom to subsidise loss-making services and remain a revenue-generating enterprise.

Outlook: The existing licensing regime allows fixed and mobile operators and internet services providers to enter the market without any serious barriers, and to compete freely. Mobile operators and internet service providers have benefited from this regime and appear generally satisfied with the current state of affairs. However, although several alternative operators have been registered for fixed telephony, only Beltelecom is active in the market. Unless Beltelecom is privatised and/or international traffic is open to competition, Belarus cannot be considered to have anything approaching a liberalised market. The government's focus appears to have moved away from Beltelecom's privatisation in recent times and alternative priorities have emerged, such as: maintaining low tariffs for national calls in order to make them affordable; digitalising Beltelecom's network; and, developing a regulatory framework that will allow Beltelecom to offer IP TV and triple play services.

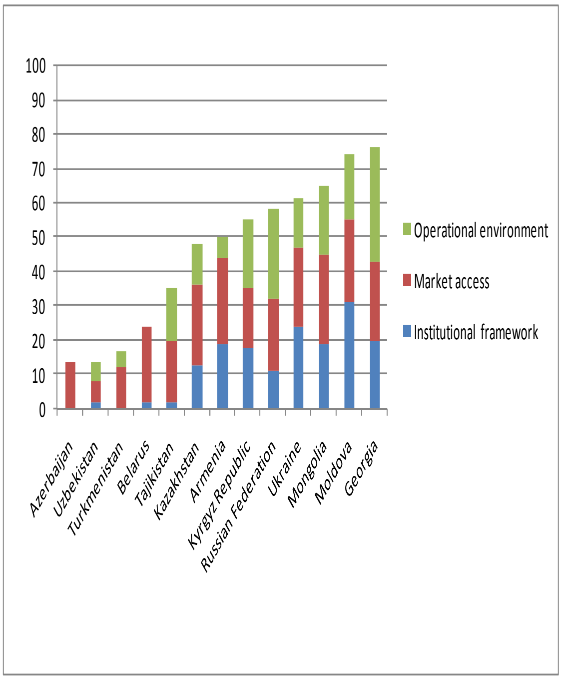
Assessment: In a 2008 assessment of the communications sector of EBRD Countries of Operation the sector regulatory regime in Belarus was deemed to have "Low Compliance" when measured against international best practice.

Key indicators for Belarus from the EBRD Assessment



This spider diagram includes six main group indicators. For each indicator, the diagram presents the scores as percentages of the maximum achievable score. The scores begin at zero at the centre of the chart and reach 1.00 at the outside, so that in the overall chart, the wider the web, the better the score in the assessment.

Regulatory spider diagram



Comparative regulatory assessment EBRD countries of operation in the Commonwealth of Independent States (CIS) + Mongolia

(see http://ebrd.com/country/sector/law/telecoms/assess/index.htm for more details).

ANNEX 4: SELECTED ECONOMIC INDICATORS

	2003	2004	2005	2006	2007	2008 Estimate	2009 Projection
Output and expenditure			*(Percentage change in real terms)*				
GDP	7.0	11.4	9.4	9.9	8.2	10.0	-3.0
Private consumption	7.4	9.6	15.0	14.6	11.3	na	na
Public consumption	0.3	-0.2	0.6	0.2	0.5	na	na
Gross fixed capital formation	20.6	19.9	19.5	26.5	15.1	na	na
Exports	na	na	na	na	na	na	na
Imports	na	na	na	na	na	na	na
Industrial gross output	7.1	15.9	10.5	11.4	8.7	10.8	na
Agricultural gross output	6.6	12.6	1.7	6.0	4.1	8.9	na
Employment			*(Percentage change)*				
Labour force (end-year)	-0.5	-1.2	0.0	0.9	1.3	na	na
Employment (end-year)	-1.0	-0.5	0.8	1.2	1.7	na	na
			(In per cent of labour force)				
Unemployment (end-year)	3.0	1.9	1.5	1.2	1.0	na	na
Prices and wages			*(Percentage change)*				
Consumer prices (annual average)	28.4	18.1	10.3	7.0	8.4	14.9	15.3
Consumer prices (end-year)	25.4	14.4	8.0	6.6	12.1	13.3	15.2
Producer prices (annual average)	37.5	24.1	12.1	8.3	16.4	15.0	na
Producer prices (end-year)	28.1	18.8	10.0	9.0	17.1	14.4	na
Gross average monthly earnings in economy (annual average)	32.5	38.6	33.4	25.5	20.3	26.5	na
Government sector			*(In per cent of GDP)*				
General government balance	-1.7	0.0	-0.7	1.4	0.4	-0.5	0.0
General government expenditure	47.7	46.0	48.0	48.0	49.6	52.7	na
General government debt	10.4	8.9	8.3	8.8	11.6	13.0	na
Monetary sector			*(Percentage change)*				
Broad money (M3, end-year)	56.3	44.1	42.2	39.3	40.0	26.3	na
Domestic credit (end-year)	64.7	39.1	34.8	53.2	22.2	51.7	na
			(In per cent of GDP)				
Broad money (M3, end-year)	16.8	17.7	19.3	22.1	25.5	24.0	na
Interest and exchange rates			*(In per cent per annum, end-year)*				
Refinancing rate	28.0	17.0	11.0	10.5	10.0	12.0	na
Treasury bill rate (3-month maturity)	na	na	na	na	na	na	na
Deposit rate (1 year)[1]	17.4	12.7	9.2	7.7	8.1	na	na
Lending rate (1 year)[2]	24.0	16.9	11.4	8.8	8.5	na	na
			(Belarussian roubles per US dollar)				
Official exchange rate (end-year)	2,156.0	2,170.0	2,152.0	2,140.0	2,150.0	2,200.0	na
Official exchange rate (annual average)	2,051.3	2,160.3	2,153.8	2,144.6	2,146.0	2,136.7	na
External sector							
			(In millions of US dollars)				
Current account	-434.4	-1,193.3	435.5	-1,431.2	-3,037.6	-5,048.8	-5,632.1
Trade balance	-1,255.6	-2,271.8	-637.6	-2,269.0	-4,071.0	-6,111.2	-6,722.4
Merchandise exports	10,072.9	13,942.2	16,108.8	19,834.7	24,328.9	33,043.3	26,434.6
Merchandise imports	11,328.5	16,214.0	16,746.4	22,103.7	28,399.9	39,154.5	33,157.0
Foreign direct investment, net	170.3	162.5	302.5	351.0	1,770.0	2,143.4	1,293.1
Gross reserves, excluding gold (end-year)	461.5	690.8	1,106.5	1,067.2	4,182.0	3,061.1	na
External debt stock	4,174.9	4,935.4	5,168.4	6,785.7	12,719.2	14,817.9	na
			(In months of imports of goods and services)				
Gross reserves, excluding gold (end-year)	0.5	0.5	0.7	0.5	1.6	0.9	na
			(In per cent of exports of goods and services)				
Debt service	13.7	11.7	12.4	16.6	14.4	na	na
Memorandum items			*(Denominations as indicated)*				
Population (end-year, million)	9.8	9.8	9.8	9.7	9.6	9.6	na
GDP (in billions of Belarussian roubles)	36,564.8	49,991.8	65,067.0	79,231.4	96,047.7	128,828.8	137,460.3
GDP per capita (in US dollars)	1,809.9	2,361.4	3,096.9	3,808.5	4,639.6	6,285.5	na
Share of industry in GDP (in per cent)	30.8	32.7	33.1	32.2	31.6	na	na
Share of agriculture in GDP (in per cent)	10.2	10.3	9.8	9.3	8.8	na	na
Current account/GDP (in per cent)	-2.4	-5.2	1.4	-3.9	-6.8	-8.4	-11.8
External debt - reserves (in US$ million)	3,713.4	4,244.6	4,061.9	5,718.5	8,537.2	11,756.8	na
External debt/GDP (in per cent)	23.4	21.3	17.1	18.4	28.4	24.6	na
External debt/exports of goods and services (in per cent)	36.1	31.5	28.4	30.5	46.1	39.7	na

[1] Data refer to weighted average interest rates on new one-year deposits in commercial banks.

[2] Data refer to weighted average interest rates for one-year loans by commercial banks.

ANNEX 5: ASSESSMENT OF TRANSITION CHALLENGES

The table below provides an overall Assessment of Transition Challenges rating for 2009 and 2005. Scores range from negligible, small, medium and large. “Negligible” means that the remaining challenges are minor and that the sector is well advanced in moving towards a well-functioning market economy. “Large” means that the remaining challenges are major and that this dimension of the sector is at an early stage of reform. The overall rating in 2009 is based on individual ratings for market structure and market-supporting institutions and policies (see methodology annex circulated separately). The 2005 overall rating is based on individual ratings for market structure, market-supporting institutions and market behaviour. Due to changes in the methodology, made necessary by the evolving meaning of transition and the lessons of the financial crisis, comparison between the two overall scores should be made with caution.

Belarus	**Overall 2009**	**Overall 2005**
Corporate		
Agribusiness	Large	Large
General Industry	Large	Large
Property and Tourism	Large	Large
Telecom	Large	Large
Infrastructure		
MEI	Large	Large
Natural Resources	Large*	Medium
Power	Large	Large
Sustainable Energy	Large	Large
Transport	Large	Large
Financial Institutions		
Banking	Large	Large
Insurance and financial services	Large	Large
MSMEs	Large	Large
Private equity and capital markets	Large	Large

* The wider overall transition gap in 2009 is due to differences in the methodological approach (the gas sector is now analysed over the whole value chain, including gas distribution). The rating change with respect to 2005 should therefore not be interpreted as a transition reversal.

Assessment of Transition Challenges by Sector

Corporate Sector

Agribusiness

Market structure: Large
Institutions/policies: Medium

Domestic prices of agricultural inputs and commodities remain largely state controlled. State- or municipally-owned companies still own most of the primary, processing and input supply agribusinesses and restructuring is at a very early stage. While some of the SME registration procedures have been simplified the overall business environment poses a constraint to private enterprise development and FDI along the whole value-chain. Processors lack international quality and hygiene standards and overall productivity levels are low in the sector. There is a high dependence on subsidised and directed credit through government controlled banks.

General Industry

Market structure: Large
Institutions/policies: Large

The state continues to play a dominant role in the industrial sector. However, recent progress in the regulatory regime and privatisation should have a positive impact on industrial sector restructuring, including under pressure from rising energy prices and declining demand during the economic crisis. In addition to the ongoing corporatisation of state-owned enterprises, the taxation of small enterprises has also been somewhat simplified recently. Furthermore, in 2008 the authorities abolished the golden share rule (the right of the state to take over management of privatised companies). However, despite recent improvements, taxation remains both heavy and complex, with simultaneous application of turnover taxes, value-added tax, and sales taxes, and equity increases at above nominal value are subject to a 24 per cent corporate income tax. The transparent privatisation of state-owned enterprises remains a key challenge.

Property and Tourism

Market structure: Large
Institutions/policies: Large

The property market is at early stages of development and the lack of foreign investors hinders its development. Many market segments and products are non-existent, while the existing stock, for instance in the office or logistics sectors, mainly consists of low-quality, Soviet-type buildings. There is widespread state intervention in the sector, and weak rule of law allows for corruption and insecure property rights. On the positive side, Belarus made progress with regard to property registration through the creation of a one-stop shop and administrative simplifications, which reduced the time needed to register property in Minsk from 231 to 21 days and made Belarus the top reformer in property registration according to the World Bank 2009 Doing Business report. Tradability of land is limited de jure.

Telecommunication

Market structure: Medium
Institutions/policies: Large

The Ministry of Communications and Informatisation is the telecoms regulator as well as policy-maker and key shareholder. Beltelecom retains its monopoly over the provision of basic voice services (local, domestic and international long distance) and has exclusive rights to own and operate fixed network infrastructure. There are four mobile network operators, two of them have been privatised to foreign investors (including MDC, the second largest operator), but the largest company remains state-owned. Government has taken steps to develop a knowledge-based society, primarily through creating a supportive regulatory environment, mostly with respect to e-commerce. More than 30 ISPs have been licensed, but few have begun commercial operations and are all dependent on Beltelecom's national network for the dissemination of their services.

Energy and Infrastructure

Municipal and Environmental Infrastructure

Market structure: Large
Institutions/policies: Large

The municipal utilities sector remains highly centralised. Utility systems are supply driven and characterised by excessive consumption and substantial network losses in both water and district heating. Demand side measures remain to be undertaken. There is little focus on financial performance and most utilities are loss-making. Investments are financed almost exclusively from grants from the state or state entities. Private sector participation is confined to urban transport. Tariff policies are socially driven and have little connection to the cost of service provision. Moreover caps on cost recovery ratios are often set (e.g. 50 per cent for water for residential users) and cross-subsidies are very large and widespread. Regulation of the sector rests with the Ministry of Housing and Utilities and there are no formalised contracts between utilities and municipalities.

Natural Resources

Market structure: Large
Institutions/policies: Large

Belarus is endowed with only limited indigenous energy resources, with small deposits of oil, oil shale and coal. None of them are of economic significance. The country is heavily reliant on Russia for its energy supplies and is an important transport corridor for both oil and gas from Russia to Western Europe. The *medium* transition gap in 2005 was based on the insufficient restructuring and commercialisation of Belarus' state-owned refineries. However, considerable challenges remain with the creation of a competitive domestic market and supporting institutions, as the main state-owned companies (Belenergo, Beltopgas, and Beltransgas[8]) lack of transparency, accountability and commercial focus. Although some progress has been made in improving cash collections while keeping tariffs

[8] Under the terms of the JV agreed in May 2007, Gazprom now owns 25 per cent of Beltransgaz. The sale of a further 25 per cent is to be completed in two instalments in 2009-10.

at cost recovery levels, there remain energy debts accumulated at the time of non-payment, and economic inefficiencies in the pricing structure due to misbalanced tariffs between customer groups. Several industrial consumers benefit from preferential electricity and gas tariffs granted by Ministry of Economy resolutions. The regulatory role is vested with the Ministry of Economy, which lacks the autonomy to properly perform the regulatory functions. A preferential tax regime between Russia and Belarus helped Belarusian oil refineries compete with other refineries in the region (for example, in Ukraine). It was lifted only in January 2007. The lack of restructuring in the sector, price distortions and weak institutions would warrant a *large* ATC overall gap.

Power

Market structure: Large
Institutions/policies: Large

The sector is still vertically integrated, with no private sector participation. There is no independent regulator. Tariffs are low and below cost recovery. The initial challenges include unbundling, creation of a framework for competition and private participation in generation, and establishing a tariff structure that ensures full long-term cost recovery and therefore supports investments, as well as providing incentives for more efficient use of energy.

Sustainable Energy

Market structure/outcomes: Large
Market institutions/policies: Medium

The energy efficiency sector is at a very early stage of development. The Belarusian economy remains one of the most energy intensive in the EBRD region. A law on energy conservation exists and an energy efficiency agency was established, but concrete results in terms of energy savings are yet to appear. Energy tariffs remain very low and do not include environmental costs. Therefore price signals do not provide incentives to use energy efficiently and to invest in RES projects. RES supportive legislation and institutional capacity remain underdeveloped and only a small proportion of energy comes from renewable resources. Belarus has ratified the Kyoto protocol and has the status of Annex 1 party, although this has to be ratified by all parties of the Kyoto Protocol (KP) before the country can host joint implementation (JI) projects and trade assigned amount units (AAUs). Some capacity in GHG management has been developed but no projects can be hosted until other countries ratify amendments to the KP. Remaining challenges include tariff increases to provide incentives for energy efficiency and RES, the development of renewable regulatory frameworks and project capacity, and progress further with CC policy implementation.

Transport

Market structure: Large
Institutions/policies: Large

The railway sector is largely unreformed as operating and policy-setting functions are not separated and core railway businesses (infrastructure, passenger, freight, etc.) are operated by the same entity. The Belarusian Railway operates as a vertically integrated, state-owned monopoly. Before 1996, the railway was managed as a department of the Ministry of Transport and Communication.

In roads, there has been good progress in sector unbundling. Many road functions, including motorway management and road maintenance, were divested and incorporated into joint stock companies. Road construction and maintenance are provided by state owned firms (although there is limited private sector participation in few areas). Road user charges, including tax on fuel sale, ecological tax, tax on car purchases, and toll fees, were introduced. However, actual budget allocation appears well below needs.

Financial Institutions

Banking

Market structure: Large
Institutions/policies: Large

The banking system remains modest in size with total credit to the private sector at around 32 percent of GDP, and the sector is dominated by few large state owned banks. Significant part of lending to the corporate sector takes place under various state programmes. While Priorbank and a number of smaller banks are foreign-owned, their impact on the sector remains modest. The elimination of the golden share rule in 2006 has opened the way for privatisation of two large state-owned banks to foreign investors over the next few years, though improvements in regulation and supervision are needed, including through coordination with foreign authorities.

Insurance and Financial Services

Market structure: Large
Institutions/policies: Large

Insurance legislation and regulation are in place. However, the insurance market remains relatively small and is dominated by state-owned insurance companies, the largest of which accounts for around half of the market. State-owned companied also benefit from monopoly rights to offer compulsory insurance, and there are restrictions on foreign ownership in the insurance sector. The leasing sector has been growing actively in recent years but remains relatively small. The state pension system remains largely unreformed.

Micro, Small and Medium-sized Enterprises

Market structure: Large
Institutions/policies: Large

MSME finance is provided by commercial banks on a limited scale and by one recently established microfinance bank. MSMEs in Belarus struggle to comply with onerous administrative requirements and suffer from a lack of access to finance. Improvements in the legal base for micro-lending raised the awareness of MSMEs regarding funding opportunities, and subsequently led to increased demand for MSME loans. However, despite the incipient development of micro credit activities in the country, the problem of a lack of access to finance is especially prominent in rural areas of the economy. There is scope for improvements in the extent of coverage of credit information services. A geographically unified collateral registry providing information on asset types and the grantor’s name of a security right is not in place yet. Also, the fact that secured creditors do not have absolute priority to their collateral outside and/or in bankruptcy procedures may even more discourage commercial banks to lend to MSMEs.

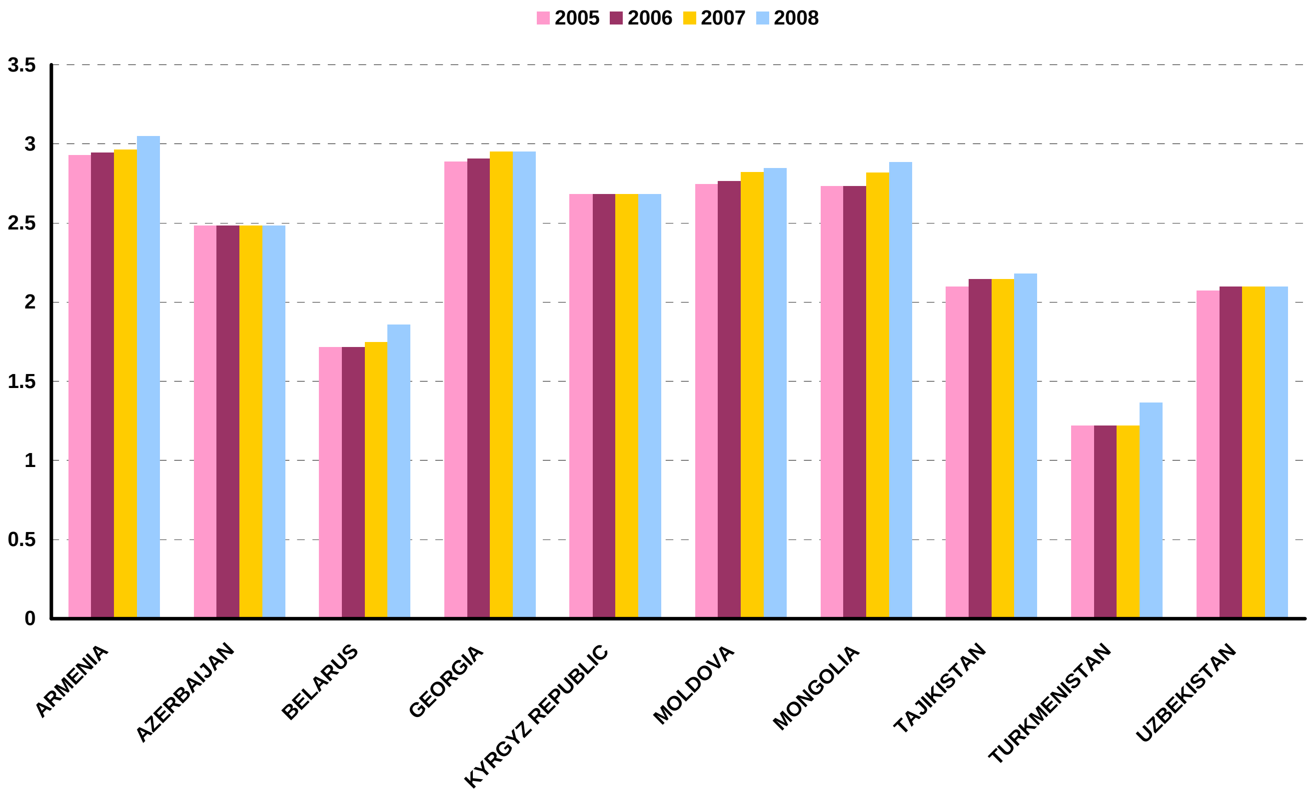
Private Equity and Capital Markets

Market structure: Large
Institutions/policies: Large

Securities market legislation is rudimentary and in need of overall reform. A commercial private equity sector is yet to develop and to date the country has not attracted significant interest of international private equity funds. A challenging business environment, limited investment opportunities and poor exit prospects all conspire against this sector.

ANNEX 6: SELECTED TRANSITION INDICATORS

Table 1: Transition Indicators (averages 2005 - 2008)



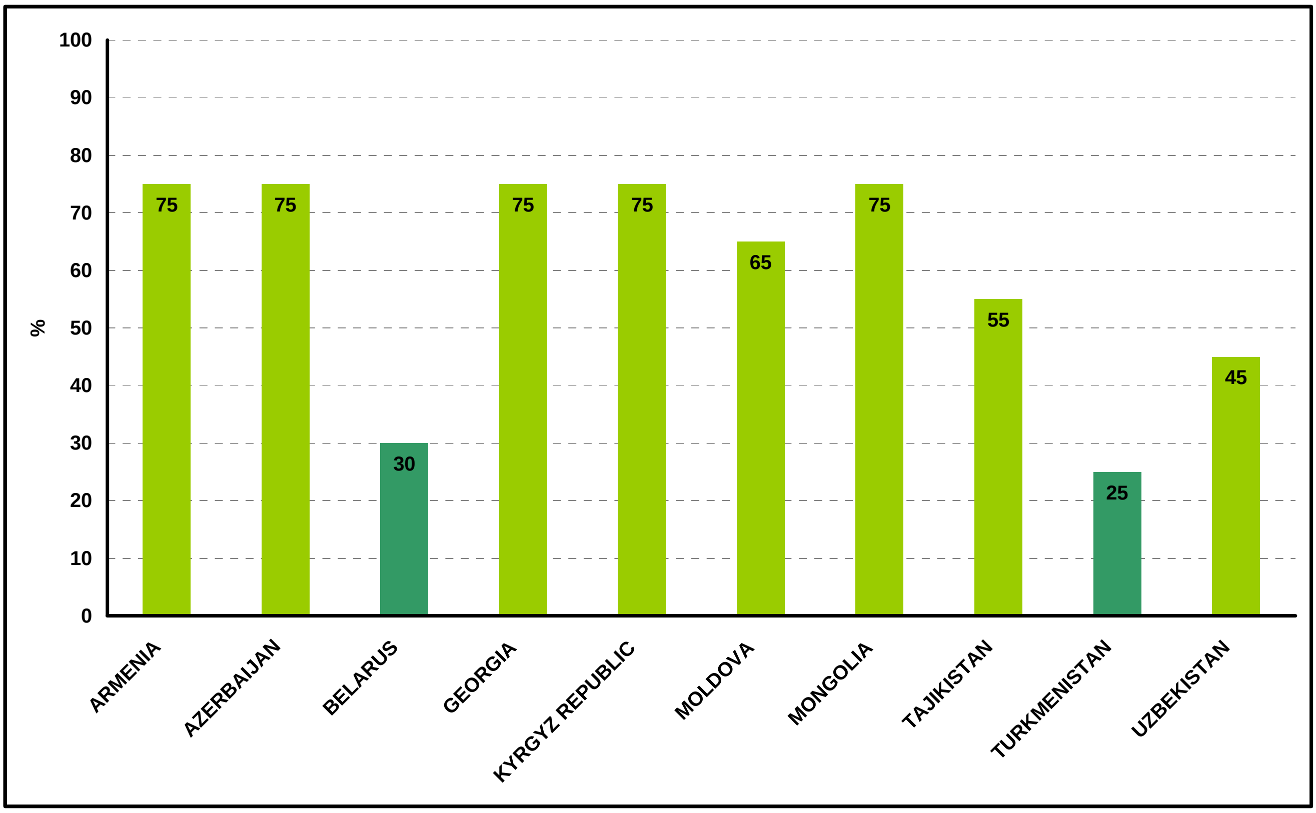
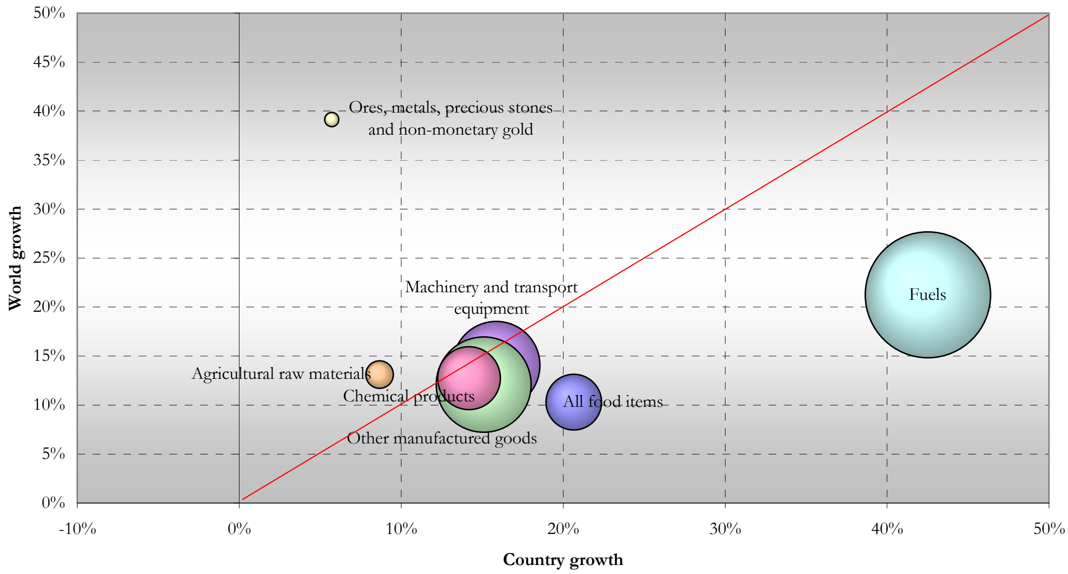


Table 2: 2008 private sector share in GDP (EBRD Transition Report estimates)

ANNEX 7: BELARUSIAN EXPORTS PERFORMANCE

Belarus – goods exports performance

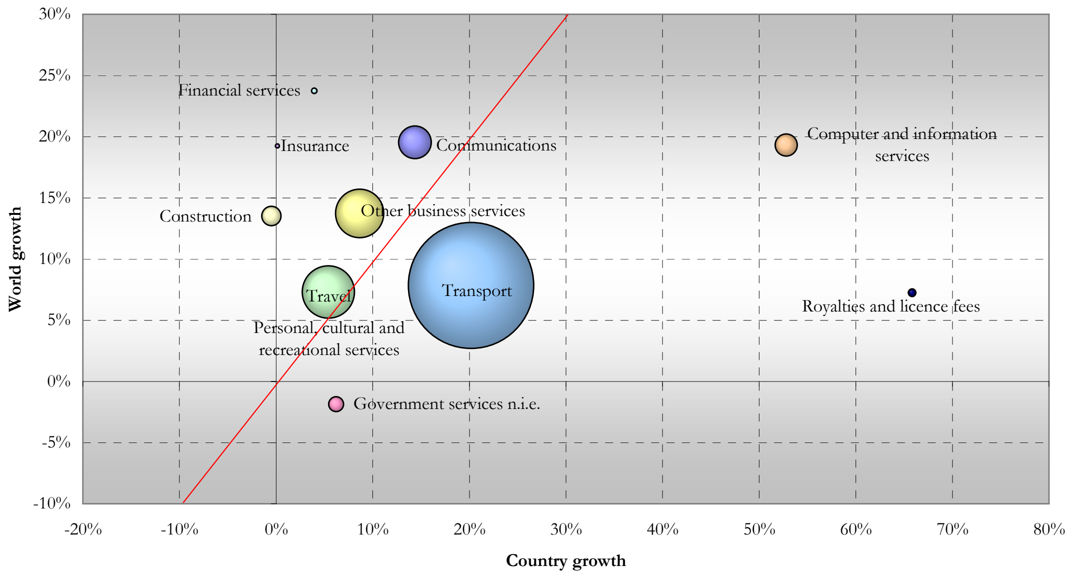
Exports by goods category



- Food, Fuels, Machinery & Transport Equipment and Other Manufacturing show best goods export performance in recent years

Belarus – services exports performance

Exports by service category



- Transport shows best export services performance in recent years. Computer and information services also performing well, but sector is very small

Note 1: growth is average annual growth in 2002-06. Anything to the right of the red line indicates better performance relative to the world, with the size of the bubble proportional to the size of Belarusian exports.
Note 2: Belarus has a number of agreements that effectively allow it to export tariff free to the Russian market, the customs union agreement signed in December 2009 between Belarus, Russia and Kazakhstan, if effected, will further reduce the trade barriers between the three countries.

ANNEX 8: APPROVED BANK OPERATIONS AND PIPELINE

(As of July 2009, EUR million.)

Sector Name	CUMULATIVE COMMITMENTS					CURRENT PORTFOLIO		
	No. of Projects	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	%
Financial Institutions	**23**	**217.2**	**175.2**	**60**	**101**	**21**	**59.7**	**84**
Infrastructure	**1**	**87.7**	**40.1**	**14**	**40.1**	**0**	**0**	**0**
Transport	*1*	*87.7*	*40.1*	*14*	*40.1*	*0*	*0*	*0*
Energy	**1**	**29.3**	**29.3**	**10**	**29.4**	**0**	**0**	**0**
Power & Energy	*1*	*29.4*	*29.4*	*10*	*29.4*	*0*	*0*	*0*
Corporate	**4**	**55.3**	**47.4**	**16**	**38**	**1**	**11**	**16**
Agribusiness	*2*	*25.2*	*18.7*	*6*	*9.3*	*1*	*11*	*16*
Telecoms Informatics & Media	*1*	*27.7*	*27.7*	*10*	*27.7*	*0*	*0*	*0*
General Industry	*1*	*2.4*	*1*	*0*	*1*	*0*	*0*	*0*
Country Total	**29**	**389.5**	**292**	**100**	**208.5**	**21**	**70.7**	**100**

Class and Investment Type	CUMULATIVE COMMITMENTS					CURRENT PORTFOLIO		
	No. of Projects	Total Project Cost	EBRD Funds	% of total EBRD	Disbursed	No. of Projects	Portfolio	%
Private	*25*	*236.9*	*190.2*	*65*	*106.7*	*21*	*70.7*	*100*
Public	*4*	*152.6*	*101.8*	*35*	*101.8*	*0*	*0*	*0*
Country Total	**29**	**389.5**	**292**	**100**	**208.5**	**21**	**70.7**	**100**
Non-Sovereign	*24*	*210*	*168.7*	*58*	*85.2*	*21*	*70.7*	*100*
Sovereign	*5*	*179.5*	*123.3*	*42*	*123.3*	*0*	*0*	*0*
Country Total	**29**	**389.5**	**292**	**100**	**208.5**	**21**	**70.7**	**100**
Debt	*24*	*377.9*	*280.4*	*96*		*18*	*55.9*	*79*
Equity	*5*	*11.6*	*11.6*	*4*		*3*	*14.8*	*21*
Country Total	**29**	**389.5**	**292**	**100**	**208.5**	**21**	**70.7**	**100**

Pipeline (Board approved 2009):
Multi products Framework III : USD 50 MM.
Pinskdrev project :USD 15 MM.

ANNEX 9: IFI ASSISTANCE

The International Bank for Reconstruction and Development

The World Bank engagement is evolving beyond what was envisaged by the 2007 Country Assistance Strategy covering 2008 - 2011 period. The view of the World Bank is that the Government of Belarus has initiated a gradual structural reform before the crisis; however, the global downturn exposed vulnerabilities of the Belarus economy and posed the need for urgent external and fiscal adjustments. This did prompt the need for significant increase in the external financing needs. An update and mid-term review of the Country Assistance Strategy is currently under preparation, which is expected to significantly increase the levels and expand the scope of lending activities originally planned in the financial years 2008 - 2011 Country Assistance Strategy.

The World Bank total cumulative lending to Belarus amounts to USD 443 million over 8 projects, approved since Belarus became a member of the International Bank for Reconstruction and Development in 1993. The current World Bank portfolio consists of USD 272 million in commitments over 4 projects in the energy efficiency and water supply sectors, and current plans for financial year 2010 include the Development Policy Loan – the first policy-based lending operation since the Rehabilitation Loan was approved in 1994 for USD 120 million – and a Solid Waste Management Project, also the Bank's first investment in the sanitation sector. Investment lending will likely further expand in financial years 2011-2012 to include the first loans to support the transportation sector in both roads and railways. These investments, although not originally envisioned in the Bank's Country Assistance Strategy for financial years 2008-2011, are justified given the financing needs of the country, a developing track record of reform, and solid performance of the existing portfolio.

The International Monetary Fund

Based on the IMF position as of July 2009, Belarus' programme with the International Monetary Fund is on track. A 15-month stand-by arrangement (SBA) in the amount of SDR 1.62 billion (about USD 2.51 billion and 418.8 percent of its quota) was approved on 12 January 2009 in support of the country's efforts to adjust to external shocks. The Fund increased its financial support to Belarus to SDR 2.27 billion (about USD 3.52 billion)—equivalent to 587 percent of Belarus' quota or 7 percent of its GDP—following the completion of the first review under the SBA on 29 June 2009.

The main objectives of the programme are to facilitate an orderly adjustment to external shocks and to address pressing vulnerabilities. To this end, the programme contains strong macroeconomic adjustment measures and addresses a number of structural issues that would ensure sustainable medium-term economic growth and external sustainability. The revised arrangement supports the government's economic programme and helps Belarus to contain the effects of a greater than expected impact from the global financial crisis. To reduce the resulting financing gap, the authorities would maintain a balanced budget in 2009, despite lower revenues; keep monetary policy adequately tight; allow more exchange rate flexibility within a fluctuation band which was widened from ±5 percent to ±10 percent around the parity rate. The revised programme envisages stronger efforts to liberalise the economy and prepare for privatisation. The latter would require the enactment of a privatisation law that conforms to best practices, and the establishment of a privatisation agency capable of advancing ambitious privatisation agenda. Measures that would improve governance and business climate includes legislative changes to increase the central bank's independence, plans to reduce further price and wage controls and remove mandatory production and employment targets for private companies.

The Official IMF position on the Republic of Belarus as of 30 June 2009

I. Membership Status: Joined: July 10, 1992; Article VIII

II. General Resources Account:	**SDR Million**	**%Quota**
Quota	386.40	100.00
Fund holdings of currency	904.20	234.01
Reserve Tranche Position	0.02	0.01
Lending to the Fund		
Holdings Exchange Rate		

III. SDR Department:	**SDR Million**	**%Allocation**
Holdings	2.29	N/A

IV. Outstanding Purchases and Loans:	**SDR Million**	**%Quota**
Stand-by Arrangements	517.80	134.01

V. Latest Financial Arrangements:

Type	Date of Arrangement	Expiration Date	Amount Approved (SDR Million)	Amount Drawn (SDR Million)
Stand-By	Jan 12, 2009	Apr 11, 2010	2,269.52	517.80
Stand-By	Sep 12, 1995	Sep 11, 1996	196.28	50.00

VI. Projected Payments to Fund [1/]
(SDR Million; based on existing use of resources and present holdings of SDRs):

	Forthcoming				
	2009	2010	2011	2012	2013
Principal				194.17	258.90
Charges/Interest	3.66	7.15	7.15	6.34	2.94
Total	3.66	7.15	7.15	200.51	261.84

[1/] When a member has overdue financial obligations outstanding for more than three months, the amount of such arrears will be shown in this section.

ANNEX 10: TAM/BAS activity in Belarus

Previous TAM/BAS experience in Belarus

The TAM/BAS Programme supports economic transition by achieving enterprise change in potentially viable micro, small and medium enterprises in the EBRD countries of operation. Since inception in 1994, the Programme in Belarus has mobilised around EUR 900,000 in donor funding, mainly from the UK, Sweden and Japan.

TAM

TAM supports the introduction of international best practice in SMEs with the potential of becoming future leaders in their market through the introduction of international Advisors from developed countries with 15-20 years professional experience in the relevant sector. TAM projects typically last around 18 months. The Programme also carries out seminar and training activities promoting international best practices by disseminating successful case-studies to entrepreneurs.

The TAM Programme began operations in Belarus in 1994 with funding from EU Tacis, which was followed by bilateral funding from several donors. In total, TAM has undertaken 24 projects in Belarus, utilising more than EUR 900,000 committed by EU Tacis, the UK, Sweden, Japan, the Netherlands, Finland, Norway and Germany. TAM projects have enjoyed a wide coverage across both industry and geographic locations with 43% of all projects undertaken outside of Minsk. The main industry focus of projects has been on Electrical Equipment, Wood Products and Non-metallic mineral products. Of the 24 completed projects undertaken in Belarus, 83% have been rated as satisfactory or highly satisfactory. What has been identified as a key factor for TAM project success has been the degree of willingness and eagerness of the staff of assisted enterprises to learn from the TAM teams.

BAS

BAS acts as a facilitator for the use of local, private-sector consultants by MSMEs to obtain a diverse array of services. BAS works on the demand and the supply side. By assisting individual enterprises to engage with local consultants on narrowly-based, specific projects with a rapid payback, it stimulates demand and the understanding of the potential benefits of using external consultants. It also directly increases the supply and quality of local advisory services, through targeted market development activities. BAS supported projects typically last around four months.

The BAS Programme has not yet initiated activities in Belarus, but hopes to do so soon depending on the availability of donor funding.

Linkages with banking

Since inception, TAM/BAS has referred seven companies which have gone on to become EBRD investments. The total value of these investments is EUR 23.6 million.

The MSME sector faces administrative and financial impediments

MSMEs in Belarus struggle to comply with onerous administrative requirements and suffer from a lack of access to finance. The problem of a lack of access to finance is especially prominent in rural areas of the economy, despite the incipient development of microcredit activities in the country. The government has ambitious plans to expand the share of MSMEs in terms of employment and output.

The business environment still suffers from several important weaknesses

According to recent editions of the World Bank Doing Business reports, substantial efforts have been made in recent years to expedite procedures for starting a business, registering property, dealing with construction permits and employing workers. However, getting credit, protecting investors, paying taxes and trading across borders remain major areas of weakness in the business environment.

Private sector development has lagged given strong state control of the economy

The economy is heavily centralised. Favourable external conditions have helped economic policy and the economy in recent years, but a reliance on Russian finance is a source of vulnerability in light of the present volatility in the Russian economy. Industry and especially agriculture benefit from government support, and many inefficient producers are reliant on the government in order to survive. Surpluses in trade with the rest of the world are consistently offset by deficits in trade (focussed on energy products) with Russia. Economic growth has been high by regional comparison in recent years, but the economy's strong links with Russia and the onset of adverse global conditions more generally, make the sustainability of this expansion uncertain.

Donors have supported TAM activities

Donor funding of TAM activities in Belarus since inception has helped to further the TAM Programme's aim of bringing about the transfer of management skills tog assisted enterprises. TAM/BAS is seeking funding to be able to continue TAM activities, as well as to initiate BAS activities in order to give impetus to the development of the local consultancy market.

Recommendations for future TAM/BAS interventions

There is a strong need for TAM/BAS interventions to address the problems faced by MSMEs in Belarus.

Given the weak development of agriculture and related sectors, there is potential for TAM/BAS to assist private farming and food-processing activities. The food sector is very important in Belarus, as in all countries. Wood processing and furniture manufacturing are also important. The construction industry has performed well in recent years, and its prospects are supported by Belarus' natural resource base. Manufacturing activities related to fertilisers also have export potential. In terms of other manufacturing activities, TAM/BAS is well-placed to assist former state-owned enterprises to restructure their operations in the direction of market planning. Other areas of the economy with sound prospects include those related to transit (Belarus is located within the transit corridor between Russia and Europe), as well as tourism, where there is significant potential for the development of private-sector accommodation facilities. The retail sector needs assistance to reach the standards now required by the market.

TAM/BAS expertise is likely to be important in the areas of quality management and certification, raw materials management and international best practices, including access to better technology and capital equipment. Other anticipated areas of need are assistance with market analysis, development planning and HR.

Cross-cutting issues

Many industrial enterprises in Belarus have benefited from cheap energy inputs based on trade with Russia, and there is scope for TAM/BAS to help selected industrial enterprises reduce their vulnerability to higher energy prices by improving energy efficiency. Rural development will remain a priority given the problems faced by MSMEs in rural locations in management skills and obtaining finance. Environmental management and gender issues will also be addressed if possible.

Continuation of TAM and initiation of BAS

Subject to donor funding being available, the TAM Programme plans to continue to support the transfer of management skills to MSMEs in Belarus. In tandem with TAM's focus on management skills, BAS would seek to act as a catalyst to the creation of a much-needed local consultancy market to support MSME development. TAM/BAS aims to promote its Programme and support its priorities through visibility activities aimed at MSMEs and a focus on market development and dissemination, particularly where a particular expertise gained from a TAM/BAS project can be shared among several enterprises.

Contribution to EBRD's policy dialogue

The TAM/BAS Country Brief strengthens the EBRD's policy dialogue toolkit by analysing the business environment and identifying key challenges faced by the MSME sector. Future challenges for the government are identified as reforming the taxation, customs, and inspection regime, improving law enforcement, education and access to finance, reducing arbitrariness and corruption.

An input for enhancing linkages with banking

In line with TAM/BAS Strategic Plan 2008-2010, TAM/BAS will continue to assist the Bank to meet its objective of creating a commercially viable project pipeline for Bank's direct investments by:

(i) helping to identifying potential pipeline (pre-investment),
(ii) providing "consulting and business" services for the preparation and support of Bank private enterprise financing projects and for the enterprises themselves, and
(iii) providing candidates for non-executive board member positions.

TAM/BAS will link MSMEs in need of finance with available EBRD instruments, including direct investments (perhaps through the Direct Investment Facility), as well as credit lines from EBRD-supported local banks.

ANNEX 11: SUMMARY OF TC PROJECTS

Country	Project name	Project description	Amount, EUR	Assignment start	Status/ Funding	OL
Belarus	Downscaling Programme	Belarus Microlending Programme: Micro Enterprise Credit Advisers. TC is provided to EBRD partner banks in the capital city and in the regions to streamline and simplify MSE lending procedures, train specialised loan officers and create efficient credit analysis and monitoring tools.	1,656,283	2000	Ongoing/Taiwan, US facility, EU, UK, Ireland, EBRD Shareholder Special Fund, National Bank of Belarus	O.Pak (R.Iksar)
Belarus	Microfinance Bank of Belarus - Start-up and Operations	Support of start-up and operation costs of the greenfield microfinance bank established by the EBRD together with several other key investors (IFC, FMO, KfW, Commerzbank, SwedFund, Shorebank International and ShoreCap). The EBRD participates in the bank with equity and a credit line.	2,225,056	2007	Ongoing/ Austria, the EU, IFC, Japan, Luxembourg, Norway and Netherlands	O.Pak (A. Vega)
Belarus	Belarus support to partner banks institution building and strengthening loan procedures for SME loans	TC for 3 participating banks: MTB, Belrosbank and RRB, BBSB. Strengthening of the credit process and credit portfolio management procedures and risk management skills	195,990	2008	Ongoing/ CEI fund	R.Iksar
Belarus	"IFRS Training and Advisory Services"	IFRS training for local participating banks	34,000	2008	Completed/ Luxembourg	R.Iksar

Funded: **4,111,329**

Country	Project name	Project description	Amount, EUR	TC Com date	Status/ Funding	OL
Belarus	Advisory Services and Training for TFP Factoring	Advisory Services and Training for TFP Factoring	190,000	14-Dec-05	Not contracted/ EBRD Shareholder Special fund TBC	D.Bolschun
Belarus	Trade Finance Advisory Services	Trade Finance Advisory Services	185,000	01-Oct-08	Not contracted/ NONC-2009-01-01	D.Bolschun
Belarus	Assistance with Institution Building	Assistance to partner bank – RRB with Institution Building	500,000	21-Nov-07	Not contracted/ EBSF-2008-07-09	I.Yabbarova
Belarus	Assistance with Institution Building	Assistance to partner bank – RRB with Institution Building	295,000	21-Nov-07	Not contracted/ EBRD Shareholder Special fund TBC	I.Yabbarova
Belarus	FI Framework Support	FI Framework Support	2,000,000	Q2 2009	Not contracted/ tbc	R.Iksar
Belarus	MSE lending operations - Extension	Belarus bank for small business	800,000	30-Nov-06	Not contracted/ NIF or US/EBRD SME Financing Facility - tbc	O.Pak (A.Vega)

Pipeline: **3,970,000**