

**BUSINESS IN  
BELARUS  
2007**

**STATUS  
TRENDS  
PERSPECTIVES**



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# **Business in Belarus: Status, Trends, Prospects. 2007**

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**Business in Belarus: Status, Trends, Prospects. 2007.** This report analyzes the macroeconomic and institutional environment for functioning of small and medium-sized enterprises (SMEs) in Belarus today and the existing infrastructure for their operation. Also, the results of two empirical studies devoted to the problems and performance of Belarusian SMEs are presented.

The study of the business environment for functioning of SMEs in contemporary Belarus was made by the Research Center of the Institute for Privatization and Management. It reveals numerous barriers to a much needed rapid growth of SMEs in Belarus. Nevertheless, some positive changes are also denoted. Still, there are many inspections and heavy penalties, complicated and costly procedures of permit issuance (licenses, certificates, and so on), deficient tax legislation and price regulation. A number of policy measures are suggested that would allow a greater role for SMEs and facilitate their development in Belarus.

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# 1. INTRODUCTION

For a long time, the development of small and medium-sized business has been set as a priority by the Belarusian authorities. However, in 2007, they have been confronted with new challenges. The inevitability of purchasing oil and gas at world market prices along with the intensified competition at the traditional Russian market make the issue of competitiveness of the Belarusian economy the most urgent economic policy task. It appears that restructuring of the state sector of the economy would require the development of small-scale private business. The authorities seem to be aware of that opportunity. There have already been some claims to support the development of small business, launch debureaucratization policies, simplify administrative barriers, lessen the tax burden on economic actors, and liberalize conditions for registration and closure of small and medium-sized enterprises (SMEs). Besides that, there is a special target set in the Program of Social and Economic Development of the Republic of Belarus adopted for the period of 2006–2010 to increase the relative share of value-added produced by SMEs to 20–22% of GDP. Currently this figure is about 10% of GDP. This is much less than in the countries of Central and Eastern Europe.

The Belarusian authorities have implemented a range of measures to improve the environment for functioning of SMEs. In particular, in 2006 registration procedures (set-ups) have been simplified, the rules for off-schedule inspections have been settled, fines and penalty fees have been reduced, and some improvements in the permit system have been introduced. More recently, in 2007, the simplified taxation system has been further streamlined (by making it more appropriate to the

needs of small-sized companies). Currently some positive steps are being made to simplify the conditions for buyouts and privatization of incompleting construction, and further reduce penalties and fines. Nevertheless, these measures are insufficient to spur the so much needed development of small business in Belarus. Moreover, the authorities continue to intervene into the economic activity conducted by individual entrepreneurs. This intervention is recently manifested in encouragement to shift to new legal forms (such as micro-enterprises, unitary enterprises, and various types of partnership). Private sector companies are still facing numerous forms of discrimination, while central and local authorities continue their administrative interference into the activity of these companies. The business environment in Belarus is being perceived as one of the worst not only in the region, but also in the world. This is confirmed by the results of research conducted by Belarusian analytical centers and business associations as well as international expert studies and comparisons (studies made by the International Finance Corporation, the World Bank, and the European Bank for Reconstruction and Development).

Formally, all necessary infrastructural institutions to support business development are available in Belarus. These institutions range from state programs for supporting entrepreneurship development (adopted on an annual basis) to establishing centers for entrepreneurship support and business incubators, and encouraging activity of business unions and associations. Despite all these efforts made and conditions provided, the number of small- and medium-sized enterprises remained

virtually unchanged over the last 10 years. New companies have not been entering the market.

The majority of representatives of business unions, experts, and entrepreneurs focus on external factors of competitiveness of small business. This is because domestically-erected administrative barriers and tax legislation result in higher costs, thereby making Belarusian companies more vulnerable to foreign competition. But competitiveness is made up of numerous factors, of which internal ones (i.e. managed by executives) seem to be the most important.

A positive development recorded in Belarus is that less and less entrepreneurs consider thorough extensive knowledge of legislation or special connections with administrative bodies as essential competitive advantages. Intensified competition encourages them to rely more on the development of professional, well-trained staff and acquiring market information. A substantial fraction of domestic business acknowledges that liberalization could make Belarusian companies even more vulnerable to foreign competition.

At the same time, Belarusian private companies display reluctance to protect and advance their interests via such ways as associations of entrepreneurs. The results of the survey show that it is only 10% of Belarusian SMEs that belong to business unions. The vast majority of SMEs relies on solving problems on their own. But the experience of other countries clearly denotes the importance of a common effort and consolidation of activities in order to protect the interests of entrepreneurs and simplify the conditions for doing business.

It appears that SME development is not only shaped by government policies, including liberalization of the environment for doing business, but also the activities of entrepreneurs to strengthen the domestic factors of competitiveness and protect their legitimate interests.

This publication contains the results of two opinion polls of executives and owners of Belarusian SMEs about the quality of the domestic business environment and the performance of private companies between 2006 and early 2007. Apart from that, it contains an analysis of macroeconomic developments as well as a review of changes in the legislation regulating the activities of SMEs in the course of 2006 and the first half of 2007. Finally, some conclusions and policy recommendations on private business development in Belarus have been devised.

The book has been prepared within the framework of the project 'Fostering the Business Community – Civil Society Alliance in Belarus'. The

project has been aimed at strengthening the dialogue among representatives of the business community, administrative bodies, analytical centers, international organizations, and mass media in contemporary Belarus.

We are truly indebted to the participants of our seminars and round table meetings and all those who contributed to fruitful discussions on entrepreneurship development in Belarus. The authors are also thankful to Mr. Jaroslav Romanchuk, Head of Scientific Research Mises Center and Mr. Vladimir Koryagin, Chairman of the Minsk City Union of Entrepreneurs and Employers. Our particular gratitude goes to Ms. Elena Suhir (Program Manager of the Center for International Private Enterprise (CIPE) in the countries of Eastern Europe and Eurasia/Central Asia, USA) for her invaluable contribution to the development of free entrepreneurship in Belarus.

*The Editors*

## 2. THE ECONOMIC SITUATION AFTER ENERGY SHOCKS: THE EARLY CONSEQUENCES

At the beginning of 2007, Belarus has experienced two energy shocks due to new terms of trade in gas and oil. Although the consequences are only beginning to manifest themselves, it is apparent that the Belarusian economy will be unable to function as before.

So far Belarus and Russia have signed two agreements: on gas supply and on oil supply. First, the price for gas imported from Russia grew from USD 46.67 to USD 100 per 1,000 cubic meters. Second, Russia has imposed an oil duty on crude oil supplied to Belarus. The duty is only a fraction (29.3%) of the one applied in Russia. Third, Belarus has assumed the obligation to charge export duties on oil products as it is established in Russia. At the same time, in the near future, the terms of gas and oil supply would deteriorate for Belarus. Specifically, in 2011 Belarus would pay an 'average European' price for gas, while the oil duty on crude oil would amount to 35.6% of the level existing in Russia. Clearly, these changes would affect the dynamics of Belarus' economic development in an adverse way and demand from the government to adjust its traditional economic policies.

### 2.1. New terms and conditions of energy supply and their early consequences

#### 2.1.1. The dependency of the Belarusian economy on gas and oil

Over the last several years, the economy of Belarus has displayed high GDP growth rates. According to official data, GDP has been growing by 10.2 % annually on average between 2004 and 2006. Preferential terms of energy supply from Russia

along with the formal existence of the customs union between Belarus and Russia had been at the heart of these strong growth rates. In particular, in 2006 Belarus imported 21 bn cubic meters of gas from Russia at USD 46.68 per 1,000 cubic meters. In comparison, at that time Ukraine paid USD 95, while Moldova and Germany paid USD 160 and USD 250, respectively. Therefore, if Belarus were to pay the German price for the volume of gas it imported, it would have to spend an additional 10% of GDP, while the Ukrainian price would take an extra 3% of Belarus' GDP. Apparently, such a 'subsidy' (whatever benchmark is taken for estimation of its size) provided by Russia has played an important role in the development of the Belarusian economy.

Trade in oil products has been another important source of economic growth. High world market prices for oil and oil products and duty-free imports of crude oil from Russia allowed Belarus to maintain a considerable trade surplus with non-CIS countries. Recently, the share of oil products in the total volume of exports has been close to 40% (while in 2002 this figure was about 18%). According to some estimates, budget revenues from the oil business amounted to approximately USD 3 bn. These revenues have helped the government to boost population income and subsidize enterprises without implementing any serious economy-wide or sectoral reforms.

The preferential terms of energy supply has also provided a cushion against some adverse trends the Belarusian economy has been facing recently:

- Deteriorating competitiveness of Belarusian goods at the Russian

and the domestic markets. Specifically, Belarus has not managed to recover its exports to Russia to reach its 2004 level. At the same time, imports of consumer and investment goods have been growing. As a result, the merchandise trade deficit is increasing, while opportunities for its financing are rather limited;

- Increased dependency of the Belarusian economy on external market conditions. Belarusian exports are largely concentrated in oil products, chemicals, and petrochemicals (jointly amounting to 50% of the total volume of exports). Prices for these types of commodities are usually subject to market fluctuations. A landslide of prices at external markets (or cost increase) would certainly dampen foreign exchange revenues.

#### 2.1.2. New arrangements on oil and gas supply and their consequences

The final agreements on supply of gas and oil appear to be a compromise settlement. As a result, the shift to new conditions is likely to be less painful than in case of the acceptance of the initial offer of the Russian side. Specifically, Gazprom offered to increase the gas price for Belarus up to USD 200 per 1,000 cubic meters from 2007 onwards. In contrast, the final agreements stipulates a gradual price increase so the 'European average' price would in fact be paid by Belarus only starting in 2011. It is also provided that Belarus would sell 50% of Beltransgaz shares for USD 2.5 bn. Gazprom would pay this amount in several installments, ending in 2010. Apart from that, Belarus has managed to increase its fees for gas transit.

As for oil supply, Russia insisted on imposing duties on oil and oil products at the levels currently established in Russia and transfer of 85% of the revenues to the Russian government budget. In contrast to the initial offer, Belarus has agreed to charge customs duties on oil products at the rate and in the order currently established in Russia. But the duty revenues would be collected by the Belarusian budget at a full scale. However, Russia has imposed export duty on crude oil supplied to Belarus (although a downward corrective ratio has been simultaneously applied), and scheduled its gradual increase up to 2009. Fundamentally, the new terms of energy supply would affect the Belarusian economy already in the course of 2007. The public sector and the external sector would be substantially affected first.

It seems that the dynamics of budget revenues could be estimated with relative precision. To begin with, a higher price for gas would allow collecting about USD 200 m more, while the sale of 12.5% of shares of Beltransgaz would provide the government with another USD 625 m. Additional revenues would also come from the new terms of trade in oil and oil products. Further, export duties would bring additional revenues, but their volume would be somewhat dampened by the need to provide VAT refund to exporters and lower revenues from profit taxes and excise taxes. According to our estimates, the oil sector would provide the budget with USD 640 m. At the same time, the state budget of the Russian Federation would acquire more than USD 1 bn due to the imposition of export duties on crude oil supplied to Belarus. In total, Belarusian oil sector enterprises would be deprived of as much as USD 2 bn. Consequently, the profitability of oil processing would decrease substantially, thereby demanding from the government to adopt the measures aimed at improving the financial situation of the Belarusian oil refineries.

Clearly, budget expenditures would also be corrected substantially in a

fashion similar to revenues. First, publicly funded companies and organizations would inevitably increase their direct expenditures for gas, heating and electricity. Second, additional funds would be required to provide subsidies for a range of sectors of the Belarusian economy, including agriculture, housing and communal services, and power engineering. Third, the volume of tax preferences could be increased (to balance the reduction of incomes). It appears that in case the budget deficit in 2007 would amount to 1.5% of GDP, this could result in the following situation:

- Additional revenues would be spent in full (about USD 1.4 bn);
- Deposits accumulated by the government in the banking system by the end of 2006 would also be spent;
- The government would face the need to attract as much as USD 0.7 bn in order to finance the budget deficit. In case the government would not use its deposits, more funds would be required.

These measures – whatever combination of them is to be implemented – would not only change the struc-

ture of revenues and expenditures of the state budget, but also require a more substantial revision of fiscal policies.

As for foreign trade, the situation is most likely to change due to the following reasons. First, higher cost of gas would be translated into the need to pay USD 1.1 bn more for imports. Increased transit fees for gas would allow to finance only a tiny fraction (USD 0.1 bn) of imports growth. At the same time, the sale of 12.5% of Beltransgaz shares implies that USD 625 m would flow via the capital account of the balance of payments. To sum up, it follows that the new terms of gas supply could result in losing as much as USD 0.4 bn from the Belarusian economy.

Next, the imposition of export duty on crude oil supplied to Belarus would deteriorate merchandise trade deficit by USD 0.8 bn. Besides that, inflow of foreign investment could drop by USD 1 bn. Prior to the changes of the terms of crude oil supply to Belarus, oil business had been investing quite actively into the Belarusian economy. Losses in this sector might lead to reduction of foreign investment.

To summarize, the net adverse impact on the balance of payment could be at USD 2.2 bn. Given that the officially announced volume of

**Box 1: The role of budget support for investment funded by internal funds of enterprises**

In 2006, 42% of investment was funded by internal funds of economic actors. Specifically, companies were using their profits (40%) and amortized deductions (60%). However, profitability of many enterprises had been secured because of indirect public support. For that purpose, the following mechanisms were applied:

- tax credits;
- tax debts restructuring;
- exemption from VAT, customs duties and some other taxes;
- provision of raw materials at preferential prices (i.e. cross-subsidization by relatively more profitable enterprises);
- debts write-off in exchange for increasing the share of the state in statutory fund.

All these measures have allowed to increase funds available to enterprises, secure their profitability, and even carry out certain investments projects.



gold and foreign exchange reserves (accumulated by the National Bank of Belarus) is about USD 1.5 bn, a resource gap could appear. This would demand to search for new sources of financing of the balance-of-payments deficit in order to maintain exchange rate stability (so much needed in Belarus now, given the dollarization of the economy).

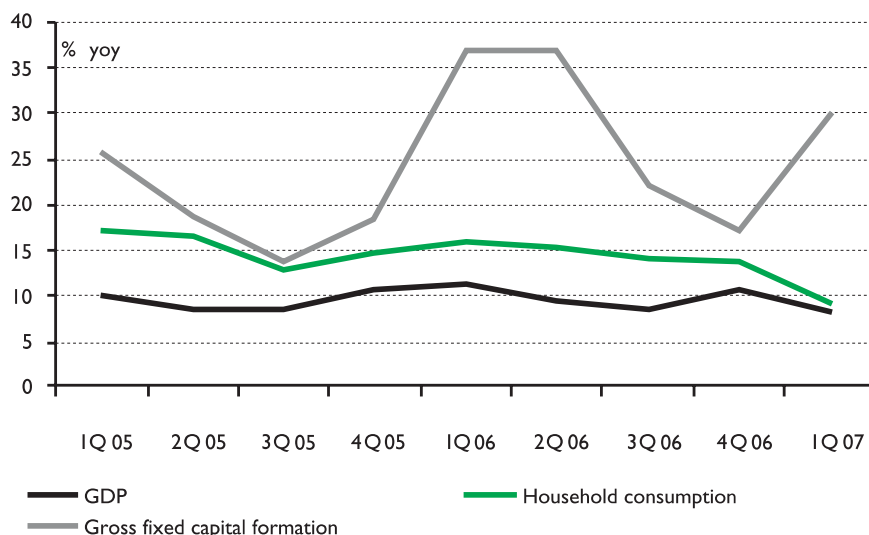
## 2.2. Macroeconomic situation after the energy shocks: major changes

### 2.2.1. The real economy

The consequences of the gas shock have not yet been felt. At the same time, problems in the oil sector have emerged rather quickly. Specifically, in the first quarter of 2007, GDP growth rate reached the level of 8.4% yoy, which is much less than in 2006 (9.9%). On the demand side, problems in the oil processing sector determined the reduction in the physical volume of exports; on the supply side their impact was manifested in output decline in the fuel industry and overall sharp deceleration of industrial output growth (table 2.1).

According to our estimates, investment has been the major demand factor of GDP growth. This factor alone secures 9.8 percentage points of GDP growth rate. This is by almost

Figure 2.1: GDP dynamics and GDP by demand factors



Source: Ministry of Statistics and Analysis; 1st quarter of 2007 – estimate made by the IPM Research Center.

one-third more than the contribution of household consumption. At the same time, almost one-third of the increase in investment has been financed by internal funds of enterprises (Box 1) and loans.

In fact, the new terms of energy trade have forced the government to make a strategic choice: to stimulate investment or to maintain high rates of consumption growth (until recently, the inflow of 'petrodollars' into the economy has allowed following both directions). Currently, certain actions made by the authorities provide us

with the evidence that in the near future (i.e. the next two years or so) they are very likely to opt for a policy of investment stimulation. The latter could be achieved by moderating wages (these measures have already been publicly announced), obtaining external loans by Belarusian banks to finance domestic investment projects, and, finally, attracting foreign direct investment (FDI). Attraction of FDI is of particular importance to Belarus since foreign investment could not only enhance economic performance as a whole, but also secure the inflow of foreign exchange needed to finance the growing energy trade deficit.

On the supply side, industry remained the major contributor to economic growth. However, its contribution to GDP growth rate dropped from 3.8 percentage points in the 4<sup>th</sup> quarter of 2006 to 2.1 percentage points in the 1<sup>st</sup> quarter of 2007. Output decline in the fuel industry has been behind this reduction regardless of the continuous attempts to arrange the proper functioning of oil processing enterprises (Box 2). The contribution of this sector into the output growth declined from 5.4 percentage points in 2006 to -0.9 percentage points over the 1<sup>st</sup> quarter of 2007. Overall, output growth

Table 2.1: GDP by demand factors

	2005				2006				2007
	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter	1 <sup>st</sup> quarter	2 <sup>nd</sup> quarter	3 <sup>rd</sup> quarter	4 <sup>th</sup> quarter	1 <sup>st</sup> quarter
<i>Domestic demand</i>	16.0	17.7	9.2	13.8	23.7	22.2	16.0	14.0	17.3
Household consumption	11.2	10.7	8.1	9.4	11.1	10.7	9.3	9.1	6.6
Gross fixed capital formation	5.9	5.8	3.6	6.5	9.7	12.6	6.0	6.4	9.8
Change in inventories	-1.3	1.2	-2.6	-2.1	2.9	-1.1	0.7	-1.6	1.0
<i>Net exports</i>	-5.2	-5.9	0.3	4.6	-17.4	-13.6	-7.0	-9.0	-8.9
<i>Statistical discrepancy</i>	-0.9	-3.4	-0.9	-7.7	4.8	1.0	-0.4	5.8	0.0
<b>GDP, %, yoy</b>	<b>9.9</b>	<b>8.5</b>	<b>8.6</b>	<b>10.7</b>	<b>11.1</b>	<b>9.6</b>	<b>8.5</b>	<b>10.8</b>	<b>8.4</b>

Note. The sum of components of domestic demand might not coincide with its growth rate since the table does not display government consumption and non-public institutions serving households.

Source: calculations based on the data provided by the Ministry of Statistics and Analysis; 1st quarter of 2007 – estimate of the IPM Research Center.

**Box 2: Belarus-Russia agreement on oil products trade: consequences for the Belarusian economy**

In January 2007, Belarus and Russia have reached an agreement on the terms and conditions of supply of crude oil and oil products to Belarus. According to this agreement, Belarus has assumed the obligation to collect export duties from oil products at the rate established in Russia. In turn, an export duty on crude oil supplied to Belarus has been introduced, but set at the level of about 30% of the same duty applied in Russia. Nevertheless, exports of Belarusian oil processing companies have become unprofitable. Also, domestic market sales of oil products have turned to be unprofitable due to high domestic excise taxes. Consequently, oil processing in Belarus, which used to be the principal 'generator' of profits, taxes, and foreign exchange for the economy as a whole, is now in need of support from the budget.

The first attempt to provide such support was a sharp (by 2.5 times) reduction of excise tax rates. However, this resulted in a dramatic increase of imports of oil products from Russia. Belarusian producers were in a way 'crowded-out' by Russian companies. The domestic oil processing sector had not generated the expected profits so excise taxes have been raised again by two times in a month's time. But the problem is yet to be solved. One of the possible solutions could be the introduction of market prices for oil products consumed by economic units of agricultural and petrochemical sectors. Price increases would then be compensated by subsidies from the budget. However, the size of the domestic market is too small to solve the problems of the oil processing sector. This sector is unlikely to recover its profits until exports of oil products are unprofitable.

rate in industry amounted to 5.9% yoy, while in 2006 it was almost twice as much (10.4%).

Another important factor of deceleration of industrial output growth has been a recession in the food industry. Its contribution to industrial output growth reduced from 1 percentage points in 2006 to -1.2 percentage points in the 1<sup>st</sup> quarter of 2007. The major reason behind this was a sharp – by 73.1% yoy – reduction of sugar production along with the increase in its inventories up to the level of 10 monthly outputs. Some problems had emerged in meat production as well. In fact, the situation in the food industry has been a reflection of more fundamental problems in trade with the Russian Federation. In particular, sugar exports to Russia had been postponed after Belarus was accused of using sugar cane as a raw material (and not sugar beet grown domestically). In a similar fashion, exports of meat products were checked after Belarusian producers had been accused of using Polish fresh meat to produce meat products for exports. Therefore, the situation with trade with Russia in non-energy commodities

has become a source of trouble for the Belarusian economy.

At the same time, the consequences of growing energy prices have not affected the financial situation of Belarusian enterprises. In the course of the first two months of 2007, profits earned by enterprises declined for the first time in recent years. Profit before taxes declined by 2.1% yoy, while net profits went down to 6.6% yoy. This fall is fully determined by declining profits in the oil processing sector and, hence, in the industry as a whole. In other branches of the economy profits have been growing, albeit at a slower rate than in the course of 2006. As a result, the total volume of profits in the economy declined by 13.6% in January-February 2006 to 11.2% in January-February 2007, while the share of loss-making enterprises amounted to 22.6% (24.7% a year ago). Nevertheless, there is still a generous budgetary support for enterprises behind such a relatively favorable situation with loss-makers. However, the opportunities for continuation of provision of such support become limited as soon as energy prices increase.

Another noticeable event in January-February of the current year has

been the accumulation of overdue bills. Their volume has been growing since the beginning of 2007 (although it declined in comparison with the last year's indicators). Specifically, since the beginning of the year, the volume of overdue bills payable increased by 7.9%, while during the same period of the last year it went down by 1.2%. At the same time, there has been a more substantial increase in the volume of debts to suppliers and the budget (while in the last year it decreased).

*2.2.2. Labor market*

Deceleration of economic growth has not affected labor market functioning in any meaningful way (at least, the data confirm that). Employment has been increasing, albeit slowly, while unemployment has been on a continuous decline. According to official data, by April 1, 2007, the unemployment rate was 1.2%. However, some changes were recorded at medium-sized and large enterprises operating in a range of sectors of the national economy. For instance, employment growth rates decreased in industry (from 0.7 to 0.1% yoy), transports (from 0.1 to -0.3% yoy), and education (from 1.3 to -0.4% yoy). At the same time, the rate of employment growth has been relatively high in construction and commerce. These sectors display high growth rates. Nevertheless, low quality of official data does not allow to make conclusive judgments about the real dynamics of the labor market. It could only be unveiled by conducting regular labor market surveys. This has not been done by the official statistical bodies.

Although the labor market has not yet responded to deceleration of economic growth (by changes in employment and/or unemployment), wage trends have been compatible with general macroeconomic dynamics. Real wage growth has decelerated right after the Presidential elections of 2006. Specifically, in the 1<sup>st</sup> quarter of 2007, economy-wide average real wage has increased by 9.6% yoy (while in the 4<sup>th</sup> quarter of 2006 this figure was 13.5% yoy). At the same

time, in March 2007 wage growth rate appeared to be 13 percentage points less than in March 2006 (the month of Presidential elections). Next, the rate of growth of USD-denominated average wage has also decreased by approximately the same value, while its level in March amounted to USD 308.1.

According to the plans announced by the government, by the end of 2007 economy-wide average wage should reach the level of USD 340 per month. This means that its growth rate would further decelerate. Given that the expected exchange rate BYR/USD is 2150, nominal wage would increase by 9.4% (December to December). According to our estimates, this is equal to an annual growth of real wages by 6.5–7.5% on average (or 16–17% in USD).

Apparently, these plans of the government confirm the expectations of a considerable deceleration of growth of incomes and expenditures of Belarusian households. As a result, consumer boom could be dampened. In fact, Belarus is currently in the 'inter-electoral' phase of its political business cycle so that the authorities are able to conduct 'unpopular' economic policies. This includes the deceleration of population income growth in order to reduce pressure on the foreign cash market and restrictions of consumer demand for imports.

### 2.2.3. Inflation

Price shocks necessarily affect inflation indicators (table 2.2). Higher gas prices do have resulted in price increases in electrical power engineering (by 20.5% in January). However, the major influence on the dynamics of producer prices has been exerted by the situation in the fuel industry, where prices went up by 45.8% per month. The reason for this price hike is the reduction of excise taxes on oil products, despite the fact that the actual increase of prices on oil products has not yet been felt. Things resumed its normal course in March 2007, when excise taxes were increased. As a result, prices in the

**Table 2.2: Consumer prices and producer prices**

	Growth rates, % yoy (period average)	
	Consumer price index	Producer price index
2001	61.1	72.1
2002	42.6	41.4
2003	28.4	37.5
2004	18.1	24.1
2005	10.3	12.1
2006	7.0	8.3
1 <sup>st</sup> quarter of 2005	12.4	15.0
2 <sup>nd</sup> quarter of 2005	10.7	12.7
3 <sup>rd</sup> quarter of 2005	9.9	10.7
4 <sup>th</sup> quarter of 2005	8.6	10.3
1 <sup>st</sup> quarter of 2006	7.7	8.2
2 <sup>nd</sup> quarter of 2006	7.1	8.3
3 <sup>rd</sup> quarter of 2006	6.5	8.5
4 <sup>th</sup> quarter of 2006	6.8	8.2
1 <sup>st</sup> of 2007	7.7	18.8

Source: Ministry of Statistics and Analysis.

fuel industry decreased in March, and producer prices have followed a similar pattern. Statistically, the net result has been an increase in producer price index by 22.6% yoy in January and its subsequent decrease by 11.6% yoy in March (2.6 percentage points more than in December 2006). This suggests a possible trend towards acceleration of inflation.

Similar trends have been recorded in relation to the behavior of consumer prices. In March, growth of consumer price index (CPI) amounted to 8.1% yoy (6.6% in December 2006). Consequently, this indicator exceeded the upper limit of planned inflation. As in the case of the situation with producer prices, the energy shock has been at the core of acceleration of inflation (measured by CPI). Higher gas prices have determined the growth of gas, heating and electricity rates for the population. Over the first three months of the current year, housing and communal services have increased their charges by 15.3%, while commodity prices went up by only 2%. In addition, the growth rate of commodity prices has also accelerated. Given that in the first half of this year, the National Bank of Belarus (NBB) has 'tightened' its monetary policy, the observed acceleration of price increase could be explained by external fac-

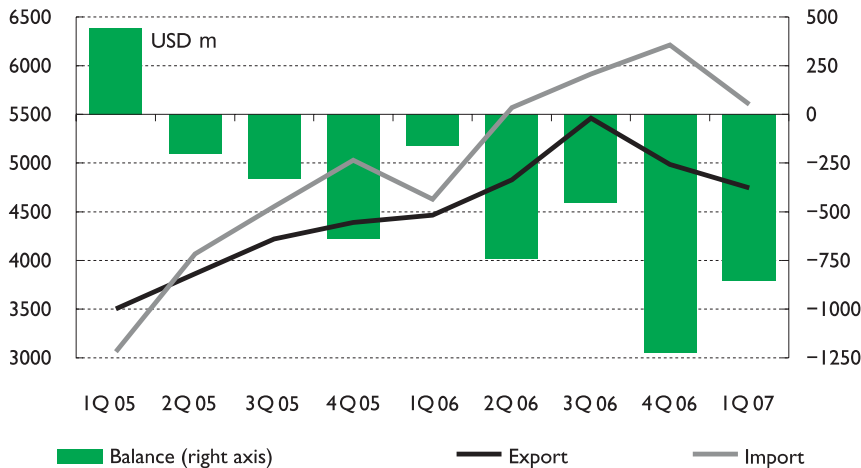
tors and, possibly, the existence of 'hidden' inflation in Belarus.

It seems that price dynamics in 2007 would to a considerable degree depend on the policy of the authorities in relation to tariffs charged by housing and communal services. It has been already stated that until the end of the year, tariffs should be raised by no more than USD 5. This implies that existing tariffs should not be revised. However, at the beginning of the current year tariffs increased, so the promise made could be broken. According to our estimates, consumer prices would grow by 8–9% in 2007 (December to December).

### 2.2.4. Foreign exchange market

An immediate consequence of the energy shock has been the 'attack' on the Belarusian ruble. The demand for foreign cash was 'stirred up' by the rumors of denomination and devaluation dramatically increased in December 2006–January 2007. Moreover, in January there was no seasonally-determined reduction in the purchase volume of foreign currency by legal entities domiciled in Belarus, while the volume of sales of foreign currency at this segment declined. As a result, foreign currency at three segments of the domestic foreign exchange market appeared to be in short supply. The deficit

Figure 2.2: Merchandise trade



Source: Ministry of Statistics and Analysis.

amounted to USD 169.6 m in December and USD 386.4 m in January. However, the NBB, being fully aware of the dangers of devaluation, has not opted for even the smallest depreciation of the BLR/USD exchange rate.

As a result, the NBB has been forced to sell a considerable fraction of its reserves of foreign exchange. But, in January their volume declined insignificantly – by just USD 53 m. Over a month, the decline was probably much larger<sup>1</sup>. Most likely, the NBB has simply purchased the ‘missing’ volume of currency from commercial banks that increased foreign borrowing. As a result, the situation at the foreign exchange market has been stabilized, partly due to the interest rate policy of commercial banks and partly due to the attraction of foreign loans.

In fact, the events of January have shown that the stability of the national currency is becoming a top priority for the NBB. This is because of its role for the sustainability of the banking system and the economy as a whole. In the current situation, any devaluation could ignite a bank run and lead to a banking and economic

<sup>1</sup> Since mid-January, the official site of the NBB does provide online information about the volume of international reserves. Prior to that, the data used to be updated on the 1st, 8th, 15th, and 22nd day of each month. Now the NBB publishes information at the beginning of each month only.

crisis. Accordingly, the NBB and the government would stimulate the inflow of foreign currency down to the limit (permitted by the existing economic model). At the current stage, resources are most likely attracted via commercial banks. Apart from that, the government plans to obtain a loan from the Russian Federation (USD 1.5 bn for two years), receive a credit rating, and even issue Eurobonds. All these measures would allow to stabilize the exchange rate of the Belarusian ruble to the US dollar by the end of 2007 at the level of 2150–2160 BYR/USD.

#### 2.2.5. Foreign trade

The decline in the volume of oil product exports has been the key determining factor of the state of foreign trade in the 1<sup>st</sup> quarter of 2007. In particular, the merchandise trade surplus with non-CIS countries decreased by 70.6% yoy. Furthermore, the total merchandise trade deficit increased by four times, from USD 162.8 m in the 1<sup>st</sup> quarter of 2006 to USD 855.4 m in the 1<sup>st</sup> quarter of 2007. The rise of export duties on oil products to the level established in Russia has resulted in a decline of profitability of oil product exports. Moreover, the government confiscated the profits earned by oil processing companies and transferred it to the National Development Fund. Consequently, oil refineries have lost funds necessary to pur-

chase crude oil. The introduction of export duties on crude oil supplied to Belarus by Russia has made tolling operations less remunerative. As a result, the Belarusian oil processing sector has fallen short of 1 m tons as against the planned volume of processing<sup>2</sup>.

The reduction of exports of oil products has also led to a decrease of the physical volume of exports and a sharp deceleration of its growth rate (in money terms). At the same time, despite the proportional reduction of oil imports, there has been no notable deceleration of growth of imports. This can be explained by higher gas prices and increase of imports of investment goods. In particular, the data over January-February of 2007 record a twofold expansion of imports of investment goods that amounted to USD 505.1 m. Specifically, this occurred due to the purchase of tube-rolling mill (USD 81.1 m, equal to almost one-third of investment imports growth). Another one-third of this increase has been provided by the purchase of agricultural machinery. Finally, almost 11% of investment imports growth stemmed from the purchases of telecommunication and computer equipment.

However, the above-described increased volume of investment imports is too small to implement a large-scale modernization of the country's economy. In fact, investment imports have been provided by investment programs of several of the largest companies (that also now face higher energy prices so that implementation of these programs has become complicated), the agricultural sector (subsidized by numerous state funds), and the most dynamic branches of the services sector. Crucially, investment is becoming the key factor for survival of traditional industries, such as light, food, machine-building, petrochemical, power engineering, and so on. Moreover, investment should preferably be of foreign origin, otherwise Belarusian

<sup>2</sup> A possible solution to this problem could lie in the establishment of a ‘Belarusian Oil Company’ specializing in imports of crude oil and exports of oil products.

companies could be squeezed out of the Russian or Central and Eastern European markets.

Competitiveness of Belarusian goods on the Russian market is turning to be an important issue. New difficulties could arise, following the above-mentioned problems with the supply of sugar, TV-sets, and meat products<sup>3</sup>. Growing costs have made the problems that Belarusian companies encounter at the Russian market more acute. The growth of the Russian economy and the subsequent increase of incomes of the population have led to a shift of internal demand towards more expensive and better-quality goods, while Belarusian goods continue to occupy market niches for 'the poor'. In the field of investment incomes, similar problems are observed. Also, Russian enterprises now switch to investment goods of foreign origin. Finally, the expansion of the Russian market intensifies competition due to the development of production facilities alternative to Belarusian ones and the entry of large transnational companies to the Russian market. These challenges are unlikely to be met by Belarusian state-owned enterprises, given the current structure of ownership and domestic economic policies.

#### 2.2.6. Balance of payments

In 2006, the current account deficit amounted to 4.1% of GDP. This figure is almost the same (or even bigger in absolute terms) as in 2004. The merchandise trade deficit

<sup>3</sup> In particular, the Belarusian producers were accused in exports of cane sugar, while only beet sugar has been allowed to enter duty-free to the Russian market. As a result, the exports of Belarusian sugar to Russia have been virtually stopped. Supplies have been resumed after the agreement on commercial and economic cooperation has been signed. According to this agreement, the solution to the 'issue' of sugar supply has been 'exchanged' for abolition of a number of formal barriers to imports of Russian goods to Belarus. The exports of Belarusian TV sets to Russia have suffered from the non-recognition of Belarusian origins of these goods due to the excessive number of imported component parts. Finally, the problems with supply of Belarusian meat products have begun after disclosure of the fact that part of these products are made from Polish meat. The imports of the latter are banned in Russia.

amounting to USD 2.4 bn has been largely financed by trade surplus in services (USD 0.8 bn). Labor income has also been an important source of financing this deficit. According to the estimates made by NBB, the net inflow of funds amounted to USD 170.9 m (including labor incomes of Belarusians working in Russia at the rate of about USD 166.3 m).

Further, the net inflow of foreign direct investment amounted to USD 531 m in 2006; including 243.1 m of investment made by Russia's Gazprom in building and servicing the Belarus segment of Yamal-Europe pipeline. Non-financial organizations have attracted as much as USD 416.8 m (net inflow). However, for the first time the major source of financing the current account deficit has turned to be the intake of funds by commercial banks at the rate of USD 731.2 m. For the Belarusian economy, this appears to be a new mode of financing the deficit. Nevertheless, it is in this way the financing has occurred since the beginning of 2007. It is very likely that it would become the most important source of foreign exchange inflow into the country in the near future.

#### 2.2.7. Public finance

In 2006, the budget surplus amounted to 1.3% of GDP. After the Presidential elections and prior to the gas price hike, the government reduced social expenditures and also 'skimmed' profits from oil-processing companies and other income-generating production facilities. The plan was to utilize accumulated funds as a 'cushion' against the adverse consequences of the energy shock.

However, at the beginning of 2007, these funds had not been used. Thanks to a sharp increase of export duties on oil products, budget revenues increased. At the same time, the government has made some attempts to limit expenditures. As a result, in the 1<sup>st</sup> quarter of 2007, the budget surplus has reached the very high level of 10% of GDP (4.2% a year ago).

The government then channeled available funds to deposits. On April

1, 2007, deposits of the government held at the NBB amounted to BYR 1.4 trillion and USD 334.5 m, and at commercial banks – BYR 2.3 trillion and USD 497.3 m, respectively. However, savings of the government at commercial banks could hardly be treated as 'funds available'. Most likely, commercial banks have already utilized them by providing investment loans to state-owned enterprises. The latter might be unable to pay them back because of higher energy prices. This scenario is very likely so the government might not be capable to use its deposits.

Changing terms of trade in energy have not only affected the structure of budget revenues, but also the structure of expenditures. In comparison with the 1<sup>st</sup> quarter of 2006, over the same period of 2007, the relative share of all major expenditure items of the consolidated budget decreased by 1 percentage points. 'Expenditures on the national economy' declined most substantially (by 1.7% of GDP), while their relative share has become smaller by 4.5 percentage points. Besides that, 'nation-wide expenditures' dropped by 0.3% of GDP. At the same time, over the first quarter of 2007 there has been a more than twofold increase of other expenditures amounting to 10% of GDP, or 17.9% of expenditures of the consolidated budget.

Changing terms of energy supply have demanded the adoption of a range of measures to deal with the adverse consequences of price increase for the real sector of the economy. First, enterprises of the housing and communal services sector have been granted VAT remissions. Most likely, this is because of a sharp increase (by 3.2 times since the beginning of the current year) in energy arrears of this sector in January 2007. Second, some (partial) exemptions from VAT and other taxes could be provided to a number of industrial enterprises. Available funds could then be transferred to local budgets (15%) and used to finance innovation activity according to business plans (85%).

In 2007, the conditions of the budget would be determined by the ability to export large volumes of oil products. This is because export duties would be likely to become the second major source of budget revenues after VAT revenues. At the same time, it is very likely that existing oil-processing enterprises or Belarusian Oil Company would require subsidization (either direct or indirect one). Besides that, additional expenditures might be required to pay for the energy consumed by publicly-funded organizations and finance investment programs in energy and some other sectors of the Belarusian economy.

Nevertheless, given the expected inflow of funds at the rate of USD 625 m (payment for 12.5% of Beltransgaz stock), a high probability of obtaining USD 1.5-bn loan from Russia, and a possibility of issuing Eurobonds, it could realistically be expected that the government would have enough funds at its disposal to finance the planned expenditures. Even more, it could probably save some funds for 2008. Therefore, the impact of the energy shock on the budget would likely manifest itself over the medium term only. It seems that the government does not need to start privatization to collect additional revenues. Instead, the government plans to spend about BYR 100 bn for nationalization of some

companies in the course of 2007 (by increasing the state's share in the statutory funds of enterprises).

#### 2.2.8. Monetary policy

The energy shock has produced some impact on the money market (table 2.3). Negotiations with the Russian Federation and uncertainty about the prices for gas and oil have informed agiotage-driven demand for foreign currency at the end of 2006. This demand has been satisfied by the commercial banks, which reduced their foreign assets and increased the supply of foreign exchange at the domestic market. In December 2006, the net foreign assets of commercial banks declined by USD 691 m, while the net foreign assets (NFA) of the monetary authorities – by USD 15 m (1% mom). Also, the reduction of the volume government deposits that used to be the major source of money supply at the end of the year appeared to be much smaller than in December 2005. As a result, the money base went up by 18% mom in December, while in annual terms its growth substantially decelerated – down to 19.8% yoy (41% in November 2006 and 73.7% yoy in 2005).

In the first quarter of 2007, the NBB has not altered the direction of its policies in any major way. First, the refinancing rate had been increased

from 10 to 11% per annum, but refinancing of the commercial banks had been substantially moderated. As a result, banks were forced to acquire resources at the interbank market (where the costs went up by up to 20%) or to attract the means of the population. For that purpose, commercial banks have increased interest rates on deposits. As a result, pressure on the foreign exchange market emanating from popular demand, decreased.

The stabilization of the foreign exchange market and the indirect regulation of the volume of foreign assets of commercial banks along with the increase in the volume of foreign currency deposits held by the government at the NBB resulted in the increase of net foreign assets of the NBB (by 13% in March). However, this did not lead to an adequate increase of money supply since the government increased the volume of national currency deposits held at the NBB due to a growing budget surplus. As a result, in the 1<sup>st</sup> quarter of the current year, the money base shrunk by 13.6%, while in annual terms (in March) its increase amounted to 22.2% yoy.

Despite the tight policy implemented by the NBB, the government has continued to stimulate provision of investment loans. In March loans to economy went up by 60.2% yoy. The maintenance of relatively sizeable volumes of investment loans has been provided by reduction of short-term loans for enterprises and population. At the beginning of the current year, the ratio of short-term to long-term loans in bank portfolios was 46 to 45%; and by the end of March it changed to 24 to 76%, respectively.

This situation has led to a further increase of interest rates at the loan and deposit market. Greater profitability of savings in turn has limited the growth of cash money supply and stimulated an increase of the volume of savings. At the same time, there has been a tendency for acceleration of growth of foreign currency deposits and the opposite for

Table 2.3: Selected monetary aggregates

	2005				2006				2007
	1 Q	2 Q	3 Q	4 Q	1 Q	2 Q	3 Q	4 Q	1 Q
<b>Reserve money</b>	<b>-3.6</b>	<b>9.7</b>	<b>25.4</b>	<b>73.7</b>	<b>-15.2</b>	<b>-6.3</b>	<b>-0.5</b>	<b>19.8</b>	<b>-13.6</b>
Net foreign assets	20.2	38.9	44.3	46.2	6.3	1.5	3.2	11.4	5.2
Net domestic credit, including	-28.8	-33.5	-22.4	24.5	-20.7	-2.8	0.1	10.2	-15.1
to general government	-20.0	-34.1	-31.9	5.3	-19.8	-16.5	-22.3	-12.7	-13.2
claims on banks	-7.5	-2.7	3.9	10.6	1.7	11.0	17.7	20.0	-6.9
Other net aggregates(net)	5.0	4.5	3.5	3.1	-0.8	-5.0	-3.8	-1.8	-3.7
<b>Broad money (M3)</b>	<b>4.6</b>	<b>16.2</b>	<b>24.9</b>	<b>42.2</b>	<b>3.6</b>	<b>16.2</b>	<b>27.5</b>	<b>39.3</b>	<b>-0.1</b>
Net foreign assets	6.0	12.6	16.4	12.8	-0.4	0.9	-1.5	-9.8	2.2
Net domestic credit, including	-3.4	4.8	14.0	40.3	4.7	20.9	33.6	57.5	2.7
to general government	-5.3	-6.7	-10.1	-1.5	-1.9	-3.1	-9.3	-6.6	-8.9
claims on the real sector	3.6	12.9	25.8	39.5	6.7	23.1	42.3	61.1	12.3
Other net aggregates	2.0	-1.1	-5.6	-10.9	-0.7	-5.6	-4.6	-8.5	-5.0

Note. Contribution of the aggregates and the rates of growth of money base and broad money are cumulative sums at the end of the period, %

Source: Own calculations based on the data provided by the NBB.

national currency deposits. This can be explained by slightly increased distrust to the Belarusian ruble informed by the energy shock and the uncertainty surrounding it. Foreign currency deposits have thus become the most important broad money aggregate. The growth of the latter has not decelerated, but accelerated substantially, from 28% yoy in 2006 to 38.7% in March 2007. At the same time, the rates of growth of other monetary aggregates have decreased considerably (by more than 10 percentage points each). This suggests that there is some decay of consumer activity (also reflected in a slower growth of M0), and of business activity (manifested in the reduction of the volume of funds at enterprises' accounts), and, finally, decreased trust to the national currency (displayed by slower growth of national currency deposits). Apparently, such dynamics of monetary aggregates implies that as soon as the interference of the NBB and the government is limited, the volume of loan provision in 2007 (and after that) becomes subsequently smaller.

### 2.3. Major challenges to the economy in the new situation

One of the key problems of the Belarusian economy is its excessive power intensity. Measured in kilograms of oil equivalent per USD 1,000 of GDP calculated by PPP, this indicator is 0.46 kilograms in Belarus comparison with 0.17 kilograms in Germany. However, this gap suggests that the government could potentially increase the efficiency of the Belarusian energy sector and secure relatively high returns to investment into this sector.

These returns could materialize over the medium- to the long-run. Today's cost increase experienced by Belarusian enterprises has made the problems they encounter at the Russian market more acute. The growth of Russia's economy and its subsequent increase of well-being of its population change the character of competition on the Russian market. Growing incomes determine

demand shifts as Russian consumers prefer to buy more expensive and better-quality consumer goods, while Belarusian producers traditionally serve the needs of the poor. In order to maintain its positions at the Russian market, Belarusian companies are supposed to reposition their products. As a result, they could acquire shares at a more 'expensive' (in terms of incomes) consumer segments. However, such repositioning is difficult to perform by state-owned enterprises.

Similar problems begin to emerge in the sector of investment goods. Russian companies shift their demand to foreign investment goods and upgrade their technologies. In 2002, Belarusian investment goods occupied 1.5% of investment in Russia. In 2006, this indicator went down to less than 1%. Belarusian companies producing investment goods (first of all, machine-building enterprises) would be forced to enhance their competitiveness substantially. This is difficult to realize, given the current structure of ownership and economic policies conducted by the government.

The expansion of the Russian market intensifies competition due to the development of production facilities alternative to the ones existing in Belarus. Also, large multinationals enter the Russian market. The need to upgrade the competitiveness of Belarusian companies is also related to the unacceptably high dependency on the Russian market. Such dependency has become more apparent in the course of the energy conflict with Russia. This has also posed a challenge to increase exports to other countries.

The set of problems described above could potentially open the way to economic reforms in Belarus. In case this way is opted for, some incoherent and inconsistent liberalization measures could be indeed expected from the government. Most likely, these would be the measures aimed at attracting foreign capital (by relaxing conditions of the functioning of the private sector) and privatizing

some of the large enterprises. Most likely, these measures would allow attracting capital and investment, restructure and modernize enterprises, and, hence, to collect budget revenues necessary for financing of social expenditures.

## 3. INSTITUTIONAL CONDITIONS FOR FUNCTIONING OF SMALL AND MEDIUM-SIZED BUSINESS<sup>4</sup>

The development of small and medium entrepreneurship is heavily shaped by legislation regulating its activity. The regulation performed by the state 'accompanies' SMEs at all stages of their development, from establishment to closure. In this regard, legal regulation of the following procedures can be observed: setup (including registration), permits provision (including licensing), certification and hygienic registration; taxation; pricing; execution of state controls; administrative and economic liabilities; and termination of (commercial) activity.

As for the negative features of Belarusian legislation regulating activities of SMEs, the experts and entrepreneurs themselves point to its instability and inconsistency; the excessive number of legal documents regulating the same question; the adoption of by-laws reflecting narrow departmental interests; complicated and non-transparent tax administration; the big number of control agencies provided with an unjustifiably broad extrajudicial authority; high, business-hurting penalty rates.

At the same time, the government has displayed some inclination to improve the business environment by abolishing and simplifying existing administrative procedures, reducing the tax burden, relaxing controls and even trimming the volume of sanctions imposed on entrepreneurs. Regulation No. 1029 of the Council of Ministers of the Republic of Belarus 'On Adoption of a Set of Measures to Achieve the Planned Indicators of Small and Medium-Sized Entrepreneurship Development for the Period until 2010' adopted on August 11, 2006 is rather indicative.

This Regulation sets a range of goals to be implemented over 2006–2010, including increasing of the share of SMEs in the economy-wide revenue up to 30%, while the number of SMEs (including individual entrepreneurs) is set to grow up to 44,000–46,000. These companies would employ between 23 and 25% of the economically active population. A special section of the above-mentioned Regulation is devoted to improving existing legislation. It suggests to develop and submit to the government a number of draft laws helping to reduce the bureaucratic regulation of the activity of legal entities and individual entrepreneurs. Also, this section proposes to adopt an exhaustive list of administrative actions and documents to submit in order to conduct entrepreneurial activity. Finally, the section envisages further improvements and simplification of registration and closure procedures of legal entities and individual entrepreneurs (including the possible adoption of the silence-is-consent principle), reduction of the registration terms, and establishment of fewer reasons for changes in the constituent documents, and so on.

However, as practice suggests, the government has not been fully committed to implementation of its benign intentions towards private business in Belarus. The case of Regulation No. 1685 'On the Measures to Encourage the Development of Entrepreneurship' adopted by the Council of Ministers of the Republic of Belarus on December 24, 2003, is rather illustrative. This regulation stipulates the adoption of a range of business environment-improving legislation. However, only about 30% of the measures have been implemented in practice, while the rest has been successfully 'transposed' to other documents, including the

Regulation No. 1029 adopted on August 11, 2006. As for the latter, some 'cautious' optimism can be expressed about its implementation. Indeed, some measures provided in this document have already been realized (see below).

### 3.1. Registration

In 2006, registration procedures have been revised again. The President's Decree No.6 adopted on April 10, 2006 amended Decree No. 11 adopted on March 16, 1999 'On Streamlining the State Registration and Liquidation (Termination of Activity) of Economic Actors'. In particular, the newer regulation suggested the following changes:

- Registration agencies now have to check the constituent documents of and amendments to them made by legal (corporate) entities and individual entrepreneurs for the purpose of the legislation compliance. This provision is not an abnormal one, because of the silence-is-consent registration method required to conduct such checks;
- A one-stop-shop registration principle has been introduced. Specifically, the registration agency has been allowed to provide not only a registration certificate, but also permission to make seals and taxpayer certificates, and some other documents required for registration with statistical bodies, the Social Security Fund, and insurance companies;
- The registration period has been reduced to 20 days and its extension is prohibited;
- The only payments charged are a registration fee and a state duty

<sup>4</sup> This chapter is written by Mr. Valery Fadeev, Honored Lawyer of the Republic of Belarus.



for providing executives with ID papers;

- Registration agencies have been provided with two new reasons for termination of activity of economic units; these are the systematic gross violation of labor legislation and payments of wages below the minimum level during three months.

Decree No.6 has come into force since June 1, 2006 so the administrative bodies were able to adjust their activities accordingly. The government adopted Regulation No. 668 on May 29, 2006 defining the mode of interaction between registration agencies and national administrative bodies on registration issues. This Regulation has established that registration agencies have to communicate (including by electronic means) with economic units to be registered in order to exchange information necessary for registration (a special information card is introduced for that purpose). Also, the communication and registration periods are clearly defined and the rules for provision of permits for making company seals are established. In its turn, the Ministry of Justice of the Republic of Belarus adopted Regulation No. 23 on April 11, 2006 that determines the unified registration and liquidation (termination of activity) forms.

Also, a positive development concerns the registration of economic units by the Administration of Justice in Minsk and in regional centers. This decision, along with the assignment of the Ministry of Justice to organize and coordinate registration and liquidation procedures of both commercial and non-profits units (following the President's Edict No. 175 adopted on April 8, 2004), has resulted in the unification of registration procedures.

As a result of the President's Edict No. 574 adopted on September 14, 2006, state duties have been substantially reduced (by two or three times), including charges for notarization of the constituent and other

documentations (and making legal copies). Given that prior to that, notarization-related expenditures made up about 80% of total registration costs, this reduction has allowed cutting costs.

The checks performed by the Ministry of Justice showed that the new registration procedures function rather well. The registration period and expenditures have been reduced (a precise estimate will be obtained in the next study of business environment in Belarus which conducted by the International Finance Corporation on a regular basis).

At the same time, the registration procedure remains to be complicated and cost-intensive. The government is aware of that, so the proposition has been made to develop a draft Law on Registration. The Law would introduce the silence-is-consent principle of registration. The Address of the President to the Belarusian People and the National Assembly acknowledges that 'the registration procedure remains to be rather expensive and complicated'.

As for the major deficiencies of the current registration system, the following features deserve to be mentioned:

- A silence-is-consent registration method;
- Excessive number of documents to submit to registration agencies;
- The requirement to provide notarization (not always requested by existing legislation);
- An unjustifiably broad list of reasons to refuse registration;
- Decentralization of registration procedure;
- Executive Authorities (Executive Committees as collective bodies) are authorized to make registration decisions.

### 3.2. Liquidation (Termination of Activity)

The President's Decree No. 6 adopted on April 10, 2006, a new liquidation procedure for individual entrepreneurs has been adopted. This can be treated as a positive development since Decree No. 11 adopted on March 16, 1999 had merely extended a more complicated liquidation procedure suggested for commercial units to individual entrepreneurs (whose status is rather different).

Apart from that, Decree No.6 introduced the simplified method of liquidation (i.e. without the need to set up a special liquidation commission) in case business activity has not been conducted for six months.

At the same time, the liquidation procedure remains to be even more problematic than registration. First of all, it should be mentioned that there is an additional reason for liquidation available in Belarus (besides two major ones – 1) by a decision of founders (partners); 2) by a court decision), that, is 'by the decision of registration agency'.

Also, the grounds for liquidation as provided in Decree No. 11 adopted on March 16, 1999 are rather controversial, like:

- Cloaking (underreporting) of profits (incomes) and other taxable items in the course of 12 months on end;
- Losses made by the end of the second and subsequent financial years; non-reporting by the commercial organization (except agricultural production cooperatives) of the reasons for incurring losses to registration agencies and tax authorities in the course of three month after the financial year is over;
- Payment of wages below the minimum monthly wage in the course of three successive months.

The liquidation procedure contains some problematic provisions (estab-

lished by Decree No. 11 adopted on March 16, 1999). This includes the need to submit a confirmation that a unit has no outstanding debts to the budget, the Social Security Fund, or customs authority, and has returned its taxpayer number. The problem is that all these agencies (and especially tax agencies) issue such a confirmation after a special check is performed. But the queue for this check is rather long so entities have to wait more than one calendar year. That is why, according to some expert estimates, tens of thousands of various units are in the process of liquidation for many years.

With this in mind, it seems necessary to adopt a special Law on Reorganization and Liquidation of Legal Entities. This Law would define procedures, rights and obligations for all participants of this process. To some extent, this task has been solved by the new version of the 'Law on Economic Organizations (Units)' adopted on January 10, 2006.

It is also important to note that economic units have to modify their documents to comply with the new version of the above-mentioned law. The deadline is August 1, 2007. This Law seems to be rather benign for economic units, but the latter have to change their documents quite considerably. But many of the entities wait till 'the last call' so registration authorities would face a work overload, queues, hassles, and so on.

### 3.3. Licensing

No substantial changes are observed in licensing over 2006 – early 2007. Nevertheless, some changes should be mentioned. In particular, the President's Edict No. 460 'On Measures for State Regulation of Imports and Exports of Certain Goods (Services)' adopted on July 17, 2006 contains some new licensing provisions related to foreign trade operations.

Although since 2003 licensing procedures have improved a little (given, for instance, the President's Decree No. 17 adopted on July 14, 2003),

entrepreneurs still have certain reasons to complain. In his annual Address to the People and the National Assembly, President Lukashenko said that 'It has come as a surprise to me that we have not yet properly regulated licensing and permits issuance. Bureaucrats have found loopholes to retain administrative discretion over entrepreneurs. They demand to obtain numerous permits that are licenses in disguise'.

It should also be added that the promise to cut the number of licensed activities to 10 or 12 (instead of 49 now, or even 400 when subtypes of activity are considered) has been broken.

The problems with licensing that have to be dealt with are as follows:

- Considerable number of licensed activities is still preserved despite some measures to reduce them;
- High expenditures to prepare documentation. In 2005, according to a survey made by the International Finance Corporation, the average costs of license was USD 216 (in 2004 it was USD 217);
- The requirements for preparation of documentation appear to be unclear and controversial;
- Licensing requirements are often unjustified and hardly executable. For instance, Regulation No. 1221 on Catering and Retail Trade Licensing (adopted by the Council of Ministers of the Republic of Belarus on November 2, 2005) regulates a range of goods sold by commercial units. This provision allows forcing entrepreneurs to sell 'specific', unpopular goods.
- In some cases, licensing requires to seek consent of the state body (or units subordinated to it) that conducts an activity for whose conduct a license is required. This provision contains a competition-constraining loophole. According to Regulation No. 1267

adopted by the Council of Ministers on September 27, 2006, companies willing to export oil and oil products have to seek consent of the 'Belneftehim' concern. The latter incorporates all major producers of oil products in the country.

- Licenses can be withdrawn based on a licensing agency decision. This does not imply immediate termination of activities of a commercial organization or an individual entrepreneur (particularly when several types of activity are carried out). In any case, such extrajudicial license termination appears to be unjustified.

### 3.4. Marking

A study of business in Belarus<sup>5</sup> denotes that the practice of marking pursues two objectives: a fiscal one and a protective one. At the same time, it has been discovered that the fiscal effect is very minor (since the cost of marks are very small), while the protectionist one is controversial by its character. This is because marking simply increases transaction costs and, thus, prices. Nevertheless, marking has not been abolished. Even more, new regulations have been adopted.

The President's Decree No. 12 adopted on August 4, 2006 amended Decree No. 9 'On Additional Control Measures on Circulation of Oil Fuel in the Republic of Belarus' adopted on July 12, 2005. Originally, Decree No. 9 introduced marking of all forms of accompanying imports of fuel from countries where no customs control and related paperwork are established. But the amended version exempts certain accompanying forms from marking. The exemption is granted in case of railway and pipeline transportation. Some other measures have been introduced in this direction.

At the same time, it has to be mentioned that the list of goods subject

<sup>5</sup> See Business in Belarus 2006: Status, Trends, Perspectives, <http://research.by/pdf/Business2006r.pdf>.

to marking has been extended by Regulation No. 669 adopted by the Council of Ministers of the Republic of Belarus on May 27, 2006. This regulation amended two major documents, such as Regulation No. 1280 adopted by the Council of Ministers on October 14, 2004 'On Approval of the List of Commodities Subject to Labeling by Controls (Identification) Marks and on Some Measures on the Implementation of the President's Decree No. 444 adopted on September 14, 2004'. Specifically, the new regulation includes grinded coffee and coffee beans and their substitutes, husks and coats of seeds, footwear, mobile phones, tea, and so on.

### 3.5. Certification

Over 2006 – early 2007 no substantial changes have been made in this area. Nevertheless, between March 2006 and March 2007, seven regulations were adopted by the State Standard of the Republic of Belarus. These have mainly been concerned with amending Regulation No. 35 'On Approval of the Loss of Products, Goods, Personnel and Other Objects of Conformance Evaluation'. These changes have merely extended the list of these objects (by 15), while some of them (three) have nevertheless been excluded (following Regulation No. 36 adopted on August 15, 2008).

It has to be mentioned that in accordance with Regulation No. 10 'On the List of Goods and Services Subject to Compulsory Certification' adopted by the Council of Ministers of the Republic of Belarus on January 8, 2003, the State Standard is responsible for approving this List. This appears to be the second-best solution since there is no barrier for narrow bureaucratic interests to be expressed. As a result, the legislation in this area might be unstable.

### 3.6. Taxation

In their study of tax rates and tax collection across 175 countries of the

globe, the World Bank and PriceWaterHouseCoopers have concluded that the best country for paying taxes is the Maldives, while Belarus is the worst (the information is taken from the Russian newspaper 'Vedomosti', December 28, 2006). Belarus has the most complicated tax system, while Uzbekistan is leading in terms of the number of taxes (130) and Brazil – in terms of time spent (2,600 hours). Gambia has the heaviest tax burden (291.4% of profits). The authors of the report claim that taxpayers in Belarus have to make 125 payments, while various taxes and dues amount to 186% of profits. Their payment requires 1,188 hours per year.

Despite the fact that a General Section of the Tax Code of the Republic of Belarus is adopted since January 1, 2004, its Special Section is not yet adopted. This is because the regulation of all types of taxes occurred via separate laws continuously revised and updated. For instance, the Law on Value-Added Tax (adopted on December 19, 1991) has been amended 25 times.

Nevertheless, some positive changes have been made. The adoption of the President's Edict No. 119 on March 9, 2007 'On the Simplified Taxation System' is the most notable event for small business of Belarus in recent years. The regulation is different from the Law of the Republic of Belarus 'On the Simplified Taxation System [Applied for] Small-Scale Economic Units' in a number of ways:

- Patents and patent fees are abolished (prior to that, they had to be paid in advance);
- Legal entities and individual entrepreneurs that use the simplified taxation system are exempted from accounting and use the special book of records (of incomes and expenditures);
- The simplified taxation system is used along with the simplified statistical accounting system;
- The right to choose the tax rate (either 10% or 8%) has been

granted (but the VAT has to be paid on a regular basis);

- Reduced tax rates have been introduced (3% and 5%, depending on whether economic units pays VAT or not, respectively) for legal entities and individual entrepreneurs located in the countryside or in small towns. In this respect, the government seems to implement the State Program for Development of Regions and Small Urban Localities over 2007–2010.

Further, on June 30, 2006, the President has issued Edict No. 419 'On the Additional Measures for Regulation of Tax Relationships'. This regulation combines all provisions related to economic liability enforced by both tax and customs agencies. Specifically, the document states that:

- Established criteria for treating transgressions as 'of little significance';
- When expiration of time limits required for fulfillment of obligations occur, the sanctions are to be imposed depending on the length of the delay;
- New measures for ensuring that penalties accurately reflect the seriousness of transgressions; when extenuating circumstances are discovered, penalties are halved;
- A 'clearing method' is introduced so the real harm is accounted for.

The Law on the Budget also envisages some changes in VAT payments in 2007, including the introduction of some exemptions (concerning the use of intellectual property rights), a change in the deduction rules (related to personal income tax), and abolition of withholding taxes (dividends are now included in non-operational profits taxed at a rate of 24%). Also, it is suggested to reduce the number of regulations issued by the Ministry of Taxes and Duties of Belarus by approximately 60%. Finally, the need to provide 40 declarations and reports are abolished.

On May 7, 2007, the President issued Edict No. 215 'On the Rates of Environmental Tax and Some Issues of its Collection'. One of the important implications of this regulation is the likely expansion of the number of payers of this tax. This is because of the inclusion of bottles and jars (except the ones produced by economic units). At the same time, there are some other important aspects of this regulation:

- According to Article 3 of the Law of the Republic of Belarus 'On Environmental Tax' adopted on December 23, 1991, the President of the Republic of Belarus is authorized to establish rates of environmental tax. But the above-mentioned Edict does not only establish the rates, but changes the objects subject to this law (i.e. bottles and jars). This contradicts Article 2 of this Law;
- The Edict has been adopted in May (i.e. in the middle of the year), and enforced since the date of its official publication. Once again, the stability of the tax legislation is rather poor in Belarus.

### 3.7. Price regulation

Price policies continue to be inconsistent. Despite the attempts to reduce direct interference into pricing, the methods of direct (administrative) regulation of prices (and tariffs) are preserved (as provided by the Law 'On Pricing'). Regulation measures include:

- Fixed prices (tariffs);
- Price (tariffs) caps;
- A mark-up (rebate) ceiling;
- A rate of return ceiling (in order to set an amount of returns to be included into prices (tariffs) subject to regulation);
- The rules for determination and application of prices (tariffs);
- Price (tariff) declarations.

Over the period considered in this study, no radical revision of price regulation is observed. However, some new pieces of legislation came into force, including:

- The President's Edict No. 615 'On Valuation Activity in the Republic of Belarus'; this regulation establishes the modes of valuation of civil rights objects. Specifically, five valuation modes are suggested: index-based, based on book value of accumulated assets, market-based, based on conversion of currency-denominated value; and based on cadastral valuation. Also, types of valuation such as internal, independent, compulsory along with the rules for their application have been provided;
- The Council of Ministers of the Republic of Belarus adopted on January 18, 2006 Regulation No. 54 'On Approval of the Public Utilities Tariff Calculation and Controls over Them';
- Also, Regulation No.4 adopted by the Council of Ministers of the Republic of Belarus on January 3, 2007 'On Establishing Tariffs for Population for the Provision of Technical Service and for Public Utilities' stipulates that tariffs charged for provision of technical services, the use of residential premises, and public utilities (such as cold-water and hot-water supply, sewage, gas, electric and heat energy, elevator usage, garbage disposal and waste neutralization) could only be set by the Council of Ministers after the approval by the President made prior to the beginning of the financial (fiscal) year on the basis of income growth and the amount of cost compensation provided in accordance with the Law on the Budget of the Republic of Belarus. The tariffs are to be applied on January 1 each year. In fact, Regulation No.4 is adopted as implementation of the President's Edict No. 604 'On Measures to Improve the Efficiency

of the Communal and Housing Services in Belarus' issued on October 6, 2006;

- The Ministry of Economy has adopted Regulation No. 203 'On the Construction Price Index' on November 24, 2006;
- The Ministry of Economy and the Ministry of Architecture and Construction has jointly adopted Regulation No. 222/35 'On the Expected Construction Price Indices' on December 15, 2006.

### 3.8. Administrative procedures

Available studies of the business environment in Belarus demonstrate that the administrative procedures are often treated by both entrepreneurs and experts as rather business-unfriendly. The administrative bodies themselves have calculated that more than 1,000 permits exist for entrepreneurs. These permits are introduced at the national and local levels, and even by verbal request of officials. The system of permit issuance is complicated, and no exhaustive, clear-cut rules are established so far.

The government of Belarus has decided to tackle this issue. In particular, debureaucratization measures have been suggested, particularly what concerns the work with legal entities and individual entrepreneurs. A special set of measures has been developed and included into Regulation No. 1029 issued on August 11, 2006. This set includes determining an exhaustive list of administrative procedures performed by state agencies and organizations as well as a list of documents required to conduct entrepreneurial activity at various stages.

It has to be emphasized that the Regulation has already been implemented. In particular, following the Prime-Minister's Order No. 135-R on November 30, 2006, a special working group has been established to devise proposals for the simplification of administrative procedures.

The group, chaired by the Deputy Prime Minister, Mr. A. Kobayakov, deals with the following issues:

- Determination of [the number and scope of] administrative procedures;
- Establishment of the criteria for the simplification of the content and the reduction of the number of administrative procedures;
- Administrative bodies and agencies should analyze the administrative procedures performed by them in order to suggest directions for simplification. Openness and accessibility of the results of this analysis have to be secured. Also, business associations have to be invited for discussion.

The working group has been provided with a schedule to revise the administrative procedures. The end result should be the eventual adoption of necessary changes in and amendments to existing legislation on the basis of decisions made by the working group.

### 3.9. Control over the activity of economic units

Belarusian entrepreneurs also point to a heavy burden of 'administrative controls'<sup>6</sup> over their economic activity, along with the above-mentioned complexity of existing legislation and the business-unfriendly tax system. In particular, entrepreneurs denote that over 2005 a single enterprise had been checked seven times. Three inspections came to check economic activity, while the rest of them dealt with technical issues (like fire safety, etc.). It should be mentioned that the intensity of control activities decreased. In 2004, a single enterprise on average was checked ten times. At the same time, in 2005 more than 70% of inspections had been off-schedule ones.

<sup>6</sup> See the analytical report prepared by the International Finance Corporation *Business Environment in Belarus 2006*, pp. 10–11, 31–39.

One of the major reasons behind the reduction of the number of inspections (along with the decrease of time needed to perform them) has been an improved management by the Controls Coordination Council and its local affiliates (established by the President's Edict No. 673 'On Some Measures for Improvement of Coordination of Activities of Control Agencies of the Republic of Belarus' adopted on November 15, 1999). Further, the President's Edict No. 151 'On the Adoption of Changes in and Amendments to the President's Edict No. 673' adopted on March 15, 2006 has introduced additional changes into the control procedures executed by economic control agencies. The new version of Edict No. 673 clearly defines the notion of 'scheduled controls'. These are performed following special coordination plans adopted at the national and regional levels and also in Minsk.

The reasons for off-schedule inspections have been redefined. These can be executed only following a special order of certain officials. A control agency is then obliged to inform the Controls Coordination Council. When an administrative body is not authorized to perform an off-schedule inspection, the latter can still be performed but on the basis of an exhaustive and clearly defined list of reasons. Again, such controls have to be approved by the above-mentioned Council.

In addition, an administrative responsibility of control agencies' officials is increased in such cases as violation of the new rules for off-schedule inspections and their approval by the Controls Coordination Council. Edict No. 151 has authorized this Council to determine a list of public bodies and other organizations whose control activity has to be coordinated and establish a certain sequence of inspections. Some other changes have been made concerning the procedural and technical aspects of controls. In general, it is expected that the implementation of Edict No. 151 would allow decreasing the 'control burden' on the economic actors.

At the same time, both experts and entrepreneurs point to a number of existing deficiencies:

- Excessive powers of inspectors;
- Sanctions out of line with transgressions committed;
- Inspectors carry no responsibility for unwarranted interference;
- The absence of comprehensive inspection procedures;
- Bias and incompetence of inspectors;
- Violation of established procedures and misconduct demonstrated by inspectors.

Furthermore, Edict No. 673 adopted on November 15, 1999 does not provide regulation of the activities of the so-called *technical inspections*, such as fire safety, sanitation and epidemiology, labor safety, and so on. Inspection procedures tend to vary depending on a specific inspectorate.

Given the above-mentioned difficulties, it seems that there is a necessity to adopt a special Law on Inspection Activity. This Law should stipulate the following provisions:

- The way in which controls are exercised (principle of legality, presumption of *bona fides* of the inspected);
- Controversies have to be interpreted to the benefit of the inspected;
- Definition of the methods of inspection activity;
- Delineation of rights, obligations and responsibilities of both inspectors and inspected;
- Determination of comprehensive inspection procedures.

Sanctions are another inspection-related problem. First of all, penalties often appear to be too heavy and even predatory, being out line with transgressions committed. Penalties

are often imposed for committing a minor, very formal transgression.

Nevertheless, some measures have been adopted to streamline the system of penalties. It has been mentioned in section 3.6 of this chapter, that the President's Decree No. 419 'On Additional Measures for Regulation of Tax Relationships' adopted on June 30, 2006 have mitigated the punishment for violating the tax legislation.

Also, since March 2006, the Administrative Code and the related Procedural and Execution Code have been adopted. These regulations provide a more rigorous but better defied procedure of administrative responsibility. In fact, this implies a stronger protection of administrative rights of economic agents. At the same time, the Administrative Code is one of the least stable pieces of legislation. The first version has been adopted in 2003, but was amended as much as 25 times since then. The Decree of the President of the Republic of Belarus No. 2 'On Some Issues of Legal Regulation of the Administrative Responsibility' has abolished the provisions of previous decrees specifying liability for off-Code violations. As for other related legislative acts issued by the President, they are in force until the Administrative Code would incorporate liability originally specified by these acts.

At the same time, the President's Edict No. 116 'On Some Issues of Legal Regulation of Administrative Responsibility' issued on March 1, 2007 abolishes some legal regulations of commercial liability. From a legal point of view, this is a benign change. In practice, it means the application of the rules for administrative responsibility only<sup>7</sup>. Also, economic actors would be better protected legally since the rules for administrative responsibility are much better delineated than those for commercial liability.

<sup>7</sup> The new Code establishes administrative responsibility for both legal entities and individual persons.

### 3.10. Provision of state support

The government has not been able to pass a 'Law on the Support for Small and Medium-sized Entrepreneurship'. However, this is not a failure. In fact, a draft Law has been too general and included many reference rules.

At the same time, an 'alternative' draft has not been passed either. This draft was prepared by a special expert group working under the auspices of the Council for Entrepreneurship Development with the assistance of the UN Office in Belarus. The alternative version of the Law has been much better in terms of tackling numerous deficiencies. But the government has perceived the alternative draft as being too radical. Nevertheless, there is some indication that there is an intention to adopt this Law anyway. Accordingly, it could be expected that the preparation would not be stopped.

Although the Law has not been adopted yet, some measures aimed to support entrepreneurship development have been implemented by the government. Specifically, the government has adopted special Regulation No. 1029 on August 11, 2006 and the President has issued Edict No. 119 on March 9, 2007 to set up a working group to simplify existing administrative procedures. In addition, there has been the President's Edict No. 108 'On Some Measures for Utilization of State-Owned Assets Not in Use' adopted on February 27, 2007. According to this regulation, the state-owned assets not used by economic actors could be utilized in the following ways:

- Selling by auctions (initial price has to be equal to a 'base-value' specified by existing legislation);
- Gratuitous conveyance of state-owned property to individual entrepreneurs and private legal entities (by allowing them either to use or to own this property).

In its turn, on February 28, 2007, the Council of Ministers has adopted a

special Program of State Support for Small Entrepreneurship over 2007.

Despite all these measures and regulations, the policies of SME support are still rather inconsistent. This statement can be illustrated by the adoption of the President's Edict 'On Making Changes in and Amendments to the President's Edict No. 285 adopted on June 18, 2005'. This regulation (in force since January 1, 2008) allows individual entrepreneurs to hire only family members of close relatives as their employees. Also, entrepreneurs either trading with or producing some expensive goods are no longer liable to pay a single tax. The government claims that these measures are necessary to make business 'more civilized' by turning individual entrepreneurs into legal entities. The officials also say that it is a worldwide practice that individual entrepreneurs do not hire employees since it conflicts with the very notion of being an 'individual entrepreneur'. This is a mere delusion. The leaders of the entrepreneurs' movement in Belarus expect that such a 'conversion' might result in an unemployment hike since about 500,000 people could be deprived of the right to be entrepreneurs. As a result, they might prefer to go into the 'shadow', while the number of individual entrepreneurs would still continue to grow. This is because actual and potential employees of individual entrepreneurs would prefer to register as individual entrepreneurs themselves in order to avoid non-hire rule described above. However, the authorities seem to be aware of this problem so an Edict of the President to ease the conversion process (to legal entities) for individual entrepreneurs is drafted.

### 3.11. Conclusions

It follows that the institutional environment for entrepreneurship development in Belarus remains rather contradictory. Although it should be admitted that some benign changes have been made (like simplification of registration and inspection procedures, the adoption of the

new rules for simplified taxation), many spheres of commercial activity are regulated either improperly or counterproductively (e.g., Edict No. 760 adopted on December 29, 2006).

It could be said that the government puts 'one step forward, but two steps back'. But the most fundamental problem is the unwillingness to abolish the paternalist policies towards private business and the continuous application of various interference measures in many aspects of commercial activity.

At the same time, some modest optimism has grown out of the President's Address to the People and the Parliament of Belarus made on April 24, 2007. It seems that changing internal and external conditions would force changing the approach to regulation of entrepreneurial activity in Belarus. Specifically, one of the sections of the Address is called 'Entrepreneurship: Private Initiative as an Essential Element of the Dynamic Development of the Country'. The content of this sector could become a guide for future changes aimed at developing SME and private sector as a whole.

## 4. THE ROLE OF SMALL BUSINESS IN THE BELARUSIAN ECONOMY

### 4.1. The number of small-sized enterprises

In 2006, the Ministry of Statistics and Analysis of the Republic of Belarus has changed the method of assessing the number of small-sized enterprises. The new methodology provides a figure of 37,660 (including 2,022 peasant households and farms), of which 2,270 entities have not been carrying out any economic activity. Still, the statistics do not capture the performance of individual entrepreneurs. As a result, the role of small-sized enterprises in the economy is grossly underestimated. In addition, there is no such notion as 'medium-sized enterprises' in the Belarusian economy so no data are provided in this regard as well.

Basically, small-sized enterprises operate in the retail and catering sectors (39.1% of their total number). Also, a substantial share of small companies is recorded in industry (22.3%). In addition, small business is present at construction (11.7%), transports (5.1%), and agriculture (6.1%).

Regional distribution of small-sized enterprises is rather skewed. A substantial share (46.5%) is located in Minsk, where the density is 97.4 small-sized enterprises per 10,000 people (table 4.1). In other regions, the number of small-sized enterprises is much less. On average (Minsk excluded), the density is 25.5 small-sized enterprises per 10,000 people. Gomel (21.4) and Brest (21.6) regions display the lowest densities, while Minsk (32.2) and Mogilev (26.5) regions display highest ones.

In 2006, the contribution of small-sized enterprises to GDP was 8.8%. In 2005, when the old method of recording was used, this figure amounted to 8.1% only. Still, this might be

indicative of the dynamics of expansion of small business in Belarus. Small-sized companies most strongly contribute to foreign trade turnover with a share of 23.9%. This is due to a rather significant share of these enterprises in imports (31.6%), while in exports it is much less (15.3% of the total volume of exports). Besides that, 7.4% of the total volume of investment into fixed capital is provided by small-sized enterprises.

Further, the share of these economic units in the total volume of output is 7.5%. The growth rate of this indicator amounts to 25% (in comparable prices), compared with the national rate of output growth at 11.3% (ta-

ble 4.2). A higher growth rate has been registered for the production of consumer goods (25.6%), while the average economy-wide growth rate is 10.5%. Small-sized enterprises display a somewhat higher share in retail turnover (10.2%). In addition, growth of retail turnover of both foodstuffs and nonfoods of these companies substantially exceed the nation-wide averages.

### 4.2. The role of small-sized enterprises in providing employment

Small-sized companies play an insignificant role in providing em-

**Table 4.1: Regional distribution of small-sized enterprises**

Regions	The number of small-sized enterprises	Per cent of the total	The number of small-sized enterprises per 10,000 people
Brest	3106	8.2	21.6
Vitebsk	3326	8.8	25.9
Gomel	3158	8.4	21.4
Grodno	2835	7.5	25.4
Minsk (city)	17503	46.5	97.4
Minsk (region)	4718	12.5	32.2
Mogilev	3014	8.0	26.5
Belarus	37660	100.0	38.8
Minsk excluded	20157	–	25.5

Source: Ministry of Statistics and Analysis

**Table 4.2: Major economic indicators of small-sized enterprises' performance, 2006**

	BYR billion	Growth rate, per cent	
		Small-sized enterprises	Nation-wide average
Industrial output (goods and services) calculated on the basis of selling prices excluding VAT, excise taxes and other receipts taxes	5197.5	25.0	11.3
Consumer goods output (including value of wines, liquor, and beer) calculated on the basis of selling prices	1736.7	25.6	10.5
Retail turnover	2087.8	33.9	17.7
Including foodstuffs	1118.9	36.0	13.8
Nonfoods	968.9	31.7	22.3

Source: Ministry of Statistics and Analysis.



**Table 4.3: Employment indicators of small-sized enterprises**

	Employees of small-sized enterprises	Average nominal wages		Economy-wide average nominal wage		Percent of the total number of employed workforce	
		BYR	growth, %	BYR	growth, %	excluding by-workers	including by-workers
Total	400375	433.3	27.3	590.7	17.6	9.2	11.0
Industry	153404	426.9	26.8	647.1	17.6	13.2	15.3
Agriculture	9847	311.0	23.3	364.8	19.8	2.2	2.5
Transport	30493	366.2	27.6	709.6	19.1	11.6	13.3
Communication	1613	524.2	27.6	652.5	11.9	2.5	3.0
Construction	60482	560.1	26.7	743.2	17.9	17.5	22.6
Trade and catering	104315	390.9	28.0	470.7	19.8	18.5	21.3
Procurement and sales	3127	481.0	29.9	–	–	8.7	10.4
Real estate activities	5896	405.3	23.3	–	–	–	–
General commercial market-supporting activity	6471	573.0	35.9	–	–	–	–
Non-manufacturing general services	5991	248.1	123.5	–	–	1.8	2.2
Healthcare, physical culture, and social services	4623	353.0	129.9	–	–	–	–

Source: Ministry of Statistics and Analysis.

ployment in Belarus. In 2006, these enterprises hired as much as 9.2% of the total number of workforce employed (when external by-workers and contract workers are included, this figure reaches 11%). Still, this is much less than in the developed countries, where up to 70% of the population can be employed at small and medium-sized enterprises.

A small-sized company employs 10.6 workers on average. This figure varies across industries and sectors. On average, industrial and transport companies employ most of the workers (18.2 and 15.8 employees per firm), while agriculture is at the low end of the scale (4.3 employees per company).

Since industry tends to employ more workers than other sectors of the national economy, a substantial fraction of employees of small-sized enterprises work in industry (38.3%). Next, trade and catering employ only 21.3% of the average number of workers on the payroll of small-sized companies, despite the fact that this sector provides the largest number of small-sized firms. Also, a considerable share of employees of small-sized enterprises is registered in such sectors as construction (15.1%) and transport (7.6%). In the latter, small-sized enterprises provide 17.5% of employment in this

sector. A somewhat larger contribution to employment is registered only in trade and catering (excluding by-workers and contract workers).

Officially, wages at small-sized firms are much lower than the nation-wide average one (by more than one-fourth). However, these companies display a rate of wage growth far above the average one in the Belarusian economy. This tendency is observed across all sectors of the economy where small-sized firms operate.

#### 4.3. Profitability and financial indicators

Small-sized enterprises provide 22.8% of total sales proceeds of goods and services in the economy. The average growth rate of revenues of small-sized companies exceeds the average nation-wide indicator by almost two times (50.2% against 25.2%, respectively). Costs have been growing on a smaller scale than in the economy as a whole, but considerably exceeded the average figure as well (47.4% against 23.6%, respectively). Profits of small-sized enterprises went up by 86.7%, which is more than four times than that in the economy as a whole (20.3%).

The majority of revenues earned by small-sized firms fall on trade and

catering (50.4%) and general market-supporting activity (18.4%). These two industries also display the fastest increase in the volume of revenues. This is particularly true in the case of companies specializing on general market-supporting activity, despite the very small number of people these firms employ (1.6% of the total number of workers are employed by small-sized companies). It may be emphasized that the rate of revenue growth of small business exceeds the average figures observed in other sectors of the economy. The same is the case with profits of small-sized enterprises. In the transport sector, the gap between profits of small-sized companies and others is most substantial. In addition, profits earned by small-sized companies are distributed more evenly than revenues (table 4.4).

As a result, the profitability of small-sized companies increased from 10.6% to 13.3%. However, this is still below the nationwide average indicator in Belarus (table 4.5). This is particularly relevant for industry, where the majority of small-sized companies operate. It is only trade and catering as well as construction that demonstrate profitability levels above the nationwide average.

The share of loss-making enterprises is also four times higher than in the national economy as a whole, despite some reduction in the number of small-sized loss-makers. The latter are numerous in such sectors as healthcare, real estate activities, trade and catering. These data suggest the existence of high risks

of running a small-sized business. The risks often stem from unequal conditions of competition with large state-owned enterprises. Finally, procurement and sales and transport are notable for the most substantial increase in profitability alongside with the reduction of the number of loss-making companies.

#### 4.4. Main characteristics of small and medium-sized enterprises: the empirical data

In February 2007, the IPM Research Center commissioned the sociometric laboratory 'Novak' to make a survey of the performance of small and medium-sized enterprises in Belarus over 2006–2007. The survey covered 410 SMEs (representative sample). The sample has been developed on the basis of the data of the Ministry of Statistics and Analysis.

The distribution of polled enterprises is shown in table 4.6. Half of them is located in Minsk, while 11% are in the Minsk region. As for other regions, SMEs are distributed rather unevenly. At the same time, in each of the regions, the share of small and medium-sized companies in the total number of enterprises does not exceed 10%.

The majority of polled enterprises is involved in trade and general services (jointly occupy 45.8%), followed by industry (18%) and construction (11.2%), while all other companies provide various types of services (table 4.7). This pattern of cross-sectoral distribution of companies is generally characteristic for the Belarusian economy. SMEs are mainly located in the services sector, providing services both to the population and business. This is because no substantial initial investments are required to operate in this field.

As for legal form of SMEs (table 4.8), the most common one is the so-called 'unitary enterprise' or limited liability company. This is due to some peculiarities of registration and formation of statutory funds of SMEs.

As for the size of the workforce employed, the distribution of companies is as follows:

- From 1 to 10 – 32.7%;
- From 11 to 50 – 45.6%;
- From 51 to 100 – 15.6%;
- From 101 to 200 – 4.9%;

Table 4.4: Revenues and profits of small-sized enterprises

	Share of industries in total revenues of small-sized companies, %	Revenue growth rate, %		Share of industries in total profits, %	Profits growth rate, %	
		Small-sized enterprises	All enterprises		Small-sized enterprises	All enterprises
Total	100.0	50.2	26.2	100.0	86.7	20.3
Industry	17.4	33.3	22.1	26.4	59.4	16.9
Agriculture	0.7	43.0	19.6	1.0	16.6	21.3
Transport	2.7	31.1	12.5	3.9	209.8	-2.0
Communication	0.2	48.5	25.8	0.7	51.1	50.9
Construction	6.2	50.5	28.8	14.0	66.2	24.4
Trade and catering	50.4	53.7	38.3	28.5	80.8	47.8
Procurement and sales	0.8	41.9	32.4	0.9	113.1	77.1
Real estate activities	0.6	41.1	-	2.2	42.4	-
General commercial market-supporting activity	18.4	75.6	-	19.6	212.7	-
Non-manufacturing general services	0.2	50.0	41.8	0.2	52.2	45.4
Healthcare, physical culture, and social services	0.2	57.7	-	0.1	-47.8	-

Source: Ministry of Statistics and Analysis.

Table 4.5: Profitability of small-sized enterprises

	Profitability of goods sold and services offered, %		Share of loss-making enterprises, %		Economy as a whole, 2006	
	2005	2006	2005	2006	Share of loss-making enterprises, %	Profitability, %
Total	10.6	13.3	26.9	25.6	8.5	13.6
Industry	9.7	11.1	24.6	24.7	16.4	15.5
Agriculture	7.0	12.0	17.1	18.9	1.4	5.3
Transport	4.4	9.2	31.1	22.9	6.5	13.6
Communication	25.4	27.8	21.6	19.2	5.3	44.8
Construction	15.2	17.5	16.5	15.8	6.8	11.0
Trade and catering	23.1	26.4	30.9	29.8	6.0	15.5
Procurement and sales	16.0	26.3	26.7	22.6	4.6	25.9
Real estate activities	40.4	44.5	34.1	29.1	-	-
General commercial market-supporting activity	4.3	8.7	25.4	25.5	-	-
Non-manufacturing general services	8.8	8.4	27.3	22.5	14.7	4.4
Healthcare, physical culture, and social services	6.9	2.1	28.8	30.1	-	-

Source: Ministry of Statistics and Analysis.

- More than 200 – 1.2%.

The vast majority of enterprises employ less than 50 workers. However, larger companies employing more than 50 workers (still, they can be treated as SMEs) operate in trade, industry, construction, transports and communication. At the same time, enterprises that provide consultancy, educational, and IT services along with catering and domestic services tend to be rather small in size.

On average, about 70% of employees are 'rank-and-file', while another 17% occupy mid-level managerial positions, and 13% are executives. There are some cross-industry differences, albeit insignificant ones (the data are provided in the table 4.9).

As can be seen, in such industries as trade, catering, and consultancy, the share of rank-and-file employees is smaller, while the share of managerial personnel is higher. A similar pattern is observed when the size of a company is considered. Smaller enterprises employ less rank-and-file workers, and more managers (table 4.10).

The majority of small and medium-sized enterprises of Belarus has been set up after 1996 (63.7% of companies are created around the end of 1990s – early 2000s, while another 12.7% were opened in 2005 or later). Finally, about one-fourth of SMEs (23.7% of polled companies) has been set up prior to 1996. Usually, 'the liquidation ratio' of small and medium-sized enterprises is relatively high. It is only the most dynamic and capable ones are able to adjust to their competitive environment. Survival requires considerable financial means and competences that are often scarce among small and medium-sized business in Belarus.

The average age of employees of small and medium-sized firm in Belarus is 39.5 years. Some statistically significant differences are observed across industries and sectors. In industry and construction, the average age of executives is

**Table 4.6: Regional distribution of polled enterprises**

	The number of enterprises, %
Minsk	49.5
Minsk region	10.5
Brest	3.7
Brest region	3.2
Grodno	5.4
Grodno region	3.2
Vitebsk	6.6
Vitebsk region	3.2
Gomel	5.1
Gomel region	3.2
Mogilev	4.9
Mogilev region	1.7
Total	100.0

Source: IPM Research Center.

**Table 4.7: Answers to the question: 'What is the major field of business activity of your company?'**

	The number of SMEs	%
Trade	165	40.2
Catering	23	5.6
Domestic services	41	10.0
Production (industry)	74	18.0
Construction	46	11.2
Transport and communication	22	5.4
Consultancy	2	0.5
Education	4	1.0
IT services	11	2.7
Other	22	5.4
Total	410	100.0

Source: IPM Research Center.

**Table 4.8: Answers to the question: 'What is the legal form of your company?'**

	The number of SMEs	%
Unitary enterprise	132	32.2
Limited liability company	150	36.6
Double liability company	74	18.0
Public corporation	23	5.6
Close corporation	18	4.4
General partnership	2	0.5
Production cooperative	9	2.2
No answer	2	0.5
Total	410	100.0

Source: IPM Research Center.

slightly higher than the average figure for SMEs as a whole (44.83 and 43.07 years, respectively). It can be suggested that the specificity of these two industries demand work experience and the availability of proper connections that are more important than in other sectors of the national economy.

Essentially, the results of this survey are similar to the earlier ones conducted by the IPM in the sense that entrepreneurial experience of executives remains between 9 and 10 years (9.6 years according to the most recent data). This indicator is rather high, thereby suggesting of the fact that people with no entrepreneurial experience have trouble

**Table 4.9: Answers to the question: 'What is the structure of employment in your company?' (%)**

Major field of business	Rank-and-file employees	Managers	Executives	Total
Trade	65.0	20.6	14.4	100.0
Catering	71.0	18.9	10.0	100.0
Domestic services	79.4	11.3	9.1	100.0
Production (industry)	74.1	16.5	9.4	100.0
Construction	76.1	11.8	12.2	100.0
Transport and communication	73.3	13.7	13.0	100.0
Consultancy	47.0	29.0	24.0	100.0
Education	83.3	8.3	8.3	100.0
IT services	70.1	18.9	11.0	100.0
Total	70.3	17.3	12.5	100.0

Source: IPM Research Center.

**Table 4.10: Company size and answers to the question: 'What is the major field of business of your company?', (%)**

Number off employees	Rank-and-file workers	Managers	Top managers	Total
From 1 to 10	63.8	17.8	18.4	100.0
From 11 to 50	74.1	17.0	8.8	100.0
From 51 to 100	70.5	17.9	11.6	100.0
From 101 to 200	75.1	14.6	10.4	100.0
Above 200	74.2	14.8	11.0	100.0
Total	70.3	17.3	12.5	100.0

Source: IPM Research Center.

entering the market. The current regulatory environment does not facilitate new setups.

As for the gender aspect, males (66.5%) outnumber females (33.5%) as executives of small and medium-sized enterprises. Women tend to prevail only in such sectors as catering and domestic services.

As a rule, executives of Belarusian SMEs are graduates of institutions

of higher education, either of technical (34.4%) or economic (30%) specialization. Next, it is only 4.4% of polled executives who obtained two university degrees. Most often, such people have degrees in technical and economic fields. Law graduates are rather rare (6.3%). MBA graduates occupy less than 1% of the total number of executives of small and medium-sized enterprises.

## 5. THE REGULATORY ENVIRONMENT AND ITS IMPACT ON SME DEVELOPMENT IN BELARUS<sup>8</sup>

For several reasons, the development of small and medium-sized enterprises is a very important and urgent task for Belarus. First, SMEs provide new jobs. Given the imminent need to cut excessive employment at state-run and semi-state plants and factories in Belarus, the private sector could absorb the 'released' labor and thus reduce potential social tensions at the labor market. Second, SME development is a crucial element of structural change in the domestic economy. Flexibility, adaptability, and efficiency are the factors that, on the one hand, make SMEs important partners of large enterprises (via such routes as subcontracting and outsourcing). On the other hand, SME development could reduce the size of the industrial sector, stimulate its restructuring, and thus facilitate the expansion of the services sector. Third, successful SME development could boost revenues of the local and national budgets and help to reduce their expenditures on supporting the existing inefficient pattern of production and employment. Fourth, SME development would foster growth of real incomes, promote middle class formation, suppress the prevalent mood of dependency in society, induce self-employment, and prevent a 'brain-drain' (or labor migration)

<sup>8</sup> This chapter is prepared by Dr. Piotr Kozarzewski (holds a PhD in Political Science, a member of the CASE Council (Center for Social and Economic Research) (Warsaw, Poland) and a Senior Research Fellow of the Institute for Political Studies of the Polish Academy of Sciences) and Dr. Elena Rakova (economist of the IPM Research Center). The chapter has been prepared within the framework of the project 'Support for SME development in Belarus on the basis of improvement of the environment for conducting entrepreneurial activity and business infrastructure'. The technical assistance to the Project had been generously granted by the Polish Ministry of Foreign Affairs.

both to the CIS and to non-CIS countries. However, the business climate in Belarus is often criticized by local and international experts for its insufficient favorability to doing business and overregulation executed by the government in a range of directions.

Nevertheless, the executive and legislative branches of authority in Belarus are aware of improvement of the environment for SMEs' functioning as an important direction of the country's development. Recently, some regulations have been adopted to alleviate time and financial costs incurred by SMEs to register and obtain certain permits. Nevertheless, these improvements appear to be insufficient and inconsistent. In addition, a draft Law 'On the Support of SMEs' has not been adopted in its original version and returned for revision instead. It is in the original version that the majority of proposals made by business unions and associations had already been incorporated. At the same time, the government currently intends to support setting up and development of only those SMEs that operate in small urban places, particularly 'factory towns' (though these plans exist on paper only).

This chapter analyzes the major obstacles to the development of small and medium-sized business in Belarus based on data collected over September–October 2006 in the course of the survey of Belarusian entrepreneurs. Research activities consisted of six regional focus groups involving entrepreneurs, chairmen of regional business associations and a poll involving 250 executives and owners of small and medium-sized businesses (representative sample)<sup>9</sup>. The paper has been written within the framework of the project aimed at supporting the development of small and medium-sized enterprises in Belarus carried out by the Research Center of the Institute for Privatization and Management (Minsk) and CASE – the Center for Social and Economic Studies (Warsaw, Poland). The project was supported by the Ministry of Foreign Affairs of Poland<sup>10</sup>. The second section provides an analysis of the major problems existing in the regulatory environment. This analysis is mainly based on the opinions expressed and quantitative estimates made by the polled entrepreneurs. The third section describes the impact of the deficient regulatory environment on SMEs' operation and traces the subsequent modes of their adjustment. The fourth section distinguishes among regulatory burdens on and modes of behavior of entrepreneurs depending on company size, the year of establishment, and field of economic activity. The fifth section concludes this chapter and makes policy recommendations.

### 5.1. Major problems of the regulatory environment

Our study confirms that there are numerous barriers to developing small and medium-sized business in the Belarusian regulatory environment. Nearly all polled SMEs experience the adverse influence of these barriers in one or another way. Only two entrepreneurs (0.8% of the sample)

<sup>9</sup> Answers of the respondents are available online at the IPM Research Center web-page: <http://research.by/rus/surveys/f9953d723aa828f2.html>.

<sup>10</sup> The views expressed by the authors do not necessarily represent those of the IPM Research Center, the CASE (Center for Social and Economic Studies), and the Polish Ministry of Foreign Affairs.

**Table 5.1: Complexity of certain elements of the regulation of SMEs' activity (%)**

Problems	Estimate					Average score
	1	2	3	4	5	
Taxation	2.8	24.1	29.6	24.1	19.4	3.3
Inspections and fines	2.8	21.4	35.7	21.0	19.0	3.3
Excessive paperwork	7.9	21.4	29.0	22.6	19.0	3.2
Licensing	10.3	22.9	31.2	19.0	16.6	3.1
Provision of permits	8.3	25.7	26.1	24.9	15.0	3.1
Price regulation	8.4	23.9	39.8	18.3	9.6	3.0
Registration	10.4	27.9	29.5	19.1	13.1	3.0
Statistical reporting	7.1	28.2	36.5	20.6	7.5	2.9
Weak protection of assets and interests of private business	11.6	28.0	33.2	15.2	12.0	2.9
Wage regulation	14.2	27.3	33.6	19.0	5.9	2.8
Unequal conditions for conducting business compared to public sector companies	16.2	27.7	23.7	20.9	11.5	2.8
No access to financial resources (or a complete lack of them)	18.7	33.5	23.9	17.1	6.8	2.6
Administrative intervention by central inspection authorities	20.7	34.7	25.9	13.9	4.8	2.5
Administrative intervention of local authorities	18.7	33.9	25.5	17.9	4.0	2.5
Employment regulation	22.4	35.6	23.2	14.0	4.8	2.4
No access to micro credits (or a complete lack of it)	25.6	31.6	23.2	14.0	5.6	2.4

Note. 1 – this is not a problem; 5 – this is a very serious problem.

Source: Own calculations based on the data collected.

**Table 5.2: Major problems of tax legislation (%)**

Problems	Estimate					Average score
	1	2	3	4	5	
Large number of various taxes	4.3	24.1	29.6	23.3	18.6	<b>3.36</b>
Tax allowances (tax burden)	4.0	20.2	34.0	19.4	22.5	<b>3.28</b>
Instability of tax legislation, its continuous change	7.1	25.8	35.3	16.7	15.1	<b>3.19</b>
Large number of charges and dues (to non-budgetary funds, for infrastructural development, etc.)	9.9	24.1	36.8	19.0	10.3	<b>3.07</b>
Inconsistency of tax legislation	4.7	24.5	33.6	21.7	15.4	<b>3.06</b>
Complexity of tax calculation	5.6	31.3	27.0	24.2	11.9	2.96
Considerable loss of time and labor to calculate taxes	27.5	36.3	21.1	12.4	2.8	2.86
Necessity to report monthly (despite that some taxes need not to be paid)	18.6	34.4	31.2	11.1	4.7	2.81
Low level of competence of tax inspectors (like low awareness of existing legislation, etc.)	11.5	31.0	32.9	14.3	10.3	2.49
Difficulties with assessing necessary information on taxes	8.0	31.1	37.5	13.5	10.0	2.27

Note. 1 – this is not a problem; 5 – this is a very serious problem.

Source: Own calculations based on the data collected.

claimed that barriers do not affect their activities. The average quantitative estimate of the strength of the regulatory barriers is 2.9 out of a five-score scale (where one means that a regulation is not a problem for a SME, and five means that a regulation is a very serious problem).

At the same time, six problems out of 16 were treated by executives as the most serious ones by giving those three scores and more. These are the problems with taxation, inspections and penalties, excessive paperwork, permits and licenses, pricing regulation, and registration. More

than one-third of the respondents estimated these problems as 'complicated' and 'very complicated' (table 5.1). Only 3 to 10% of respondents perceive the above-mentioned barriers to conducting entrepreneurial activity as 'insignificant' (one score). In addition, 10 other characteristics of the regulatory environment have been assessed as 'problematic' by a considerable number of polled entrepreneurs.

The analysis reveals that for the vast majority of entrepreneurs, the above-mentioned barriers are complex and interrelated. This implies that the cases of negative assessment of individual aspects of the regulatory activity are rather rare. This is confirmed by a high correlation between estimates of all types of the barriers (while very high levels of significance are observed)<sup>11</sup>.

Below the majority of 'constituting elements' or 'building blocks' of the Belarusian regulatory environment are described. Although such a widespread barrier as 'excessive paperwork' is not dealt with in detail, it is clear that the solution to this issue is closely related to the solution of all other difficulties, such as pricing regulation, controls of wages employment, permit issuance, tax and statistical reporting, and so on.

#### 5.1.1. Taxes and taxation

Over the past few years, taxation remains one of the most urgent problems for Belarusian SMEs. Estimates made by a number of international organizations, local experts and entrepreneurs tend to be very close to each other. In particular, The estimate made by experts of the World Bank within the framework of 'Doing Business' project shows that Belarus has a tax system which ranks among the five worst systems in the world<sup>12</sup>.

<sup>11</sup> Pairwise correlation (Spearman's method) provides correlation coefficients of above 0.25; the level of significance is higher than 0.001.

<sup>12</sup> See a report prepared by the World Bank: Doing Business 2006, available at: <http://www.doingbusiness.org/ExploreEconomies/Default.aspx?economyid=19>.

**Table 5.3: Taxation-related factors (%)**

Problems	Factors			
	1	2	3	4
Instability of tax legislation, its continuous change	0.881			
Inconsistency of tax legislation	0.879			
Complexity of calculations	0.692			
Big number of various taxes		0.872		
Amount of total tax payments (tax burden)		0.836		
Considerable number of charges and dues (to non-budgetary funds, to support infrastructural development, etc.)		0.736		
Low competence level of tax inspectors (like poor knowledge of existing legislation, etc.)			0.875	
Difficulties with assessing information on taxes			0.760	
The need to report all taxes (even some of them that don't need to be paid)			0.702	
Considerable expenses of time and energy to calculate taxes				0.683

*Note.* Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; the number of factors is defined following Kettel's method. Factors explain 77.5% of the observed variance. The table displays factors with a value above 0.5.

*Source:* Own calculations based on the data collected.

Almost all polled entrepreneurs complained about taxation. Only 2.8% of them do not see any difficulties in this area. The table 5.2 clearly shows that, for the majority of entrepreneurs interviewed, taxation problems are not limited to high tax rates in itself (although in any country, to pay less taxes is a natural propensity of any entrepreneur). Rather, respondents complain about the considerable number of taxes, charges and dues, the instability and inconsistency of tax legislation, and its complexity (manifested in the necessity to perform labor-consuming calculations) (table 5.2).

Many of the participants in the focus groups expressed their readiness to pay all taxes, but noted that it is impossible to do so. The reason is that neither tax inspections nor entrepreneurs are capable to follow exactly and interpret correctly all existing tax and related regulations. Apart from that, there is often a necessity to obscenely 'grovel' through unclear and contradictory tax regulations. As a result, considerable material and non-material resources are diverted. Entrepreneurs have to employ the whole army of accountants. The number of these is many times higher than that is needed by small and medium-sized firms in neighboring countries. In Bela-

rus even the smallest company, needs to employ at least one accountant on a full-time basis.

Factor analysis shows that problems with taxation could be divided into four major groups. In general, it has been confirmed that the heavy tax burden is only one of the problems entrepreneurs face (table 5.3):

1. Complexity, instability, and inconsistency of tax legislation;
2. Heavy tax burden;
3. Lack of information and poor knowledge of some provisions of (and/or changes in) existing tax legislation of tax inspectors;
4. Tax management (the need to spend a lot of time and resources to make tax calculations).

It should be stressed that the third and the fourth group of factors are closely interconnected. Impoliteness and arrogance of tax inspectors could be illustrated by quoting one of the focus-groups' participants: 'Go and read there [on the wall, where the leaflets of the Inspection of the Ministry of Taxes and Duties are stuck]. Everything is there'. The complexity and overregulation of tax legislation, its frequent updates,

all lead to an increase in the number of accountants in the country. As a result, the fourth group of factors becomes more salient: transaction and imputed costs of SMEs are growing (i.e. expenditures of time, labor, and resources spend to employ a growing number of accountants that have to calculate numerous taxes, while there is a lack of time and specialists to deal with financial and management accounting and planning, etc.). As a result, business competitiveness deteriorates, and costs and prices for end products grow<sup>13</sup>.

More than one-third of the SMEs interviewed benefits or has benefited from tax preferences. On the one hand, this allows concluding that their accountants are high-caliber professionals skillfully able to use various opportunities for reducing of the tax burden provided in the existing legislation. On the other hand, accusations made by some representatives of SMEs that tax preferences are used exclusively by state-owned companies seem to be exaggerated.

Some SMEs (and their number is in fact growing) use the so-called simplified system of taxation. At the same time, official statistics provide us with a figure of 15% of SMEs (that use this system). But individual entrepreneurs do not use this system, or are simply unable to use it for a number of reasons. Among the most widespread causes is inappropriate criteria applied for a shift to using this system, high tax rates, high patent fees, and the need to make tax payment in advance. As has already been mentioned above, reform of the existing simplified tax system could become an important 'support mechanism' for the government encouraging 'transfer' of a fraction of entrepreneurs from being individual entrepreneurs to other legal forms, such as 'Private Unit Enterprise', 'Limited Liability Company', 'Dou-

<sup>13</sup> It has to be fairly stressed that the problems and deficiencies of tax legislation are also pressing for state-owned enterprises. However, their financial capacities in tax management and calculation, and more sympathetic treatment of tax inspections make tax problems less acute.

**Box 3: Taxation, individual entrepreneurs, and small business**

Problems of tax management, i.e. calculation and reporting, are one of the most urgent for small-scale private companies. The results of the study using focus-groups show that it is the number of different taxes and not the tax burden itself (although it matters, too) that is the most disturbing. The law requires accounting for all taxes, including those that don't need to be paid by a company. Accordingly, this requirement explains why individual entrepreneurs are unwilling to turn into registered juridical (legal) entities. The government has indeed considerably simplified the procedure and reduced the costs of registration, and also diminished the size of the statutory fund for many juridical (legal) entities. However, those individual entrepreneurs that need more than three employees (this limit is set by the law) and generally want to become a small enterprise are still unwilling to register as a juridical (or legal) entity. This unwillingness mainly stems from taxation problems. Therefore, the reforms to simplify the tax system and its popularization are important dimensions of the government's activity.

ble Liability Company', etc. A draft version of the President's Edict 'On the Simplified System of Taxation' indeed envisaged a considerable simplification of the collection of single tax in contrast with the existing system applied to small economic units. If these changes are adopted, the government estimates that the share of SMEs using this system could reach 25%.

*5.1.2. Pricing regulation*

Despite the formal price liberalization that has been implemented in two 'waves' (in 1992–1994 and then in 2002–2003), pricing regulation remains to be a meaningful barrier for entrepreneurs. Formally, the vast majority of prices for goods and services are not regulated by the state. Experts of the European Bank for Reconstruction and Development have estimated the progress in price liberalization in Belarus by giving the score 'three' (while 'one' is a mark for a planned economy, and 'four plus' is standard for a fully-fledged market economy). But this is the lowest indicator among all post-socialist countries (except Turkmenistan and Uzbekistan)<sup>14</sup>.

It appears that there are numerous restrictions on free pricing in Belarus. Still, there are price caps for private companies (i.e. 0.6% per month). In case this limit has to be exceeded for some prices, new prices have

to be 'registered with' or declared to special price-controlling bodies. Existing legislation also stipulates the need to provide planned and reported calculations (mind that in market economies, public officials are not concerned with justification of prices as such), restricts the rate of return (in some cases), and so on. Anti-trust legislation has also been employed. Specifically, this legislation contains a provision on the dominant position of enterprises not only at the national, but also at the local (regional) markets. Following this provision, various methods of pricing regulation could be applied to enterprises irrespective of their ownership (including joint ventures) that abuse their dominant position (more than 50% of the market share, including enterprises at the local (i.e. regional) level). It has to be mentioned that with regard to the so-called 'socially important' goods and the goods produced by state-owned enterprises, pricing regulation is even more widespread and detailed.

Considerable pricing regulation brings about various problems for private companies. Incomplete statistics and 'grey' imports turn enterprises operating at competitive markets (competing with Russian, Chinese, and other producers) or innovating (since any company that produces innovative goods is treated as having a dominant or even monopoly position on the market) into 'monopolists'. However, price

regulation and profitability ceilings worsen innovative and investment capabilities of enterprises, deteriorate their competitiveness, and even force them to leave the Belarusian market.

It is also worth noting that the majority of entrepreneurs claim that tough administrative regulation is not an efficient and proper way to control the price level in the economy as a whole. The majority of polled executives and owners of Belarusian SMEs have answered negatively to the question whether prices for their goods and the general price level would go up after pricing regulation is relaxed. Nevertheless, some expect a short-term price hike. In contrast, it could be feasibly claimed that competition and limited demand would bring prices down to their original level. Prices and inflation are determined by the policies of the NBB. Further, there would be more business-productive employment of labor and material resources in contrast to the current pattern shaped by the requirements to fulfill the provisions of pricing regulation legislation. As a result, transaction costs and money expenditures of companies would be lower and/or their competitiveness would be enhanced.

Pricing regulation is perceived as a problem by the vast majority of entrepreneurs interviewed. Only 8.4% of them consider that all existing regulations in this area are insignificant. Major problems with price regulation are estimated (in descending order) in table 5.4. Instability and inconsistency of pricing regulation legislation and excessive paperwork have been granted three and higher scores. However, other issues related to price regulation by the state are very important to entrepreneurs. Similar to other polls, the most 'overregulated' areas of SMEs' activity, more than one third of the respondents gave these problems scores 4–5.

Factor analysis allows distinguishing among five groups of problems related to price regulation (see table 5.5):

<sup>14</sup> *Transition Report 2006*, European Bank for Reconstruction and Development, London, 2006.



1. Benchmarks set for regulation and calculation of new prices;
2. Unequal conditions in price setting and excessive paperwork;
3. Inconsistency and instability of legislation;
4. Cost and profitability regulation;
5. The lack of information.

The results of the factor analysis have confirmed that the problem of pricing regulation is rather complex. As such, it can not be reduced to the absence of opportunity to set prices freely. Bulky, variable, and non-transparent pricing regulation is of equal or even greater importance to entrepreneurs. It leads not only to high financial, but also substantial non-material costs.

### 5.1.3. Permits and licenses

The necessity to obtain permits and licenses is one of the most complicated problems of the regulatory framework Belarusian SMEs are confronted with. According to a study made by the International Finance Corporation, in 2004 the total costs of registration, license and permit issuance, and certification was USD 3,840 on average. In particular, 17% of polled entrepreneurs mentioned that they were paying some extra money unofficially. On average, the amount of the unofficial payment was USD 665 in 2004 or almost 28% of GDP per capita in total<sup>15</sup>. According to the estimates made by IFC experts, the system of permit provision existing in Belarus covers 90% of SMEs. On average, it is necessary to obtain five permits for a start-up. In 2004, 45% of the respondents have been granted permits of various stripe, or six permits each on average. In order to obtain one permit, 2.5 months were spend, while the total costs of obtaining all necessary permits were approximately USD 1,400.

The study made by the IFC maintains that there is no coherent ap-

<sup>15</sup> *Business environment in Belarus*, analytical report, International Financial Corporation, Minsk, 2005.

**Table 5.4: Major problems of pricing regulation (%)**

Problems	Complexity estimate <sup>a</sup> :					Average score
	1	2	3	4	5	
Instability of legislation, frequent changes in legislation	6.0	23.5	29.1	25.1	16.3	<b>3.21</b>
Inconsistency of legislation	8.4	23.2	30.4	26.4	11.6	<b>3.08</b>
Excessive paperwork necessary to follow price regulation procedures	6.8	29.5	31.1	18.3	14.3	<b>3.02</b>
The need to use state-provided prices	11.2	24.7	35.5	17.1	11.6	2.92
Unequal opportunities for price increases between private and state-run enterprises	11.6	28.7	28.3	18.7	12.7	2.92
Calculation of target and reported calculations	8.4	28.7	39.0	18.3	5.6	2.84
Profitability regulation	10.8	31.1	29.1	19.9	9.2	2.84
Regulation of discounts and price decrease	10.4	31.5	29.1	21.5	7.6	2.83
Determination of cost items (i.e. expenditures that can be accounted as costs)	12.9	26.9	32.5	18.9	8.8	2.83
Regulation of price increases	9.2	27.9	40.2	16.7	6.0	2.82
Considerable expenditures of time and labor to calculate prices and follow the requirements of price regulation	8.0	31.6	34.8	18.8	6.0	2.81
The need to register new prices	9.6	31.9	34.7	15.9	8.0	2.80
Difficulties with obtaining information	28.4	36.4	22.0	8.4	4.4	2.25

Note. 1 – this is not a problem; 5 – this is a very serious problem.

Source: Own calculations based on the data collected.

**Table 5.5: Pricing regulation-related factors**

Problems	Factors				
	1	2	3	4	5
Regulation of price increase	0.815				
Regulation of discounts and price decrease	0.783				
The need to register new prices	0.752				
Calculation of target and reported calculations	0.710				
The need to use state-provided prices		0.785			
Unequal opportunities for price increases between private and state-run enterprises		0.761			
Excessive paperwork necessary to follow price regulation procedures		0.529			
Inconsistency of legislation			0.882		
Instability of legislation, frequent changes in legislation			0.849		
Determination of cost items (i.e. expenditures that can be accounted as costs)				0.641	
Profitability regulation	0.600			0.607	
Considerable expenditures of time and labor to calculate prices and follow the requirements of price regulation				0.582	
Difficulties with obtaining information					0.936

Note. Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; the number of factors is defined following Kettel's method. Factors explain 77.5% of the observed variance. The table displays factors with a value above 0.5.

Source: own calculations based on the data collected.

proach to permit issuance in Belarus. Accessible and transparent regulations are absent, while coordination among various public bodies and free access to necessary information

is rather poor. The major problems that the respondents have been facing when applying for permits are the absence of a single source of information (66%), excessive paperwork

(66%), and the need to go through numerous official procedures (66%). On top of that, more than 50 public bodies are entitled to issue permits. This procedure is regulated by more than 200 legal acts. Still, it is hardly possible to count the number of permits that exist in Belarus as well as legislative acts that regulate this process in detail.

It is discovered that the problems with obtaining permits and licenses occupy the fourth and fifth places in the general list of problems (16 in total) most urgent for private business in Belarus (see table 5.1). Only 8.3% of entrepreneurs interviewed do not experience any troubles with obtaining permits, while 10.3% do.

Yet, laboriousness and non-transparency are characteristic for obtaining permits (i.e. the need to sacrifice a lot of time and labor to get licenses and permits; the same applies to the procedures of obtaining them as such). Charges for licenses and permits are also troublesome for entrepreneurs (table 5.6).

The factor analysis allows grouping the opinions of entrepreneurs on problems of licensing and obtaining permits into four major categories (table 5.7):

1. Large number of licenses and permits;
2. Formal and informal financial costs;

3. Considerable expenditures of time and labor;
4. Problems with obtaining necessary information.

In general, the factor analysis indicates a multifaceted nature of the barriers erected by the existing system of issuing of licenses and permits. There is no single dominant factor whose change could be meaningful for entrepreneurs in the sense of bringing about radical improvement of the situation.

#### 5.1.4. Inspections and penalties

Inspections and penalties are the second (after taxation) most urgent problems of the business environment in Belarus. Only 2.8% of the respondents perceive inspections and penalties as bearing no trouble for them. Despite the numerous claims made by the officials concerning 'the one-check-per-year rule', the public bodies commissioned to exercise control and supervision interpret these claims as one check per year per single public body. Yet, this remains very much a good intention because in practice one public body performs several checks of a single SME. Inspections and penalties turn to be a 'Damocles Sword' for the development of business. The power of those using this weapon is augmented by high and unjustifiably heavy penalties applied within the framework of unstable and inconsistent legislation. The ability to 'come to terms with' the control agencies is often crucial for the future of either enterprise. Table 5.8 provides estimates of various aspects related to inspections and penalties.

The statistical analysis of the answers given by the respondents has revealed a high interrelation of all problems related to inspections and penalties mentioned above. In other words, enterprises that suffer most from inspections and penalties in practice suffer from virtually all aspects (ranging from heavy fines to difficulties with assessing information) in a more or less uniform fashion. This is confirmed by a high positive correlation among all of the

**Table 5.6: Major problems related to obtaining licenses and permits (%)**

Problems	Complexity estimate:					Average score
	1	2	3	4	5	
Considerable expenditures of time and labor in order to obtain licenses and permits	9.5	27.7	32.4	16.6	13.8	<b>3.29</b>
Difficulties with accessing information about licenses and permits	21.0	30.6	31.3	13.9	3.2	<b>3.20</b>
Large number of licenses and permits	10.7	19.0	41.3	19.0	9.9	<b>3.11</b>
The need to obtain permits when changing the type of economic activity	6.3	24.6	34.9	20.2	13.9	<b>2.98</b>
The need to obtain permits and licenses when starting a new type of activity	26.5	35.2	24.5	11.1	2.8	<b>2.98</b>
Considerable financial costs for obtaining licenses and permits	5.2	21.0	32.9	21.4	19.4	2.96
Authorities providing permits wring out informal remuneration (bribes)	11.1	24.9	35.6	14.2	14.2	2.48

Note. 1 – this is not a problem; 5 – this is a very serious problem.  
Source: Own calculations based on the data collected.

**Table 5.7: Groups of factors related to licenses and obtaining of permits**

Problems	Factors			
	1	2	3	4
Large number of licenses and permits	0.830			
The need to obtain permits and licenses when starting a new type of activity	0.806			
The need to obtain permits when changing the type of economic activity	0.802			
Unofficial payments to permit-issuing agencies	0.929			
Considerable financial costs for obtaining licenses and permits	0.579			
Considerable expenditures of time and labor in order to obtain licenses and permits	0.901			
Difficulties with accessing information about licenses and permits	0.971			

Note. Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; the number of factors is defined following Kettel's method. Factors explain 77.5% of the observed variance. The table displays factors with a value above 0.5.  
Source: Own calculations based on the data collected.

above-mentioned problems, given a high significance of coefficients obtained (less than 0.001).

In turn, the factor analysis confirms that the problem of inspections and penalties is a complicated one. There are three statistically significant groups of factors (see table 5.9):

1. Large number of inspections and excessively heavy fines;
2. Considerable expenditures of time and labor for servicing of inspections that are often targeted to seek a violation since the very outset (i.e. the existence of a certain bias);
3. Low levels of competence of inspectors and legal defenselessness of the inspected.

Over the first nine months of 2006, 1,911 checks had been performed at the polled enterprises. This means that there were 7.7 checks per enterprise (implying that there could be about 10 checks over 2006 as a whole). Nevertheless, it should be noted that there is indeed a considerable decrease in the number of checks made. For instance, in 2004, there had been an average of 23 checks made at one enterprise<sup>16</sup>.

But checks are still numerous. In 2006, only 4% of enterprises had not been checked. About one quarter of enterprises had been inspected relatively infrequently (up to 10 times). 'Record-holders' had been checked very intensely. The first place is occupied by a commercial company located in the Vitebsk region. It had been inspected 53 times (!). The second place is given to a similar company of this region (inspected 48 times), while the third place belongs to a transport company from Brest. The latter was inspected 'only' 44 times. Further, the maximum number of checks made by one body over the first nine months of 2006 at individual enterprises is 13 (sanitary inspections), 11 (tax inspection),

<sup>16</sup> *Belarusian Business 2006: The State of Affairs, Trends, and Prospects*, available at: <http://research.by/pdf/Business2006r.pdf>.

**Table 5.8: Major problems related to inspections and penalties (%)**

Problems	Complexity estimate:					Average score
	1	2	3	4	5	
Heavy fines	2.0	8.3	32.1	23.4	24.2	<b>3.50</b>
Excessively heavy punishment	3.2	18.7	33.1	21.1	23.9	<b>3.44</b>
Fiscal orientation of checks (on the outset they are targeted to establish violation of law and/or to impose a fine)	5.2	4.4	31.0	22.2	20.2	<b>3.31</b>
Considerable number of checks	2.4	27.3	37.5	16.6	16.2	<b>3.17</b>
Difficulties in protecting a SME against checks	4.0	24.0	37.2	23.2	11.6	<b>3.14</b>
Considerable expenditures of time and labor for servicing of checks	5.2	22.7	41.0	18.7	12.4	<b>3.10</b>
Low level of competence of public bodies exercising controls (i.e. insufficient knowledge of legislation, rules, and procedures, and the like)	11.9	34.5	33.3	13.9	6.3	2.68
Difficulties with accessing information about rules, norms, etc.	21.7	35.6	23.3	13.4	5.9	2.46

Note. 1 – this is not a problem; 5 – this is a very serious problem.

Source: Own calculations based on the data collected.

**Table 5.9: Groups of factors related to inspections and penalties**

Problems	Factors		
	1	2	3
Heavy fines	0.872		
Large number of checks	0.837		
Excessively heavy punishment	0.756		
Difficulties with accessing information about existing rules, norms, etc.	0.845		
Considerable expenditures of time and labor to service checks	0.663		
Fiscal orientation of checks (since the outset they are targeted to establish violation of law and/or to impose a fine)	0.644		
Low level of competence of public bodies exercising controls (i.e. insufficient knowledge of legislation, rules, and procedures, and the like)	0.813		
Difficulties with defending SME against the power of inspectors	0.776		

Note. Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; the number of factors is defined following Kettel's method. Factors explain 77.5% of the observed variance. The table displays factors with a value above 0.5.

Source: Own calculations based on the data collected.

**Box 4: Some opinions expressed by the participants of the focus-groups about inspections and penalties**

Possibly, there are fewer checks made these days. However, fines get heavier.

Numerous inspectors come only for 'finding something wrong'. Checks are made not for the sake of checking, but for the sake of fining.

[They] come knowing in advance how much and where to extract [money].

Some very minor changes are leveled by regular changes and amendments very poorly understood by everyone. Continuous changes in legislation and the army of 'inspectors' destroy confidence in the future and undermine long-term planning and development.

This [tax] legislation could not be respected.

Inspectors have some 'tricks' (that reflect recent changes in legislation) prepared in advance. They use these tricks to find violations and to impose fines with certainty.

The existing legislation and the power of authorities performing checks on small business can not survive. Good lawyers and accountants cost a lot. SMEs could not afford them.

'You should know that!': this is a typical answer of inspectors.

and 7 times (fire safety inspection, militia, KGB).

Our study records that almost a half of inspections ends with a fine (40% on average). At the same time, inspectors detected no violations among 16% of firms in the sample. However, fines had been charged in

the 50% of cases among the 70% of enterprises checked by tax inspectors. Finally, 20 enterprises (8.4% of the total number) had been fined at every check made by inspectors. Most often, fines have been used by tax inspections, fire safety and sanitary inspections (these bodies have also been making inspections

most frequently). The most 'efficient' checks (in the sense of share of checks resulted in fines) have been run by the Ministries, administrative departments, state concerns, environmental safety inspections, fire safety and tax inspections (excluding customs that checked enterprises included in the sample once and fined them) (table 5.10).

**Table 5.10: Answers to the question: 'How many times was your company checked in 2006 and how often were fines charged?'**

Public body making check	Total number of checks	Number of checks per company	Number of checks that resulted in fine	Percentage of checks that resulted in fine
Tax inspection	490	1.97	0.97	45.6
Fire safety inspection	323	1.30	0.67	49.8
Sanitary inspection	306	1.23	0.40	32.3
Local authorities	119	0.48	0.12	19.8
Environmental safety inspection	108	0.43	0.22	52.8
Licensing authority	98	0.39	0.18	40.3
Price controls bodies	94	0.38	0.14	34.9
Militia	92	0.37	0.06	10.9
The Committee for State Controls	84	0.34	0.08	26.3
(Product) Standards Controls	73	0.29	0.14	43.0
Consumer Protection Bodies	59	0.24	0.10	40.0
Office of Prosecutor	27	0.11	0.04	25.6
State Security Services	25	0.10	0.03	25.6
Ministries, Public Departments, and State Concerns	17	0.07	0.04	61.5
Customs	1	0.00	0.00	100.0
Total	1191	7.74	3.20	40.0

Source: Own calculations based on the data collected.

**Table 5.11: Areas in which entrepreneurs perceive unequal conditions of doing business as compared with the public sector (per cent of those who have chosen either answer)**

	%
Taxation (the absence/provision of preferences)	55.8
The attitude of public authorities exercising controls	47.5
Prohibitions for private sectors to conduct certain types of economic activity	35.8
Rental fees	35.0
Prices for raw materials	34.2
Terms and conditions of obtaining permits/licenses	31.7
Access to loans	30.8
Access to public procurement tenders	28.3
The attitude of local authorities	26.7
Public procurement	18.3
Mechanisms of price-setting (i.e. the possibility to increase prices)	15.8
The attitude of judicial authorities	11.7
Other	2.5

Note. 50% of entrepreneurs perceive unequal conditions of conducting business between private and public sector

Source: Own calculations based on the data collected.

#### 5.1.5. Administrative intervention

In this publication, administrative intervention is interpreted as activities not provided for by the existing legislation but nevertheless performed by the public authorities at various levels of hierarchy in a discretionary fashion and directed against entrepreneurs.

There is both direct and indirect administrative intervention. The indirect one is principally manifested in the establishment and maintenance of unequal conditions of conducting business between enterprises of private and public sectors. This type of administrative intervention is experienced by half of polled entrepreneurs.

Unequal conditions are observed in virtually all spheres and areas of business activity. Nevertheless, taxation and the attitude of inspection authorities are most problematic from the point of view of SMEs' executives. As for checks, a 'biased' attitude of control agencies towards private companies and a subsequent grievance felt by entrepreneurs are both apparent and explainable. Apart from that, entrepreneurs are also facing more than 10 manifestations of inequality between the private and public sector. Specifically, there are prohibitions to conducting certain business activities, differential rental fees and prices for raw materials, unequal access to loans and public procurement tenders, and so on (table 5.11).

Direct intervention of the authorities is also widespread. This type of intervention is about direct administrative interference of public bodies into activity of small and medium-sized enterprises. This in-

terference is experienced by 40% of polled entrepreneurs. In practice, it takes on the form of direct regulation, command, and instruction to enterprises, or, alternatively, more or less formal requests and recommendations that have to be fulfilled by entrepreneurs 'voluntarily' (but 'forcedly' in practice). Most often, two sorts of direct administrative intervention are observed. These could be labeled as 'gavel work' (i.e. compulsion to carry out certain 'social' obligations not provided for by existing legislation, including landscaping, land improvement, patronage of collective farms, etc.) and 'rent-in-kind' (paid as enterprises are forced to spend their funds for social needs, charity, subscription to state-owned newspapers and magazines, etc.). On top of that, there are at least eight types of administrative intervention, including the demands to reduce or increase prices, refusal to provide office space and working facilities, instruction to produce output at certain specified rates (table 5.12).

Despite the fact that only 40% of respondents reported about cases of administrative intervention, in reality it seems to be much more widespread. This is because the questions asked (like about the size of the 'grey' sector, corruption, etc.) pose a certain threat to the respondents. Even the most rigorous and honest assurance of the anonymous nature of the study are not convincing to private sector companies. Apparently, administrative intervention is 'inferior' to other barriers of regulatory framework in terms of their importance. Nevertheless, its relatively small and 'innocuous' character (in contrast to a 'damage' produced by taxation or a system of provision of permits and licenses, excessive paperwork, etc.) does not imply that the reduction or liquidation of these unlawful practices would not foster the development of entrepreneurship in the country and increase the degree of trust to the business climate in the country (especially by foreign partners and potential investors alike).

## 5.2. The impact of the regulatory environment on SMEs' activity and the modes of their adjustment

In the previous section it has been shown that small and medium-sized private business of Belarus is confronted with numerous barriers touching upon nearly all crucial spheres of economic activity. In many respects, entrepreneurs see themselves in a 'state of siege', being forced to fight permanently with an unfavorable external environment.

This state of affairs imposes constraints on the activity of enterprises in one or another way. Our survey records that it is only four entrepreneurs (1.6% of the sample) who said that regulatory barriers are not

meaningful to them. The vast majority mentioned that there are considerable losses of time and labor, limited opportunities to increase output, substantial increase of financial costs, and so on (table 5.13).

The analysis of information in the table 5.13 shows that substantial material and non-material costs as well as barriers to enterprise development are the principal negative repercussions of an unfavorable and overregulated business environment. At the same time, the answers of entrepreneurs vary depending on the company size, its 'age' and market specialization. This means that various enterprises are confronted with different adverse consequences due to existing regulatory barriers.

**Table 5.12: Different types of administrative intervention into SMEs' activity (per cent of those who have chosen either answer)**

	%
The need to carry out certain obligations (land development, landscaping, patronage of collective farms, and so on)	52.2
Requisitions of various stripe (the need to sacrifice funds for social needs, charity, subscription to state-owned newspapers and magazines, and so on)	48.9
Requirement to decrease/increase prices	33.7
Refusal to provide office space and working facilities	32.6
Instruction to produce output at certain specified rates	20.7
Provision of certain preferences for disabled persons, veterans, and so on besides those established by existing legislation	13.0
Instruction to render services to the population in certain specified volumes	10.9
The need to increase wages (instruction to increase wages at certain specified rates)	9.9
The use of wage grid for setting up wage rates	8.7
The need to set up a primary trade union organization	5.4
Other	3.2

*Note.* 40% of entrepreneurs experienced administrative intervention.

*Source:* Own calculations based on the data collected.

**Table 5.13: The impact of barriers to conducting business on enterprise's activity (per cent of those who marked either type of impact)**

	%
Leads to considerable losses of labor and time	46.5
Does not allow to increase output of goods/services	41.2
Leads to substantial increase of financial costs	37.4
Restricts adoption of innovative methods (new technologies, modes of work, and the like)	27.6
Forces to close business down	23.0
Leads to changing the type of business activity (the one with lesser barriers)	22.6
Deteriorates competitiveness of Belarusian companies as compared to goods/services produced by foreign companies (on the domestic market)	13.6
Deteriorates external competitiveness of Belarusian companies	10.3
No impact	1.6

*Source:* Own calculations based on the data collected.

**Table 5.14: General perception of the strength of barriers to conducting business and estimate and forecast of enterprise's performance**

Answers of the respondents	Strength of the barriers
'What are the changes in economic position of your enterprise over the last two years?'	
Deteriorated considerably	3.46
Deteriorated slightly	3.23
No change	2.89
Improved slightly	2.69
Improved considerably	2.72
'What is your forecast about economic position of your enterprise in 2007?'	
Some deterioration	3.17
No change	2.92
Some improvement	2.84
Considerable improvement	2.57

Note. 1 – this is not a problem; 5 – this is a very serious problem.

Source: Own calculations based on the data collected.

**Table 5.15: Answers to the question: 'To what extent are the enterprise's modes of behavior typical for companies of your branch/field of activity?', (%)**

Activities of enterprises	Never	Sometimes	Often
Seek no argument, but fulfill all the requirements in full	23.0	53.8	23.7
Lodge complaints to higher echelons of authority	29.3	64.8	5.9
File actions	20.8	70.4	8.8
Attempt to avoid fulfillment of some requirements	25.1	61.0	13.9
Try to 'come to terms with' [the authorities] (right up to bribing in either way)	22.6	61.1	16.3
Relocate their activity to other countries	42.4	49.2	12.4
Shift part of their activity to the 'shadow' sector	43.8	49.8	6.4
Try to unite to protect their interests collectively	30.3	53.4	16.3
Share information with each other	25.0	45.6	29.4

Source: own calculations based on the data collected.

**Table 5.16: Groups of factors related to actions of enterprises**

Actions of enterprises	Factors			
	1	2	3	4
Attempt to 'come to terms with' (up to bribing in either form)	0.747			
Shift part of their activity to the 'shadow' sector	0.698			
Attempt to avoid fulfillment of some requirements	0.660			
Relocate their activity abroad	0.611			
Share information with each other		0.855		
Attempt to unite in order to protect their interests collectively		0.788		
File actions			0.840	
Lodge complaints to higher echelons of authority			0.823	
Seek no argument, but fulfill all the requirements in full				0.911

Note. Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; the number of factors is defined following Kettel's method. Factors explain 77.5% of the observed variance. The table displays factors with a value above 0.5.

Source: Own calculations based on the data collected.

The hypothesis of the considerable adverse impact of legal and administrative barriers on the functioning and development of private enterprise is confirmed by a statistically significant correlation between the perception of the overall strength of the regulatory burden (measured as a normal average of complexity estimates of various areas of SME regulation) and estimates and forecasts of the dynamics of enterprise performance. For instance, more negative estimates of economic performance over the last two years and less optimistic (more optimistic) forecasts for 2007 are compatible with a more critical perception of the regulatory burden by entrepreneurs (table 5.14).

The majority of entrepreneurs are not passive when confronted with the barriers and indeed try to overcome them by using various formal and informal modes of behavior. It should be mentioned, however, that there has been no such question as to what sort of informal 'modes of adjustment' are being used by the entrepreneurs. This issue appears to be too delicate to ask openly. Instead, the question has been formulated in the following way: 'To what extent are the enterprise's [informal] modes of behavior typical for companies of your branch/sphere of activity?' Accordingly, the answers collected should not be interpreted as a statistical reflection of the actual state of affairs, but as reference information about the ways and methods of counteraction to existing barriers (table 5.15).

Only three respondents hold that enterprises of their sphere of activity take no steps to counteract the existing barriers and impediments to conducting business. The most frequent reactions are information sharing and attempts to fulfill legal and administrative requirements in full, while the least frequent ones are relocation of business abroad or to the 'shadows'.

The factor analysis allows us to reveal four types of reactions (modes of behavior) of Belarusian entre-

preneurs to existing barriers (table 5.16):

1. *Evasion*: enterprises are trying to find 'alternative routes' and to use some – perfectly legal and not perfectly legal – methods to avoid fulfillment of existing norms and instructions, payment of taxes or fines, and so on, right up to relocation of business abroad or into the 'shadows';
2. *Mutual assistance*: enterprises attempt to help each other in searching for the necessary information about laws, rules, and instructions and also try to unite in order to protect their interests collectively;
3. *Struggle*: this includes active forms of counteraction, such as commercial disputes and complaints to the higher echelons of authority, filing actions, and so on;
4. *Conformity*: attempt to fulfill all the requirements imposed 'from above' in full, with an extreme degree of precision.

Notably, these four types of reactions very often replicate the character of generalized business strategies adopted by companies of all branches or sectors. In other words, enterprises choose a single model as the principal way of reacting to the existing regulatory environment from the set described above, including evasion, mutual assistance, struggle, and conformity. At the same time, a mixture of elements is rare. This is confirmed by the results of the cluster analysis. This reveals the existence of four distinct models of behavior as well as a positive correlation among the answers to the questions about the possible reactions to existing barriers.

To begin with, for the first cluster of Belarusian SMEs struggle of enterprises with the barriers of regulatory environment is the most typical behavior. Enterprises are often struggling alone, in a severe way (there is a negative correlation with such models of behavior as mutual

**Table 5.17: The results of cluster analysis of the groups of factors related to activities of enterprises (the final cluster centers)**

Factors	Clusters			
	1	2	3	4
Evasion	0.06560	-0.50144	<b>1.32575</b>	-0.49816
Mutual assistance	-0.28495	<b>0.57718</b>	-0.26917	-0.07792
Struggle	<b>0.83031</b>	-0.59848	-0.35909	-0.21955
Conformity	-0.39021	-0.75745	0.12078	<b>1.40514</b>

*Note.* The cluster analysis completed was made by using the k-average method.  
*Source:* Own calculations based on the data collected.

assistance and conformity). Mutual assistance is typical for the second cluster. This implies that enterprises mutually support each other (there is a negative correlation with other possible types of behavior). As for the third cluster, there is evasion from the most odious 'rules of the game' or those that could not be realistically respected (the results of factors such as struggle and mutually assistance are negative, given the low statistical significance of the coefficient in the conformity model). Finally, the fourth group of firms is behaving in the following way. When confronted with the barriers to conduct entrepreneurial activity, firms choose conformity and fulfillment of all existing requirements (the results of other possible types of behavior are negative) (table 5.17).

As mentioned above, the dominance of either mode of behavior is hard to determine statistically with a high degree of precision. What could be done is to construct some vision of what strategies are relatively more widespread, and vice versa. It could be said that the four strategies described above are observed relatively frequently. Of them, struggle was the most frequent (34% of all SMEs that took part in the research displayed it), while mutual assistance was used by approximately 27% of firms, conformity – by about 22%, and, finally evasion – by 17%.

There are also 'inter-group' interactions whose existence has been detected following the results of the correlation analysis (specifically, Spearman rank correlation coefficients have been calculated) of the

respondents' answers to questions about their possible mode of behavior (answers are provided in tables 3.3 and 3.4). It has to be mentioned that enterprises that use the conformity strategy are also trying to 'reach an agreement about' certain issues with various control and permit-issuing agencies. In addition, the correlation coefficients show that there is some interrelation between mutual assistance and evasion strategies on the one hand, and mutual assistance and struggle strategies on the other. In other words, enterprises that 'weave' some web of mutual assistance are also seeking to use it for both more passive (assistance in evasion from certain barriers) and more active forms of resistance (such as assistance in the struggle with barriers).

As such, the use of strategies of behavior is itself evidence of an unfavorable business environment as well as of the existence of continuous contractions and conflicts between entrepreneurs and administrative bodies. On the one hand, there are few entrepreneurs ready and capable to 'play the game' to fully comply with official rules. The participants of the focus-groups have persistently stressed that if there were clear, well-defined, stable, feasible and legitimate rules, they would be happy to respect all of them. On the other hand, an overregulated, and, by its nature, an 'anti-entrepreneurial' business environment fosters the formation of distorted modes of behavior of entrepreneurs as observed from the standpoint of public bodies and the basic principles of a market economy. Distortions include evasion, escape to the 'shadows', refusal 'to obey the

**Table 5.18: The results of the Pearson correlation analysis of interaction between inspections and modes of behavior**

Inspections	Factors			
	Evasion	Mutual assistance	Struggle	Conformity
Total number of inspections	-0.159 <sup>a</sup>	0.229 <sup>b</sup>	0.043	-0.093
The number of inspections resulting in the imposition of fines	-0.247 <sup>b</sup>	0.037	-0.072	-0.183 <sup>b</sup>
Percentage of inspections resulting in the imposition of fines	-0.129 <sup>a</sup>	-0.257 <sup>b</sup>	-0.156 <sup>a</sup>	-0.149 <sup>a</sup>

Note. <sup>a</sup> Significance level is no less than 0.05; <sup>b</sup> Significance level is no less than 0.01.  
Source: Own calculations based on the data collected.

rules', perception of public bodies as a hostile force, narrowing of horizons of business planning, shift of business activity to the neighboring countries or its premature end, and so on. The distorted and unconstructive modes of reaction to the business environment are manifested in the overall absence of a comprehensive approach to the choice of a general strategy of behavior. Belarusian SMEs display no interpenetration and combination of the modes of behavior accepted, while the latter are not mutually exclusive in the vast majority of situations.

Each of the models contains certain prospects of success and a degree of efficiency allowing decreasing the overall burden imposed by regulations. This can be illustrated by the interrelationship of the models of behaviors and inspections and fines that companies are subjected to. As the data in the table 5.18 shows, the modes allow to reduce the number of inspections resulting in the imposition of fines, but the only strategy that allows to reduce the overall number of inspections is evasion (this is observed from a statistically significant negative value of the correlation coefficient). The evidence is hardly surprising. In case a company relocates its activity abroad or in the 'shadows', it turns to be out of reach by inspectors. As it is often said: 'no papers – no basis for inspection and imposition of fines'.

It is notable that the total number of inspections is strongly and positively correlated with the mutual assistance strategy. It could be suggested that an excessively large number of inspections (whose number exceeds

the average figure for the SME sector) fosters enterprises to cooperate with each other. This is because other models are about struggle with the unfavorable environment alone. This appears to be a deficient strategy for enterprises exposed to inspections and fines much more strongly than their counterparts.

### 5.3. Differentiation of regulatory burden and the models of behavior

The analysis made above has shown that all companies suffer in either way from numerous administrative and legal barriers hindering enterprise development. However, it could be suggested that assessment of the character of and the levels at which these barriers exist vary across enterprises depending, specifically, on their size, their year of establishment, and branch specialization.

Indeed, our analysis has confirmed the existence of differences in the manifestation of barriers and their perception by entrepreneurs. However, the magnitude and significance of these differences are not particularly high. Many of the differences detected could be easily explained. In particular, they are related to the character of enterprises' activity influenced, above all, by their branch specialization. It is clear that sanitary inspection bodies would exercise control over trading companies or public catering ones rather than over building companies. Also, the significance of such barriers as, for instance, pricing regulation or permit issuance would differ across various branches of the economy. It

has to be taken into consideration that the characteristics of all enterprises are to some extent interrelated. In particular, the size of enterprises is often connected with the branch it is operating in and the year it has been established. The largest private companies exist in construction and industry, while the smallest ones operate in the domestic services sector and public catering. As a rule, more mature firms tend to be larger than their less mature counterparts. It is important to note that the relatively small number of enterprises surveyed (250 in total) does not allow to adequately research branch differences. So it is only some general trends could be detected relatively sufficiently.

In general, smaller firms tend to perceive the domestic regulatory environment more positively than larger ones. The same observation is recorded for less mature companies, but also for more mature ones, although the statistical correlation is much weaker here. As for branch specificities, building companies are most aware of existing deficiencies, while domestic services companies display the lowest degree of awareness (table 5.19). This variation could be explained in a number of ways. First, given the above-described interrelationship among characteristics of companies, it is hard to identify with precision which of the three characteristics such as size, age and branch, is most determining. It can only be maintained that, following the SMEs' executives point of view, the business environment of Belarus is the least friendly for the largest, most mature companies carrying outside construction. In a similar fashion, managers of small, immature firms providing domestic services perceive the business environment as least unfriendly (though in both cases these characteristics are not necessarily intersecting).

The 'age' differentiation in estimating the burdens of the regulatory environment could be additionally explained in the following way. 'Young' firms have not yet been confronted with all of the barriers that their more mature counterparts have already been persistently facing. However,



an opposite explanation is also very likely. Recently, founders of companies are much better acquainted with the possibilities that the business environment offers. Accordingly, they are less subjected to adverse influences emanating from the external environment (it happens in a variety of ways, including, for instance, operation in a less 'troublesome' field of business activity). Alternatively, new companies are ready to solve the issues described above by 'arming' themselves with 'umbrellas' of numerous accountants and lawyers and trying to improve management, marketing, and other domestic factors of competitiveness. At the same time, bigger companies (employing more than 50 workers) run large businesses that require necessarily carrying out considerable paperwork, certificates, permits, etc. Also, such companies are of greater potential interest for fiscal bodies. Accordingly, these bigger firms tend to estimate the burdens of the regulatory environment as relatively heavier than their smaller counterparts.

There are also certain differences in choosing a certain type of behavior. The choice depends on the size of the company, its age and branch specialization (table 5.20). In particular, conformity or struggle is chosen by relatively more 'mature' companies. Further, the younger the firm, the less frequently conformity is observed and more frequently evasion and mutual assistance are practiced. However, in the least mature firms, the ones established after 2003, opportunistic behavior, i.e. refusal to struggle and inclination to respect all the rules and requirements are the dominant modes of behavior. At the same time, small companies more frequently opt for evasion and less frequently – for mutual assistance. In contrast, the largest firms tend to choose struggle, while evasion is the least frequent strategy utilized by them. The branch specialization does not provide additional insight since differences are rather weak. In other words, there are no industry-specific pronounced strategies of behavior. Still, companies providing domestic services

**Table 5.19: General perception of the magnitude of barriers to business activity**

Groups of companies	Average	Minimum	Maximum	Standard deviation
<b>Year of establishment:</b>				
Prior to 1996	<b>3.0</b>	1.4	4.6	0.8
Between 1996 and 2000	2.9	1.3	4.6	0.8
After 2000	2.8	1.0	4.6	0.8
including:between 2001 and 2003	2.8	1.0	4.6	0.7
after 2003	2.7	1.0	4.3	0.8
<b>Field of operation:</b>				
Trade and catering	2.9	1.3	4.6	0.8
Domestic services	2.6	1.3	4.1	0.8
Industry – production	2.9	1.4	4.3	0.7
Construction	<b>3.0</b>	1.3	4.6	0.8
Transport and communication	2.8	1.0	4.2	0.8
Other services	2.7	1.0	4.4	0.8
<b>Number of employees:</b>				
Less than 10	2.7	1.3	4.4	0.8
11-50	2.9	1.0	4.6	0.8
Above 50	<b>3.1</b>	1.8	4.6	0.8

Note. 1 – no barriers to 5 – all factors are the barriers  
 Source: Own calculations based on the data collected.

**Table 5.20: Groups of factors related to activity of companies**

Groups of companies	Evasion	Mutual assistance	Struggle	Conformity
<b>Year of establishment:</b>				
Prior to 1996	<b>-0.16</b>	-0.01	0.13	<b>0.20</b>
Between 1996 and 2000	-0.03	-0.11	-0.01	-0.04
After 2000	0.12	0.12	-0.09	-0.13
including:between 2001 and 2003	<b>0.15</b>	<b>0.17</b>	0.00	<b>-0.30</b>
after 2003	0.04	0.00	<b>-0.31</b>	<b>0.28</b>
<b>Field of operation:</b>				
Trade and catering	0.02	-0.08	<b>0.18</b>	-0.07
Domestic services	<b>-0.24</b>	<b>0.38</b>	-0.02	<b>0.21</b>
Industry – production	0.08	-0.09	-0.14	-0.04
Construction	-0.18	0.11	<b>-0.21</b>	-0.01
Transport and communication	<b>0.20</b>	<b>0.28</b>	0.00	-0.05
Other services	-0.02	-0.14	-0.09	0.05
<b>Number of employees:</b>				
Less than 10	<b>0.21</b>	<b>-0.22</b>	-0.08	0.12
11-50	0.00	0.06	-0.05	-0.03
Above 50	<b>-0.21</b>	0.04	<b>0.32</b>	-0.06

Note. The table displays average values of factor scores (calculated by using the regression equation). Values have been obtained by using factor analysis of answers to the question about the most typical activities of enterprises confronted with barriers to enterprise development. The highest and the lowest values are in bold (their absolute value/module is above or equal to 0.15).  
 Source: Own calculations based on the data collected.

often choose mutual assistance or conformity, while those operating in transport and communication adopt either mutual assistance or evasion.

Therefore, the reasons for choosing an adjustment model to the barriers imposed by the external environment are not straightforward. It seems that this choice has a multifaceted nature

(as it has been shown above, all four strategies are potentially effective). However, it depends, first of all, on the market share occupied by a company, the style of its management, the opportunities to use internal factors of competitiveness, relations with administrative agencies, the intensity of competition and possibilities to interact with competitors.

## 6. CONSEQUENCES OF EXCESSIVE REGULATION OF SME ACTIVITY

### 6.1. Corruption

Despite the official data on improving the situation with corruption in Belarus, international sources provide information leading to an opposite conclusion. According to Transparency International, famous for its estimates of corruption world-wide, the situation with corruption in Belarus has worsened over the last several years. In 2002, Belarus was ranked 36<sup>th</sup> by the corruption perception index, while in 2005 it occupied the 107<sup>th</sup> place, and in 2006 even slid to the 151<sup>st</sup> place. The experts of Transparency International estimated the level of corruption in Belarus on the basis of four studies. This downfall is particularly acute in contrast to a more or less stable or even improving situation in neighboring countries (Figure 6.2). Russia moved to the 121<sup>st</sup> place from 126, and Ukraine – to 99 from 107. The current position of Belarus (151<sup>st</sup>) is accompanied by CIS countries such as Tajikistan, Uzbekistan, and Kyrgyzstan. The bottom of the list is occupied by states such as Haiti, Burma, Iraq, Guinea, and Sudan.

President Lukashenko has adopted a special State Program on Tackling Corruption over the period of 2007–2010 by adopting Edict No. 220 on May 7, 2006. In general, the new program addresses the same range of issues as the previous one: to decrease the number of corruption crimes, increase the efficiency of legal instruments for fighting corruption, strengthen public prosecutor's supervision and state controls over the appropriate implementation of anticorruption measures, and create efficient mechanisms of corruption prevention.

However, it is very unlikely that the new program would alter the situa-

**Table 6.1: Answers to the question: 'How often executives of private companies are forced to bribe (in any way) administrative agents?' (%)**

	% of the respondents		
	2002	2005	2007
Infrequently	40.7	57.0	45.4
Permanently	39.4	20.3	22.7
No such phenomenon exists	18.5	18.8	28.8
Refuse to answer	1.4	4.0	3.2
Total	100.0	100.0	100.0

Source: IPM Research Center.

**Table 6.2: Answers to the question: 'How often executives of private companies are forced to bribe (in either way) administrative agents?' (%)**

	No such phenomenon exists	Infrequently	Permanently
Field of activity			
Trade	30.3	46.1	20.0
Catering	21.7	52.2	26.1
Domestic services	24.4	51.2	14.6
Industrial production	39.2	33.8	27.0
Construction	23.9	50.0	21.7
Transport and communication	31.8	45.5	22.7
Consultancy	0.0	100.0	0.0
Education	25.0	25.0	50.0
IT services	18.2	36.4	45.5
Other	13.6	54.5	27.3
The number of employees			
From 1 to 10	38.3	41.4	20.3
From 11 to 50	23.5	52.0	24.6
From 51 to 100	31.1	45.9	23.0
From 101 to 200	31.6	42.1	26.3
Above 200	0.0	40.0	60.0
Region			
Minsk	26.1	51.3	22.6
Minsk region	30.0	32.5	37.5
Brest and Brest region	32.1	46.4	21.4
Grodno and Grodno region	36.7	56.7	6.6
Vitebsk and Vitebsk region	35.0	27.5	37.5
Gomel and Gomel region	17.6	55.9	26.5
Mogilev and Mogilev region	53.9	42.3	3.8
Year of establishment			
Prior to 1996	23.7	45.4	25.8
1997–2004	28.7	46.4	22.6
2005 and later	38.5	40.4	17.3

Source: IPM Research Center.

tion with corruption in Belarus unless the government would fundamentally simplify and liberalize 'the rules of the market game'. Moreover, as the

experience of Russia and Ukraine suggests, excessive legal regulation when combined with a limited opening of the economy, partial privatiza-

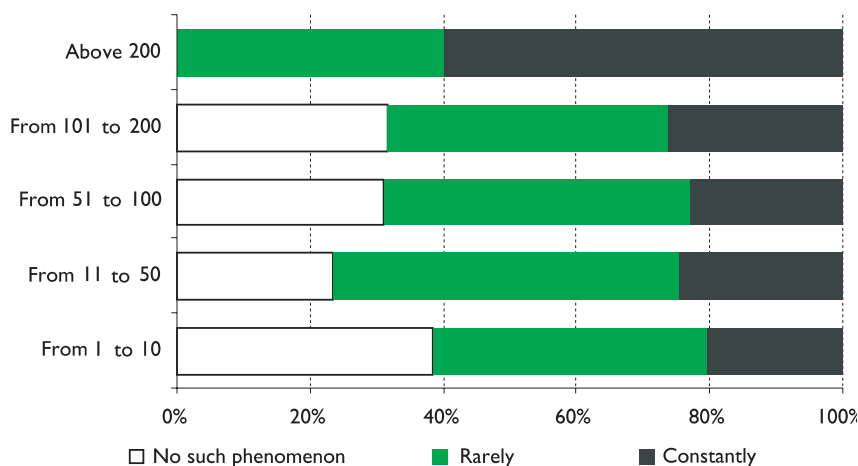
tion and the stimulation of foreign investment might deteriorate the situation with corruption. Importantly, as the experience of other countries suggests, not a single country tackled corruption exclusively by means of punitive justice and draconian sanctions. Competition, openness, transparency, publicity, simplicity and accessibility are the major tools for fighting with corruption.

**Bribes:** According to the results of the survey of Belarusian SMEs conducted by the IPM Research Center<sup>17</sup>, a considerable share of the respondents bribes either permanently or from time to time various administrative agents (tables 6.1 and 6.2). This share – about 70%<sup>18</sup> – remained unchanged over a number of years, despite the implementation of anticorruption measures. This indirectly confirms the conclusions made by the Transparency International about the high level of corruption in the Belarusian administrative bodies.

The number of bribes depends on the size of the company (Figure 6.1). Large firms do not conceal that 60% of them bribe on a continuous basis, while 38% of small companies claim that there is no such phenomenon as bribery in the field of business they operate in. Probably, this can be partially explained by the possibility that there is no one to bribe (since special connections and acquaintanceship are needed for that purpose) or that there is no reason to do so (since turnover of a firm is too small to risk with bribing).

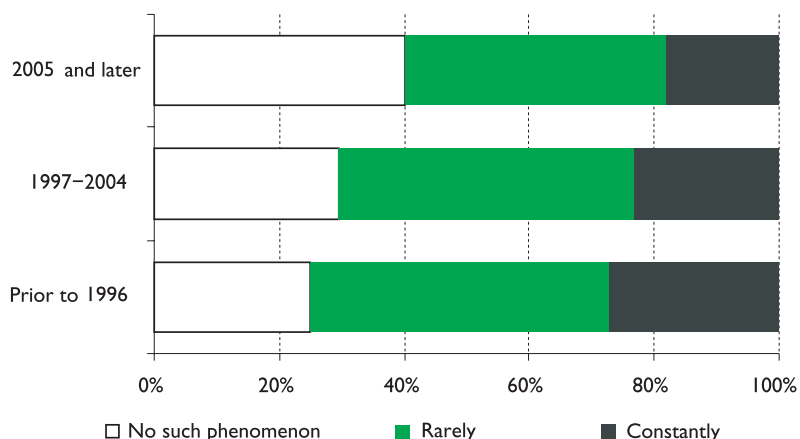
This conclusion is confirmed by looking at a company's age. In particular, 40% of companies established after 2005 claimed that there is no such

**Figure 6.1: The relation between the size of the company and frequency of bribing**



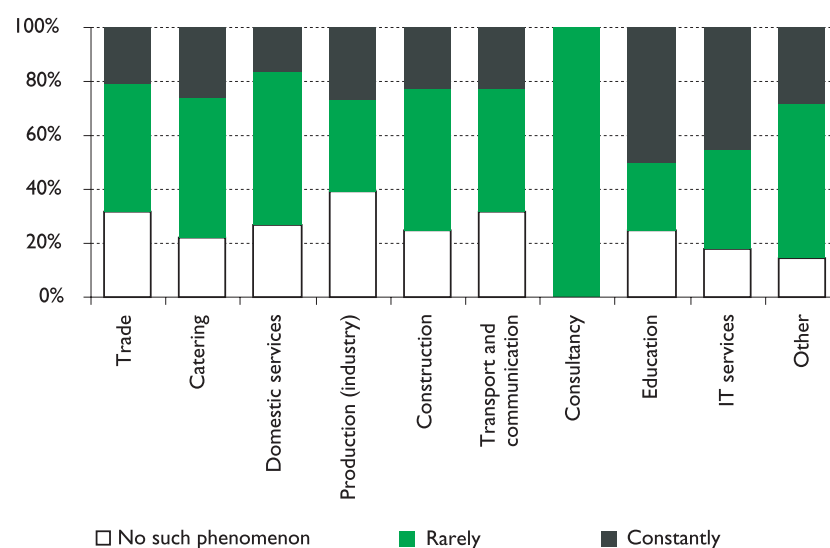
Source: IPM Research Center.

**Figure 6.2: The relation between the year of establishment and the frequency of bribing**



Source: IPM Research Center.

**Figure 6.3: The relation between the field of business and the frequency of bribing**



Source: IPM Research Center.

<sup>17</sup> The survey has been conducted by the 'Novak' laboratory on the request of the IPM Research Center. Both owners and top managers of 410 SMEs (a representative sample) were polled. Representative error is 3%.

<sup>18</sup> The actual data might be well above the ones provided here. This is because some respondents do not believe in the anonymity of the survey and do not trust interviewers. As a result, these respondents choose such options as 'refuse to answer' or 'no such phenomenon exists'.

phenomenon as bribery in the field of business they operate in. At the same time, it is only 25% of 'old-timers' (created prior to 1996) (Figure 6.2) that denoted the existence of bribery. Also, 'older' firms tend to bribe both in-

frequently (48 and 42%, respectively) and continuously (27 and 18%).

Companies operating in fields such as catering, trade, and construction tend to bribe officials most frequently

(Figure 6.3). Apparently, these sectors are most vulnerable to various checks of control agencies in contrast to industrial production or provision of non-material services (IT, legal, consultancy, and so on). Similar researches and interviews with entrepreneurs reveal that not tax inspections or state control agencies are most corrupted, but instead sanitary and fire safety inspections, and others.

In a regional perspective, the situation with corruption appears to be 'best' in the Mogilev region, given the percentage of answers 'there is no such phenomenon' and to the question about the need to bribe continuously (table 6.2). It is very likely that the experiment on simplification of permit system and liberalization of the regulatory environment for conducting business implemented by the Mogilev regional executive committee has resulted in some success<sup>19</sup>.

**Table 6.3: Answers to the question: 'How widespread do you think such a phenomenon as 'kickbacks' in return for profitable contracts is in Belarus?' (%)**

Transaction made	% of the respondents		
	2002	2005	2007
Every tenth	11.6	20.5	17.6
Every fifth	18.8	21.3	17.6
Every third	14.3	15.5	13.7
Every second	10.6	8.8	9.5
Every single	12.7	1.5	3.7
There is no such phenomenon	25.9	25.5	33.4
No answer	6.1	7.0	4.6
Total	100.0	100.0	100.0

Source: IPM Research Center.

**Table 6.4: Answers to the question: 'How widespread kickbacks in return for profitable contracts are in Belarus?' (%)**

Transaction made	There is no such phenomenon	Every tenth	Every fifth	Every third	Every second	Every single	Field of business											
							Trade	Catering	Domestic services	Industrial production	Construction	Transport and communication	Consultancy	Education	IT services	Other		
							The number of employees											
							From 1 to 10	From 11 to 50	From 51 to 100	From 101 to 200	Above 200							
												Region						
							Minsk	Minsk region	Brest	Grodno	Vitebsk	Gomel	Mogilev					
														Year of establishment				
							Prior to 1996	Between 1997 and 2004	2005 and later									

Source: IPM Research Center.

**'Kickbacks' and unofficial payments in cash:** Almost one-third of private firms (27%) grants kickbacks (i.e. provide money in return for a transaction made, an order obtained, and so on). It happens whenever the deal is made or in every second or third transaction made by a firm. Also, the number of kickbacks seems not to change over time (tables 6.3 and 6.4).

The number of kickbacks depends on the size of the company. In particular, 40% of companies employing less than 200 workers use kickbacks in every single or every second deal. In contrast, only between 12 and 15% of small firms do so (Figure 6.4). Kickbacks appear to be relatively more widespread in such sectors as transport, communication, and construction (table 6.4).

**Shadow turnover:** A tendency for slight improvement is recorded in this area (tables 6.5-6.6). The volume of shadow turnover, or deals not reported in the books of the company

<sup>19</sup> The Mogilev regional executive committee works together with the International Finance Corporation to improve the business climate in the region.

seems to be declining over a number of years (i.e. the volume of deals made in cash is declining). However, this could simply mean that firms opt for more advanced forms of tax optimization. Also, the boundaries between legal ways to minimize tax payments and shadow turnover schemes are often blurred, so the data on the volume of shadow turnover should be assessed with care.

## 6.2. Estimation of costs induced by excessive state regulation

### 6.2.1. Reporting and communication between executive and administrative agents

In terms of economic freedom, Belarus ranks among countries such as Cuba, North Korea, Turkmenistan, and Iran. The European Bank of Reconstruction and Development estimates reform progress and private sector development of Belarus as one of the worst among 27 transforming economies (Belarus is provided the last place but one, doing better than Turkmenistan only)<sup>20</sup>.

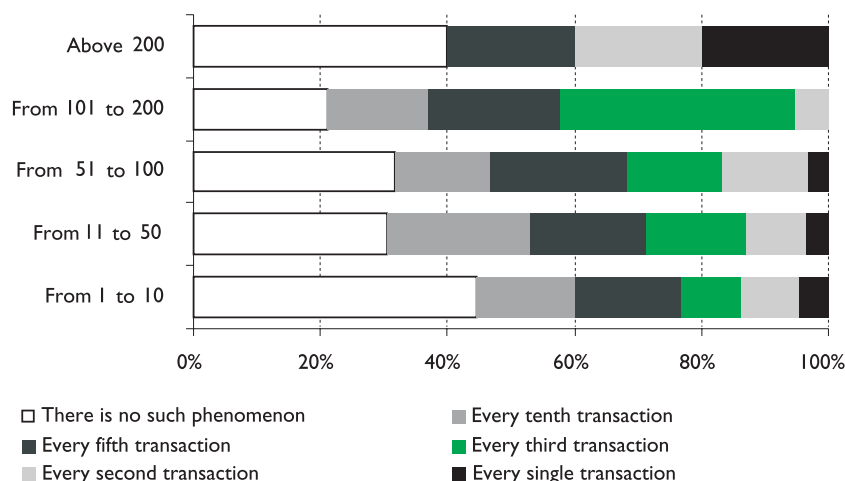
The costs of excessive state regulation are substantial. These costs imply that the number of SMEs in countries with an unfavorable business climate does not grow. As a result, countries are trapped in a vicious circle of poverty since the absence of competition and excessive regulation of the business environment lead to high prices, capital flight, brain drain and an underdeveloped financial system, lesser jobs, lower tax revenues, and so on.

The results of the research on the regulatory environment for conducting business by private SMEs in Belarus help to better perceive and estimate a range of aspects of excessive state regulation.

First, even small and medium-sized companies (sometimes employing up to 10 workers) are instructed about the 'desirable' rate of output

<sup>20</sup> See *Index of Economic Freedom* (2006), Heritage Foundation; *Freedom in the World* (2007), Fraser Institute; *Transition report* (2006), EBRD and other reports.

**Figure 6.4: The relation between the size of the company and the number of kickback-granted transactions**



Source: IPM Research Center.

growth. When instructions are not fulfilled, the executive is summoned to the City Executive Committee (or any other Executive Committee). Naturally, not a single executive of a private SME is eager to go there, since the authorities possess a range of instruments to exert pressure on private companies. The share of SMEs instructed about the output of their growth rate appears to be unchanging over a number of years (table 6.7). The need to fulfill indicators provided by the authorities should be seen as one of the factors behind high rates of economic growth in contemporary Belarus.

The survey shows that instructions are given in various fields of business, varying from 34% in the services sector (educational, consultancy, legal,

and so on) to 44% in construction. At the same time, bureaucrats tend more often to command the activity of 'older' than that of 'newer' SMEs (41% in SMEs established prior to 1996, and 38% in companies set up between 1997 and 2004, and 29% in companies created after 2005). As in previous years, there is a relation between instructions and the size of the company (table 6.8).

A vast number of forms to fill in, indicators to report and submit to public bodies are big problems for private (and even state-owned) companies. Virtually every single entrepreneur denotes that every year there are more and more papers and forms to deal with despite the nearly universal computerization and the spread of Internet use.

**Table 6.5: Answers to the question: 'What is the share of shadow turnover (unreported deals) in the total turnover of private companies?' (%)**

	% of the respondents			
	2000	2002	2005	2007
Up to 10%	14.4	17.5	25.0	23.2
10–25%	28.5	19.0	26.5	19.3
26–50%	16.8	3.4	15.0	13.2
51–75%	18.2	3.4	3.8	6.1
Above 75%	–	3.2	1.3	1.5
No answer	15.1	36.0	7.0	3.4
There is no such phenomenon	6.9	17.5	21.5	33.4
Total	100.0	100.0	100.0	100.0

Source: IPM Research Center.

Our research indicates that a typical SME uses on average 3.14 employees to prepare the necessary reports to administrative bodies. The 'older'

the company, the larger the number of reports to submit (very likely, this is related to size, i.e. larger number and different types of activity). Spe-

cifically, an average of 3.56 employees deal with preparing reports in companies established prior to 1996, while this figure drops to 3.11 in companies set up between 1997 and 2004, and to 2.56 in firms created in 2005 or later.

**Table 6.6: Answers to the question: 'What is the share of shadow turnover (unreported deals) in the total turnover of private companies?' (%)**

	There is no such phenomenon	Up to 10%	10–25%	26–50%	51–75%	Above 75%
Field of business						
Trade	37.3	24.1	16.5	13.9	6.3	1.9
Catering	26.1	30.4	21.7	13.0	8.7	–
Domestic services	28.2	28.2	25.6	12.8	–	5.1
Industrial production	45.8	13.9	19.4	6.9	12.5	1.4
Construction	29.5	29.5	18.2	18.2	4.5	0.0
Transport and communication	38.1	19.0	28.6	9.5	4.8	0.0
Consultancy	0.0	50.0	50.0	0.0	0.0	0.0
Education	50.0	0.0	25.0	25.0	0.0	0.0
IT services	0.0	36.4	27.3	36.4	0.0	0.0
Other	22.7	31.8	22.7	18.2	4.5	0.0
The number of employees						
From 1 to 10	42.6	19.4	17.1	12.4	6.2	2.3
From 11 to 50	31.5	26.0	21.0	13.8	6.6	1.1
From 51 to 100	30.6	27.4	22.6	14.5	4.8	0.0
From 101 to 200	26.3	26.3	26.3	15.8	0.0	5.3
Above 200	20.0	20.0	0.0	20.0	40.0	0.0
Region						
Minsk	29.3	30.8	21.2	14.1	3.5	1.0
Minsk region	39.0	19.5	22.0	14.6	4.9	0.0
Brest	51.9	11.1	14.8	18.5	3.7	0.0
Grodno	24.2	30.3	12.1	18.2	12.1	3.0
Vitebsk	45.0	7.5	5.0	10.0	25.0	7.5
Gomel	26.5	17.6	41.2	11.8	2.9	0.0
Mogilev	60.9	17.4	17.4	4.3	0.0	0.0
Year of establishment						
Prior to 1996	39.1	26.1	15.2	15.2	3.3	1.1
Between 1997 and 2004	30.9	23.8	22.3	12.9	8.2	2.0
2005 and later	45.8	20.8	16.7	14.6	2.1	0.0

Source: IPM Research Center.

**Table 6.7: Answers to the question: 'Is your company instructed about the rate of output growth by the authorities?' (%)**

	2002	2005	2007
Yes	20.0	40.0	38.0
No	80.0	56.0	61.0
No answer	–	4.0	1.0
Total	100.0	100.0	100.0

Source: IPM Research Center.

**Table 6.8: Answers to the question: 'Is your company instructed about the rate of output growth by the authorities?' (%)**

	From 1 to 10	From 11 to 50	From 51 to 100	From 101 to 200	Above 200
Yes	26.1	37.7	48.4	80.0	60.0
No	73.9	62.3	51.6	20.0	40.0
Total	100.0	100.0	100.0	100.0	100.0

Source: IPM Research Center.

On average, an executive of a typical SME spends 9.27 hours per week (i.e. more than one working day) to communicate with administrative agents. In contrast to reporting, the opposite relationship is observed between the age of a company and the scope of its communication. The 'younger' the company, the more its executive communicates with bureaucrats. The executives of companies operating in construction, transport and communication exceed all other sectors in terms of time spent on communication with bureaucrats (between 11 and 14 hours per week). At the same time, the reporting of these companies are most labor intensive (4.6 employees are involved in its preparation at one SME).

Having all these numbers collected, it is possible to calculate the costs of excessive regulation. Let us assume that the wage of a mid-level employee dealing with reporting is USD 300 per month. Let us add 40% of social security contributions to that amount. As a result, we have USD 420 per month as total wage costs. There are 33,000 small-sized companies in the country, along with about 2,000 middle-sized ones. Consequently, the costs to employ one 'unproductive' worker (to prepare reports useless for a company, but requested by administrative bodies; no added value is created) is USD 5,040 per year. If we multiply that amount by the total number of private SMEs in Belarus (approximately 35,000), the total amount of annual costs appears to be USD 176.4 million<sup>21</sup>. When we assume that of three employees dealing with reporting, there is more than one 'redundant' employee, the costs of

<sup>21</sup> To make calculations, we employ the method used by the International Finance Corporation. See *Business Environment in Belarus 2006*, Analytical Report, IFC.

running business goes up to USD 250–400 million per year.

However, these are the direct costs borne by SMEs to pay wages to ‘unproductive’ (from SMEs’ point of view) employees. On the other hand, costs related to unnecessary reporting are incurred by the state. But these costs are paid by citizens’ taxes, which are spent to pay bureaucrats, service desk employees and recording officials, to cover the costs of equipment and office space. It is possible to play with and speculate on numbers, but it seems to be the case that total reporting costs could reach up to USD 1 billion in the economy as a whole (2.7% of GDP).

Unproductive costs of Belarusian SMEs are bigger when the time spent by executives forced to communicate with administrative bodies is taken into account. Also, a special job position was introduced at private companies, a Deputy Director. This person is supposed to visit various officials and administrative bodies, ranging from executive committees to ministries and departments. To hold such an employee is costly, so the costs of Belarusian SMEs now more easily appear to be no less than USD 1 bn. Naturally, all these costs are translated into the higher prices of end products.

Of course, this calculation of costs of excessive reporting is rather approximate and should be approached with care. Nevertheless, there is no doubt that financial and labor resources employed by private business to fulfill the plethora of legislative rules could be diverted to a more productive course. Such a diversion could then help to cut costs, bring additional volume of investment, and reduce prices.

### 6.2.2. Transaction costs of state regulation of prices

Inefficiency and cost-intensity of excessive state regulation could be confirmed by the results of a more detailed research on the ‘costs’ of such a narrow area as pricing

**Table 6.9: Provide major determinants (not more than three of them) of prices set by your company for goods produced (services offered)**

	The number of SMEs	%
Production and sales costs	175	42.7
Prices of competitors	177	43.2
Consumer demand	151	36.8
Public utilities (tariffs for electricity, heating, etc.)	90	22.0
Rental payment	135	32.9
Wholesale prices, supply prices	134	32.7
Taxation	192	46.8
Legislation regulating profits and prices	68	16.6
Other	4	1.0
No answer	3	0.7
Total	410	100.0

Source: IPM Research Center.

**Table 6.10: SMEs costs to fulfill the rules of pricing regulation legislation**

Field of Business	How many people calculate costs and prices at your enterprise?	How many hours per month are spent to fulfill the rules of pricing regulation legislation?	Imagine that the administrative regulation of prices is abolished in the country. What would be time saved by your company? (number of employees)	Imagine that the administrative regulation of prices is abolished in the country. What would be the savings on costs at your company? (USD per month)
Trade	2.77	39.73	2.29	907.34
Catering and domestic services	2.19	52.52	2.07	560.00
Industrial production	3.19	43.17	2.44	1170.41
Construction	3.14	72.49	2.44	1062.33
Transport and communication	2.76	70.94	3.33	872.73
Other	2.34	26.65	2.00	929.17
The size of the company				
From 1 to 10	1.60	31.17	1.28	473.71
From 11 to 50	2.73	52.15	2.10	900.81
From 51 to 100	3.84	50.07	3.26	1785.90
From 101 to 200	5.79	62.40	5.91	960.00
Above 200	8.80	112.00	9.00	933.33

Source: IPM Research Center.

regulation. It is not a secret that all prices in Belarus are regulated by the state either formally or informally. The regulation spans from the 0.6% monthly price increase cap to regulation of mark-ups and rates of return. However, the list of the most significant administrative barriers to development of private enterprises does not include pricing regulation, mainly due to the lack of enforcement<sup>22</sup>. At the same time, virtually all executives claim that

<sup>22</sup> Pricing regulation is discussed in section 5.1.2.

output produced by their companies is sold at prices they choose. For a long time, prices have been regulated by the market (competition and population income) and a tight monetary policy of the National Bank of Belarus. However, in order to fulfill all pricing regulation requirements, private companies have to sacrifice considerable amounts of time, energy, resources, and nerves.

The survey shows that the major determinant of price level is taxation, followed by such factors as prices of competitors and production costs.

Pricing regulation is given the 8<sup>th</sup> place (table 6.9).

The respondents that answered to these questions said that on average 2.75 workers deal with calculation of costs and prices at a typical SME. Each of these employees spends about 46 hours per month (or about 6 working days).

Naturally, these figures are averages and tend to vary depending on the size of the company and the field of business (table 6.10). They also vary across the sample. In addition, abolition of some legislative rules, labor costs drop to 2.31 employees to deal with costs and price calculations. As a result, companies are able to save about USD 924 per month.

The application of the approach described above allows calculating total costs incurred by SMEs to fulfill pricing regulation legislation. The total costs appear to be USD 924 multiplied by 1.4 and then by 12, or USD 15,523 per year. Given 35,000 SMEs in Belarus, we obtain as much as USD 543.305 m per year.

As it can be expected, the major rules of pricing regulation legislation diverting resources of the firms to the greatest possible extent to spend on unproductive labor are preparation of report cost calculations (50%), registration of new prices (43%), and preparation of routine calculations (39%). In comparison, monthly price caps have been noted by 25% of the respondents, and rates of return – by only 4%.

It appears that in the conditions of a deteriorating state of the market in terms of prices and declining profitability of state-owned plants and factories, simplification of regulation, i.e. the abolition of indeed unnecessary norms and permissions, would allow releasing a considerable volume of resources back to the country's economy. These means could then be utilized by private business in a variety of ways: to increase investment or consumption, spend more on advertising or representation. In any case, simplification could release between USD 1 and 3 bn; if these resources would be spent inside the country, national competitiveness at both micro- and macro-levels could be enhanced.



## 7. ECONOMIC AND FINANCIAL PERFORMANCE OF BELARUSIAN SMES

### 7.1. Economic Performance

The research conducted enables us to assess the financial performance of enterprises. In general, our results are congruent with the data provided officially. Half of respondents is modest in estimating the economic performance of their companies, while one-third of them perceive it as good (table 7.1).

Good economic performance has been denoted more often by SMEs operating in the construction sector (53.3%), transport and communication (52.4%), and other highly profitable sectors. Also, good economic performance is distinctive for private economic entities providing various services (the number of respondents that estimate their performance as 'good' or 'very good' amounted to 75%).

The 'time factor' is not decisive for performance: no meaningful differences in estimates are observed when the year of enterprise's establishment is taken into account. In general, across the sample, half of SMEs representatives denote an increase of such indicators as the volume of sales and profits. Further, 30% of them point to growth of employment at their companies, while 20% indicate an increase in investment (table 7.2). Approximately the same number of respondents keeps their forecasts made for 2006 unchanged for 2007. A favorable macroeconomic environment, growth of population incomes, and investment activity of state-owned enterprises all positively affect the dynamics of volume of sales and profits of enterprises over the last several years. Enterprises expect that the external environment for doing business would change substantially in the near future.

In contrast to such indicators as turnover and profits, employment and investment generally have remained stable over 2006, or had been either growing or decreasing marginally. This has been observed against the background of a considerable increase of the volume of investment in fixed capital (31.4% in 2006 as against 2005) (according to the data provided by the Ministry of Statistics and Analysis). Most likely, this is because small and medium-sized enterprises are less motivated and financially capable to invest in contrast to larger companies operating in the Belarusian economy.

There are substantial differences in estimates of SMEs' performance indicators across sectors of the economy and types of ownership. The same thing could be expected in 2007. However, in contrast to other

companies, in 2006 the volume of turnover, profits, and investments has been growing more frequently at enterprises employing less than 100 workers. There is some positive correlation between estimates of the dynamics of turnover and profits and the size of companies (Pearson correlation coefficients are 0.148 and 0.169, respectively, significance level is 0.01). Accordingly, there is a direct relation between the size of enterprises and the dynamics of such indicators as the volume of sales and profits. Larger companies tend to experience the growth of these indicators more often. Also, larger enterprises are more optimistic in their forecasts for 2007, although the interrelationships are not very close in that case.

The research allowed to reveal the factors behind changes in (decrease

**Table 7.1: Answers to the question: 'How do you estimate the current economic performance of your company?'**

	The number of SMEs	%
Very good	6	1.5
Good	153	37.3
Neither good nor bad	215	52.4
Bad	22	5.4
Very bad	4	1.0
Hard to answer	10	2.4
Total	410	100.0

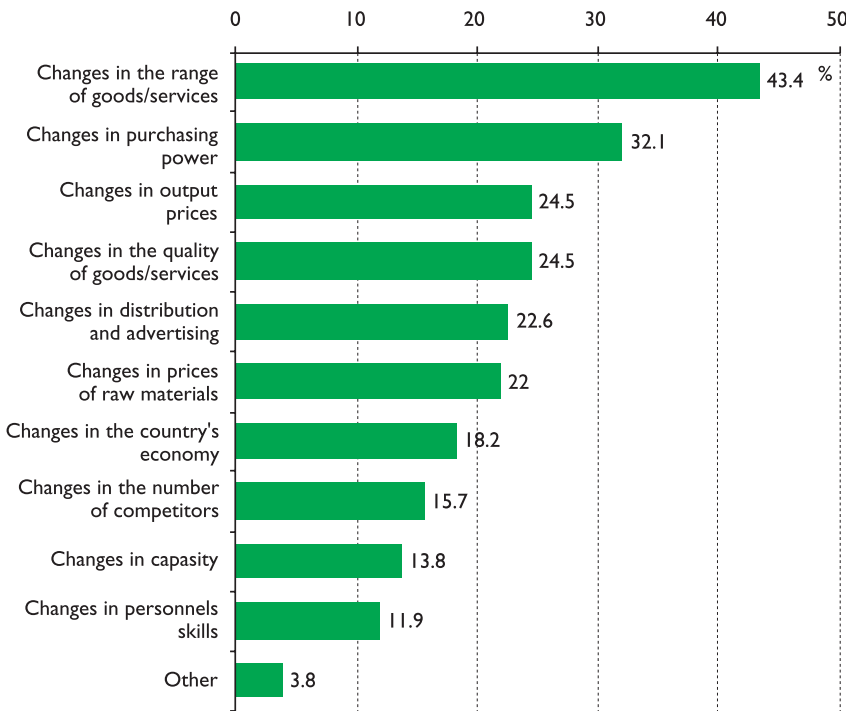
Source: IPM Research Center.

**Table 7.2: Answers to the question: 'Please estimate the dynamics of the performance indicators provided below. What is your forecast for 2007?' (%)**

Indicator	Dynamics			Forecast for 2007		
	Increase	No change	Decrease	Increase	No change	Decrease
Turnover (volume of sales)	41.7	47.5	10.8	47.5	40.2	12.3
Profit	33.1	48.6	18.3	39.8	44.6	15.5
Employment	29.1	61.6	9.3	26.8	63.1	10.1
Investment	19.3	59.7	21.0	23.9	57.5	18.5

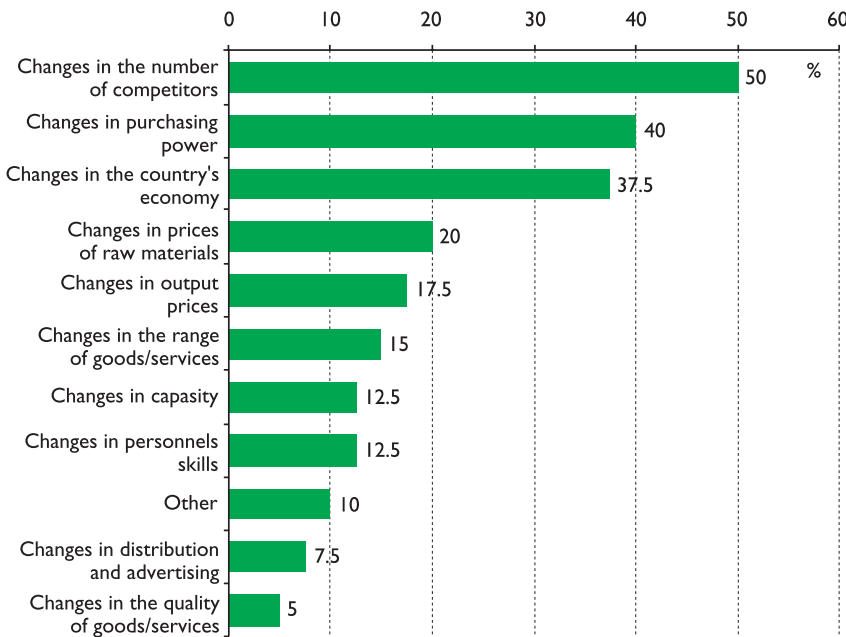
Source: IPM Research Center.

Figure 7.1: Factors behind the growth in the volume of sales in 2006



Source: IPM Research Center.

Figure 7.2: Factors behind the decline in the volume of sales in 2006



Source: IPM Research Center.

or increase) the volume of sales of small and medium-sized enterprises in 2006. According to the data collected, the most common factors that drive an *increase in the volume of sales* are changes in the range of products/services and in purchasing capacity. The first factor has been denoted of consumers by 43.4% of

polled SMEs (that increased their volume of sales in 2006), while the second has been stressed by 32.1% of them (Figure 7.1).

On the other hand, there is a range of factors adversely affecting the volume of sales. These are as follows: appearance of new competitors on

the market (this refers to 50% of polled enterprises facing a decrease in the volume of sales), changes in purchasing power (40%), and also transformations in the country's economy (37.5%) (Figure 7.2).

Thus, external environment factors are usually mentioned as dampening growth of sales. In contrast, factors endogenous to enterprise performance (product range, quality, and prices) are seen as affecting growth of sales in 2006 in a positive way, along with such an exogenous factor as changes in the purchasing power of consumers. This affects the volume of sales of SMEs in both positive and negative ways. A positive influence is mainly observed in construction (58.3%), trade (37.3%), and catering and domestic services (40%). At the same time, a negative influence is claimed to occur in trade (47.6%). Most likely, this is because the growth of population incomes shifts consumer demand to more expensive and better-quality goods.

Change in the number of competitors as a sales-dampening factor has been mentioned by companies operating in the catering and domestic services sectors (66.7%), and also in industrial production (60%). Hence, these sectors of the economy can be perceived as the least monopolized ones in the Belarusian economy.

Despite the generally optimistic plans for growth and development, respondents tend to avoid the answer about the volume of earned profits, although the vast majority of them denote its smallness (table 7.3).

In 2005, the respondents operating in the catering, domestic services and industrial production sectors (19% and 22.5%, respectively) reported about considerable profits earned. In 2006, it has been a characteristic feature of construction (22.2%), the transport and communication (27.3%) sectors (table 7.4). Therefore, some changes in the attractiveness of sectors for business to operate in have occurred. High profits are also a distinctive feature of the education sector over the last

two years, but in 2006 it has been observed much less frequently.

Small companies (employing up to 50 workers) record higher profits much less frequently both in 2005 and 2006 (table 7.5). The scale of their activity is usually small, and so are the profits.

## 7.2. Expansion of economic activity

The survey shows that 76% of the respondents plan to expand their activity in the next year or two. In this regard, the most optimistic companies are located in Minsk (87%), while the most pessimistic ones are the SMEs from the Brest (53.6%) and Vitebsk (60%) regions. As for sectoral specialization, providers of services (consultancy, education, tourism, etc.) (82%) and catering companies (64%) plan to expand their activity in the near future. Further, market 'newcomers' tend to be more ambitious than companies with a longer history. However, the difference is rather small: 81% of companies established since 2005 intend to growth, as against 74.7% of the SMEs set up prior to 1996.

It is possible to define four groups of factors on the basis of different SME plans to expand activity (table 7.6):

1. Investment-intensive (increase of investment, management change, price cuts);
2. Intensive (skills upgrade of employees, advertising activity, quality and price increase);
3. Expansionist (search for and entry to new outlets);
4. Extensive (broadening of the product range and branching out to new types of activity);

It has to be noted that the factors of the extensive and expansionist nature plan to be utilized by companies most intensely, while investment-intensive ones (requiring the use of loan capital and conducting investment) seem to be an inferior

**Table 7.3: Answers to the question: 'What is the volume of profits/losses of your company in 2006' (%)**

	High profits	Modest profits	Neither profits, nor losses	Small losses	Big losses
2006	13.9	65.3	13.9	5.2	1.7
2005	13.4	57.5	20.1	7.7	1.3

Source: IPM Research Center.

**Table 7.4: Answers to the question: 'What is the volume of profits/losses of your company in 2006' (%)**

	Trade		Catering and domestic services		Industrial production		Construction		Transport and communication	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
High profits	7.8	11.7	19.0	10.9	22.5	12.5	11.6	22.2	4.5	27.3
Modest profits	63.4	64.2	47.6	64.1	52.1	77.8	62.8	60.0	68.2	59.1
Neither profits nor losses	23.5	17.3	22.2	15.6	14.1	5.6	16.3	8.9	9.1	4.5
Small losses	4.6	4.3	11.1	7.8	8.5	2.8	9.3	8.9	13.6	4.5
Big losses	0.7	2.5	–	1.6	2.8	1.4	–	–	4.5	4.5
Total	100	100	100	100	100	100	100	100	100	100

Source: IPM Research Center.

**Table 7.5: Answers to the question: 'What is the volume of profits/losses of your company in 2006?' (%)**

Number of employees	From 1 to 10		From 11 to 50		From 51 to 100		From 101 to 200		More than 200	
	2005	2006	2005	2006	2005	2006	2005	2006	2005	2006
High profits	9.2	6.9	13.7	14.0	17.7	22.2	10.0	20.0	60.0	60.0
Modest profits	53.8	65.4	61.5	68.8	61.3	60.3	45.0	60.0	–	20.0
Neither profits nor losses	25.2	21.5	18.1	11.8	12.9	7.9	30.0	5.0	20.0	–
Small losses	10.9	3.8	5.5	4.8	8.1	6.3	10.0	10.0	–	20.0
Big losses	0.8	2.3	1.1	0.5	–	3.2	5.0	5.0	20.0	–
Total	100	100	100	100	100	100	100	100	100	100

Source: IPM Research Center.

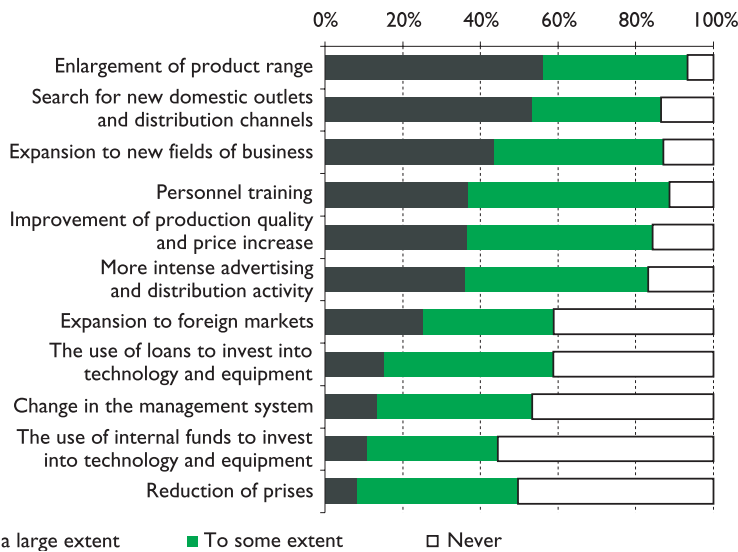
**Table 7.6: Sources of expansion of SMEs' activity**

	Factors			
	1	2	3	4
Attraction of loan capital to invest in technology and equipment	0.764			
Changes in the management system (reorganization, staff reduction, and so on)	0.700			
Attraction of additional financial resources (issuing of shares and bonds) to invest in technology and equipment	0.552			
Price cuts	0.512			
Skills upgrade	0.838			
Advertising and marketing measures	0.706			
Quality and price increase	0.595			
Search for new outlets and distribution channels (domestic ones)	0.849			
Entry to external markets	0.660			
Development of new types of activity	0.753			
Broadening of the product range	0.684			

Note. Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; rotation is conducted in 7 iterations.

Source: IPM Research Center.

**Figure 7.3: Answers to the question: ‘What are the factors to be employed in expansion of your activity (if any)?’ (%)**



Source: IPM Research Center.

**Table 7.7: Answers to the question: ‘How do you assess the efforts of the government to protect the national interest of Belarus in the course of the energy conflict with Russia’ (%)**

	Minsk	Minsk region	Brest	Grodno	Vitebsk	Gomel	Mogilev
Fully support	26.3	42.1	27.8	20.0	29.4	14.3	26.1
Rather support than otherwise	50.0	31.6	55.6	48.0	58.8	75.0	56.5
Rather unsupportive than otherwise	15.8	23.7	16.7	28.0	11.8	10.7	17.4
Fully unsupportive	7.9	2.6	–	4.0	–	–	–
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Note. Regional centers (Brest, for instance) includes not only the capital, but also other cities and towns of the region.

Source: IPM Research Center.

**Table 7.8: Company specialization and answers to the question: ‘What are the consequences of the gas price hike for your business?’ (%)**

	The whole sample	Trade	Catering	Domestic services	Industrial production	Construction	Transport and communication
Substantial cost increase related to growth of tariffs for electricity, heating, and gas	42.7	34.5	65.2	56.1	47.3	52.2	40.9
Modest cost increase related to growth of tariffs for electricity, heating, and gas	33.7	33.3	30.4	26.8	36.5	28.3	36.4
Business could become unprofitable due to new tariffs	9.0	6.7	13.0	2.4	16.2	15.2	9.1
Considerable reduction of consumer demand for goods produced by SMEs	12.2	15.2	4.3	7.3	20.3	6.5	13.6
Modest reduction of consumer demand for goods produced by SMEs	15.6	23.6	–	7.3	13.5	8.7	9.1
Other	2.4	2.4	–	2.4	–	4.3	–
No consequences	2.7	3.6	–	7.3	–	2.2	4.5
Hard to answer	4.4	3.6	–	4.9	4.1	6.5	4.5

Note. Not more than three options were allowed to choose.

Source: IPM Research Center.

choice (Figure 7.3). Such reluctance to use investment resources can be explained by a range of economic reasons (such as high interest rates, administrative complexities needed for loan provision, i.e. guarantees, pledges, market valuation of property, provision of business plans, and so on) and psychological ones (reliance on own abilities, psychological barrier to applying for a loan, etc.). Development of new types of economic activity, search for new outlets, broadening of product range, and so on are perceived by the majority of SMEs as the most convenient and efficient strategies of expansion of their activity.

### 7.3. Energy shock

According to the results of the survey, 21% of respondents fully support the efforts deployed by the government in the recent ‘energy conflict’ with the Russian Federation. Another 40% of respondents said, when replying to the question ‘how do you assess the efforts of the government to protect the national interest of Belarus in the course of the energy conflict with Russia’, that they rather support the government than otherwise. Next, 13.2% of respondents tends to be rather unsupportive than supportive, and, finally, 22.4% of the respondents chose the ‘hard to answer’ option. At the same time, no substantial regional differences are observed, although Minsk and Grodno regions seem to be less favoring the efforts of the Belarusian government (table 7.7).

The gas price hike is seen by the executives of private SMEs as leading to cost increases (42.7%). At the same time, a small increase in tariffs for electricity, heating, and gas (33.7%) is expected along with some demand contraction (15.6%). According to representatives of SMEs, cost increase is most substantial in such sectors as catering, domestic services, and construction. Most likely, this is due to the relatively high share of and subsequent increase of expenditures on heating and electricity consumed by offices and facilities

of domestic services and catering companies. At the same time, 50% of industrial production enterprises noted substantial cost increase.

On the other hand, approximately one-sixth of polled enterprises operating in industry and construction worries about the repercussions of new energy tariffs. They are perceived as capable of making business unprofitable. In particular, 20% of industrial SMEs are concerned about a possible reduction of demand following higher costs and, hence, prices. Expectations of demand contraction stem from con-

cerns about some decrease of well-being of the population caused by a possible increase of expenditures on public utilities (table 7.8).

Possible consequences of higher energy prices for business also depend on the size of enterprises (table 7.9). Larger companies more frequently denote considerable cost increase related to higher tariffs for energy consumption, and point to a more substantial demand contraction caused by the same reason.

By supporting and even favoring the efforts of the Belarusian government to protect national interests

in the course of the energy conflict with the Russian Federation, the majority of respondents at the same time display a pessimistic attitude toward the expansion of trade and economic cooperation of the two countries. Specifically, companies expect that it would become more difficult to sell Belarusian products on the Russian market (30.3%), and vice versa (17.6%). The former problem is mentioned more often by industrial enterprises and construction companies, while the latter is anticipated by trading companies that concede a possible wave of protectionism (table 7.10).

Across the regions, Brest (53.3%) and Grodno (23%) are most pessimistic about future trade and the economic relationship between Belarus and Russia. According to the opinions of the respondents of these regions, it would become much more complicated to sell Belarusian goods on the Russian market. Also, similar problems with sales of Russian goods in Belarus are expected by companies located in the Brest (26.7%) and Minsk (25.6%) regions.

**Table 7.9: Company size and answers to the question: 'What are the consequences of the gas price hike for your company' (%)**

Number of employees	From 1 to 10	From 11 to 50	From 51 to 100	From 101 to 200	Above 200
Substantial cost increase related to growth of tariffs for electricity, heating, and gas	32.8	46.5	43.8	60.0	80.0
Modest cost increase related to growth of tariffs for electricity, heating, and gas	39.6	33.2	32.8	10.0	–
Business could become unprofitable due to new tariffs	7.5	9.6	10.9	10.0	–
Considerable reduction of consumer demand for goods produced by SMEs	11.2	9.1	18.8	25.0	20.0
Modest reduction of consumer demand for goods produced by SMEs	17.2	12.3	21.9	20.0	–
Other	3.7	–	6.3	–	20.0
No consequences	1.5	4.3	1.6	–	–
Hard to answer	6.7	3.2	1.6	10.0	–

Source: IPM Research Center.

**Table 7.10: Company size and opinions on the possible consequence of changing Russia-Belarus relationship (%)**

	The whole sample	Trade	Catering	Domestic services	Industrial production	Construction	Transport and communication
Harder to sell Belarusian goods in Russia	27.1	26.7	13.0	12.2	43.2	30.4	22.7
Easier to sell Belarusian goods in Russia	3.2	3.6	–	–	2.7	6.5	4.5
Easier to sell Russian goods in Belarus	4.6	3.6	8.7	4.9	6.8	4.3	9.1
Harder to sell Russian goods in Belarus	12.9	21.2	13.0	7.3	8.1	4.3	9.1
No consequences	33.2	30.3	43.5	51.2	24.3	34.8	31.8
No change in trade and economic relationships between two countries	2.9	3.0	–	2.4	1.4	–	9.1
Hard to answer	20.0	16.4	26.1	24.4	16.2	21.7	22.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IPM Research Center.

#### 7.4. The European future for Belarus

Executives of Belarusian SMEs do not question the importance of the independence of the Belarusian state. In particular, 65% of them consider that Belarus should be a sovereign state and build partner relations with the Russian Federation. Another 32% think that Belarus and Russia should create a union of independent states with close political and economic ties. Finally, only 3% of respondents believe that Belarus should become part of the Russian Federation.

A somewhat larger share of Belarusian entrepreneurs supports the idea of European integration. Specifically, 69% of the respondents claim that Belarus should aspire for membership of the European Union. The opposite view is held by 31%. Yet, there are certain regional differences

noticeable. In particular, 'pro-European' entrepreneurs are located in the Minsk (88%) and Mogilev (81%) regions, while smaller number of supporters is found in Grodno (74%), Vitebsk (74%), and Minsk (67%)

As soon as intra-EU conflicts and crises (related to difficulties of adopting the European constitution, further efforts to open up internal markets, and initially labor markets, the entry of new members, etc.) are over, the attractiveness of the 'European' direction of private sector development would be growing.

The values of executives and managers of SMEs are shared by rank-and-file employees. The latter account for 20% of the total number of employed in the Belarusian economy. According to research conducted by the IPM Research Center, private sector workers express pro-market and pro-reform values attitudes most strongly. In particular, 60% of private sector workers appreciate the value of private property and acknowledge the need to implement major transition reforms in Belarus (such as privatization, price and foreign trade liberalization, opening of the banking and infrastructural sectors, etc.)<sup>23</sup>. In contrast, only 30% of the population has the same attitude. Accordingly, it can be expected that expansion of the private sector in Belarus would lead to expansion of pro-European and pro-market attitudes in Belarus.

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<sup>23</sup> See Analytical Notes of the IPM Research Center 'Attitude of Belarusian population to market reforms' <http://research.by/pdf/WP2006r06.pdf> and 'Perception of market economy values by the population of Belarus' <http://research.by/pdf/WP2006r07.pdf>.

## 8. COMPETITIVENESS OF BELARUSIAN SMEs

### 8.1. Internal and external factors

Despite a 'record' low number of SMEs in the country, the survey shows that 75% of respondents claimed that their companies have many competitors, while only 2% of them said that there are no competitors at all in their field of business. The question of how competition has changed over the last three years has been answered in the following way: 72% of respondents denoted its intensification (while the number of Belarusian SMEs and foreign companies remain roughly unchanged), while another 21% acknowledge no change in the competitive environment, and, finally 3% observe a less intense competition.

Our research allows to group the major barriers to SME development in the following way (table 8.1):

1. *The lack of internal funds* (high costs of raw materials and components; inability to increase the volume of sales given the production facilities available to the company; small size of production premises; the lack of own funds for company development);
2. *State of the market and the situation in the country as a whole* (high tax rates; complicated system of taxation and mandatory payments; unstable economic situation in the country; too intense market competition);
3. *The lack of necessary competences* (the absence of goods ideas about conducting business; the lack of proper competences to run a company; the absence of qualified workers; difficulties with obtaining loans);
4. *Problems with labor resources* (high firing costs, the fear of mak-

ing wrong, loss-making decisions; the lack of funds sufficient to hire new employees; and high labor costs).

It has to be noted that the 17 factors mentioned above have been ranked according to a scale provided (ranging from 'does not matter / no concern – small importance – average importance – considerable importance – utmost importance').

The results of the survey show that external factors, ranging from taxes and competition to the unstable situation in the country – have a greater importance to the majority of respondents than the lack of own funds (a factor of internal nature). It is also illuminating that 48% of polled enterprises have denoted the unstable economic situation in the

country as a factor of considerable and even utmost importance, while another 24% have treated this factor as having an average importance to their business.

At the same time, such factors as competences, knowledge, and new ideas are not perceived by the majority of respondents as critical for the success of their business. High firing or hiring costs, labor costs, and so on are very important issues for business in Western and, increasingly, Eastern Europe, but not in Belarus.

It appears that the major competitive advantages of SMEs are professional staff, knowledge of the market and the ability to predict market dynamics. Three years ago the picture was somewhat different. At that time,

**Table 8.1: Groups of factors related to major barriers to SME development in Belarus**

Barriers	Factors			
	1	2	3	4
High costs of raw materials, components, etc.	0.827			
The inability to increase the volume of sales given the capacities available	0.727			
Small size of production premises	0.714			
The lack of own funds for company development	0.516			
Insufficient demand	0.467			
High taxes		0.846		
A complicated system of taxation and other compulsory payments		0.790		
Unstable economic situation in the country		0.660		
Intense market competition		0.550		
The absence of good ideas about conducting business			0.776	
The lack of proper competences to run a company			0.745	
The absence of qualified workers			0.616	
No attractive loan offers by banks and other financial institutions			0.479	
High firing costs				0.725
Fear to make wrong, loss-making decisions				0.649
The absence of sufficient funds to hire new workers				0.624
High labor costs				0.573

*Note.* Selection method: Principal Component Analysis; Rotation Method: Varimax with Kaiser Normalization; rotation is completed in 7 iterations.

*Source:* IPM Research Center.

every fourth respondent has denoted the knowledge of legislation, but now only every sixth has done so. Ties with the authorities and the existence of proper 'links' have been emphasized by 11% of the respondents (table 8.2). Finally, such factors as strategy and even philosophy of the company, efficient human resource management, and a strong managerial team are considered as competitive factors by only 10% of SMEs' executives.

By denoting employment of professional staff as a competitive advantage, only one-third of the respondents emphasized the need for professionally trained employees. All other companies educate their workers by themselves, or merely rely on self-education and self-training, or simply do not use any sort of training. It is then only 15% of polled SMEs' executives who considered taking an MBA degree for them or their employees as useful.

A somewhat relative unimportance of the fourth group of factors (such

as labor market regulation) can be explained by the specificities of labor market regulation in Belarus. In contrast to France or Poland, in Belarus hiring and firing procedures are easy, while the costs of firing are minimal. However, the hope for lower interest rates or lower tax rates as a way to increase rates of return and to solve many other problems can be explained by the confidence of the respondents in the continuation of entry barriers to the market both for the Belarusian and the foreign ones. This expectation is not correct. Even though the political situation would be kept intact, the slightest simplification of the regulatory environment would attract new economic actors to Belarus.

Accordingly, Belarusian SMEs should be prepared for a future market liberalization and intensified competition. For that purpose, they should start investing money, time, and effort in personnel education at both the middle and upper levels of management.

## 8.2. Training personnel at Belarusian SMEs

As it has been shown above, 22.5% of SMEs do not train their employees, while another 15.6% of companies point to self-education as the only way of training used in the organization. This is not always the best way to obtain high-quality and called-for types of knowledge. Nevertheless, self-education as an additional way of acquiring new knowledge by employees could positively affect the competitiveness of the company.

Only one-third of respondents provide professional training for their employees (i.e. courses, seminars, etc.). Approximately the same number of polled SMEs (32%) train their employees themselves, while 13% of them use outside trainers to enhance competences of the employees. In general, enterprises that provide personnel training are inclined to combine various methods and forms of education. In Belarus, the use of outside trainers or specialists tends to dominate (along with self-education and education without outside help) (table 8.3).

According to the opinions of respondents, accounting departments need training more frequently than any other (45.3% of polled executives of SMEs). The complexities of tax legislation and high risks of doing business in the existing institutional environment of Belarus demands upgrading accountant skills. Also, in the respondents' view, departments involved in product promotion (such as the sales department – 32.6% of respondents, marketing department – 30.6%), and also the procurement department have to be provided with training. Logistics and marketing play one of the key roles in successful performance of business. This is in fact acknowledged by executives (table 8.4).

There are certain differences in the approach of small and medium-sized business to personnel training depending on the firm's age. Most likely, new firms have fewer prob-

**Table 8.2: Major competitive advantages of enterprise (as they are seen today), (%) (maximum three answers allowed)**

	2002	2005	2007
Professional staff	39.9	57.0	60.7
Knowledge of the market, the ability to predict market dynamics	59.8	48.3	42.7
Ability to produce competitive goods	34.7	39.5	36.8
Knowledge of up-to-date market techniques	18.3	27.0	17.1
Efficient human resource management	17.2	21.0	20.7
Strong managerial team	16.1	15.3	18.3
Ties with the authorities and influential people (proper 'links')	16.1	12.8	10.7
Knowledge of legislation	25.9	12.5	12.9
Strategy and philosophy of the company	19.6	11.8	14.1
Other	1.0	2.0	2.9
No reply	0.2	0.0	0.7

Source: IPM Research Center.

**Table 8.3: Answers to the question: 'What form of personnel training has been recently used in your company?' (%)**

	The whole sample
Self-education	48.0
Attendance of courses, seminars or trainings	35.3
Within-company training without outside trainers	32.0
Within-company training by using outside trainers	13.0
Traineeships	8.8
No training provided	22.5

Source: IPM Research Center.



blems with qualification of marketing people due to a number of reasons (on the one hand, higher level of background business education obtained by younger people, and, on the other hand, ambitions and recent presence on the market). In contrast, newcomers are likely to have the work of the accounting department not properly developed. Alternatively, executives of younger firms consider that untrained accountants make more mistakes that result in fines, which are a serious impediment and threat to development of their companies. Accordingly, the need to train accountants as the top training priority is expressed by 63.4% of small- and medium-sized enterprises set up after 2005. At the same time, new companies could have problems with sales from the start. Also, the need to train sales people is denoted by 46.3% of respondents in the group of younger firms. This figure exceeds the sample average.

Further, it has to be emphasized that managers of newly established companies consider themselves to be more qualified than the ones of more 'mature' companies. The need to train executives of new enterprises is mentioned by only 4.9% of the respondents (while in the whole sample this figure goes up to 8.5%). As for the mid-level managers, the need for their skills upgrade is considered by 7.3% of the respondents.

There are no considerable differences in the training priorities of different departments across various sectors of the economy. The only exception is that SMEs operating in industry and construction fairly stress the necessity of training employees of their production departments (54.1% and 64.7%, respectively), while trading companies prefer training sales people (58.6%). It has to be noted that 64.3% of polled SMEs operating in the transport and communication sectors consider the need to enhance their competences in the sphere of marketing. Most likely, this is due to the intensification of competition in these parts of the economy. Alternatively, companies might need to implement consider-

able marketing efforts to attract new clients, given the degree of market saturation.

In case SMEs train their employees by using services provided by professional, specialized companies, the following criteria are taken into account: the quality level of educational programs offered, reputation, costs of programs, and recommendations of partners and colleagues (table 8.5).

Naturally, the quality of programs offered is a decisive factor determining the choice for a training institution. This factor is closely connected with its reputation, which is a certain quality guarantee. These two options (i.e. quality and reputation) are often selected together in the sample. Nevertheless, there is a group of companies (about 4% of the sample) that treat both quality and reputation as insignificant. For them, costs are more important than these more 'traditional' factors. Also, these companies tend to attach more value to recommendations given

by partners and colleagues and to advertising distributed by a training company.

Enterprises located in the Minsk region (45.6%) are more often concerned with the costs of training programs than companies from other regions. Most likely, this is due to a broader access to training programs in this region, while the number of programs offered is larger. In this situation, the cost factor tends to play a more important role. At the same time, SMEs of the Minsk region (66.9%), and also of the Grodno (71.4%), Vitebsk (81.8%), and Mogilev (100%) regions more often consider the quality of training programs offered in choosing training institutions. In contrast, enterprises of the Minsk (46.2%) and Grodno (35.7%) regions pay less attention to the reputation of educational organizations.

The question about the best training institution was hard to answer. In particular, 64.6% of polled companies had difficulties providing any names

**Table 8.4: The year of establishment of company and answers to the question: 'What departments need training most?' (%)**

	The whole sample	Prior to 1996	Between 1997 and 2004	2005 and after
Accounting	45.3	48.7	39.7	63.4
Sales	36.2	37.2	34.0	46.3
Marketing	30.6	34.6	30.4	22.0
Procurement	30.3	10.3	10.3	9.8
Production	21.8	35.9	29.9	26.8
Middle-level managers	10.1	20.5	24.7	7.3
Executives	8.5	6.4	9.8	4.9
Other	2.9	6.4	2.6	0.0

Source: IPM Research Center.

**Table 8.5: Answers to the question: 'How do you train (or have you trained) your employees by using services provided by specialized companies: what sort of criteria do you apply when selecting educational institutions?' (%)**

	The whole sample
The quality of educational/training programs offered	68.3
Reputation of the institution	45.2
Costs of the program	42.3
Recommendations of partners and colleagues	36.1
The presence of well-known trainers and educators	19.2
Comfortable training conditions	10.1
Advertising (activity of the company)	6.3
Other	1.0

Source: IPM Research Center.

**Table 8.6: Answers to the question: ‘Do you consider an MBA degree as a necessary condition for the successful performance of your enterprise?’ and ‘Do you consider that as necessary for you personally?’ (%)**

	2002		2005		2007	
	MBA for employees	MBA for yourself	MBA for employees	MBA for yourself	MBA for employees	MBA for yourself
Yes	20.9	16.4	14.8	10.7	15.2	15.6
No	22.5	22.8	40.9	36.1	50.0	40.0
I have already obtained MBA degree	–	–	–	1.3	–	2.0
Hard to answer/I do not know what MBA is	56.5	60.8	44.4	51.9	34.8	42.4
Total	100.0	100.0	100.0	100.0	100.0	100.0

Source: IPM Research Center.

(it has to be noted that the question was an open one, i.e. respondents were asked to write down names by themselves). Given that about one-third of Belarusian SMEs do not use services of specialized training institutions to upgrade skills of their employees, this makes sense. Still, some names have been provided. Most frequently these were the Business School of the Belarus State University (Minsk), the Business School of the Institute for Privatization and Management (Minsk), ‘Zdes i Seichas’ (‘Here and Now’) (Minsk), and various extension and skill upgrade courses.

As for particular figures, 6.1% of respondents trained their employees at ‘Zdes i Seichas’ company, another 4.4% referred to the School of Business of the Belarus State University, and, finally, 3.4% send their workers to the Business School of the Institute for Privatization and Management. In Belarus, advertising (by using direct mailing) is the most intensely used by the School of Business of the Belarus State University and the Business School of the Institute for Privatization and Management. At the same time, 25% of respondents are not aware of any of these two companies, while the vast majority of polled SME executives do not know most of them, or they heard something about some companies.

In order to obtain information about training programs, SMEs rely on direct mailing (42%), the ‘Chief Accountant’ journal (34.6%), web-

pages of educational institutions (31.9%), the web-portal [www.tut.by](http://www.tut.by) (31.5%), and ‘Ekonomicheskaya Gazeta’ (22.4%). It appears that direct mailing remains to be the most efficient way to provide potential clients with information about business education opportunities.

Further, employees with MBA degrees (seen as a precondition for successful performance at a company) are demanded by 15.2 of polled SMEs, while 50% of them do not think that is necessity, and another 34.8% are unaware of what an MBA is (although the number of those who do not know about MBA went down considerably over the past several years). An approximately similar distribution of answers is recorded for the question to executives about their attitude to the MBA degree. Only 2% of respondents graduated with a MBA. It should be mentioned that the number of executives who consider obtaining an MBA degree by themselves or by their employees as unnecessary for running their business successfully, is also growing over the years (table 8.6).

The survey shows that the demand for people with MBAs comes from companies operating in consultancy (50%), transport and communication (27.3%), and also in education (25%). In these sectors of the economy, executives more often consider the need to obtain such a degree. Also, executives of larger companies more often than those of the smaller firms want to obtain MBA themselves and employ peo-

ple with MBA degrees. Also, they are relatively more well-informed than other executives about what an MBA degree is. Across the regions of Belarus, MBA is most popular in the Minsk region, where the share of those who are ignorant of this degree at all is much smaller than in all other regions of Belarus.

## 9. INFRASTRUCTURE FOR SME DEVELOPMENT SUPPORT IN BELARUS

### 9.1. Major elements of infrastructure for business development in Belarus

The infrastructure for support of small-scale entrepreneurship plays an important role in the general system of business support. As such, this infrastructure is a body of state, non-state, public, and commercial organizations regulating activities of enterprises and providing educational, consultancy, and other services necessary for business development, and sustaining the environment and conditions for conducting entrepreneurial activity.

The major units of infrastructure are centers for entrepreneurship support (CES), incubators of small-scale entrepreneurship (ISE), techno parks, innovation centers, technology transfer centers, funds for financial support for entrepreneurship, and, finally, business associations and business unions.

In the following, a short account will be given about the units of infrastructure for entrepreneurship support currently operating in Belarus.

#### 9.1.1. Centers for entrepreneurship support

The first institution began to spread in Belarus was centers for entrepreneurship support (CES). Officially, they started to operate since 1997, when the Council of Ministers has issued Regulation No. 1111 'On the Centers for Entrepreneurship Support in the Republic of Belarus' on August 1997. Many of these centers have emerged in response to the growing needs of entrepreneurs for consultancy on various issues related to organization and conduct of entrepreneurial activity. Some of the centers have been set up later by both government and non-government organizations.

In general, CES provide consultancy on various issues, ranging from registration and licensing to education and assistance in conducting marketing research, the search for potential investors and sources of financing investment projects. It appears that CES are commercial companies, like consultancy firms. However, their goals of profit-making and sustainable development of private entrepreneurship often tend to conflict each other. Now there are 38 CES operating in Belarus.

#### Brest region

Brest Regional Center for Small Business Promotion

Business-Center Ltd.

Coliseum

'Brest Business Incubator' Ltd.

Yukola-Info-Brest

#### Vitebsk region

Vitebsk Marketing Center

Vitebsk Center for Entrepreneurship Support 'The House of Science and Technology'

Polotsk Center for Support of Entrepreneurship

Novopolotsk Center for Entrepreneurship and Real Estate

#### Gomel region

Gomel Business – Innovation Center

BusinessCenter

BelTrustInfo

State Educational Enterprise for Training and Retraining of Agricultural Personnel of Hoiniki's RIK

EdinistvoServis

#### Grodno region

APSEL

Technology Ltd

Club of Entrepreneurs

#### Minsk region

Borisov Center for Support of Entrepreneurship

Center for Development of Agricultural Entrepreneurship 'Komarovo'

Smolevichi Business Center

#### Mogilev region

Mogilev City Center for Development of Small-Scale Entrepreneurship

Chaussy Business Center

Shklov Territorial Center for Development of Small-Scale Entrepreneurship

Scientific and Analytical Center for Information, Innovation and Technology Transfer

Impulse

Intellect Consulting

AgroCapitalConsult

#### Minsk (city)

Center for Entrepreneurship Support 'BELPRED'

Center XXI Century

ADSGARANT

YurSpektr

Your Life

ENVEK

The Basics of Consumer Knowledge

## BELINMANAGEMENT

Stolny

Technological Park of the Belarusian National Technical University 'Metolit'

Private Extension Courses for Small and Medium-Sized Business of 'Center XXI Century'

### 9.1.2. Business incubators

Incubators are the second important infrastructure units available for entrepreneurs in Belarus. They operate not only to render consultancy services, but also provide office space for starting small firms and entrepreneurs. Office premises are offered below market prices. Also, some associated services are provided like secretaries, use of office equipment, and so on.

Business-incubators are an important tool for regional economic development, aimed at rendering efficient assistance to start-ups or immature companies.

As far as their specialization is concerned, business-incubators might vary widely. Their activity can be focused on either production of goods or provision of services (or, alternatively, on a combination of these). This choice is subject to local conditions specified and/or the goal set. Sometimes, incubators can be more like techno park-type or like innovation centre-type organizations, although in the majority of cases are either business owners (fully or partially) or companies with a record of operation at the market. The establishment and activity of business-incubators are regulated by their statutes and also a range of internal documents specifying credentials and regulations of individual departments and functionaries.

Consultancy services provided by business-incubators cover production and economic issues, conclusion of contracts, information support, educational measures, etc.

These services are available not only to 'incubated' enterprises, but to all startups in a given region.

In general, business-incubators help improving the starting conditions and prospects for survival of inexperienced entrepreneurs. Apart from that, admittance of small and medium-scale entrepreneurs 'firmly on their feet' enables to share experiences of entrepreneurial activity. This is helpful to all participants. Flexible conditions for renting space and, partially, equipment, joint usage of some essential services, assistance to obtaining necessary information, establishing contacts and developing markets, along with spatial proximity to active and dynamics, young entrepreneurs all provide an excellent background for successfully overcoming the difficulties of the starting stage of business development.

In Belarus, the activity of business-incubators is governed by the administrative Regulation No. 640 'On Incubators for Small-Scale Entrepreneurship in the Republic of Belarus' issued on June 4, 1997. In accordance with this Regulation, an incubator is defined as an organization created on the basis of any legal body (irrespective of ownership type) in order to provide special premises to be used as office space or shop floor by small-scale start-up entrepreneurs for the purpose of rendering assistance to them in gradually developing their business and acquiring financial independence.

On May 1, 2007, the list of incubators in Belarus looks as follows:

- 'Map' J.S.C. (Minsk region);
- Science and Production Enterprise 'NPO 'Center' (Minsk);
- 'Mogilev Technological Park' J.S.C. (Mogilev);
- 'Business-Center' J.S.C. (Gomel region, Mozyr City);
- Apsel (Grodno region, Lida City);
- 'Gomel Business and Innovation Center' J.S.C. (Gomel);

- Legal Group 'Law and Order' J.S.C. (Vitebsk);
- 'AkademRemStroiSnab' (Minsk);
- Brest Innovation Business Center Ltd. (Brest);
- 'Trud' J.S.C. (Grodno).

### 9.1.3. Business Unions

There are several large business-unions in Belarus operating at the national and regional levels (including all regional capitals). Below information is provided about the best-known organizations:

National Association 'Business Union of Entrepreneurs and Employers named after Prof. M.S. Kunyavski' (BSPN)

Web-page: [www.bspn.nsys.by](http://www.bspn.nsys.by)  
Phone: +375 (17) 298 1149, 298 3279

The BSPN is a non-profit organization initially established as a voluntary association of non-state companies in order to facilitate market reforms and development of the private sector in Belarus. Today the organization has gone beyond its corporate goals. The Union is an essential part of civil society in Belarus and one of the leading business associations operating at the national and regional levels.

For the BSPN, the major activity has been and is the promotion of enterprise competitiveness and development, creation of new jobs and efficient employment as well as the principal factor behind the formation of a middle class and poverty reduction. For that purpose, the BSPN employs various tools. The organization has the following priorities among its activities:

- The formation of a favorable legal and business environment by taking part in law-making activities;
- Protection of the legal rights and interests of employers with regard to state bodies and social partners such as trade unions;

- Promotion of development of existing commercial units by improving managerial skills, expanding markets and broadening (external) cooperation;
- Support for small and medium-sized startups, initially via making the organization of centers for entrepreneurship support function more efficient;
- Improvement of organizational work, the information provided and analytical aspects of the functioning of the BSPN.

Currently the BSPN has about 200 small, medium and large private companies as its members, including domestically and internationally renowned ones like 'Pinskdrv' J.S.C. (one of the leading furniture producers in Belarus and Russia), 'Milavitsa' J.S.C. (a major lingerie producer), and others.

The Union has been intensively cooperating with the government, Parliament, and the Interagency Committee on Small Entrepreneurship and Interagency Council on Exports. Cooperation is mainly concentrated in such areas as the improvement of legislation regulating business development in Belarus. Also, the interests of entrepreneurs are represented by participating in the work of the National Council on Social and Labor Issues, the Board of the Social Security Fund, the Consultancy Council on Foreign Investment, and a range of their state and public organizations. Also, the protection and representation of the interests of entrepreneurs (both members and non-members of the BSPN) are provided via requests (notes) submitted to the Council of Ministers, various ministries, and other state bodies.

Consultancy and providing information is the most popular type of assistance granted by the lawyers of the Union to Belarusian entrepreneurs. Also, the organization conducts various seminars and trainings on different aspects of doing business in Belarus. This activity helps to consolidate the interests of entrepreneurs by establishing spe-

cial-purpose associations (by now, four of them have been created: of construction companies, infrastructural companies, tourist organizations, and woodcraft enterprises).

The BSPN devotes its efforts to promote a correct understanding by the country's population of the role of business. For that purpose, the quarterly publication 'Business-Press' is issued; in addition, a brochure entitled 'Entrepreneurship BSPN. Business Environment' has been rather popular. The members of the BSPN also joined worldwide agreement on principles of corporate social responsibility.

The BSPN is a regular and reliable partner in many joint projects run by a number of international, foreign, and domestic organizations like the UN Development Program, Eurasia Foundation, USAID as well as projects financed by the German government, ILO, IFC, the World Bank, the Institute for Privatization and Management, and so on, all designed to support Belarus.

National Association 'Belarusian Union of Entrepreneurs'

Web-page: [www.bae.iatp.by](http://www.bae.iatp.by)  
Phone: +375 (17) 227-15-96

The Belarusian Union of Entrepreneurs (BSP) is the national public association of representatives of large, middle, and small-scale private business. The organization consists of about 800 active members, including more than 20 leaders of national organizations, more than 300 corporate executives, along with individual entrepreneurs, experts (economists and lawyers), and journalists all taking part actively in entrepreneurship support programs. In addition, the Union has more than 17,000 associated members. The representatives (coordinators) of the BSP conduct their activity not only in Minsk and the regional capitals, but also more than in 60 smaller regions of the country.

National Public Association 'Belarusian Scientific and Industrial Association'

Address: 15 Marx-street 220050  
Belarus  
Phone: + 375 (17) 227-18-84

The major activities of this association are the establishment of business connections among industrialists, specialists, scholars, and entrepreneurs; expert evaluation of draft legislation and other legal documents; interaction with various administrative bodies and trade unions in order to secure employment; assistance in attracting investment into the Belarusian economy and search for new outlets.

The BSPN also takes part in the preparation and provision of expert analysis of investment and business plans and consultancy and marketing services; participates in setting up efficient systems of legal, economic, technical, and other types of information; studies and promotes the use of advanced forms of industrial and entrepreneurial activity; strengthens the cooperation between sciences and application of scientific endeavors in these areas.

National Council of Trade Union of Workers of Cooperatives, Small-sized Enterprises, and other Forms of Entrepreneurship in Belarus 'Sad-ruszstast' ('Unity')

Address: 21 Pobeditelei-Avenue  
220126 Minsk  
Phone: 375 (17) 203-80-65

The organization provides information on urgent issues related to entrepreneurial activity, including the assistance to solving problems arising in the course of interaction between entrepreneurs and administrative bodies; assists in searching for partners in Belarus and abroad; selects education programs and international exchange programs; holds education seminars on urgent topics, such as assistance to obtaining preferential loans due to job creation and promotion of social development of workers' collectives.

Minsk City Union of Entrepreneurs and Employers (MSSPiR)

Web-page: [www.allminsk.biz](http://www.allminsk.biz)  
Phone. +375 (17) 298 2450, 298 2438, 298 2452

The major directions of Union's activity are as follows:

- Development of personal contacts and professional networking of founders of companies, their executives, and entrepreneurs;
- Promotion of various forms of business cooperation between Belarusian and foreign entrepreneurs;
- Provision of necessary, up-to-date information to the members of the Union;
- Protection of the rights of entrepreneurs and acting for them in various administrative and governing bodies.

Currently, there are more than 800 small and medium-sized enterprises and individual entrepreneurs who are members of the Union. In 2006, all of them have joined worldwide agreement on principles of corporate social responsibility.

Over 2006–2007, the MSSPiR has organized and held a number of meetings of the Metropolitan Business Club of Directors, the Creditors' Club, the international Trading Club, several national and international conferences, and a range of other events. Apart from that, various seminars have been organized and consultation has been provided for accountants and financial officers of small and medium-sized companies as well as educational seminars held for individual entrepreneurs.

On March 27, the MSSPiR and regional business associations of Brest, Vitebsk, Gomel, Grodno, and Mogilev have jointly held a conference 'Twenty Years of Belarusian Entrepreneurship: From Cooperatives to the National Business Platform of Belarus'. The event was marked by the presentation of the 'National Business Platform of Belarus' (NBP). The latter has been prepared jointly with the Scientific Mises Research Center, the Research Center of the Institute for Privatization and Management, and the MSSPiR in cooperation with regional business as-

sociations of Brest, Grodno, Gomel, Vitebsk, and Mogilev.

One of the ways to protect the rights and act for the interests of entrepreneurs is participation in law making. In the course of productive cooperation with various levels of authority, the Union does not only provide them with information about the problems of entrepreneurship in Belarus, but also offers specific propositions on improving the business environment in Belarus.

There are following regional business associations (regional associations) currently registered in Belarus:

- Public association 'The Union of Entrepreneurs of Brest Region 'Assistance';
- Gomel regional organization of the trade union of workers of cooperatives, small-sized enterprises, and other forms of entrepreneurship 'Sadrusznast' ('Unity');
- Public association for the promotion of private entrepreneurship 'Sadrusznast' 'Unity' (Gomel City);
- Public association of entrepreneurs of Mogilev region;
- Public association 'Association of Employers and Entrepreneurs' (Vitebsk City);
- Grodno regional organization of the trade union of workers of cooperatives, small-sized enterprises, and other forms of entrepreneurship 'Sadrusznast' ('Unity').

Public Association 'The Union of Entrepreneurs of Brest Region'

Web-page: [www.bae.iatp.by](http://www.bae.iatp.by)  
Address: Internatsionalnaya-street 17 Brest

The public association 'The Union of Entrepreneurs of Brest Region' is a non-profit organization that unites executives of private companies, individual entrepreneurs, journalists, lawyers, economists, and accountants on a voluntary basis. This organization takes an active part in

entrepreneurship development and support programs.

The public association has the following directions of activity set:

- Representation of the interests of entrepreneurs to the executive authorities: City and District Executive Committees and Brest Regional Executive Committee
- Assistance in the area of labor legislation, provision of work record cards, necessary literature and comments on the Labor Code;
- Consultancy on issues related to the Civil Code;
- Protection of the rights and interests of entrepreneurs;
- Establishment of international linkages in order to search for potential investors and business partners (in particular, Cooperation Agreements have been concluded with the Council of Entrepreneurs under the Auspices of the Mayor and the Government of Moscow, Slovak and Czech Trade Chambers);
- Conduct of cultural events: celebration of the Day of Renaissance of Entrepreneurship, Christmas parties, etc.
- Organization of business trips to the countries of Western Europe for the purpose of signing cooperation agreements with public and business associations and acquainting with the sights and culture of countries visited;
- Assistance in obtaining of funding from the special financial support funds of the region;
- Conduct of free-of-charge seminars on labor issues.

A big role in the development of entrepreneurship and private sector in Belarus is played by a nationwide association of non-profit organizations entitled 'Confederation of Industrialists and Entrepreneurs (Employers)'. This organization (or Union 'KPP(N)')

or simply 'Confederation') is a union of non-profit organizations that solidly represents employers, industrialists, and entrepreneurs working in Belarus. The Confederation has been set up on May 28, 1993 by three founding unions of industrialists, entrepreneurs and employers: the Belarusian Scientific and Industrial Association, the Belarusian Union of Entrepreneurs, and the Belarusian Union of Entrepreneurs and Tenantry.

Initially, the Confederation has functioned as a coordination and consultative body (while not being legally entitled) in order to develop integrated approaches and make decisions on a parity basis. For the purpose of closer coordination of employers' activities, included within the framework of the National Council on Labor and Social Issues, the Confederation was registered on September 10, 1996 at the Ministry of Justice of the Republic of Belarus as a legal corporate body (or, in fact, as a public association). Following a change in legislation, on December 29, 1999, the Confederation has been reorganized and re-registered at the Minsk City Executive Committee by turning it into the non-profit association of legal entities.

Currently the Confederation consists of 11 unions and associations (as public associations).

Being an umbrella-type nation-wide organization and a social partner at the national level, it is acknowledged as the most representative association of industrialists, entrepreneurs, and employers of Belarus. Nowadays, the KPP(N) consolidates and represents the interests of about 5,000 enterprises and organizations (including leading national companies) totally employing approximately 60% of laborers of Belarus and producing more than 70% of the country's GDP. As for the membership profile, about 80% (about 4,000) members of the Confederation are small and medium-sized companies, and more than 70% of the members (about 3,500) belong to the private sector. In the National Council on

Labor and Social Issues, representatives of the Confederation are provided nine seats of eleven reserved for employers (while two other places are provided for employers cooperating with the Confederation).

#### 9.1.4. Specialized public associations and associations for entrepreneurship development and promotion in Belarus

Besides centers for entrepreneurship support, business-incubators and business unions, there are plenty of specialized public organizations and associations functioning on a voluntary basis in the field of promotion of entrepreneurship and private sector development. Some of their members are relatively large-scale organizations playing a considerable role in the development of entrepreneurship and protection of the rights and interests of entrepreneurs, while some of them are rather small.

Below a list including the majority of these organizations is provided:

- Public association 'Belarusian Union of Taxpayers' (BSN) unites taxpayers, such as specialists and executives (of legal entities).
- National Union of Employers (BelSN) is a national public association of employers. A number of small and medium-sized companies are affiliated with this Union via regional and branch organizations of employers. For instance, Vitebsk region Union of Employers (VOSN) unites about 400 companies located in that region.
- Belarusian Association of Carriers (BAMAP) is a national organization of legal entities operating in the transport sector and specializing in international transport services;
- Belarusian Chamber of Commerce and Industry (BelTPP) unites hundreds of exporters;
- Belarusian Union of Builders (BSS) is an association of construction companies and producers of building materials;

- Belarusian Agro-industrial Union (BelAPS) is an association of organizations operating in the fields of agriculture and agricultural production;
- Belarusian Associations of Radioelectronics, Informatics, and Instrument-making enterprises (BelREIP) unites legal entities (enterprises) working in these branches of the economy;
- Belarusian public association of lawyers specializing in economic issues;
- Belarusian public association of accountants and auditors;
- Belarusian public association of dentists;
- Belarusian public association of farmers;
- Belarusian public association of specialists on anti-crisis management and bankruptcy;
- Belarusian public association of auditors;
- Public association 'Avtoperevozchik' ('carrier');
- Public association 'The Guild of Professional Interpreters';
- Public association 'Association of Owners and Drivers of Vehicles';
- Public association 'Belarusian Union of Lessees';
- Public association 'Belarusian Motor-car Federation';
- Public association 'Belarusian Association of Accountants';
- Public association 'Belarusian Association of Assessors';
- Public association 'Belarusian Association of Women Lawyers';
- Public association 'Belarusian Association of Administration and Management';
- Public association 'Belarusian Association of Transport Experts and Analysts';

- Public association 'Belarusian Association of Forwarding Agents';
- Public association 'Club of Entrepreneurs';
- Public association 'Guild of Marketing Specialists';
- Public association 'Non-government Association of Belarusian Motor Transport Users';
- Public association 'Mogilev City Union of Entrepreneurs and Taxpayers';
- Public association 'Association of Light Industry Entrepreneurs';
- Public association 'Taxi of the Republic';
- Public association 'Belarusian Union of Designers';
- Public association 'Belarusian Union of Transport Workers';
- Public association 'Belarusian Insurance Union';
- Public association 'Belarusian Association of Industrialists and Entrepreneurs'.

## 9.2. State support of entrepreneurship in Belarus

Every year a special State Program for the Support of Small-scale Entrepreneurship is adopted in Belarus. The Program declares the importance of the development of entrepreneurship in the country and promises to provide generous support by, among other aspects, simplification of the regulatory environment. However, these promises are far from being fulfilled in full so the targets and directions of activity adopted are 'successfully transferred' to next year's program.

The major standings of the State Program for Support of Small-scale Entrepreneurship in the Republic of Belarus for 2007 are provided below<sup>24</sup>:

<sup>24</sup> The Program is adopted by special Regulation No. 264 of the Council of Ministers of the Republic of Belarus on February 28, 2007.

### *The aim and purposes of the Program:*

The Program is aimed at promoting the further development of small-scale entrepreneurship, facilitating the increase of the share of small-scale entrepreneurship in the total volume of revenue (generated by all economic units in the Belarusian economy as a result of goods sold and serviced provided), the number of small-sized companies, and creation of new jobs in this sector.

In order to achieve the aim specified above, the following major tasks have to be fulfilled:

- Improvement of existing legislation, regulating the assistance to and development of small-sized economic units;
- Assistance in the provision of financial aid to these units;
- Provision of material aid to small-sized economic units;
- Development of the infrastructure necessary for the expansion and support of small-sized entrepreneurship;
- Upgrade of information services to small-scale entrepreneurship;
- Establishment of international linkages in the field of small-scale entrepreneurship;
- Improvement of the educational and training system for employees of small-sized firms.

### *Program financing*

Program activities are to be financed by the state budget at the volume of BYR 206.4 million, while another BYR 192 million are to be used by the Belarusian Fund for the Financial Support of Entrepreneurs. In addition, local budgets would assign BYR 1.972 million. The Program suggests to use other sources of funding amounting to BYR 1,000,998 million, of which BYR 1 trillion would come from commercial banks.

### *The expected results of program implementation*

It is expected that the implementation of various measures stipulated by the program would enhance the development of the entrepreneurial sector, suggest positive dynamics of growth of the number of small-sized companies, and, in first instance, in small and medium cities and towns and at the countryside. These measures, in turn, would allow reducing social tensions by securing employment and providing higher incomes of the population and to level and decrease social risks arising in the course of economic transformation, and also increase the efficiency of interaction between the state and civil society. It is envisaged that the program implementation would result in increasing the share of small-scale entrepreneurship in the total volume of revenue collected by economic units from selling goods or rendering services to a level of 22.8% in 2007; bring the number of small-sized companies up to 34,000 units, and raise the share of employees working for small-sized companies as well as individual entrepreneurs to 15.3% of the economically active population.

## 9.3. Business unions, business associations, and Belarusian SMEs: the empirical data

The results of our survey show that 10% of SMEs belong to business unions. This indicator tends to decrease in comparison with the results of the previous surveys. In 2005, this figure was 15%, while in 2002 – 16%. As for branch affiliation, the structure seems to be rather even.

However, the following trend can be observed: the longer the market history of a company, the larger the likelihood of its membership in either business union (table 9.1). At the same time, new companies seem to be reluctant to join business unions either because there is no information about this possibility or there is a lack of confidence in the necessity of such membership.



According to the results of the survey, SMEs are reluctant to join various associations of entrepreneurs because these are perceived as incapable of solving the problems companies are confronted with (39.8% of respondents). Also, the lack of information about the activities of these associations is mentioned (37.8%). In 2007 as against 2005, the reasons for not-joining have not changed (Figure 9.1).

Advertising and raising awareness of entrepreneurs about the opportunities and advantages of membership in associations of entrepreneurs could encourage them to join and, via increased membership, enhance the negotiating position of business and thus broaden their opportunities to advance and protect its interests.

The reason for the rather modest membership figures provided above is that about half of Belarusian SMEs is not inclined to contribute to improvement of the business climate in the country (43.9% of the respondents). Such passivity of business actors precludes some positive developments in the business environment change.

However, less than one-third of polled entrepreneurs (25.6%) are ready to take part in the preparation of documents and implement other measures to improve the business environment in Belarus personally. At the same time, 21.9% of the survey participants express their agreement to grant material (or any other type of) aid, while 11.2% of them said that aid can only be provided in case their personal interests are somehow served, and another 10.7% is ready to provide assistance unconditionally. Nevertheless, the data show that the number of those who are ready to support any measures on improvement of domestic business climate have decreased in 2007 as against in 2005. (table 9.2).

In 2005–2006, experts of the Analytical Center ‘Strategy’, Minsk City Union of Entrepreneurs and Em-

**Table 9.1: Answers to the question: ‘Is your company a member of any business union’ (given the year of establishment) (%)**

	The whole sample	Established prior to 1996	Established between 1997 and 2004	Established in 2005 and later
Members	10.3	16.5	9.3	3.9
Non-members	89.7	83.5	90.7	96.1
Total	100.0	100.0	100.0	100.0

Source: IPM Research Center.

#### Box 5: Business Unions and Associations

Usually, chambers of commerce, trade and industry groups, professional associations, employers’ confederations, associations of employers, unions of representatives of small-sized business, etc. are organized as business unions and associations. They lobby for the interests of business and also fulfill institutional roles in the development of social dialogue<sup>25</sup>.

As for the most important business associations, these are often trade and commerce chambers that could be organized in a ‘continental’, ‘Anglo-Saxon’, or a ‘mixed’ way. The difference lies in the membership principle (either compulsory or voluntary).

A ‘*Continental Model*’ is typical for France and Germany. Membership is compulsory here, while the Chamber is provided with extended powers delegated by the government. Also, it is liable to obtaining state subsidies. The model suggests the existence of regional affiliates, thereby creating the ground for some monopolization. The major deficiency of this model is some uncertainty related to a ‘double subordination’ to the state and the private sector.

As for ‘*Anglo-Saxon Model*’, existing in Great Britain and the U.S.A., the membership is voluntary. Chambers are not subordinated to the state in any way, and also free to set up the rates of membership fees and define services to be offered. Here chambers compete with each other.

A ‘*mixed Model*’ (Japan, Russia) imply the use of a single model blended with the elements of another one.

In general, the strength and power of either association of entrepreneurs are not always related directly to its size (the number of its members). For instance, in 2004, the Chamber of Commerce and Industry of the Republic of Kazakhstan incorporated only 424 companies (421 in 2005), but provided services to more than 40,000 other enterprises<sup>26</sup>. A meaningful role for the chamber of commerce and industry in Kazakhstan is established by existing legislation that stipulates a separate legal form for a non-commercial, non-government organization granted with a rather broad set of rights.

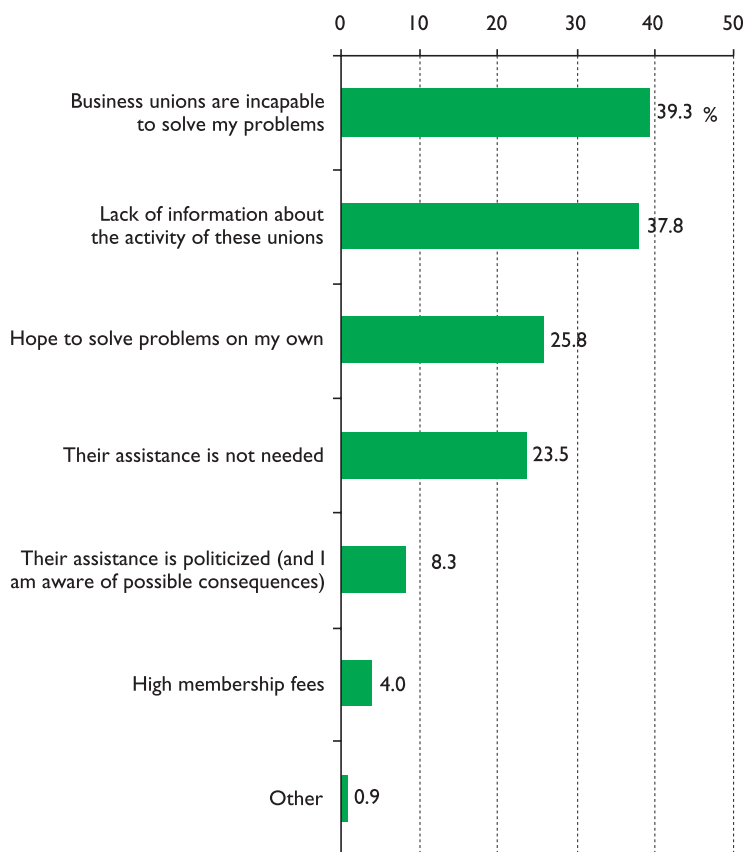
In Russia, there are numerous business associations divided according to territory and branch affiliation. The Russian Union of Industrialists and Entrepreneurs (Employers), the All-Russian Public Organization ‘Delovaya Rossiya’ (‘Business Russia’), the National Public Organization of Small and Medium-Scale Entrepreneurship ‘Opora Rossii’ (‘Foothold of Russia’) are the largest ones. These organizations represent and promote the interests of large, medium and small business, respectively. Each of these associations has huge membership (for instance, the members of the Russian Union of Industrialists and Entrepreneurs collectively produce up to 60% of Russia’s GDP<sup>27</sup>). However, in order to strengthen the bargaining position with the government of the Russian Federation, the above-mentioned organizations established the Coordination Council of Business Unions.

<sup>25</sup> Romanchuk, Y. (2004) Development for the Sake of the Future. International Finance Corporation. Analytical Bulletin *Small and Medium-sized Business in Belarus*, No. 17.

<sup>26</sup> The Chamber of Commerce and Industry of the Republic of Kazakhstan (2005) *The Concept of Development for 2005–2007*, <http://www.cci.kz/179>.

<sup>27</sup> Web-page of the Russian Union of Entrepreneurs and Employers, <http://www.rssp.ru/>.

**Figure 9.1: Answers to the question: 'Why have you not joined any association of entrepreneurs?' (maximum three answers are allowed) (%)**



Source: IPM Research Center.

**Table 9.2: Answers to the question: 'How would you personally assist the development of the business climate in the country?' (%)**

	2005	2007
Not ready	43.5	43.9
Ready to provide material (or other types of) aid to an association of entrepreneurs in case issues of personal concern are addressed	30.5	11.2
Ready to provide material (or other types of) aid in order to implement any business environment-improving measures	8.0	10.7
Ready to participate personally in the preparation of documents and other events aimed at improving the business climate in the country	11.5	25.6
Other	1.3	2.7
No answer	5.3	7.1
Total	100.0	100.0

Source: IPM Research Center.

ployers, and the Research Center of the Institute for Privatization and Management have developed a National Business Platform. The document contains a range of proposals on the six most urgent issues improving the business climate:

protection of property rights and development of market economy institutions; taxation; licensing and permit issuance; inspections, fines, and penalties; registration and liquidation; access to information and openness of administrative bod-

ies<sup>28</sup>. The document does not only address the issues of conducting business in Belarus, but also suggests ways of solving them.

The survey shows that about 40% of respondents are more or less familiar with the provisions of the Platform. It appears that the supporters and the opponents are approximately equally distributed (table 9.3). The Platform is most supported in the Brest and Vitebsk regions and in Minsk City. Entrepreneurs of Mogilev City display the lowest level of awareness.

It follows that SMEs employing between 50 and 200 people are most informed about the provisions the Platform offers (table 9.4). It is interesting that the representatives of relatively big medium-sized business (employing more than 200 people) may be aware, but are unsupportive or never heard about it. This may be explained by a larger capacity to adapt to the existing business environment so relatively large-scale business are reluctant to change the established rules of the game, or simply don't care about it.

As for branch affiliation, least supportive to the provisions of the Platform are people operating in construction, manufacturing, and trade (table 9.5).

Now the Platform is being updated. Every single entrepreneur is invited to offer his or her propositions either by sending them via regular mail or by simply calling the Minsk City Union of Entrepreneurs and Employers.

<sup>28</sup> More information about the platform can be found at the web-site of the Minsk City Union of Entrepreneurs and Employers at: <http://allminsk.biz/content/blogsection/8/74/> or Mises Research Center <http://liberty-belarus.info/>.

**Table 9.3: Regional profile and answers to the question: 'Are you aware of the National Business Platform and its major provisions?' (%)**

	Minsk and Minsk region	Brest region	Grodno region	Vitebsk region	Gomel region	Mogilev region	Total
Fully aware and support	3.3	–	–	–	2.9	–	2.2
Aware and rather support	17.8	32.1	11.8	35.0	5.9	7.4	18.3
Aware, but rather not support	13.6	–	17.6	5.0	23.5	7.4	12.6
Aware, and do not support at all	3.7	–	5.9	2.5	8.8	–	3.7
Not aware, hear about it for the first time	60.3	67.9	61.8	52.5	58.8	85.2	61.7
Other	1.2	–	2.9	5.0	–	–	1.5
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IPM Research Center.

**Table 9.4: Company size and answers to the question: 'Are you aware of the National Business Platform and its major provisions?' (%)**

Number of employees	From 1 to 10	From 11 to 50	From 51 to 100	From 101 to 200	More than 200
Fully aware and support	2.2	1.6	1.6	10.0	–
Aware and rather support	12.7	20.7	27.0	10.0	–
Aware, but rather not support	9.0	9.8	25.4	20.0	25.0
Aware, and do not support at all	2.2	4.9	4.8	–	–
Not aware, hear about it for the first time	73.9	60.3	41.3	55.0	75.0
Other	–	2.7	–	5.0	–
Total	100.0	100.0	100.0	100.0	100.0

Source: IPM Research Center.

**Table 9.5: Company specialization and answers to the question: 'Are you aware of the National Business Platform and its major provisions?' (%)**

	Trade	Catering	Domes- tic ser- vices	Manu- facturing	Con- struc- tion	Trans- port and com- muni- cation	Consul- tancy	Educa- tion	IT services
Fully aware and support	2.4	4.3	2.4	–	–	9.1	–	–	–
Aware and rather support	15.2	21.7	12.2	18.3	24.4	22.7	50.0	25.0	36.4
Aware, but rather not support	10.4	4.3	4.9	14.1	20.0	18.2	–	25.0	27.3
Aware, and do not support at all	4.3	–	4.9	2.8	6.7	–	–	–	–
Not aware, hear about it for the first time	67.1	65.2	70.7	64.8	46.7	45.5	50.0	50.0	36.4
Other	0.6	4.3	4.9	–	2.2	4.5	–	–	–
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: IPM Research Center.

## 10. CONCLUSIONS AND RECOMMENDATIONS

Small and medium-sized business in Belarus plays a certain role in the social and economic development of the country. However, the total number of SMEs (and individual entrepreneurs), the share of their output in GDP, their retail turnover and employment continue to be marginal. Even worse, there has been no change over the last five years. At the same time, the unduly ambitious plans of the government to increase the share of SMEs in the GDP and employment could be realized as soon as coherent policies simplifying the regulatory environment for SMEs' functioning are implemented.

Without the assistance of the government and the parliament, small business in Belarus has a chance to remain small-scale, and not a medium, one with no 'margin of safety' at all. Accordingly, it is exposed to greater risks of bankruptcy when the economy would be more open (for instance, for inflow of capital from Russia). In addition, the feeble dynamics of set-ups and the low number of SMEs per 1,000 people (in comparison not only with the market economies, but also with the neighboring countries of the CIS) all lead to low competitiveness among domestic SMEs. This situation, in turn, leads to higher domestic prices, lower quality of SMEs' production, and weaker dynamics of their innovation and investment activities.

Entrepreneurs identify the following major, often interrelated problems of the regulatory environment:

1. *Taxation*: Our research has shown that the tax system of Belarus is the strongest impediment to enterprise development. Tax rates are not a problem per se. Rather, the trouble is related to unstable, incoherent and even contradictory tax laws, the lack of access

to information, and considerable expenditures of time and labor to calculate taxes.

2. *Big number of inspections and excessively heavy fines*: Entrepreneurs often mention an unbiased attitude of inspection bodies along with the inability to defend their interests in the environment characterized by discretionary powers of inspectors (capable to arrest enterprise's activity for a while). Also, inspectors sometimes display incidental ignorance of legislation. The variability and inconsistency of legislation amplified by the existence of numerous inspectors make entrepreneurs victims of the existing regulatory environment.
3. *Price regulation* (ranging from regulation of price calculation, their change due to the lack of access to information about some aspects of relevant legislation): as a rule, government regulation of prices diverts considerable labor and material resources from more productive usage and does not lead to the desirable prevention of price increases. On the one hand, there are both formal and informal opportunities for setting prices at a level needed by a company within the framework of existing legislation. On the other hand, the share of output produced by SMEs in the total output and retail turnover is too small to impact the inflation rate in the country.
4. *Excessive paperwork and complicated administration procedures*: this problem has many aspects, since it is present in nearly all spheres of regulation – from taxes to wage regulation.
5. *The system of obtaining permits and licenses* is still far from the

standards of a market economy. It is bulky, labor-demanding, and expensive.

Next, our research has shown that entrepreneurs encounter similar groups of factors that are observed across all of the aspects analyzed that define the content of the business environment for small and medium enterprises:

1. Legal deficiencies – existing legislation is complex, contradictory, and unstable. Accordingly, it is often hard to fulfill all of the requirements demanded by the law.
2. Overregulation – all spheres of enterprise's activity are regulated in great detail and in a very tough way. As a result, efficient strategies and tactics of enterprise behavior are difficult to choose.
3. High costs of various kinds, both material (financial costs to pay taxes, fines, duties, extortions, bribes, wages of those who monitor accounting and permission procedures, etc.) and non-material costs (time and labor spent to fulfill the demands set by existing legislation and public administrative bodies), formal and informal alike.
4. Insufficient access to information and low levels of competence of inspectors working for public bodies; this does not allow following the whole multitude and variability of rules and requirements related to enterprise's functioning or to obtain the necessary information on time.

Apart from that, entrepreneurs have often pointed to the unequal conditions for carrying out business activity in comparison with the public

sector and disclosed numerous instances of administrative intervention given the defenselessness of private companies in the face of public bodies.

It should be noted that such suppression of private enterprise is a rather inefficient economic policy tool. This leads to a variety of negative consequences that are not yet fully comprehended by policy-makers. First, it *leads to the formation of a very business-unfriendly climate* creating numerous impediments to enterprise development. As a result, the costs of conducting business grow considerably, resources are diverted from more productive utilization, and effective business strategies are hard to implement. Consequently, SME competitiveness becomes constrained, thereby hampering the development of some enterprises, while others are even forced to stop their activities altogether. Therefore, the task of a drastic increase of the share of small and medium business in the Belarusian economy appears to be far from accomplishment.

Second, *the complete number of regulations, orders and bans are applied inefficiently* in real life. Naturally, all these rules are impossible to follow in reality. Also, their fulfillment would inflict costs threatening the very existence of companies as such. According to our estimates, every fifth enterprise tries to respect all of the requirements provided by the regulatory environment. As for the others, they opt for various forms of resistance – active and passive, formal and informal ones that go beyond existing legislation.

Third, the complexities and over-regulation observed in the business environment along with the administrative arbitrariness *all prevent the formation of respect towards government institutions, law abidance, and the inclination to follow 'the rules of the game'*. Rather, economic 'dissent', legal nihilism and the desire to bypass various bans and restrictions are encouraged. The state is perceived as some alien and hostile

external force. Accordingly, there is a danger of an 'institutional trap'. In this situation, the efficiency of government policies to improve the business climate (if such policies are to be implemented at all) could decrease. This is because entrepreneurs would not be ready to change their behavior and mental attitudes developed in a distorted institutional environment. As a result, destructive stereotypes would prevail.

Fourth, the existing regulatory environment contributes to *a negative perception of Belarus and its business climate*. As a result, Belarus has low volumes of foreign direct investment.

When the interests of business and the state diverge, both parties suffer. In order to find a proper way out, a number of major factors 'responsible' for the adverse business environment are singled out next. *First*, there are the economic policies implemented at the national level. These policies are mainly based on 'manual regulation' of major economic processes. Accordingly, private entrepreneurship appears to be a *de-facto* a hostile element for those who conduct such policies. *Second*, the quality of existing legislation is low. It is too complicated, unstable, and contradictory, resulting from economic policies attempting 'to keep an eye on everything' and the lack of professionalism when drafting laws. *Third*, there are the policies of local authorities that distrust private business and perceive it as a source of material and non-material resources. *Fourth*, the behavior of entrepreneurs also plays its role. In particular, this behavior is to some extent strengthening the current dysfunctional nature of economic relations in the country (although it is not their fault, but rather their misfortune). At the same time, entrepreneurs do not use all opportunities available to increase their protection from the adverse factors of the business environment and to secure the development of their enterprises.

Providing specific recommendations on each of the directions and the

barriers of the regulatory environment discussed above go beyond the tasks of this publication. Below we provide only two major directions necessary for the future development of the Belarusian SME sector.

First of all, it is *necessary to abolish two major types of barriers, such as ideological and legal-administrative*. The attitude towards private initiative has to be changed and systemic contradictions and conflicts between entrepreneurs and the state have to be resolved. Entrepreneurs should be turned from potential criminals to one of the pillars of the country's development. Also, substantial changes in existing legislation are required, including simplification of existing legislation and the abolition of numerous barriers. This would allow turning entrepreneurship into a force capable of increasing the efficiency of functioning of the domestic economy as a whole.

Second, following the pattern of developed market economies, there should *be active forms of support for entrepreneurs implemented* in Belarus. Laissez-faire policies (that many Belarusian entrepreneurs advocate these days by claiming that the 'best form of support is non-interference'<sup>26</sup> appear to be inadequate. Without a doubt, the consequences of the reduction of the regulatory burden would soon become apparent. On the long run, however, entrepreneurs would experience growing difficulties related to the emergence of new challenges to their development.

Belarus is to a large extent an open economy subject to an international competitive struggle. As soon as the factors of development stemming from favorable terms of trade with its neighbors are exhausted, domestic producers could lose their competitive advantages. In turn, the support for domestic entrepreneurs should not mean protectionism, but the measures aimed at enhancing innovative capabilities of SMEs both internally and externally. The major

<sup>26</sup> See *Belarusian Business 2006: The State of Affairs, Trends, and Prospects*, available at: <http://research.by/pdf/business2006r.pdf>.

directions of such support would cover the system of skills upgrade of managers and employees, transfer of new technologies, provision of loans, development of innovation networks and best practices, and so on.

In order to simplify 'entry conditions' and increase the number of entrepreneurs, the following measures have to be implemented:

- Adoption of a law on registration to make procedure more stable;
- Introduction of a silence-is-consent registration method;
- Reduction (approximately two-fold) of the number of documents necessary for registration;
- Abolition of unjustified reasons for refusal of registration. The only reasons to refuse registration should be a lack of necessary documentation or submission of the documents to an improper administrative body;
- Withdrawal of the right to make registration decisions for Executive committees. However, this problem could be solved by setting up a single registration body (following the experience of some other countries).

Apart from that, *the draft Law on Registration and Liquidation* could meaningfully incorporate the following provisions:

- It should be unequivocally stated that liquidation is permitted following the decisions of property owners (founders, partners) or the court. Registration bodies should not decide about liquidation. Apart from that, the reasons for liquidation based on a court decision should be trimmed two-fold at least;
- All five procedures for reorganization, the sequence and the order of registration should be clearly defined. As for reorganization, organizational and legal forms that any unit wants to be transformed into have to be clearly specified;

- The content of the procedures for reorganization and liquidation has to be simplified as much as possible; in particular, the number of documents required for submission has to be reduced, a one-stop-shop principle has to be utilized so economic units are not bothered with collective unnecessary documentation;
- The practice for simplified liquidation has to be extended further; this is particularly relevant for those units that either have not started activity at all or have not carried out any activity for a long period time;
- A-silence-is-consent principle has to be introduced for reorganization and liquidation.

In the field of *licensing*, the following measures seem to be necessary:

- Adoption of a special Law on Licensing (following the example of Russia);
- Reduction of the number of licensed types of activity by establishing an exhausting list and preventing its further 'expansion', adding new subtypes included;
- Revision of license requirements and conditions by excluding bureaucratic discretion and competition-constraining measures;
- Reduction of the number of documents required for obtaining a license;
- License could only be withdrawn following a court decision;
- Legal continuity has to be ensured in case of reorganization.

Despite the fact that *certification* now seems to be properly regulated, some additional improvements could be introduced:

- The government (as it had been established once) should provide an exhaustive list of goods that should be certified;
- The list should not be amended too often;

- Adaptation periods should be provided in case new goods are inserted into the certification list;
- Making the activity of certification agencies more transparent and simplification of their certification procedures.
- Certificates of conformance issued by other countries should be accepted in Belarus more broadly that it is now.

No substantial changes have been made in the functioning of *the taxation system*. Still, it is riddled with a number of deficiencies. When these are properly addressed, taxation in Belarus could be considerably simplified and the tax burden could be reduced to release financial resources:

- A Special Section of the Tax Code is not yet adopted, thus leading to a continuous and unproductive change of legislation on individual taxes;
- A considerable number of subordinate legislation on individual taxes makes the taxation system complicated and incoherent;
- The excessive number of taxes, including turnover taxes. The latter could be abolished (or at least reduced in number), as many experts and entrepreneurs demand quite reasonably;
- Periods of taxation are far from being optimal for business, while the accounting system is rather complicated making time losses;
- Despite some reduction, penalties are too heavy, and often imposed for minor transgressions.

With regard to *pricing*, the following policy measures are suggested:

- Price regulation and controls should be applied only to monopolies and producers of 'socially-important' goods and services (i.e. goods demanded by the vast majority of the population, including low-income groups);

- At the same time, the list of these 'socially-important' goods and services has to be made exhaustive;
- Redundant pricing controls and discretion of control agencies in the sphere of pricing have to be abolished;
- Price declarations have to be abolished; otherwise it would facilitate direct interference into pricing decisions of economic entities. Also, some 'indirect' controls have to be abolished.
- Administrative agencies have to establish clear-cut and accessible rules for passing the administrative procedures required;
- As for more general aspects of this process, a one-stop-shop principle and a silence-is-consent method have to be deeply entrenched; permits have to be prolonged automatically if no transgression is recorded.

*The administrative procedures* could be improved in the following ways:

- A special baseline Law on Administrative Procedures has to be adopted (along with other legislative acts). This legislation has to provide clear-cut criteria for executing administrative procedures, delimit the authority of various public bodies in this domain along with exhaustive lists of necessary documents, charge rates, etc;
- This law should act as a benchmark for streamlining existing legislation so that all unnecessary administrative procedures will be abolished or simplified;
- The relevant information has to be available in full and free of charge for everyone, while the administrative agencies have to provide entrepreneurs with prompt and free interpretation of existing legislation;
- General control principles (principle of legality, presumption of bona fides of the inspected);
- Interpretation of existing controversies for the benefit of the inspected;
- Definition of the methods of inspection activity;
- Delineation of rights, obligations and responsibilities of both inspectors and inspected;
- Determination of comprehensive inspection procedures.

*Inspections* remain an important problem for private business. The analysis made in Chapter 3 calls for the adoption of a separate Law on Controls. This legislation should provide the following:

Finally, there is the important problem of *sanctions*. Often, penalties are high and even 'business-ruinous' and applied even in the case of minor transgressions. The reduction of penalties would make the conditions for conducting entrepreneurship in Belarus much more business-friendly.

## APPENDIX: ANSWERS TO QUESTIONS POSED IN THE QUESTIONNAIRE 'DEVELOPMENT OF SMALL AND MEDIUM-SIZED ENTERPRISES IN BELARUS'

### 1. What is the major field of business your company is engaged in?

	Number of SMEs	%
Trade	165	40.2
Catering	23	5.6
Domestic services	41	10.0
Production (industry)	74	18.0
Construction	46	11.2
Transport and communication	22	5.4
Consultancy	2	.5
Education	4	1.0
IT Services	11	2.7
Other	22	5.4
<b>Total</b>	<b>410</b>	<b>100.0</b>

### 2. What is the legal form of your company?

	Number of SMEs	%
Unitary enterprise	132	32.2
Limited liability company	150	36.6
Double liability company	74	18.0
Public corporation/joint stock company	23	5.6
Close corporation/joint stock company	18	4.4
General partnership	2	0.5
Production cooperative	9	2.2
No answer	2	0.5
<b>Total</b>	<b>410</b>	<b>100.0</b>

### 3. How many people are employed at your company?

	Number of SMEs	%
From 1 to 10	134	32.7
From 11 to 50	187	45.6
From 51 to 100	64	15.6
From 101 to 200	20	4.9
Above 200	5	1.2
<b>Total</b>	<b>410</b>	<b>100.0</b>

### 4. When was your company established?

	Number of SMEs	%
Prior to 1996	97	23.7
1997–2004	261	63.7
2005–2006	52	12.7
<b>Total</b>	<b>410</b>	<b>100.0</b>

### 5. What is the personnel structure of your company (%)

- Rank-and-file employees – 70%
- Mid-level managers – 17%
- Executives – 13%



**6. What are the major obstacles to the development of your company? (%)**

	No importance	Small importance	Medium importance	Considerable importance	Crucial importance
1. Insufficient demand	21.5	18.7	26.4	26.2	7.2
2. High material costs (of inputs)	23.1	19.9	21.3	26.6	9.0
3. Capacity limitation	28.0	19.1	32.5	14.9	5.5
4. Small size of shop-floors	29.8	25.7	26.4	13.9	4.2
5. Lack of own funds for company development	13.5	17.3	32.1	23.7	13.3
6. Lack of attractive loan offers (by banks and other financial institutions)	20.6	19.8	27.6	21.6	10.3
7. Lack of proper skills to run a company	42.5	32.5	15.6	7.7	1.8
8. Lack of ideas about conducting business	33.4	28.3	23.9	11.3	3.1
9. Lack of qualified personnel	31.4	22.2	26.3	15.3	4.8
10. High labor costs	21.6	26.8	31.7	17.3	2.6
11. Lack of funds to hire new employees	32.9	26.7	22.8	13.5	4.1
12. High firing costs	45.6	31.3	12.3	9.7	1.0
13. Unstable economic situation in the country	12.2	16.6	23.5	27.0	20.7
14. The fear of making a decision resulting in losses	24.4	23.9	28.3	18.0	5.4
15. Tough market competition	10.1	13.1	26.3	32.6	17.9
16. High taxes	3.1	6.6	18.8	38.7	32.8
17. Complicated tax system and the need to pay other dues	4.6	7.7	20.0	33.3	34.4

**7. Does your company have many competitors?**

	Number of SMEs	%
No competitors	9	2.2
Few competitors	95	23.2
Many competitors	306	74.6
Total	410	100.0

**8. How has competition changed during the last three years?**

	Number of SMEs	%
Intensified	296	72.2
No change	87	21.2
Decreased	11	2.7
Hard to answer	16	3.9
Total	410	100.0

**9. Please list major competitive advantages of your company as of today (maximum three answers are allowed)**

	Number of SMEs	%
Professional, well-trained staff	249	60.7
Knowledge of the market, the ability to predict market development	175	42.7
The ability to produce competitive products	151	36.8
The awareness of contemporary market technologies	70	17.1
Efficient personnel management	85	20.7
Strong management team	75	18.3
Ties with administrative agents 'persons of importance'	44	10.7
Knowledge of existing legislation	53	12.9
Development and application of strategy and philosophy of company	58	14.1
Other	12	2.9
No answer	3	0.7

**10. How many people at your enterprise are dealing with reporting to administrative agencies?**

3.14 people.

**11. How much time do you devote to communicating with administrative agencies (i.e. contacts and agreements of various stripe)?**

9.27 hours per week.

**12. What is the share of shadow turnover (unreported deals) in the total turnover of private companies (on average)?**

	Number of SMEs	%
No such phenomenon	137	33.4
Up to 10%	95	23.2
Between 10 and 25%	79	19.3
Between 26 and 50%	54	13.2
Between 51 and 75%	25	6.1
More than 75%	6	1.5
No answer	14	3.4
Total	410	100.0

**13. How often the executives of private companies are forced to bribe (in any way)?**

	Number of SMEs	%
No such phenomenon	118	28.8
Rarely	186	45.4
Constantly	93	22.7
No answer	13	3.2
Total	410	100.0

**14. To what extent are 'kickbacks' widespread in Belarus?**

	Number of SMEs	%
No such phenomenon	137	33.4
Every tenth	72	17.6
Every fifths	72	17.6
Every third	56	13.7
Every second	39	9.5
Every single	15	3.7
No answer	19	4.6
Total	410	100.0

**15. Has your company ever been instructed by the authorities about the output growth rate?**

	Number of SMEs	%
Yes	154	37.6
No	252	61.5
No answer	4	1.0
Total	410	100.0

**16. What are the dynamics of the following performance indicators? What is your forecast for 2007?**

Indicator	Performance			Forecast for 2007		
	Growth	Stable	Decrease	Growth	Stable	Decrease
Turnover (sales volume)	41.7	47.5	10.8	47.5	40.2	12.3
Profit	33.1	48.6	18.3	39.8	44.6	15.5
Employment	29.1	61.6	9.3	26.8	63.1	10.1
Investment	19.3	59.7	21.0	23.9	57.5	18.5

**17. What are the reasons behind change in sales (if any) of your company? (maximum three answers are allowed)**

	Number of SMEs	%
Change in prices of raw materials	46	11.2
Change in prices of final products	46	11.2
Change in the quality of goods/services	42	10.2
Change in the range of goods/services	75	18.3
Change in the number of competitors	47	11.5
Change in the country's economic situation	45	11.0
Change in purchasing capacity	69	16.8
Change in the distribution and advertising	39	9.5
Change in personnel qualification	24	5.9
Change in capacity	28	6.8
Other	10	2.4
No change in the volume of sales	190	46.3
No answer	15	3.7

**18. What are the profits/losses of your company as of 2006?**

	High profits	Modest profits	Neither profits nor losses	Small losses	Considerable losses
In 2006	13.9	65.3	13.9	5.2	1.7
In 2005	13.4	57.5	20.1	7.7	1.3

**19. How do you estimate the current performance of your company**

	Number of SMEs	%
Rather good	6	1.5
Good	153	37.3
Neither good nor bad	215	52.4
Bad	22	5.4
Rather bad	4	1.0
Hard to answer	10	2.4
Total	410	100.0

**20. Do you plan to expand your activities in the next year or two?**

	Number of SMEs	%
Yes	310	75.6
No	100	24.4
Total	410	100.0

**21. In case you plan to expand your activities, what are the major elements of your expansionist strategy?**

Factors	To a large extent	To a small extent	No use
1. Development of new fields of business	43.5	43.5	13.0
2. Broadening of the product range	56.0	37.2	6.7
3. Search for domestic outlets	53.4	33.1	13.5
4. Expansion to external markets	25.2	33.7	41.1
5. New advertising and distribution measures	36.0	47.2	16.8
6. Personnel training	36.9	51.9	11.3
7. Improvement of the quality of products and price increase	36.6	47.7	15.7
8. Reduction of prices	8.5	41.2	50.4
9. Change in the management system of company	13.5	39.9	46.6
10. The use of loans to invest into technology and equipment	15.1	43.7	41.2
11. The use of additional internal resources (like issuing of shares or bonds) to invest into technology and equipment	11.0	33.6	55.5

**22. How many employees calculate costs and prices at your company?**

2.75 employees.

**23. Can you estimate how many hours per month are spent to fulfill all necessary provisions of legislation regulating prices (e.g. calculation of costs and prices, declaration of prices, etc.)?**

45.96 hours per month.

**24. Imagine that administrative price regulation is abolished in Belarus. How many hours would your company save as a result of this policy action?**

4.47 employees per month.  
841.3 USD per month.

**25. Specify major factors that determine prices charged by your company (maximum three answers are allowed):**

	Number of SMEs	%
Production and sales costs	175	42.7
Prices of competitors	177	43.2
Consumer demand	151	36.8
Tariffs for public utilities (electricity, heating, etc.)	90	22.0
Rental fees	135	32.9
Wholesale/suppliers prices	134	32.7
Tax rate	192	46.8
Legislation regulating prices and profits	68	16.6
Other	4	1.0
No answer	3	0.7

**26. Is existing legislation regulating prices an important factor that constrains prices for products your company offer at the market?**

	Number of SMEs	%
Yes	278	67.8
No	128	31.2
No answer	4	1.0
Total	410	100.0

**27. Can you specify major provisions of price-regulating legislation that diverts resources of your company from a more productive usage? (maximum three answers are allowed)**

	Number of SMEs	%
The need to provide planned calculation	146	38.5
The need to provide report calculation	190	50.1
Registration of new prices	164	43.3
Price caps	96	25.3
Rate of return ceilings	115	30.3
Other	15	4.0

**28. Which employees of your company need training most of all (specify department)? (maximum three answers are allowed)**

	Number of SMEs	%
Accounting department	141	45.0
Sales department	114	36.4
Marketing department	95	30.4
Procurement department	32	10.2
Production	97	31.0
Mid-level managers	67	21.4
Executives	26	8.3
Other	10	3.2

**29. What kind of personnel training has been recently used by your company?  
 (please specify all possible forms)**

	Number of SMEs	%
Courses, seminars, trainings	143	34.9
Within-company training	132	32.2
Within-company training by using external trainers	54	13.2
Traineeships	37	9.0
Self-training	195	47.6
No training is provided	93	22.7

**30. Please, rank major criteria determining your decision to employ a person:**

	Of crucial importance	Of modest importance	Of no importance
Experience and professional qualities	92.1	6.9	1.0
Education	58.0	34.8	7.3
Recommendations provided by relatives, friends, or colleagues	28.6	44.6	26.8
Moral qualities	49.4	42.3	8.4
Kinship and friendships	11.5	42.7	45.8
Age	28.8	51.6	19.5
Gender	16.6	41.5	42.0
Recommendation by previous employers	46.0	37.4	16.7
Life-style and habits of new employee	34.5	43.1	22.4
Other	30.0	35.0	35.0

**31. Please specify three organizations that you consider the best in terms of personnel training:**

1. Zdes i Seichas (Here and Now) (ZiS) (21.4%)
2. The Business School of the Belarus State University (21.4%)
3. The Business School of the Institute for Privatization and Management (20.7%)
4. Extension courses (14.5%)
5. Institutions of Higher Education (10.3%)
6. INEP Business School (8.3%)
7. XXI Century-Consult (4.8%)
8. Marketing Systems (3.4%)
9. Center for Innovation Management (4.1%)
10. Center for Entrepreneurship Support (1.5%)
11. Kluchevye Resheniya (Key Decisions) (2.1%)
12. SATIO (0.7%)

**32. In case you provide (or provided) training for your staff by using the service of a professional company, what are the criteria of your company choice? (maximum three answers are allowed)**

	Number of SMEs	%
Reputation	95	45.0
Quality of service	144	68.2
Price	90	42.7
The availability of well-known trainers and lecturers	40	19.0
Recommendation of partners and colleagues	76	36.0
Comfortable conditions of training	21	10.0
Advertising	13	6.2
Other	2	0.9

**33. What sources of information you are using to search for training program?**

1. Direct mailing by educational organizations – 42.0%
2. Web-pages of education organizations – 31.9%
3. Web-pages of business unions:
  - 3.1. Minsk City Union of Entrepreneurs and Employers – 4.1%
  - 3.2. Business Union of Entrepreneurs and Employers named after Prof. M.S. Kunyavski – 2.4%
4. other web-pages:
  - 4.1. tut.by – 31.5%
  - 4.2. open.by – 9.2%
  - 4.3. Bel.Biz – 7.8%
  - 4.4. Other – 3.4%
5. Advertising in the printed media:
  - 5.1. 'Belgazeta' – 9.2%
  - 5.2 'Belorusy i Ryinok' – 10.8%
  - 5.3. 'Ekonomicheskaya Gazeta' – 22.4%
  - 5.4. 'Business-Revue' – 5.1%
  - 5.5. 'Argumenty i Fakty' – 7.5%
  - 5.6. 'Glavnyi Buhgalter' – 34.6%
  - 5.7. 'Finansovyi Director' – 9.5%
  - 5.8. 'Otdel Kadrov' – 7.8%
  - 5.9. 'Marketing, Advertising, Sales' – 17.3%
  - 5.10. Other – 4.7%
  - 5.11. 'Nalogovy Vestnik' – 1.4%
6. Radio advertising – 10.5%.

**34. Please provide the names of organizations providing business education. To what extent are you aware of their services?**

	Heard something	Advertising was received (direct mail or e-mail)	Personnel was training in 2005
Zdes I Seichas (Here and There)	23.4	9.3	6.1
Kluchevye Resheniya (Key Decisions)	22.4	5.6	0.7
SATIO	17.1	6.8	0.5
Marketingovye Sistemy (Marketing Systems)	21.7	7.8	2.0
INEP Business School	20.2	9.0	1.7
The Business School of the Institute for Privatization and Management	18.8	13.2	3.4
XXI Century Consult	29.0	10.0	2.2
Mercury International	16.8	4.9	0.7
The Business School of the Belarus State University	33.4	11.5	4.4
Center for Innovation Management	22.0	7.8	1.2

**35. Do you consider an MBA degree held by your employees as a necessary condition of successful performance of your company?**

	Number of SMEs	%
Yes	61	14.9
No	201	49.0
I do not know what an MBA degree is	140	34.1
No answer	8	2.0
Total	410	100.0

**36. Do you consider obtaining an MBA degree as your personal need?**

	Number of SMEs	%
Yes	64	15.6
No	164	40.0
I hold this degree	8	2.0
No answer	174	42.4
Total	410	100.0

**37. Are you a member of any business union?**

	Number of SMEs	%
Yes	42	10.3
No	364	89.7
Total	410	100.0

**38. In case of non-membership, why are you not a member of a business union? (maximum three answers are allowed)**

	Number of SMEs	%
High membership fees	14	4.0
Business unions are incapable to solve my problems	137	39.3
The activity of business unions is politicized	29	8.3
No information about the activity of business unions	132	37.8
Hope to solve problems on my own	90	25.8
Their assistance and service are not needed by my business	82	23.5
Other	3	0.9

**39. Are you aware of the National Business Platform and, if so, are you supportive of its major ideas?**

	Number of SMEs	%
Fully aware and support	9	2.2
Aware and rather support	74	18.0
Aware, but rather not support	51	12.4
Aware, and do not support at all	15	3.7
Not aware, hear about it for the first time	250	61.0
Other	6	1.5
No answer	5	1.2
Total	410	100.0

**40. Are you personally willing to contribute to improving the business climate in Belarus? If yes, in what ways?**

	Number of SMEs	%
Not ready	180	47.2
Ready to provide material (or other types of) aid to an association of entrepreneurs in case issues of personal concern are addressed	46	12.1
Ready to provide material (or other types of) aid in order to implement any business environment-improving measures	44	11.5
Ready to participate personally in the preparation of documents and other events aimed at improving the business climate in the country	105	27.6
Other	11	1.6
Total	410	100.0

**41. What are the possible consequences for your company of the gas price hike (maximum three answers are allowed):**

	Number of SMEs	%
Considerable cost increase induced by growth of electricity rates	175	42.7
Modest cost increase induced by growth of electricity rates	138	33.7
Business would become unprofitable	37	9.0
Considerable reduction of consumer demand	50	12.2
Some reduction of consumer demand	64	15.6
Other	10	2.4
No consequences	11	2.7
Don't know/No answer	18	3.1

**42. Could changing relations between Belarus and Russia affect your business?**

	Number of SMEs	%
Harder to sell Belarusian goods in Russia	111	27.1
Easier to sell Belarusian goods in Russia	13	3.2
Easier to sell Russian goods in Belarus	19	4.6
Harder to sell Russian goods in Belarus	53	12.9
No consequences	136	33.2
No change in trade and economic relationship between the two countries	12	2.9
Hard to answer	66	16.1
Total	410	100.0

#### 43. Should Belarus aspire EU membership?

	Number of SMEs	%
Yes	277	67.6
No	124	30.2
Hard to answer	9	2.2
Total	410	100.0

#### 44. What kind of relation should Belarus establish with Russia?

	Number of SMEs	%
Belarus should be a sovereign state and build partnership	266	64.9
Belarus and Russia should create a union of independent states closely tied to each other both politically and economically	128	31.2
Belarus should become a part of the Russian Federation	13	3.2
Hard to answer	3	0.7
Total	410	100.0

#### 45. How do you assess the efforts of the government to protect the national interest of Belarus in the course of the energy conflict with Russia?

	Number of SMEs	%
Fully support	86	21.0
Rather support than otherwise	164	40.0
Rather unsupportive than otherwise	54	13.2
Fully unsupportive	14	3.4
Total	92	22.4
Fully support	410	100.0

#### 46. Region

	Number of SMEs	%
Minsk	203	49.5
Minsk region	43	10.5
Brest	15	3.7
Brest region	13	3.2
Grodno	22	5.4
Grodno region	13	3.2
Vitebsk	27	6.6
Vitebsk region	13	3.2
Gomel	21	5.1
Gomel region	13	3.2
Mogilev	20	4.9
Mogilev region	7	1.7
Total	410	100.0

#### 47. Gender

	Number of SMEs	%
Male	272	66.3
Female	137	33.4
No answer	1	0.2
Total	410	100.0



**48. Position**

	Number of SMEs	%
Executive/Director	196	47.8
Deputy Director	188	45.9
Chief Accountant	9	2.2
Department/division Head	10	2.4
Other	7	1.7
Total	410	100.0

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Printed by "Nevskij Prostor", Ltd  
6 Toreza Av., 194100, Saint-Petersburg