

In this issue:

Estimating the consequences of Belarus' withdrawal from the EU's Generalized System of Preferences; tracking changes in the legislation regulating entrepreneurial activity in Belarus; and assessing the quality of business environment in Belarus (done by entrepreneurs themselves).

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Dear Readers!

Eight issue of our quarterly review 'Small and Medium-Sized Business in Belarus' starts with the analysis of possible economic repercussions of Belarus' withdrawal from the EU's Generalized System of Preferences (GSP) (first section). It appears that the losses would not exceed USD 70 m per year. This figure is much less than the estimates provided in the vast majority of the media.

The second section deals with the characteristics of the institutional environment and state policies for SME development. It has to be noted that no substantial changes have been observed in the regulatory environment during the 2nd quarter of 2007. However, some legislative acts could imply cost reduction for some SMEs (especially companies operating in construction). At the same time, state programs adopted to induce enterprise development and improve administrative procedures surrounding it remain declaratory by character.

In the 2nd quarter of 2007, the government has announced its plans to improve economic performance of the largest enterprises by conducting initial public offerings (IPO). The third section of the review contains the analysis of pros and cons of a partial privatization of Belarusian companies via IPO. In this regard, the Polish experience is invoked and a range of policy recommendations for the government of Belarus on IPO-based privatization is provided.

The final section offers assessment of alternative costs caused by excessive regulation of business environment. Specifically, average costs of fulfillment of the requirements of price-regulating legislation and resulting losses for a typical SME and the Belarusian economy as a whole are estimated. It appears that Belarusian SMEs collectively spend annually about USD 1 bn in order to make reports, communicate with numerous administrative agencies, and follow the requirements of price-regulating legislation.

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Editors

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1. REPERCUSSION OF BELARUS' WITHDRAWAL FROM THE EU'S GENERALIZED SYSTEM OF PREFERENCES¹

The EU has decided to withdraw Belarus from its Generalized System of Preferences (GSP) since June 21, 2007. For independent trade unions whose rights have been systematically violated (and resulted in such a decision of the EU) this step is perceived as an important step to make the policies of the Belarusian government 'more friendly' to independent trade unions. This expectation is backed up by available estimate of the possible repercussions of Belarus' withdrawal. According to various media, they seem to be substantial. Below the consequences are estimated with a certain degree of precision to check whether one could indeed expect them to be sizeable enough to impact the policies of the government.

1.1. The Generalized System of Preferences

The Generalized System of Preferences (GSP) is designed to foster economic development of those transition and developing economies that did not conclude separate trade agreements with the EU. The GSP covers only 'duty-free' products. Within the framework of the general arrangements (available to all beneficiary countries), 3,300 products are allowed to enter the EU market duty-free, while 3,700 are classified as 'sensitive' so a tariff preference is provided. Tariff preference is determined as a flat rate reduction of the MFN duty rate. On average, such reduction is about 25% (while for textiles it is 20% and for some other goods amounts to 30%). In case a country is granted additional preferences within the framework of the so-called 'special incentive arrangements' (for the protection of labor rights and of the environment), tariff reduction could be doubled.

1.2. Estimating possible repercussions of Belarus' withdrawal

In case Belarus is withdrawn from the GSP, tariff preferences are abolished.

Table 1: Belarus' exports to the EU: 2006 data

Product code	Product category	Volume of exports, USD m	Share in total exports to the EU, per cent
27	Mineral fuels and oils	3185.5	59.8
44	Wood and articles of wood	405.1	7.6
72	Iron and steel	315.6	5.9
31	Fertilizers	214.8	4.0
73	Articles of iron and steel	189.5	3.6
87	Vehicles	147.8	2.8
62	Apparel and clothing	131.2	2.5
84	Boilers, machinery and appliances mechanical	89.4	1.7
	Other	849.7	16.0

Source: estimated on the basis of the data taken from Eurostat and the Ministry of Statistics and Analysis of Belarus.

Accordingly, companies would face MFN duty rates. Currently a simple average MFN tariff is about 4%. However, exact rates vary depending on the product category and the degree of 'sensitivity' of either product. The sensitivity of products is determined by the situation of the sector manufacturing the same products of the EU. At first sight, it appears that the Belarusian exports could become dearer by 4% on average. Accordingly, the volume of losses could amount to minimum USD 214 m (given the volume of Belarus' exports to the EU in 2006). Earlier, more dramatic figure of EUR 300 m has been provided in the media. These losses would be distributed across the Belarusian exporters thus inflicting lower profits and/or slower output and real wage growth.

However, it seems that the above-mentioned estimates are seriously exaggerated. They do not account for the real structure of the Belarus exports to the EU. This structure determines how far tariffs would be augmented in reality. In fact, for a number of product groups, MFN duty rates are zero so no tariff preferences are provided. In order to estimate possible repercussions of Belarus' withdrawal from the GSP, one has to look at the structure of the country's exports to the EU (see Table 1).

As it can be seen from the table 1, Belarus' exports to the EU are concentrated in the sectors producing goods with a relatively low value-added. Despite the vastness of the product range, five export groups account for 80% of exports, namely mineral fuels and oils, wood, iron and steel and articles thereof, and fertilizers. The tariff preferences for these goods are not very substantial. In addition, zero MFN rates are rather common.

Nevertheless, in case Belarus loses its beneficiary status, tariffs applied to certain export items would go up from zero rates to 3.5–4.7%. For certain apparel and textile items, tariffs would increase from 9.6% to 12%. However, the most 'pessimistic' estimate of overall harm could vary between USD 52.2 m and USD 66.6 m (per annum). In contrast, a more 'optimistic' view provides us with a figure of losses varying between USD 23 m to USD 36 m. As for the major product categories, tariff increase would be rather minor. On average, exporters of oil and oil products could face tariff increased by 0.34%, of fertilizers – by 0.6% and of articles of iron and steel – by 0.04%. As for other product groups, tariff increase could be negligible.

1.3. Selected quantitative estimates

An often-mentioned quantitative estimate of possible losses of EUR 300 m is a very rough and incorrect one. Most likely, it has been obtained by multiplying the volume of Belarus' exports to the EU in 2005 (about EUR 3.3 bn) by 10% (an expert estimate of possible losses) so the final figure of EUR 300 million has been obtained. In 2006, Belarus exports to the EU grew up by 27.5% so the figure has to be adjusted accordingly.

It could be claimed that such an estimate does not account for the 'real-world' structure of Belarus' exports. A more realistic estimate could be provided by breaking the Belarusian exports down to the 8th digit of the trade code. However, this is only the first step. A much more thorough analysis requires taking into consideration price elasticities existing at the EU markets for the Belarusian goods. At the same time, it might well be the case that importers from the EU would not reduce their demand for Belarusian goods despite tar-

¹ This section is prepared on the basis of the study made by the Belarusian Institute for Strategic Studies (BISS), see http://www.belinstitute.eu/images/stories/documents/biss_gsp_rus.pdf for details.

Table 2: Possible losses of Belarus from the GSP withdrawal: quantitative estimate (in the annual terms)

Product code	Product category	Possible losses, USD thsd	Per cent of export of given product group
27	Mineral fuels and oils	17231.2	0.5
44	Wood and articles of wood	2951.2	0.7
72	Iron and steel	0.0	0.0
31	Fertilizers	1681.5	0.8
73	Articles of iron and steel	108.8	0.1
87	Vehicles	3619.1	2.4
62	Apparel and clothing	6760.3	5.2
84	Boilers, machinery and mechanical appliances	292.8	0.3

Source: own estimate.

iff-induced price increase. This particularly concerns raw materials and intermediary goods exports that could not easily be substituted, given, for instance, higher transport costs and other related factors. It has to be noted that less rigorous analytical endeavor (i.e. without accounting for price elasticities) could not be discounted because of its formal incompleteness. This is because Belarus is a small open economy, which is a 'price-taker' at the EU markets. So it could be expected that Belarusian companies might indeed suffer from lower profits and pay smaller wages (see below).

This estimate includes only the first step, i.e. breaking down the Belarusian exports to the 8th digit and then applying MFN duty rates. Our estimate covers only eight product groups that occupy about 84% of Belarus' exports to the EU (see Table 2). As for other product groups, losses could hardly exceed USD 35 m. This is the 'worst-case' scenario. In contrast, a more realistic assessment is much more modest, namely USD 10 m or so per year. Also, it has to be taken into consideration that exports of some products are regulated by separate agreements. This is the case of trading with textiles and apparel. Specifically, a range of products is allowed free circulation (subject to the presentation of an import authorization), while some goods arrive to the EU duty-free within the framework of the arrangements for outward processing of textile products. Still, textiles sector could loose up to USD 6.7 m (in the annual terms) due to the tariff increase from 9.6% to 12%. This relative high tariff rate is applied because of the 'sensitivity' of textiles sector in the EU.

How these losses could manifest their influence in the future? It appears that reduced exports, if materialize, would

lead to lower profits and wages, especially given energy price hike and the strong reluctance to devaluation of the Belarusian ruble. If the 'worst-case' scenario is to materialize (i.e. with a losses ranging between USD 52.6 m to USD 66.6 m), then profitability in the economy might decrease by 1.84% and USD-denominated real wages fall by 0.6%. A more optimistic assessment of estimates (as varying between USD 23 and 36 m) give us 0.9% and 0.3% on these indicators, respectively.

As for individual sectors of the economy, chemical and petrochemical industry might face some troubles. Specifically, in the least favorable cases wages could decrease by 5.9% (in the US dollar terms), while in the light industry they could go down by 2.6%. In metallurgy and wood processing, withdrawal from the GSP might 'eat' up to 0.1 and 1.6% of the total wage fund, respectively. Again, this is the most pessimistic assessment of the possible repercussions. In reality, however, we expect these losses to be rather negligible.

2. INSTITUTIONAL ENVIRONMENT AND PUBLIC POLICY FOR SME DEVELOPMENT

2.1. Changes in government regulation of SME development in Belarus

In the 2nd quarter of 2007, no substantial changes in the parameters of economic policies and the functioning of legal institutions regulating activity of small and medium-sized enterprises (SMEs) have been recorded. The institutional environment for doing business remains complicated, unstable, and incoherent.

Despite some success in the field of development and small and medium business, SMEs continue to play a mi-

nor role in the social and economic progress of the Belarusian society. In fact, this has been admitted by the Chief of Department for Entrepreneurship of the Ministry of Economy, Mr. A. Lihachevsky, at the sitting of the General Committee on Economic Affairs of the Central European Initiative held by the Chamber of Representatives of the Belarusian Parliament. In 2006, SMEs produced 9% of the country's GDP, while in 2005 their share was 8%. The total number of SMEs in 2006 reached the figure of 38,000 (increased by 14% as against 2005). The number of individual entrepreneurs (IEs) was 192,000 (increased by 8% over a year). At the same time, IEs paid more taxes in 2006 than in 2005 by USD 55 m (growth by 23%). At the same time, the share of foreign small-sized companies in the total number of SMEs accounted for 4%. This is much lower than in the developed market economies, and also in many of the transition economies, including the CIS countries.

With higher energy prices and slower economic growth in Belarus, the government has reasserted the role of SME. Specifically, some claims have been made on public to foster SME development in Belarus and liberalize the environment for their functioning. Also, the representatives of administrative bodies continue to insist that 'the existing territorial and sectoral structure of small business is inadequate to the priorities of social and economic development of the country'. At the same time, the government critically perceives the fact that 40% of small-sized companies and up to 80% of IEs are operating in wholesale and retail trade (mainly dealing with the imported goods). According to the opinions expressed by the officials, developed manufacturing sector is one of the factors behind strengthening of export potential and import-substitution in Belarus.

The Belarusian government is still inclined to manage nearly all economic processes in the country, including the field and site of entrepreneurial activity.

² This opinion has been expressed by the Chairman of the Council for Enterprise Development in Belarus, Mr. V. Zinovskiy, at a joint sitting of the Council for Enterprise Development and the Business Union of Entrepreneurs and Employers named after Prof. Kunyavskiy (BSPN) held in Mogilev; at this sitting, the issues of small industrial enterprises were discussed.

However, almost nothing has been done so far to make manufacturing more attractive for entrepreneurs. The need to obtain numerous permits and certificates is a very serious problem for many entrepreneurs both in terms of time and financial costs. The complicated access and expensiveness of bank loans, high rental fees and tax rates, and many other problems all make many production projects and ideas unprofitable since the very outset. SMEs specializing in production and exports face some additional problems. For instance, in case of trade with Russia there are clearing problems (related to the application of the zero VAT tax rate to goods supplied to the Russian Federation).

The sharp increase in the merchandise trade deficit has forced the government to stabilize foreign exchange market. However, instead of liberalization of economic activity leading to capital inflow from abroad, the government opted for 'optimization of imports' and import-substitution policies in general. In particular, enterprises producing import-substituting commodities could be provided with tax preferences in the future. The draft version of the President's Edict 'On the Measures to Stimulate Production and Sales of Some Commodities' has been prepared and submitted to the adoption by the President. This regulation suggests exemption from profit and turnover taxes manufacturers of nearly 300 import substitutes (but the condition is that the sale proceeds obtained from domestic manufacture should be no less than 90%)³.

In order to induce enterprise development in small urban and rural localities and countryside, the draft version of the President's Edict 'On the Regulation of Entrepreneurship at the Countryside' has been prepared. This regulation provides tax holidays for a period of four years for manufacturing enterprises. As for the simplified tax system used by small business in Belarus, the representatives of the Ministry of Economy said – referring to the calculations made by entrepreneurs and experts – that the rates of revenue tax at 10% (in case VAT is not paid) and 8% (in case VAT is paid) are still high and burdensome for many producers. Currently, the Ministry is considering the possibility of cutting these rates to 8 and 6%, respectively.

³ Ekonomicheskaya Gazeta, No. 16, 2007.

In addition, the government has approved a list of urban-type communities where reduced tax rates for SMEs and IEs could be applied in case the simplified tax system is used. Specifically, the government selected 138 urban-type communities with a population up to 50,000 people⁴.

The government also expects that the President's Edict No. 296 adopted on June 1, 2006 would foster business development in Belarus. This regulation offers the ways of granting financial assistance to small enterprises in Belarus. It is to be implemented within the framework of special state programs or via the support for the activity of guarantee funds (already operating in the Grodno and Brest regions).

In general, the Comprehensive Program for Development of Regions, Small and Medium Urban Localities over 2007–2010 envisages fostering of enterprise development in small urban and rural localities of Belarus⁵. Specifically, the Program provides reduction of profit tax by 50% and exemptions from a road use tax and a due to the National Agricultural Support Fund for economic units residing and functioning in small and medium urban localities. Besides that, deputies at regional and local levels are granted the rights to provide preferences for real-estate tax, land tax, and environment tax (a fraction collected as payment for the use of natural resources). The budget of the program is set at BYR 2 trn (including BYR 500 bn provided by the state budget). In addition, the President's Edict empowers regional executive committees to grant preferences of various stripe, including loan guarantees at the expense of local budgets⁶.

2.2. Administrative reform

In his recent annual Address to the Parliament and the people of Belarus, President Lukashenko has stressed the need to lessen administrative burden on small and medium-sized enterprises, reduce and de-bureaucratize market entry to economic units. A special group on simplification of administrative procedures

for setups has been created in November 2006 (following the order of the Prime Minister) and chaired by the Deputy Prime Minister, Mr. A. Kobyakov.

The group held several sitting. According to the experts' opinion, the most important achievement of this group so far is the determination of [the number and scope of administrative procedures.

As for the goals of this working group, they are as follows: to reduce the number of administrative procedures, establish optimal (the least required) time for passing them, decrease the amount of documents for submission and define their exhaustive list, and make fees proportional to costs. It is also suggested to make information about administrative procedures accessible, clear, and transparent and define a complete list of reasons to refuse registration. Finally, unified requirements for passing administrative procedures should be adopted. It is expected that the propositions made by the working group would be used as a background for preparation of amendments and changes in existing legislative acts.

According to the proceeding of the working group's sitting, administrative bodies should revise all of the existing administrative procedures applied to legal entities and individual entrepreneurs and then present the results to the broader public.

The information about the simplification of administrative procedures is to be provided to economic units via the web-pages of administrative bodies and business unions and the Belarusian media. These entities would also collect propositions of entrepreneurs on improving administrative procedures. In addition, the International Finance Corporation (IFC) and business unions should play a substantial role in this process. Administrative bodies are instructed to discuss the details and specificity of administrative procedures and make propositions towards simplification or preservation of existing ones with the IFC and business unions.

But a rather tough schedule of submission of the list of revised administrative procedures, propositions towards their improvement and examination of related materials (that have to be done by 38 administrative bodies between May and September 2007) causes some

⁴ Regulation of the Council of Ministers No. 703 adopted on May 30, 2007.

⁵ President's Edict No. 265 adopted on June 7, 2007.

⁶ President's Edict No. 266 adopted on June 8, 2007.

concerns about the successful reform of the administrative procedures. In any way, success depends on how implementation work is organized and comprehensiveness of propositions to be made by entrepreneurs, business unions, and experts.

2.3. Changes in legislation

The compulsory certification of a range of construction work (including painting, papering, plastering, facing, glazing, and flooring) is introduced since July 1, 2007. As a result, entry barriers for small business and 'first-timers' would be higher. Also, occupancy of door openings and window opening should be certified since September 1, 2007⁷. In order to pass the certification procedures, economic units (both individual entrepreneurs and legal entities) should employ qualified personnel, acquire necessary equipment, including control ones, technological documentation on works to be completed, and, finally, establish quality controls, and so on.

Currently certification costs as much as BYR 820,000 per any single type of work; in case several of them have to be certified the costs increased by 30% per each additional type of work. It could be calculated that the certification of seven types of work costs as much as BYR 2.5 m. In addition, in case lab tests are required, costs increased by BYR 1 m in addition. In its turn, certification requires purchase of control equipment, provision of training, etc. In addition, rental costs (of office space and warehouse), formation of the statutory fund, purchase of equipment, search for employees, and wage payments. All these costs have to be borne by a small company prior to any profit is collected.

Growing prices in construction and higher tariffs for public utilities caused by energy price hike have forced the government to adopt a range of measures to moderate price increase. In particular, Regulation No. 138 'On Some Issues of VAT collection' stipulates that VAT is not to be paid by companies rendering all services related to (but not the services per se) construction and renovation of housing stock and a broad range of housing and communal services. This measure is aimed at contain-

ing price and tariff increase that Belarusian consumers might face.

Since March 1, a new version of the Administrative Code has been adopted. One of the changes has been the modification of responsibility of economic units for violation of pricing rules. In accordance with the Article 12.4, the violation of the rules of price- or tariff-making by administrative agents and individual persons could result in penalties varying from 10 to 40 base-units (one base unit is equal to BYR 31,000). In case of second violation in the course of the calendar year, penalty range varies between 10 and 80 base-units. Also, penalties for other types of transgressions related to price-making have been revised.

On March 19, 2007, Regulation No. 129 'On Some Measures to Develop International Traffic' has been adopted. This regulation is aimed at fostering the development of exports (on CIF terms, or 'cost, insurance, freight' and on CFR ('costs and freight') and, consequently, improving the quality of export operations and services of Belarusian carriers at the international freight market. According to this Regulation, transport companies are exempted from VAT in case they provide transport services outside Belarus. It is also established that since July 1, 2007 to June 30, 2010, new vehicles of foreign manufacturing could be temporary imported (up to 34 months) to Belarus (without paying customs duties and VAT) in case of their use for rendering international transport services. However, in order to be liable to this preference, companies should purchase the same number of vehicles of domestic manufacture. Accordingly, it appears that the use of the preference is somewhat limited.

It follows that the above-mentioned regulation is beneficial for mainly large transport companies, including state-owned ones. This is because small and medium-sized enterprises are hardly able to purchase a relatively big number of new vehicles. Moreover, many of them do not need to buy vehicles manufactured in Belarus.

Legislation regulating the activity of individual entrepreneurs (IEs) has become more rigid. It could result in crowding of IEs out of individual markets. Until April 1, 2007 IEs were allowed to import and trade with non-food, alcohol-

containing products packaged in vessels in sizes up to 1 liter (or less than 1 kilogram in weight) (i.e. mainly perfumes and cosmetics, liquid detergents and cleaning fluids, antifreezes, solvents, and so on). For that purpose, no other license was required other than a license for retail trade and catering. In other words, prior to April 1, 2007, no license was needed to import these products. However, since April 1, 2007, new license has been introduced⁸.

On May 10, 2007, a new 'Law on Advertising' has been adopted. The major innovation of this law is the regulation of advertising of alcoholic beverages (including beer) and tobacco products, including the establishment of the 'critical time' for advertising. The Law comes into force since November 2007. This Law contains new provisions regulating the placement and distribution of advertising by using telephonic, telex, facsimile, cellular, and electronic means. These advertising channels are to be used only following the consent of consumers.

Also, the new Law imposes some limitations on advertising of beer and low-alcohol beverages. Outside advertising of beer and conducting of promo-actions aimed at stimulating sales of beer and low-alcohol beverages will be fully prohibited in Belarus. According to the new rules, no advertising of tobacco products and alcoholic beverages is allowed at airports, train and bus stations, public transport and underground stops. Images of people and animals shall not be used in advertising of alcoholic beverages and tobacco products. This advertising shall not be placed at the media focusing on environment, education, and healthcare and shown at posters, stands, illuminated indicator boards, and other means of outside advertising. Less strict rules are applied to tobacco products until January 1, 2008, but since that any public advertising of tobacco products is prohibited in full.

It could be expected that the above-mentioned measures related to regulating advertising could weaken the competitive positions of Belarusian beer producers facing intense competition with Russian and Ukrainian companies. These companies conduct large-scale advertising campaigns to promote their products at the Belarusian market.

⁷ See Regulation issued by the State Committee for Standardization No. 58 on November 29, 2006.

3. PRIVATIZATION OF LARGE COMPANIES BY USING IPO: PROS AND CONS

Recently, claims have been made on public about the use of IPO (initial public offering) by Belarusian officials. In particular, the Deputy Prime Minister, Mr. Vladimir Semashko and the Deputy Minister for Economy, Mr. Nikolai Zaichenko both mentioned IPO as a way to improve the financial position of Belarusian enterprises (oil refineries in the first instance), and at the same time find out the approximate market value of shares of these enterprises. Mr. Zaichenko said that Belarusian oil processing and petrochemical enterprises would conduct IPO internationally by the end of the current year.

3.1. The advantages and limitations of IPO

In Western market economies, IPO is a standard procedure for many companies. It is particularly widespread in the United Kingdom.

IPO has the following advantages:

- Disclosure of a substantial amount of information about enterprises; as a way of privatization, it is transparent and open m;
- Privatization becomes accessible to the public and foreign investors. The latter has a right to restructure company (in contrast, in case of direct sales via investment auctions investors could face some considerable limitations and obligations);
- Company price is determined by market so the government could obtain the maximum revenue;
- In case strategic investors acquire majority holding, management often appears to be a high-caliber one;
- IPO is a proper background for creating a well-functioning national stock exchange.

At the same time, there are some limitations and difficulties related to IPO:

- Listing requirements can be too complicated (especially for transition economy) so the preparation period might be too long;
- IPO costs might be very high so it is only companies with good market

prospects that are capable to conduct it;

- In case preparation procedures are improper and/or there is no restructuring prior to privatization is done, stock could be substantially undervalued;
- IPO might result in the 'suboptimal' property structure, i.e. there is no guarantee that 'efficient owners' would emerge automatically after IPO is conducted;
- There is a possibility of blocking the privatization process due to the absence of incentives by managers and the existence of interest groups who are against this way of privatization.

3.2. Case-study: IPO in Poland

IPO has been rather popular in Poland. However, first five companies had been making preparations for that over the course of almost two years. The costs (related to pre-IPO preparation and listing) amounted to 50% of revenues from selling stocks. Over 1990–1996, 28 companies had managed to sell their shares openly. Industrial enterprises were among the pioneers, followed by the banks (Bank Handlowy) and then the telecommunication companies (Telekomunikacja Polska).

Now the price for fulfillment of listing requirements amounts to 10% of equity value. Costs are smaller because Polish underwriters (and not the foreign ones) are involved now. Also, the market for underwriters has become not only dense, but also much more competitive than 15 years ago. Over the whole privatization period, there were 60 IPO in Poland, 20 in Estonia, and one several in Hungary.

In Poland, the government has been driven by the following incentives when utilizing IPO:

- Creation of a stable, 'scandal-free' stock market;
- Setting up of proper conditions for the development of investment funds (pensions funds in the first instance);
- Increasing the price of companies by selling large holding of stocks to strategic investors;

- Making the idea of privatization more popular among the public (especially at the early stages of privatization);
- Engaging of national capital into the privatization process (the means of the population and SMEs).

In the case of privatization of 'Bank Handlowy', there was an attempt to advance the idea of 'people's capitalism' in banking sector, but with no further success. This idea was driving the government's choice of companies for privatization via IPO. In particular, breweries and food companies were the pioneers. What followed were construction material companies (such as cement mill), metallurgical, machine-building, chemical and petrochemical companies, and, finally, banks and telecommunication companies (in every branch of the economy, from two to four companies were privatized via IPO).

3.3. Privatization via IPO: why 'case-by-case' option is the most appropriate one

As it has been mentioned above, the Polish government has utilized IPO in order to create and develop trustworthy financial market, support development of investment and pension funds, and, crucially, signal that privatization policies are to be continued in the future. However, one of the major problems are considerable time and financial costs related to preparation of all necessary documentation and its examination by the Committee of Directors of Stock Exchange. IPO in Poland has been regulated by the Polish Equity Law and the rules of the Warsaw Stock Exchange.

At the beginning, listing requirements were rather strict. In particular, companies were required to prepare a special agreement on guaranteed placement of stock to be approved by the Polish Securities and Stock Market Commission. Prospects had to contain very detailed information about companies.

However, the major problem was the preparation of all necessary financial documents and reports according to the international standards (balance sheet, statement of assets and liabilities, auditor's conclusion, and so on). Often, the 'translation' of national reports into an international format has resulted in the reduction of profitability (or even net losses) of company.

Apart from financial reports, it has been necessary to prepare a large number of documents. For instance, in order to make 'offering circular', i.e. the brochure offering equity for sale, a company has been required provide the following information and/or documentation:

- Detailed information about all material risks related to investment into this particular company and an assessment of [country's] macroeconomic and political risk;
- Description of company's business strategy as well as plans in the field of research and development;
- Information about work collective,
- Information about subsidiaries, property, and lawsuits (if any);
- Description of the regulatory environment for functioning of company, including the analysis of competitive environment;
- Detailed description and analysis of the financial situation and performance of a company;
- Description of skills of executives and managers, their compensation and their property shares.

Also, listing requirements include full disclosure of information and maintenance of transparency, namely:

- Financial and operational results of company's activity;
- Ownership of relatively large holdings of stock and distribution of votes should be described;
- The list of the members of Committee of Directors and other company officials has to be published and the remuneration they receive;
- Risk factors have to be forecasted and estimated;
- Any other issues related to employees and other stakeholders as well as the structure and policy of corporate governance have to be described.

The need to fulfill all of the requirements mentioned above make the process of preparing to IPO rather lengthy (ranging from one to three years) and, of course, costly. In some cases, IPO is never done for a variety of reasons, such

as the lack of information, unwillingness of enterprise managers (who are uninterested in IPO). It can thus be concluded that privatization via IPO can only be performed on a 'case-by-case' basis.

3.4. Using IPO for privatization in Belarus: discussing the possibility

Privatization is one of the most important but complicated reforms in the course of economic transformation. There are many privatization strategies. Each of them has their pros and cons. Due to the complexities and large-scale character of privatization, the choice of the specific model of privatization (IPO, direct sales, bankruptcy and liquidation) depends on the criteria chosen.

Privatization via IPO is characterized by a greater degree of transparency, more possibilities for participation of the population, and the support of equity market development. But IPO requires preparation of development plans for companies, while their accounting and financial indicators should be presented in accordance with the international standards.

However, both financial and time costs related to preparing for IPO and fulfilling of the listing requirements suggest that it is mainly financially sustainable and successfully performing enterprises that could conduct it. At the same time, in transition economies uncertainties caused by economic and political risks along with absence of the necessary information could make preparation [process] much longer than expected.

With this in mind, the following recommendations can be devised for Belarusian companies in case they are intended to conduct IPO:

- IPO makes sense in the situation of 'case-by-case' privatization; also, it is beneficial for equity market development. Politically, it signals the intention of the government to continue and deepen privatization process;
- Enterprises (whose shares are to be offered at stock exchange) should be selected on the basis of clear and transparent criteria;
- Pre-privatization restructuring should be done at enterprises intended to conduct IPO;
- Plans for attracting internal and external (foreign) funds, training spe-

cialists, and passing all of the necessary procedures have to be disclosed;

- Given expensiveness and time-consuming nature of the preparation process, IPO should not be considered as a means of solving the fiscal problems of the state.

There is also a possibility that managers could attempt to block IPO process as such. Alternatively, the optimal structure of property might not be created (because of 'dispersion' of shares or the absence of 'real' owners). Accordingly, there is no guarantee that IPO would lead to better financial performance.

In the majority of transition economies, domestic stock exchanges have been used for IPO. This has helped to develop domestic equity markets due to the opportunities available to both population and domestic strategic investors. Currently large Russian companies resort to IPO both at home and abroad (including New York, London, or Frankfurt Stock Exchange).

Belarus does not have its own equity market. Accordingly, IPO could only be conducted abroad. It is possible that Belarusian companies would go to the Middle East markets due to the much more relaxed requirements and standards. But in any case, it is unrealistic that IPO would take place by the end of the current year.

4. ESTIMATION OF ALTERNATIVE COSTS INDUCED BY EXCESSIVE STATE REGULATION

4.1. Reporting and communication between executives 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 so-called 'transforming economies' (Belarus is provided the last place but one, doing better than Turkmenistan only)⁹.

⁹ Data are taken from the report made by Heritage Foundation (2006) *Index of Economic Freedom*, Fraser Institute (2007) *Freedom in the World* and EBRD (2006) *Transition Report*.

Table 3: 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 4: 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.

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, a 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 Belarus¹⁰ 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 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 (see Table 3). 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 4).

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.

The 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). Specifically, 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.

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 take are most labor intensive (4.6 employees are involved in its preparation at one SME).

Having all these numbers collected, it is possible to compute 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 of middle-sized ones. Consequently, the costs to employ one 'unproductive' worker (to prepare reports useless for a company, but requested by administrative bodies; in that case, 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 m¹¹. When we assume that of three employees dealing with reporting, there is more than one 'redundant' employee, then the costs of running business goes up to USD 250–400 m 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 spend 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 bn in the economy as a whole (2.7% of GDP).

Unproductive costs of Belarusian SMEs are bigger when the time spent by exec-

¹⁰ The evidence was collected within the framework of the study of the environment for functioning of SMEs in Belarus. The survey has been conducted in February 2007. It covered 410 executives and owners of the SMEs (representative sample). The details can be found at: <http://research.by/rus/surveys/ba8c266b453d0117.html>.

¹¹ In order to obtain these figures, a method applied by the International Finance Corporation has been used: see IFC (2006) *Business Environment in Belarus*.

utives forced to communicate with administrative bodies is taken into account. Also, a special 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. Such an employee is costly to hire, 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 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.

4.2. 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 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 lack of enforcement. At the same time, virtually all executives claim that output produced by their companies is sold at prices they need. 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 8th place (Table 5).

The respondents that answered to these questions said that on average 2.75

Table 5: 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
<i>Legislation regulating profits and prices</i>	68	16.6
Other	4	1.0
No answer	3	0.7
Total	410	100.0

Source: IPM Research Center.

Table 6: 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 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
<i>The size of the company</i>				
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.

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). These figures 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 regulations. 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 can be expected, the major rules of pricing regulation 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 in 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, then national competitiveness at both micro- and macro-levels could be enhanced.