# Don't let the money to mess up the reforms: Few notes on the new round of Belarus – IFIs negotiations

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Last week the Belarusian delegation represented by top economic officials attended the Spring Meetings of the World Bank Group and the International Monetary Fund. According to the Belarusian media, they planned to discuss a joint program of the Government and the National Bank on macroeconomic stabilization and structural reforms. Representatives of the economic authorities announced that they will present the related "roadmap" to the IMF and the EurAsEC Anti-Crisis Fund (ACF) in order to get the support for this program from both institutions. Although the "joint program" was not presented to the public yet, some general remarks about the lessons learned from the previous programs of Belarus and these IFIs and about several important elements of the new program look reasonable.

## Lessons: Reform incentives

The IMF tried to learn from the 2009 program itself, formulated the main lessons in its Ex Post Evaluation: "the criticality of incorporating fully **ownership**, including at the highest levels, in program design and conditionality" and a need of "greater reliance on **prior actions** or more explicit high-level endorsement of the program's goals" (IMF, 2011, p. 2–3). In other words, in order to count on the new program, the Belarusian authorities should develop the new reform program themselves and start its implementation without the IMF support, demonstrating consistency and comprehensiveness of their policies.

Secondly, the new program should take into account the issue of incentives related to **program sequencing**. According to initial design of 2009 stand-by arrangement, 1/3 of the loan was disbursed as a first tranche and the remained 2/3 were to be disbursed in four tranches. The ACF in 2011 used similar approach (1/3 as a first tranche and 2/3 in five tranches). However, in both cases large front-loaded financing hindered efficiency of conditionality (especially in terms of structural benchmarks), as it allowed meeting the most urgent financing needs of the authorities with minor effort.

**Excessive flexibility** of IFIs in modification of performance criteria also negatively influences program efficiency. The IMF was too flexible in modification of performance criteria of the 2009 program: in fact, most of them were modified and then approved by the Fund (see IMF, 2009a,b; IMF, 2010a, b). Similar situation was observed with the Anti-Crisis Fund loan: second, third, fourth and fifth tranches of the loan were given to Belarus despite several quantitative control targets and indicative targets were not met at every stage (ACF, 2011; ACF, 2012a, b, ACF, 2013). Thus, it the authorities faces such a flexible approach to program performance criteria, they have stronger incentives to justify the necessity of waiver / modification of the criteria than to meet them. However, revisions of performance criteria may happen because of unexpected shifts in external environment or bottlenecks in initial program design related to underestimated role of political economy and improperly defined sources of economic vulnerabilities.

## Lessons: Program design

Given the situation in Belarus[1], external adjustment requires a **proper mix of macroeconomic and structural policies even in a short run**. The IMF in 2009 and the ACF in 2011 put structural benchmarks as medium-term ones. Taking together recommendation about "greater reliance on prior actions" and the urgency of structural policies, major steps towards price liberalization (including producer prices), state-owned enterprise restructuring, and privatization (at least small and medium scale) look natural precondition of the new financing arrangements.

Next, **accurate specification of program benchmarks** is crucial for overall program efficiency. The biggest lesson is failure of the 2009 IMF program in terms of its approach towards directed lending (or lending under government programs). In the 2009 program, he IMF required abolishment of additional transfers of government deposits to commercial banks as a prior action[2]. The government met this benchmark and transferred its deposits to the Na-

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[1] The fact that "Belarusian economic model reached its limits" has become a commonplace: e.g., in its recent press release the IMF stated that "Belarus' economic model continues to make it highly vulnerable to economic shocks as was illustrated once more by the recent market turmoil, triggered by a deteriorating external environment. The recurrent pressures are rooted in the continual inability of Belarus' over-determined central-planning model to deliver sustainable growth." (IMF, 2015).

[2] Prior to the program, these deposits served as the main source of financing of directed lending.

tional Bank. However, having substantial inflow of government deposits, the National Bank started to channel them to the commercial banks for further lending under government programs (IMF, 2011, p. 10) – and this had not contradicted to the program's requirements[3]! Furthermore, quantitative monetary targets were set as end-of-period indicators, and the government met them thanks to "*non-conventional actions*"[4].

Taking into account the fact that the authorities plan "co-financing" of the new program by the IMF and the Anti-Crisis Fund[5], **pre-program consultations between the IFIs** looks natural: coordinated position on program design, conditionality and performance criteria may improve the overall efficiency of the program and reduce incentives distortions.

## What's wrong with the current IMF recommendations?

Actually, almost nothing. It seems that the IMF learnt from the previous experience of cooperation with Belarus: almost all issues mentioned in the previous sections are taken from the IMF documents. The latest IMF document related to Belarus (press release on the completion of the Article IV consultations mission, see IMF, 2015) summarizes main broadly formulated recommendations of the Fund concerning overcoming the current economic problems of Belarus. However, as the economic dynamics of the country follows the same cycle (loose policies to enhance growth – accumulated imbalances – currency crisis – strengthened policies – slow growth – attempts to enhance growth, etc.), related policy advice is becoming "typical" too, stressing the importance of strengthening of the macroeconomic policies and criticality of structural reforms.

First, it seems that IFIs working in Belarus sometimes forget that wages should be set by the market, not the government, and instantly advise to freeze nominal wage or to link its growth to labor productivity growth. However, in "normal" situation, the government should influence only wages in so-called budgetary sector (health care, education, public administration, etc.) and state-owned enterprises. According to the Belarusian legislation, in both cases wages are linked directly to labor productivity (and this solution is also far from perfect), but through this channel the government can influence average wages in the economy only partially. According to the IMF, "nominal wages should be kept constant in 2015 to compensate for excessive past growth and to preserve the competitiveness gain from recent exchange rate adjustment", but on the one hand productivity could fell even in nominal terms, and on the other in some cases keeping wage constant could create such problems as labor out-migration and brain drain. Focus on "optimization" of employment (i.e. reduction of excessive employment) in case of state-owned enterprises or optimization of job duties and employment in case of budgetary workers creates the room for nominal or even real wage increase[6] and stays completely in line with principles of structural reforms.

Second, the IMF calls for "time-bound plan to bring utility and transport tariffs rapidly to full cost recovery". However, costs of this sector remain largely non-transparent, while its overall efficiency stays questionable (see World Bank, 2011). It looks natural to mention the importance of the utility and public transport sectors reform and elimination of cross-subsidization, i.e. not only "time bound" rapid increase of the related tariffs for households, but also reduction of these tariffs for enterprises (and elimination of energy subsidies to selected sectors and companies). After all, rapid increase of utility tariffs together with wage freeze could deteriorate household welfare and increase poverty significantly (see Shymanovich and Chubrik, 2013).

Third, in the mentioned statement IMF says nothing about the effect of its recommendations and overall economic situation on the labor market, although some indicators and anecdotal evidence witnesses serious negative changes: reduction of employment and increase of unemployment (see Chubrik, 2015). Taking into account the fact that **political economy matters** for sustainability of the results of any reform program, such issues should be considered in details, not in one sentence about the need to "strengthen of safety nets to protect the vulnerable".

Anyway, it is too early to speak about the bottlenecks of the new program: it has been presented to the IFIs only a week ago and most probably contain the most important elements of macroeconomic and structural policies. The aim of this paper is just to recall the key lessons of the past and to warn about some – not all – important features of the current economic situation that should be taken into account by the program authors and the IFIs.

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[3] As it was mentioned by the IMF itself, "even though the authorities adhered to the letter of the program, the spirit was not met" (IMF, 2011, p. 10).

[4] Period average performance criteria could be used instead to resolve this drawback, see IMF, 2011, p. 24

[5] And, in fact, by the World Bank: for instance, the 2009 stand-by arrangement with the IMF was supported with the World Bank's development policy loan.

[6] Similar approach (fixed wage bill plus reduction of the number of employees) was declared by the authorities in the budget-2014.

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