

In this issue:

Foreign trade in Belarus in 2007. The main changes in legislation related to SMEs development. IFC survey: the problems of state agencies inspections of SMEs. International experience in reforming tax payment and the possibilities of applying this experience in the Belarusian tax system. National Business Platform: suggestions on tax system reforms.

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Dear Readers!

We present to you the eleventh issue of the quarterly review “Small and Medium Business in Belarus”, devoted to an analysis of the problems of Belarusian entrepreneurship and possible solutions to them.

In the first section of the issue is an analysis of the foreign trade results in 2007. This, in our opinion, is of particular interest, as Belarus faced an energy shock. The second section contains our traditional analysis of those changes in the institutional environment that are related to private enterprise functioning on the Belarusian market. In the first quarter of 2008, many changes occurred – in Belarusian terms – improving the business climate: the “golden share” was abolished, a set of preferences and guarantees of legislation stability for residents of free economic zone was provided, some procedures related to paying taxes and foreign trade activities were simplified.

In the third section we have a look at the data of the International Financial Corporation (IFC) survey on controls and inspections of SMEs by state agencies. As the main problems the IFC experts outlined the absence of a systematic approach to choosing the objects of inspections; complexity and non-transparency of inspections; technical requirements are not in agreement with modern practice; and, accordingly, these requirements are difficult or impossible to comply with.

In the fourth section we review the international experience in tax reforms, the problems with fulfilling all tax forms and paying taxes in Belarus; and offer suggestions for improving the tax system of Belarus. One should admit that tax legislation in Belarus is gradually improving. However, the IPM Research Center surveys show that taxes are still too high, and the way of paying them still is very costly and complex, especially for SMEs. In the final section, we present the section of the National Business Platform, which is also devoted to ways of improving the Belarusian tax system.

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Materials of this issue are prepared by experts of the IPM Research Center. The experts’ opinions reflected in these materials may not necessarily coincide with the position of the IPM Research Center.

1. FOREIGN TRADE OF BELARUS AFTER DOUBLE THE ENERGETIC SHOCK

In 2007 Belarusian external trade suffered from a double energy shock which was connected with a change of oil and gas terms of trade with Russia. According to the data of the Ministry of Statistics and Analysis, in 2007 as a result of a faster import growth (28.3% yoy) than the growth of exports (23.3% yoy), a merchandise trade deficit of USD 4.3 bn (165.4%) occurred. This amounted to 9.8% of GDP (7.2 % in 2006) (Figure 1). This growth is partly explained by the fact that the increasing deficit in trade with Russia – which was caused by the change in oil and gas terms of trade – was compensated to a lesser extent by a decreasing surplus in trade with non-CIS countries.

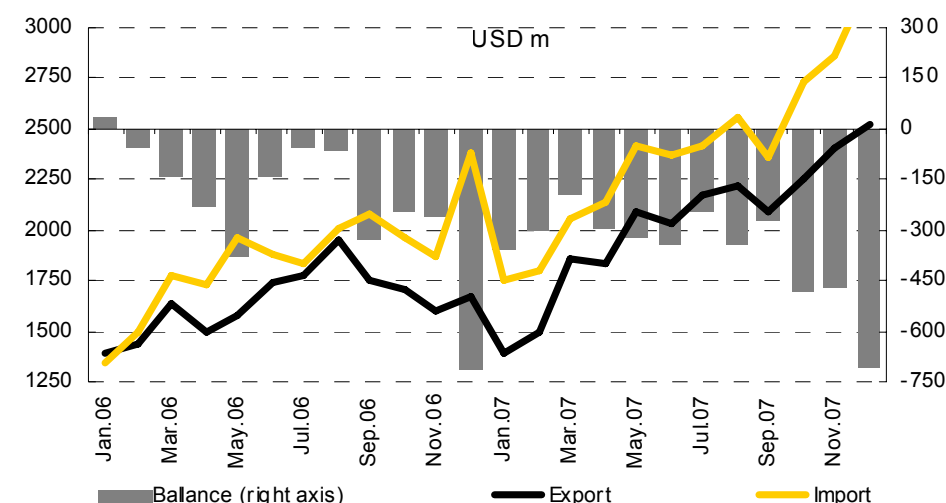
An important role in compensating the merchandise trade deficit was played by the trade of services. According to NBB estimates (according to the methodology of the balance of payments) the deficit in merchandise trade was financed by the surplus in the trade of services for 31.3%. Despite the favorable dynamics in services trade, the external trade deficit amounted to USD 7.2 bn or 6.1% of GDP (4.2% in 2006), however the government set the goal to achieve a surplus of USD 0.5 bn.

This substantial growth of the trade balance deficit is largely explained by a change in the balance of the energy goods trade: from positive (USD 131.7 m in 2006) to negative (USD 1.6 bn) due to a two-fold increase in the price of gas and a 34.6% increase in the price of oil. As a result, the general terms of trade index declined to 0.97, having deteriorated compared to 2006 (1.04).¹ This was exclusively caused by unfavorable terms of trade of energy goods (1.03 in 2006 and 0.80 in 2007), while of consumer goods the terms of trade considerably improved (Table 1).

Taking into account that more than a third of exports and imports consists of energy goods, one could expect that in 2008 the terms of trade of this group

¹ The terms of trade index represents a ratio of average export prices to average import prices. This is an indication of change in the proportion of external trade. In other words, it allows estimating which amount of imports one can purchase for 100 units of exports.

Figure 1: Merchandise trade dynamics



Source: Ministry of Statistics and Analysis.

Table 1: Terms of trade indices 2006–2007

	2006	2007
All goods	1.038	0.975
All, energy goods excluded	--	1.077
Investment goods	1.083	1.075
Intermediate goods	1.035	0.917
Energy goods	1.029	0.802
Other intermediate goods	1.028	1.044
Consumer goods	0.997	1.064
Food goods	1.011	1.066
Non-food goods	0.986	1.058

Source: Ministry of Statistics and Analysis.

will mainly determine the state of foreign trade in general.

Export and import growth was mainly caused by an increase in prices (76% and 75% respectively), while there were some regional differences. The growth in monetary volume of export both within the CIS as well as outside the CIS was for 64.8% and 70% (respectively) caused by price increases in exports, primarily for energy and foods. This trend is observed in trade with non-CIS countries. Exports to this part of the world consisted for 65.5% of oil products and potash fertilizer, for which average prices grew much stronger than physical volumes. 53.6% of the growth in imports from Russia can be explained by the price factor, while import growth from non-CIS countries was mainly caused by an increase in physical volumes.

In the goods structure of foreign trade in 2007 there were no significant changes. As before, the main export products were oil products (31.6%), potash fertilizer (5.6%), and ferrous metals (4.4%). Also, the share of mineral products in exports fell from 38.8% to 35.8%, which

was caused by a reduction in oil product exports at the beginning of the year, and also by the disruption of Belarusian oil deliveries to foreign markets due to pipeline transportation problems (of the Transneft pipeline). In order to stimulate supply of oil for tolling operations at Belarusian refineries and to normalize oil products exports, state subsidies were introduced for those companies delivering oil to refineries. These subsidies to oil suppliers were set at the level 130% of the Russian export duty on oil supplies to Belarus when oil is delivered by pipeline, while subsidies for oil deliveries by railway were set at the level 110%. It should be stressed that such tolling operations of oil refining amounted to about a third of total export volume. The situation with oil product trade illustrates that the problem of the trade balance deficit can be solved only by increasing the competitiveness of non-energy goods, most of which have already met with serious competition; in particular on the Russian and Ukrainian markets.

Taking into account that 54.8% of the total trade deficit are other (non-ener-

gy) producers' goods, an increase in exports of such traditional export products as potash fertilizer and ferrous metals partly improved the trade balance situation. The agreement of "Belaruskaya Kalinaya Kompanya" (Belarusian Potash Company) made with IPL, the biggest Indian importer of fertilizer, on the increase of prices for potash by USD 50 per ton (compared with the level of August 2006), as well as an increase in prices for potash delivery to South-East Asia up to USD 300 per ton facilitated this. Predicting that the conjuncture of the potash fertilizer market on the medium term would stay favorable, one can assume that this group of goods would play an important role in compensating the negative merchandise trade deficit, arising from trade with Russia.

It is worth mentioning that in 2007 some positive trends emerged in the export structure related to a growth of the investment goods share from 12.4% to 14.1%. Besides, the shares of such goods as transport vehicles grew (from 10.4% in 2006 to 11.8% 2007), while machinery and equipment grew (from 8.7% in 2006 to 9.5% in 2007). At the same time, the structure of imports of investment goods does not confirm the statements made on comprehensive production modernization, which could conduce regional and product diversification of exports. The growth of imports of investment goods in 2007 was almost for one third accounted for by imports of agricultural technical appliances (tractors, machines, and mechanisms for harvesting crops) and a single tube mill which cost USD 81.1 m.

As one of the possible directions of solving the foreign trade problem, the government still considers reducing consumer goods imports and import substitution of consumer goods. For example, plans have been drafted for domestic car production. However, one should note that despite the almost two-fold increase in the deficit in the trade of non-food consumer goods, its absolute volume amounted to USD 724.9 m in 2007, i.e. 16.7% of total trade deficit. And its contribution to the increase of the trade balance deficit amounted to 15% (Table 2). This situation was mainly caused by an increase of deliveries of cars to the internal market. That is why it is unlikely that the attempts to limit consumer goods imports or substitute

Table 2: Contribution of selected groups of goods to the growth of the trade deficit in 2007

	Growth	
	USD m	Contribution, %
Investment goods	247.2	-14.3
Energy products	-1774.8	103.3
Other producers' goods	-273.4	15.9
Foods	229.6	-13.5
Non-foods	-257.0	15.0
Others	110.8	-6.4
Total	-1717.6	100.0

Note. January–December 2007 to January–December 2006.

Source: Calculations based on data from the Ministry of Statistics and Analysis.

imports by domestic production could considerably change the state of the trade balance.

Therefore, the main directions of achieving a balanced development of foreign trade are moving away from energy specialization, entering new markets and creating internationally competitive products.

2. CHANGES IN THE INSTITUTIONAL ENVIRONMENT OF SMEs

During the last few years the institutional environment in which Belarusian SMEs operate was continuously criticized by both Belarusian and international experts. For a long time this critique was mainly ignored by the authorities. However, currently the government and the National Bank are working on measures to improve the business climate in Belarus. A joint working group was created, which works on improving legislation. Around the turn of the year (2007/2008), a set of measures on easing the registration of enterprises, licensing, and paying taxes was already adopted. SMEs in small and medium towns with populations under 50,000 had already been given substantial benefits. Nevertheless, numerous impediments for free business development in Belarus still exist.

Russia could be an example for Belarus in the sphere of intensifying reforms in the SME sector. In Russia, as it appears from the last statements from the current president and the president-elect, the necessity of improving the business environment for SMEs is connected with the goal of increasing the middle class by 60–70% by 2020. To this end, there are plans for tax reforms (VAT and other taxes reduction) and abolishing some administrative barriers (permits; easing

licensing, access to financial resources and infrastructure). Among some other potential measures, the most topical is addressing the problem of numerous inspections of SMEs by state agencies, first of all of small business. At the end of March President-elect D. Medvedev made a statement about the necessity to end the abusive state control of business; moreover, to ban state control bodies visiting small enterprises without a court order or decision of an attorney. According to Medvedev, control over business in Russia comes from 45 directions, and only at the federal level 30 agencies are involved. He characterized such control as "legalized bribe" or "blackmail" and accordingly emphasized the necessity of reforms in the field of state control and supervision. Addressing the problem of excessive controls and an often prejudiced attitude of officials during inspection of an SME is important for Belarus as well (see Section 3).

Therefore, Russia and Belarus deal to a large extent with the same problems and solutions in the sphere of state business regulation. As mentioned above, in the first quarter of 2008 some amendments in legislation were adopted in Belarus, most of which should improve the conditions for entrepreneurial activity and increase the business climate rating (for example in the World Bank Doing Business report). Nevertheless, some measures leave the current unfavorable conditions for doing business unchanged. In the following we offer an overview of the main changes in legislation that were adopted in the first quarter of 2008 related to SME functioning.

2.1. Price regulation

In the first quarter of 2008 the government continued using the methods of administrative price regulation. For ex-

ample the Council of Ministers by resolution 944 since January 1 again set the limit of price increase on goods (services) produced in Belarus by 0.5% per month.² In case of the necessity to increase prices an enterprise has to register the new price before having economically proved the necessity of such price increase.³ Nevertheless, as the SME heads mention in informal discussions, such registration of a price increase is very complicated. In practice the state organs agree to register new prices only when a company is generally loss making or loss making in certain product (service) categories, which have a considerable weight of total production volume, and even then not always. Meanwhile, when an enterprise exceeds their price increase limit without registering new prices, their additional income received due to such price increase would be confiscated. Also an additional fine/penalty which is twice the extra turnover (resulting from the price increase) would be charged.

In general, price regulation in Belarus remains expensive (it takes time and money including paying salary for additional employees to fulfill all necessary requirements), and inefficient. As empirical business survey shows, the administrative price regulation existing in Belarus almost has no influence on the level of final prices SMEs charge for their products (or services). Rather on the contrary, high taxes and costly excessive state SME regulation (permits, impediments, etc.) determine a high price level, sometimes even higher than those in neighboring countries.⁴

Among positive aspects one could mention that the restrictions on price increases are not applied on products (or services) that are produced by commercial enterprises with foreign investments. Besides, individual entrepreneurs and, since February 2008, SMEs

using the simplified system of taxation are free of price registration when they cannot meet the set price limits.⁵ But in general for improving the business climate a full price liberalization is needed (first of all for all SMEs).

2.2 Finance for small business

According to the results of numerous studies, the lack of domestic resources and limited access to credit remain important factors restricting Belarusian SME development.⁶ Getting credits is still costly and complicated for the majority of SMEs, even within microfinance projects. At the same time the state hardly provides funds and credits for SME support.

In general, financial support of small business in Belarus is provided through the central and local budgets. However, as the experience of many years shows, this system is inefficient. It puts a large personal responsibility on the shoulders of officials for providing funds (so they are not eager to provide finance because they don't want to be held accountable for payback failure). Accordingly, the procedures of getting finance are becoming more and more complicated. Moreover, the funds given to SMEs are small and therefore sometimes not worth pursuing, especially when compared with the cost in time and effort spent acquiring them.

In 2008 the state is supposed to provide BYR 193 m for SME support from the central republican budget and about BYR 1.9 bn from local budgets, which is a small amount (it is less than USD 1 m). Moreover, the main financial support to SMEs is to be provided by specialized financial organizations, first of all banks. Accordingly, access of small business to bank credit needs to be improved.

In addition, in March the National Bank sent out a special letter⁷ recommending the banks that, if necessary, they

should work out special programs and intensify SME and individual entrepreneurs' crediting, especially in small and medium towns, in order to stimulate SME development. Another important problem is crediting of new SMEs that still have no balance and/or no credit history. Currently the banks are only allowed to supply credit to new SMEs and individual entrepreneurs that are registered in small municipalities and who realize investment projects that are just up to EUR 2,000 in size. This measure is supposed to improve the access of new SMEs located in backward regions to credits and to stimulate their creation and development.

The opening of the Belarusian bank for small business (BBSB) is also thought make it easier for SME's to have access to financial resources. According to official data, it could start providing credit already in May 2008. The bank was created according to the initiative of the European Bank for Reconstruction and Development (EBRD) and the International Financial Corporation (IFC). It is planned that the bank will provide commercial credit from USD 100 to 200,000 and micro credits up to USD 10,000 for individual entrepreneurs, micro-, small- and medium enterprises. Initially, the bank plans to work in Minsk and the Minsk region, where 50% of all Belarusian SMEs are registered. It is expected that seven branches and four clearing offices will be opened in all regions of Belarus within the first five years of the BBSB's operation. By the end of 2008 the credit portfolio of BBSB would amount up to EUR 7–8 m.

2.3. Foreign trade activities

As reduction of the trade deficit is a very important goal for the government (see Section 1), the government plans in 2008 to adopt a few changes in legislation in order to ease the regime of foreign trade transactions, custom clearance procedures, conditions of a foreign trade contracts. For example in March a presidential decree⁸ was signed with some simplifications in regulations of foreign trade transactions. Its intention is to clarify certain definitions and procedures dealing with foreign trade contracts. Now the National Bank is allowed to extend the maximum terms of foreign

² The letter of the Ministry of Economy 12-01-09/481 from March 28, 2008 "On the limit of price increase".

³ Resolution of the Council of Ministers of the Republic of Belarus 944 from July 18, 1999 "On adoption of the order of registration the prices of enterprises in case of impossibility of meeting the limits of price increase (in the edition of resolution of the Council of Ministers of the Republic of Belarus 252 from February 22, 2008).

⁴ Glambotskaya, A., Rakova, E. (2007). Regulatory barriers for SME development in Belarus: the role of price regulation, <http://www.research.by/pdf/pp2007r04.pdf>

⁵ Resolution of the Council of Ministers of the Republic of Belarus 252 of February 22, 2008 "On adoptions of the changes and amendments to the resolution of the Council of Ministers №944 of July 18, 1999".

⁶ Chubrik, A., Pelipas, I., Rakova, E., (ed.) (2007). Business in Belarus: Status, Trends, Prospects. <http://www.research.by/pdf/business2007r.pdf>; <http://research.by/rus/surveys/>

⁷ Letter of the National Bank 04-23/147 of March 11, 2008.

⁸ Edict 178 on March 27, 2008 "On the way to conduct and control foreign trade activities".

operations (the maximum terms of foreign contracts performance, however they stay unchanged – 60 days in import contracts and 90 days in export contracts). The commercial banks are allowed to register a certificate of import transaction and registration certificate of export transaction. Payments for giving permission to extend a contract are abolished. According to the new decree, registration of import and export transactions within foreign trade contracts would be made if the total cost of the contract exceeds EUR 3,000 (now this is EUR 1,500), and statistical declarations – for sums over EUR 1,000 (now this is EUR 200). This measure is supposed to reduce the financial and time costs of small enterprises for fulfilling state requirements for conducting foreign trade.

Edict 40⁹ adopts the procedure “On the status of being a bona fide participant in foreign trade”. The document simplifies custom clearance for SMEs and individual entrepreneurs which are bona fide followers of Belarusian legislation. The owners of the status “bona fide participant in foreign trade” will get the possibility to import goods for their own production needs in a simplified way and with the necessity to use them immediately without customs procedures – the needed custom clearance would be followed according to the notification principle without showing the goods in the custom office.

The “bona fide participant in foreign trade” status is granted to enterprises when they have conducted foreign trade for at least three years without breaking the customs law. This status is valid for three years only. If an enterprise does break the law, the status would be withdrawn.

Therefore, SMEs who will get this status would enjoy minor simplified customs procedures and benefit by directing the time and money saved to their internal goals. A similar practice is widely applied internationally towards various regulative procedures. Accordingly, Belarus could put this experience to wider use for improving its business environment. However, in general, the new legislation changes state regula-

tions over foreign trade in a minor way. SMEs, and all Belarusian enterprises, are waiting for further and more fundamental changes that would simplify many procedures. Belarusian banks should enjoy further liberalization as well, as now they spend lots of resources, going over every deal with a fine-toothed comb.

In order to modernize and encourage investments in production assets, edict 41¹⁰, starting from January 1, 2008 applies a zero custom duty on many kinds of production equipment and machineries for a nine months term. Zero custom is applied if a price of imported equipment is more than USD 20,000 and is produced after 2002.

2.4 Investment and privatization

Edict 144 on March 2008¹¹ abolished the “golden share” – a special right of the state to participate in the management of a joint stock company. Despite the rather limited practice of designating golden shares (since 1999 it was for a few years applied at 23 JSCs only), the existence itself of a golden share negatively affected the investment image of the country, including the position of Belarus in international business ratings. The government expects that the golden share would immediately solve the problem of a low attraction of FDI. Nevertheless, according to export estimates, this is a step in the right direction but will be insufficient if further measures on liberalization of the economy would not follow. Investors rate the business climate by indicators including various factors. There are many other impediments for private investment (administrative barriers, controls, fines, violations of property rights, weak judicial system, etc.).

A positive step for stock market development and business climate improvement in Belarus is the reduction of the tax rate on the income from share and bond transactions from 40% to 24% since April 1, 2008.¹² Moreover, now the

costs of enterprises to issue bonds are classified as costs. Earlier, such expenses could only be financed from profit. Accordingly, the decree encourages Belarusian private enterprises to issue bonds for attracting financial resources.

Edict 113¹³ allows buying loss-making state enterprises based on contest. However, the obligations for such purchases include:

- Implementation by the buyer of an investment project and social programs of the enterprise which is to be acquired;
- No job losses in the enterprise for the period of paying back all debts, creation of additional jobs according to investment project;
- Assumption by the buyer of all debts of the enterprise to be acquired;
- Land should be rented by the buyer (i.e. the absence of a possibility to privatize the land where the enterprise to be acquired is located).

The starting price of a loss making enterprise that is to be acquired is set at 20% of its balance sheet value (book value) as of January, 1 of the relevant year. If the assessed value is zero or negative, then the takeover price would be set on a base unit (BYR 33,000).

Buyers of loss-making enterprises would get a three year term for paying back all debts and a six year term for the payment of the purchase sum itself.

It is supposed that implementation of this edict would contribute to reducing the amount of loss-making state enterprises, to attract investments in order to modernize these enterprises; and to increase additional budget revenues. Nevertheless, one should admit that an overvalued starting price and tough investment conditions would make such purchases too expensive for the majority of private investors. We assume that very few Belarusian SMEs would use this edict because of its high costs, while foreign investors would still be discouraged by high risks and the unfavorable investment climate.

¹⁰ Edict 41 on January 28, 2008 “On a rate of a custom for imported to Belarus technological equipment”

¹¹ Edict 144 on March 4, 2008 “On acknowledgment that some edicts of the president of Belarus are no longer in effect”.

¹² Decree 5 on March 20, 2008 “On adoptions changes and additions to the decree №43 on December 23, 1999”.

¹³ Edict 113 on February 25, 2007 “On order and conditions of selling state loss making enterprises”.

Since April 1, 2008 edict 42 came into effect.¹⁴ According to the edict, the residents of free economic zones (FEZ) get guarantees of legislation stability (during seven years they will enjoy a special legal regime and taxation) and new preferences. They can get preferences for rent if they implement investment projects; they are exempt from real estate tax and tax on purchasing an enterprise, from payments to the Innovation Fund of the Ministry of Architecture and Constructions and are not obliged to sell foreign currency.

Besides, the authority of the FEZ administration is growing. Currently it can independently decide on enterprise registration in the FEZ, if the new enterprise has more than EUR 1 m of investments in its investment portfolio. This measure is supposed to reduce the number of procedures which are needed for registration in the FEZ (earlier the number of needed agreements with different agencies amounted up to 5–8, and the process of registration in FEZ could take up to a year). In turn, this could attract new large investors to the FEZ. The FEZ administration now can make decisions on giving to rent state assets.

2.5. Taxation

Since April 1, 2008 Edict 145¹⁵ essentially expanded the terms within which tax declarations should be submitted for ecological taxes, land taxes and tax for real estate. As a result, ecological tax could be paid once a quarter (not once a month). Also, the tax forms can now be submitted once a quarter (or even twice a year). The way of paying ecological tax for industrial waste was changed. It is planned that due to a change in paying agents of ecological tax, their amount would decline from 15,000 to 80, while the budget tax revenues would remain unchanged (as the main payers of this tax are very large enterprises, while others submit 'empty' tax declarations).

The land tax and rent payments for land areas that are in state-owned, would be charged once a quarter in an amount of j of the annual sum.

Therefore, the implemented reforms in taxation slightly simplify paying selective taxes, releasing time and simplifying the work of accountants. This is of high importance for SMEs, many of which cannot afford employing two or three accountants professionally engaged in tax administration.

Nevertheless, the tax burden in Belarus remains high. It amounted to 47.3% of GDP in 2007 data, in contrast to a 40.2% tax burden in neighboring Russia (according to our estimates). The high taxes and complicated way of paying taxes hamper SME development and decrease the competitiveness of Belarusian goods (for more information on the tax system in Belarus see Section 4).

2.6. Other changes

Decree 3¹⁶ cancelled quoting the import of alcohol, non-food products containing alcohol and non-food ethyl alcohol (ethanol). Alcohol products import now will be regulated by holding contests for finding enterprises which would "provide alcohol import on the most beneficial conditions". A competent state commission would organize the contests. Experts predict that the alcohol market in this case would remain monopolized and non-transparent.

Only state companies or companies with more than 30% of shares state-owned, would have the right to produce spirits like vodka, cognac, and brandy. The licenses issued earlier would expire after September 1, 2008. Therefore, alcohol production shifts more and more towards state monopoly and control.

The Council of Ministers approved a list of municipalities, which was sanctioned by Presidential Decree 1 (on January 28, 2008) "On encouraging production and realization of goods (services) in small cities, towns and villages".¹⁷ In the Brest region (oblast), all municipalities except larger cities such as Baranovichi, Brest and Pinsk were included in the list; in the Vitebsk region – all settlements except cities such as Vitebsk, Novopolozk, Orsha and Polozk; in the Gomel region – except Gomel, Ghlo-

bin, Mozyr, Rechizca and Svetlogorsk; in the Grodno region – except Grodno and Lida, in the Minsk region – except Borisov, Godino, Molodechno, Sluzk and Soligorsk; in the Mogilev region – except Bobruisk and Mogilev. Decree 1 provides some preferences for setting up business in small towns and villages. Indeed, it is worth mentioning that small cities and villages in Belarus have poor infrastructure and facilities (roads, internet, hotels, labor market). Therefore, the desire of the government to encourage business in such places is understandable but such hopes have low chances for meeting reality.

3. SME's INSPECTION AND CONTROL

The International Financial Corporation (IFC) has prepared the analytical report "Control and Supervision Activities in Belarus" (2008).¹⁸ The survey is based on interviews with 525 heads and owners of SMEs' and individual entrepreneurs, which represent all sectors of the Belarusian economy and was devoted to such barriers to entrepreneur development as state inspections.

As the IFC surveys, conducted in 2005–2007, show, the number of inspections and their total duration strongly decreased. The average number of inspections hosted by an average company decreased from 10 in 2004 to 4 in 2006, while the duration of inspections went down from 24 days to 6 (Figure 2).

The respondents mentioned that the number of both financial and technical inspections decreased. This was achieved mainly due to a reduction in the number of unscheduled inspections. However, as IFC experts stress, despite the trend downwards, the current number of inspections remains very high, and these inspections not always are justified.

For example, in 2006, according to the survey, approximately 64% of SMEs¹⁹ hosted inspections of the fire safety agency. Meanwhile the majority of SMEs are not related to the sectors and industries that have a relatively high fire-risk or are at risk from other hazards.

¹⁴ Edict 42 on January 28, 2008 "On adoption of changes and additions to some edicts of president of Belarus related to the issues of free trade zones activity".

¹⁵ Edict 145 on March 6, 2008 "On some issues of paying taxes, rent and giving tax declarations".

¹⁶ Decree 3 on February 29, 2008 "On some issues of state regulation of production, sale and advertisement of beer, alcohol and tobacco products.

¹⁷ Resolution of the Council of Ministers 483 on March 31, 2008 "On places which are under the authority of Edict №1 on January 28, 2008".

¹⁸ The full survey one can find on <http://bel.biz/content/view/9356/125/>

¹⁹ One should mention that, indeed, the number of such inspections in general fell compared with 2005.

Even more so, 18% of SMEs with potentially dangerous kinds of activities did not host any inspections of the fire safety agency.

Along the same lines, 42% of all SMEs were inspected by the sanitary agencies in 2006, while the activities of only 11.8% of SMEs were related to production of food, medicine, children goods, the sale of perishables, etc. and were potentially dangerous from the sanitary or epidemiology point of view. At the same time, 28% from the group of potentially dangerous enterprises did not host any inspections from these agencies in 2006.

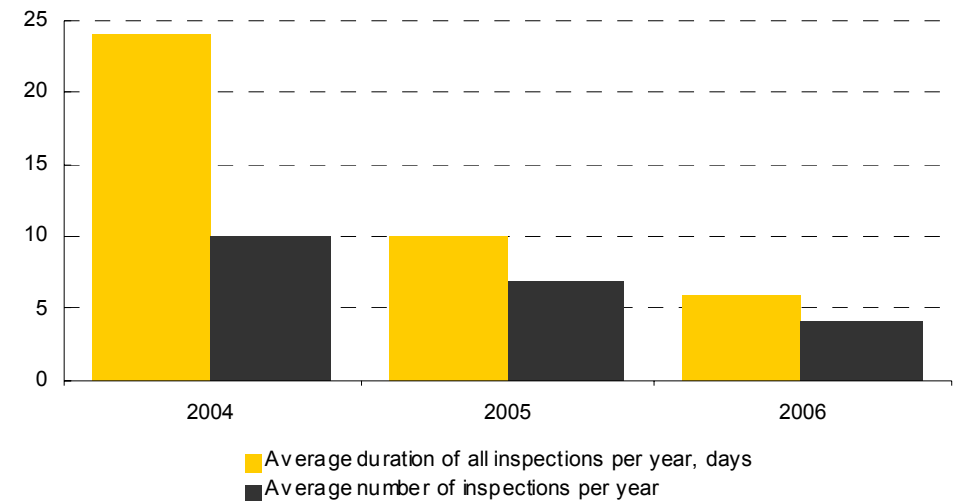
Therefore, the state control agencies lack a systematic approach for choosing the objects for their inspections. According to IFC experts, a higher number of SMEs inspections than needed for control of risk and emergency cases prevention leads to a situation when the resources of the inspection agencies are used inefficiently. Besides, additional inspections take the resources of enterprises for non-productive purposes.

As one more problem in this regard IFC experts stressed the complexity and obscurity of the procedures of inspections (Figure 3). This is caused by an insufficient knowledge by SMEs of their own rights and obligations (when inspectors come), as well as by the practice of conducting an inspection. The entrepreneurs are not happy with excessive powers of inspectors and absence of detailed, clear and uniform procedures of conducting an inspection (mostly this is related to the inspections of the State Control Committee and the taxes agencies).

IFC specialists also point out the weak informative work of the control agencies and, as a result, SMEs are not aware of and do not understand all norms and rules of technical regulations. Moreover, the large amount of existing norms and rules are not very well adapted to modern practices in Belarus.

On average, appearing from inspections, 42% of SMEs violated legislation. 52% of violators were fined. Such a high percentage of violators is not surprising, according to the IFC. In the Belarusian budget there are revenue article such as “administrative penalties and economic sanctions, withholdings”, as well as “incomes from confiscated property liquidation”. Accordingly, inspections in Belarus have rather a fiscal than a preventive and prophylactic charac-

Figure 2: Changes in the number and duration of inspections hosted by an average company in 2004–2006



Source: IFC (2008). Control and Supervision Activities in Belarus 2008.

Figure 3: Complexity and non transparency of an inspection procedure negatively influence SME activity (% of SME that mentioned the seriousness of a problem)



Note. One respondent outlined more than one problem.
Source: IFC (2008). Control and Supervision Activities in Belarus.

ter, which they are supposed to have.

As directions for reform in the sphere of state control and inspections, the IFC suggests:

- To adopt the Law “On control and inspection activities”;
- To introduce a system of coordinating the inspections which are carried out by different agencies and information exchange between them;
- To strengthen the informing of SMEs, to revise and abolish technical rules that are unfit for modern practices in the economy and country;
- To change the accent from inspec-

tions and penalties to consulting activities, to encourage study and informing SMEs on norm and rules applied;

- To reduce overlapping activities of state control agencies;
- To limit the judicial powers of state control authorities related to proper expropriation, suspension of business activities and closure of companies;
- To eliminate unscheduled inspections;
- To make sure that the economic sanctions levied correspond to the gravity of violations committed;

- To make sure that business-related legislation is applied uniformly;
- To revise general principles of the existing rationale of control and inspection activities and principles of evaluating the activities of control agencies.

4. REFORMING THE TAX SYSTEM: INTERNATIONAL EXPERIENCE AND POSSIBILITIES FOR BELARUS

4.1. Ease of paying taxes: comparative data

According to the World Bank survey, Belarus held the last position in the world in ease of paying taxes in 2006.²⁰ One may argue about methodology and the correctness of assumptions and estimations, but it seems abundantly clear that the Belarusian tax system is complex, contradictory and costly in execution. Recently, the government took certain steps towards easing the tax system. Still, a lot is left to be done.

The World Bank together with audit and consultancy firm PricewaterhouseCoopers conducted a survey in 2007 trying to compare the ease of paying taxes in 178 countries around the world.²¹ As the survey shows, today tax systems strongly diverge in different countries. For example, there are only four business taxes in Hong Kong, all at low rates (for instance, corporate income tax is only 17.5% of taxable profit). In other countries, among which is Belarus, business people pay more than 10 taxes, and most of them are paid monthly. In many countries, paying taxes on-line becomes more and more popular and possible (Sweden, the Baltic states, some Asian countries). At the same time, in many countries, after fulfilling extended, fifty pages long tax forms, they are brought in person to the tax office (sometimes monthly). There they are 'discussed' or checked with a tax officer in order to make sure that calculations are correct (New Guinea, Syria, Zimbabwe, Belarus, Ukraine). Therefore, differences are observed not only in tax rates, but also in the administrative burden.

²⁰ World Bank (2007). Doing Business 2008, <http://www.doingbusiness.org/>

²¹ World Bank and PricewaterhouseCoopers (2007). Paying Taxes 2008. The Global Picture.

Table 3: Countries, ranked by ease of paying taxes

	Easy of paying taxes	Number of payments	Time to comply
Belarus	178	178	174
Ukraine	177	176	176
Russia	130	58	151
Kazakhstan	44	15	105
Poland	125	122	146
Lithuania	71	68	54
Latvia	20	7	78
Germany	67	39	65

Source: World Bank, PricewaterhouseCoopers (2007). Paying Taxes 2008. The Global Picture.

Table 4: Distribution of answers to the question "What are the main barriers to your business?" (%)

	«1» – this is not a problem, «5» – this is a very serious problem					Average score
	1	2	3	4	5	
Tax system (high rates, complex system, often changes in legislation, etc.)	4.2	7.0	18.7	26.2	43.9	4.0
Bureaucratic barriers and limitations (registration, permits, licensing, reporting, etc.)	4.6	6.8	20.2	27.1	41.3	3.9
Inspections and fines	7.3	8.9	20.5	27.4	35.8	3.8

Source: IPM Research Center (2007). Business in Belarus 2007. State, Trends, Perspectives.

In general, according to the survey, it is easy to pay taxes in such countries as the Maldives, Singapore, Hong-Kong, China, and the UAE. In contrast, it is most difficult to pay taxes in Belarus, Ukraine, Congo, South Africa, and Venezuela (in terms of spent time and efforts). As both groups include countries from all over the world are included, it is more correct to compare Belarus with countries in the same geographical region (Table 3).

Tax regulation directly influences business activity in a country. Investors, local and foreign, take this into consideration. Accordingly, countries with a high number of taxes have a smaller amount of existing and starting SMEs per capita. This implies that reforms to decrease the sheer number of taxes and to simplify paying taxes results in an increase in entrepreneurial activity, higher rates of labor participation and lower rates of unemployment among women. For example, in Brazil the reforms of tax payment resulted in an increase in start-ups by 13% already at the second year. Tax rates' lowering also leads to an increase in entrepreneurial activity and budget tax incomes. Examples of this are the countries of Central and Eastern Europe (Poland, the Check Republic, the Baltic countries, Slovakia).

4.2. The problems of paying taxes in Belarus and directions of addressing them

Over the past few years, taxation remains

one of the most urgent problems for Belarusian SMEs. For instance, according to the IPM Research Center data, the tax system is leading the list of main barriers for doing business (Table 4).

Almost all polled entrepreneurs complained about taxation. Only 4.2% of them do not see any difficulties in this area. The table 4 clearly shows this. For the majority of entrepreneurs interviewed, taxation problems are not limited to high tax rates in itself. Rather, respondents complain about the considerable number of different 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).

In the focus groups hosted by the IPM Research Center, the participants expressed that they would love 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. Entrepreneurs have to employ a whole army of accountants. The number of these is many times higher than is needed by small and medium-sized firms in neighboring countries. In Belarus even the smallest company, needs to employ at least one accountant full-time.

Problems of tax management, i.e. calculation and reporting, are one of the most urgent for small-scale private com-

panies. 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 legal entities. The government has introduced a so called simplified system of taxation; it also simplified the procedure and reduced the costs of registration, and even diminished the size of the statutory fund for many legal entities. However, the entrepreneurs claim to make further reductions in the rates of the current simplified tax system (from 10% to 8% of turnover).

SMEs' heads and accountants mention the necessity of changing instructions and simplifying them substantially. The terminology of legal documents is complex and contradictory; besides, instructions tend to be changed often. There are lots of additions, exclusions, comments, etc.; one can hardly watch all of them; and in order to understand them and follow in a right way, one needs to read a few specialized comments made by several different specialists. Meanwhile, specialized accounting magazines and brochures are quite expensive and not all SMEs can afford subscription.

The tax bases also need considerable reforming (first of all, related to costs). Many expenses are normalized; however, the norms of including some expenses in the costs are often unclear, insufficient or contradictory. Part of the expenses the enterprises make for marketing or providing information are supposed to be financed from profits. When mistakes are made due to misunderstanding the legislation (when wrong expenses are included in costs, distorting or reducing profits), enterprises face punishment with high penalties.

One more failure of tax administration, according to the heads and accountants of SMEs, is the overregulated realm of documentation. Even the smallest mistake in a document, a technical slip (a missing dot or comma) may result in rendering the document wrong or invalid. All this increases the costs of administrative taxes.

A final peculiarity, on which SMEs com-

Table 5: Major problems of tax legislation (%)

	«1» – this is not a problem, «5» – this is a very serious problem					Average score
	1	2	3	4	5	
Large number of various taxes	4.3	24.1	29.6	23.3	18.6	3.36
Tax allowances (tax burden)	4.0	20.2	34.0	19.4	22.5	3.28
Instability of tax legislation, its continuous change	7.1	25.8	35.3	16.7	15.1	3.19
Large number of charges and dues (to non-budgetary funds, for infrastructural development, etc.)	9.9	24.1	36.8	19.0	10.3	3.07
Inconsistency of tax legislation	4.7	24.5	33.6	21.7	15.4	3.06
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

Source: Kozarzewski, P., Rakova, E. (2007). Regulatory environment and trends in SME development. In Kozarzewski, P., Rakova, E. (Eds.) *Belarusian Private Business: External And Internal Factors of Development*.

plain, is the high turnover of inspectors and often weak qualifications (especially in the field of IT – poor knowledge of a computer, computer software); poor knowledge of Belarusian legislation and internal instructions, irresponsibility and indifference (losing documents, phrases like “I do not have visitors today, come tomorrow”, “You brought the wrong document”, etc.), and sometimes even impoliteness and rudeness. “I had to spend a few hours in order to explain to an inspector their own instructions, and after that had to type all data by myself” – note one of the focus group participants.

4.3. The work of the government on improving the tax system

One should admit that the government and the Working Group chaired by A. Kobayakov²² work to lower the tax burden and to ease the methodology of calculating and paying taxes. Besides, representatives of the Ministry of Taxes and Fees work and have already achieved some positive results of their work in simplification of tax legislation and clarification of its norms (elimination of its dubious understanding). For instance, 3–4 years ago it was quite normal when documents of the Ministry of Finance contradicted instructions issued by Ministry of Taxes and Fees. Today

most of tax legislation is applied directly without any additional clarification.

For the last three years 12 tax payments were liquidated in Belarus. Five more tax payments were abolished in the first quarter of 2008. Since 2008 legal entities are freed from paying the road tax, the fee to the fund of construction science development (0.5% of the costs of all construction works), three local fees (for retail trade, construction and external advertisement in foreign languages). However the Working group on simplification of taxation argued that the biggest achievement is the reduction of turnover taxes. In 2008 the rate of turnover taxes went down from 3% to 2%. As a result legal entities will keep about BYR 1 trillion. In 2009–2010 the fee to the Republican fund for agricultural producers support is planned to be abolished. All turnover taxes will be abolished by 2011. The state also creates considerable preferences in taxation for SMEs, which are set up in small and medium size towns (they are freed from paying some fees and taxes).²³

Therefore, the tax legislation slowly, but gradually improves. Obviously taxes in Belarus are high and the way they are administrated is costly and time consuming. Accordingly, the Ministry of taxes and fees, the Ministry of Finance and

²² The Working group Chaired by deputy prime minister of Belarus A. Kobayakov was set up in 2006 to improve administrative procedures and to stimulate the development of entrepreneurship in the country.

²³ Decree 1 as of January 28 2008. “On stimulating production and sales of goods (services, works)”. The proposition of the Decree covers residential areas with the population up to 50,000 people.

the Working Group chaired by A. Kobyakov have lots of work to be done in order to equal the tax burden and ease of paying taxes in Belarus with the neighbor countries of Belarus. Although, if Belarus sets an ambitious goal to reach the list of top 20 or top 50 countries with a high quality of business climate, the room for tax reforms is even wider. Up to now, the entrepreneurs admit slow progress, but still complain for very costly way to administrate taxes.

Many countries choose different tax reforms in order to simplify tax administration and reduce tax rates. For the last three years 65 countries reformed their tax system. The main directions of such reforms were the rate of corporate income tax reduction; abolishment of some taxes, and simplifying the way they are paid.

Among the main suggestions for easing tax administration and tax burden reduction in Belarus already in 2009, one can point out:

- To abolish the real estate tax (for SMEs) or eliminate this tax for the most part on fixed assets (equipments, machinery) and using this tax only for real estate objects (buildings, constructions);
- To unite (combine) in one payment real estate tax and land tax;
- To abolish local fees such as the public transport renovation fee and a municipal infrastructure maintenance and developing fee;
- To set unified rates of the local tax for retail sales and tax for services at a 5% rate;
- To abolish fees to the Republican fund for agricultural producers;
- To declare tax calculations (declarations) once a quarter with the simultaneous obligation for tax payers to pay taxes every month, and shift to a quarterly paying corporate income tax and VAT (and ideally social taxes as well);
- To reduce rates for social taxes;
- To speed up the shift to a electronic tax reporting system;
- To cancel for private enterprises, and first of all for SMEs, fees (contributions) to state innovation funds;
- To reduce rates (from 10% to 8%) in

the system of simplified taxation in order to involve more SMEs in this system;

- To simplify (to abolish) a set of instructions (laws) and the language they are written in, as well as bases for some tax calculations.

5. THE NATIONAL BUSINESS PLATFORM: TAXES AND TAX ADMINISTRATION²⁴

Despite certain successes in improving the tax system, it remains one of the largest impediments to business development and improved competition. In the process of implementing the provisions of the 2006–2007 Platform, all payroll taxes were repealed in the draft of the 2007 Law on the Budget. The Working Group on Simplifying the Tax System (WG STS), which was created by the Belarus Council of Ministers under the guidance of Deputy Prime Minister A. Kobyakov, supported our proposal to eliminate the sales tax. The group directed the Ministry of Trade to submit a proposal to significantly reduce the number of people required to make payments to the Ministry of Trade's Innovation Fund. There has been no such progress on any other innovation funds. The WG STS supported the Platform's proposal to eliminate the real estate tax on fixed assets. This issue was debated during the adoption of the 2008 Law on the Budget. We have been successful in improving the environmental tax for services. We proposed to reduce it to 5%. Our proposal to eliminate the sales tax still remains without support. Although the working groups have been very active, the government has not taken any steps towards a systemic simplification of the tax system or towards reducing the tax burden.

During 2007, the government has not adopted a decision to eliminate restrictions on allocating certain expenses to the cost of production. The government did not support our proposal to transition to an individual flat tax. Businesses continue to pay turnover taxes. The Working Group made a proposal to eliminate these taxes in the 2008 budget law. The government likewise has refused to

reduce property taxes; instead it has taken steps to increase them. Nor has the tax on dividends been reduced, which prevents a proper development of the stock market and promotes capital flight from the country. The authorities also failed to approve our proposal to permit legal entities to purchase small orders of products, raw materials and parts in the Russian Federation with cash and subsequently pay the VAT in Belarus (up to RYR 60,000 per transaction). The government restricts corporate property rights, thus promoting inequality in corporate taxation and business activity, discriminating against cash payments and blocking the free conversion of bank funds to cash.

Market competition is limited by different tax regimes for different sectors of the economy and different companies. The business community suggests reducing payroll taxes for social security. An active policy of fiscal revenue growth, which will become possible due to the development of small and medium size businesses, will bring to life a more stable social security system. Despite their promises to reduce the overall tax burden in 2006 and 2007, we have observed that it is growing. There are no cases in economic history of long-term rapid growth in GDP when more than 30% of GDP is redistributed through the budget. In Belarus, this figure is now 50% of GDP.

Restructuring the tax policy did not yield any results. Presidential edict №119 ordered a review of the simplified tax system for small and medium size businesses in order to increase their attractiveness. The resulting changes were superficial and could not stimulate the development of small business effectively.

The Government has not done enough to institute an electronic tax reporting system (including via the Internet). The advantages of an information economy and electronic government have not been put to use. Bureaucrats resist extending tax filing periods. The Belarusian tax code has not been amended to interpret contradictions in the tax laws in favor of the taxpayer. Companies are forced to spend significant resources on storing a large number of documents after an audit.

Thus, so far the government has not been able to make use of the recommendations of the business communi-

²⁴ Platform has been created by Belarusian expert and entrepreneurial society in order to improve business climate and encourage the dialogue between the government and entrepreneurs.

ty, despite the fact that their implementation would help the government reduce administrative and oversight costs by USD 2.5–3 billion. In addition, it would significantly increase potential investment to Belarus (by USD 1.5–2 billion) and save the households up to USD 1.5 billion due to lower taxes on goods and services. Without systemic tax reform, business in Belarus will be unable to get on its feet and promote the emergence of an innovative, civilized nation.

We believe the following steps should be taken to promote the creation of a strong and prosperous Belarus:

- Reducing the overall tax burden to 30% of GDP;
- Simplifying the tax system, consolidating taxes and fees, and improving the mechanism for payment of VAT on imported goods. We believe that VAT should be paid only on the results of business activity, not in advance;
- Combining all profit taxes into a single payment. Repealing local targeted fees such as the public transport renovation fee and the municipal (or district) infrastructure maintenance and development fee;
- Repealing mandatory contributions by private businesses to innovation funds (funds of the Ministry of Trade, the Ministry of Architecture and Construction, etc.) and transitioning to voluntary participation in innovation, investment and other funds;
- Eliminating the real estate tax on fixed assets;
- Further simplifying the procedure for payment of the environmental tax;
- Eliminating the restrictions on the deduction of various expenses for purposes of taxation and price formation;
- Transitioning to a flat rate of individual income tax no higher than 10%;
- Eliminating the double taxation of subsidiary profits;
- Creating conditions to stimulate investment, innovation and cooperative business (subcontracting). Tax stimulus programs to encourage business investment and innovation;
- Repealing turnover taxes and payments;
- Repealing the sales tax;
- Reducing the corporate real estate tax rate;
- Permitting legal entities to purchase small orders of products, raw materials and parts in the Russian Federation with cash with subsequent payment of VAT in Belarus (up to RYR 60,000 per transaction);
- Reducing required social insurance contributions;
- Reducing required contributions for mandatory accident insurance;
- Eliminating special tax and other regimes and privileges for any individual business, i.e. enforcing the constitutional provision on equal economic opportunity;
- Amending the Tax Code to include provisions requiring that all contradictions in the tax laws be interpreted in favor of the taxpayer;
- Reducing the individual tax on dividends to 10%. Establishing a 0% tax rate on dividends paid by high tech firms;
- Simplifying accounting, reducing paperwork, and transitioning to international accounting standards;
- Creating a simplified tax system, combined with minimal government regulation and paperwork for small and medium-sized businesses;
- Instituting an electronic tax reporting system (via the Internet);
- Allowing small and medium-sized businesses to file tax reports and make tax payments only once per quarter;
- Instituting an electronic (including online) statistical reporting system, with simplified and reduced reporting requirements, and consolidation of items that require comprehensive reporting. Expanding the practice of random statistical analysis. Reducing administrative liability and eliminating criminal liability for unintentionally misreporting statistics;
- Reducing the time for which accounting records must be kept after an audit;
- Enacting a three-year statute of lim-