

In this issue:

SME development, investment climate and FDI attraction in Belarus. The main changes in legislation that regulates entrepreneur activity. Privatization in Belarus in 2008. The import substitution policy and its influence on SME development. The development of market for passenger transportation: key factors and directions for reform. Wages in Belarus: legal restrictions and reform proposals. National Business Platform.

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Dear Readers!

Before you lies the 12th issue of the quarter review "Small and medium business in Belarus", which is devoted to the problems of Belarusian business and ways to solve them.

The first section contains an analysis of the changes in investment climate of the country and legislation, regulating doing business. The government continues to declare a policy of liberal regulatory changes in legislation, however, in our opinion, these changes are still do not have a systematic and general character and are rather partial and pointed.

In the second section you will find a study on changes in the sphere of privatization in Belarus. Due to a worsening trade balance, privatization, together with borrowing, is an important source of foreign investments attraction to the country.

In the third section we consider different directions of the import substitution policy in Belarus and its consequences for free private entrepreneurship. In the fourth section we present the analysis of the development of the market for passenger transportation. We analyze factors which hamper the market development, as well as suggest some regulative reforms for changing the situation. In the fifth section there are the results of studies conducted by the IPM Research center analysis, concerning wages regulation in Belarus and reform agenda. In the last, conclusive, sixth section we offer to your attention the next chapter of the national Business Platform, devoted to the suggestions of Belarusian business on improving the permit system in Belarus, as well as state inspections and punishment.

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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. SME DEVELOPMENT, INVESTMENT CLIMATE AND FDI ATTRACTION IN BELARUS

1.1. Indicators of SME development

On the 1st of April 2008, the number of small enterprises in Belarus amounted to 51,000. Compared with the same period in 2007, their number increased by 36%. 20.5 thousand small enterprises (40% of the total) functioned in the sphere of trade and catering industry, 10.7 thousand (21% of the total) - in industry, 5.3 thousand (10% of the total) - in construction. In January-March 2008, there were 440.3 thousand employees working in small enterprises (10% of the total work force), including in industry – 171.8 thousand, in trade and catering – 110.8 thousand, in construction – 67.3 thousand people. During the first three months of 2008, small enterprises produced goods and provided services worth BYR 4.3 trillion, which is a 22.6% increase when compared with January-March 2007.

The actual number of medium enterprises is not included in Belarusian statistics. However, one could hardly foresee any significant increase of their number in the near future. Despite the efforts of the authorities directed at improving the business climate, the changes that already have been made are still not sufficient for mass appearance of new private enterprises. The Ministry of Statistics itself explains the increase in the number of small enterprises by their campaign on shifting individual entrepreneurs in private unitary enterprises. At the same time, because a considerable amount of legal and administrative barriers for doing business persists, the majority of individual entrepreneurs resist to shift to the form of an private unitary enterprise and continue to function either under a status as an Individual Entrepreneur (and having also registered their employees as such), or in the shadow economy.

As numerous business surveys conducted by the IPM research center¹ show, doing business in Belarus, requires considerable intellectual, labor, and financial costs, which many small enterprises are unable to bear. Especially small enterprises with employees up to ten people, most of all suffer from complicated and

high taxation, expensive and labor intensive procedures of obtaining licenses, certificates and other permits, state price regulation, and so on. The government takes some steps to improve the conditions of doing business. But for example only a small number of small enterprises can use the simplified tax system. Many adopted changes in legislation with respect to entrepreneurship apply only to already existing medium enterprises, while barriers for entry are still high. The government created beneficial conditions for setting up businesses in small towns and villages, but it is difficult to use them, due to a lack of appropriate infrastructure, management, etc. in these places.

It is to be expected that there would be a meeting for easing doing business in Belarus with the participation of the president in July 2008, which could lead to long-awaited changes in the business climate. Up to now, the government acts in their usual way, slowly implementing cosmetic reforms. Disbelief in the possibilities and potential of the local private sector leads to a situation where the government puts its bet on one card, which is foreign capital. The conditions for creating a stock market and foreign investment attraction are gradually being created in the country. In the following we provide you with the main changes in the legal sphere, which are aimed at improving the business and investment climate which were made in the second quarter of 2008.

1.2. Centers to support small business in the regions

The government resolution provided a legal and organizational base for the creation and functioning of centers and basic centers for support of entrepreneurship.² Their main task is development of and support for small business in the regions, as well as coordination of activities in oblast centers and in Minsk. It is planned that one basic center will be created in every oblast and in Minsk, which could later open various branches. Up to now, basic centers are opened in Brest, Gomel, Mogilev and Minsk. The resolution provides as legal basis for further activities, which would allow them to attract necessary financial resources.

According to the document, besides coordination of the work of other centers, the main directions of the activities of the basic centers are analysis of trends in SME development; participation in, elaboration and realization of programs of state support of business; formation of an informational database on entrepreneurial issues in the regions; informing small businesses about the system of state support of small business in Belarus. The centers would enjoy the financial support of the central and local governments.

The resolution determines that a center of support of entrepreneurship is an organization of any form of property that is created with the goal of providing economic and organizational support to small businesses. Besides, the organization should have a technical base and qualified personal.

Let us remind you that nowadays in Belarus there are 37 centers for support of entrepreneurship. 13,589 people used their services in the first quarter of 2008. During this period, the centers organized and conducted 217 courses and seminars in which 6,208 people took part. However, despite the fact that one should encourage the activity of centers for support of business, lots is required in reforms and chances in approaches to support.

The experts of the IPM Research Center earlier wrote about the problems of interaction between entrepreneurs and the organizations of business infrastructure (centers for support of entrepreneurship, incubators of small business, techno parks, foundations of financial support of entrepreneurship, business unions and business associations, as well as consultants and business schools) in Belarus. They analyzed the inclination of private firms to join business unions, spheres of cooperation between entrepreneurs and organizations of business infrastructure, evaluation of quality of functioning of this organization, expectations of entrepreneurs in the sphere of cooperation with organizations which support business development, as well as the main obstacles for cooperation between these organizations and entrepreneurs.³

¹ <http://research.by/rus/surveys/>

² The resolution of the Council of Ministers #825 on June, 9, 2008.

³ Gorzynski, M. (2007) Entrepreneurs and organizations of business environment, IPM Research Center Working Paper 07/09.

1.3. The main changes in legislation

The government actively works on improving the investment climate in Belarus, as was already mentioned in the previous issue. For the first three months of 2008, 15 documents were adopted which aim at improving the business climate in Belarus. The changes were in the sphere of easing acquiring and selling land, the possibility of buying unused state property for a small amount (equivalent to USD 16) on an auction, simplifying customs services for enterprises, which have the status of being bona fide participants in foreign trade, cancelling the golden share, and granting four mining concessions. According to vice-prime minister A. Kobyakov, the plan adopted by the government on improving the investment climate in the country consists of 28 separate points, among which 15 are already implemented and 11 are in the final stage of agreement. However, in the second quarter there were no considerable legal changes in the business climate.

For simplification of the procedures for foreign investors coming to the country, the Ministry of Economy created the National Investment Agency. It is planned that this agency will work with all foreign investors in the sphere of new investments (green-field privatization), as well as privatization of already existing enterprises within the principle of a one-stop-shop.

Let us recall that the state investment program assumes to create 400 new production facilities and modernization of 600 existing ones by 2010. Investment in assets by 2010 should increase by 2.2 times compared with 2005. The head of the government, S. Sidorski, stresses in his interviews that the government is first of all interested in direct investments, and promises to make everything possible in order that the investment climate in the country is improved.

A good signal to investors, according to the government, would be the intention to reduce the tax burden by 1.2 percentage points of GDP by 2009. As a result, more than BYR 1.4 trillion would remain in the enterprises. In the previous year, the tax burden to GDP reduced by 0.6 percentage points. It is expected, that a decision on pursuing a three year plan

of privatization would encourage investors to invest in Belarus.

Nowadays in Belarus there are more than 4.2 thousand enterprises with foreign capital from 68 countries. The main country investors are Russia, the UK, Austria, Switzerland, and Germany. The aim of the government is to rank among the top 30 countries with the best conditions of doing business.

The Ministry of Economy offers new approaches in regulation, entrepreneurial activity, (taxation, registration, licensing, crediting). The government also considers the possibility of putting a moratorium on checking entrepreneurs, stability of legislation in this sphere for the next five years, and some other benefits. Also, the authorities are elaborating a document which assumes a reduction of terms and simplification of the procedure of declaring bankruptcy (acknowledging an enterprise as being bankrupt). The government also aims to further develop the stock market and investment funds, as well as venture capital companies.

However, the government works on all these changes by itself, without the participation of businesses and the analytical community, which leads to a reduction of efficacy of changes, and often partial character of regulatory reforms.

1.4. Reform of price regulation

The state price regulation first of all of the production of private companies, is an essential barrier in SME development. In the second quarter of 2008, the council of Ministers of the Republic of Belarus organized a working group which included the representatives of the department of price policy of the Ministry of Economy, business unions and private enterprises. The head of the group is the head of the business union of entrepreneurs and employers (BUEE) Georgi Badei. The working group works within the governmental working group for simplifying the tax system (the head is vice-prime minister A. Kobyakov). G. Badei's working group sent its recommendations to the government.

The position of entrepreneurs and business unions was expressed by the executive director of BUEE, Ghana Tarasevich as: "the market should regulate prices for goods, apart from so-

cial important and production of monopolies. Now, in Belarus, everything is turned upside down: there is a limited list of goods on which one can set free prices, while for all others the prices are regulated. We would like it to be the other way around."

Up to now, it is unclear exactly which of the working group's recommendations the government would implement. There is no clarity on terms either. The department of price policy of the Ministry of Economy suggests reforming state price policy in 2009-2010, while business representatives insist on changes already in this year in order to put the Law "On pricing" into effect starting next year. Despite the fact that the law was adopted in May 1999, all these years it was not taken into effect. Since only a few days after its adoption the president signed the Edict #258, according to which the government "when necessary" was allowed to set the maximum indices of change in the prices for goods and services (on a quarterly basis). According to G. Tarasevich the government uses this right too actively. The officials obliged producers to register and justify their prices, which only increases the administrative costs of businesses.

According to Victor Margelov, vice president of Minsk Capital Union of Entrepreneurs and Employers (MUEE), entrepreneurs oppose the procedure of governmental approval of prices as declaration of prices takes lots of time and effort by SME personnel. "The Ministry of Economy is ready to cancel the declaration of new prices and tariffs for new products for enterprises, as well as declaration when the price increase is within the governmental index of price increase (not more than 0.5% per month). Energy tariffs increase very sharply, however, but companies are not allowed to increase their prices accordingly. Half a percent is nothing." According to Margelov, the Ministry of Economy is willing to compromise by increasing a few tens of positions in the list of goods and services prices for which are not regulated by the state. "Here our wishes don't meet – up to now, thousands of goods one can easily be exempt from state price regulation as they don't influence inflation," Margelov said.

MUEE especially insists on canceling state price regulation for small enterpris-

es. Pricing here is determined by the market. That is why it is inefficient to use state regulation. Nowadays many small enterprises are loss making as they cannot increase their prices. We can easily lose all our small business, Margelov claims.

In their presentation of arguments to the government on the inefficiency of state price regulation and recommendation of its canceling, the representatives of business unions use among other things the surveys and publication of the IPM Research Center. Many publications of the IPM Research Center are devoted to the problems of state price regulation and the attitude of entrepreneurs towards it, contain financial and labor cost connected with fulfilling all norms of price legislation.⁴

1.5. Investment climate through the eyes of the heads of foreign companies

According to the survey that was conducted by the German-Belarusian Economic Club, the heads of 57% of enterprises with foreign investments which work in Belarus consider the investment climate in the country as sufficient/acceptable. This was announced on 30 May 2008 on the fifth plenary meeting of the Advisory Group for foreign investment by the head of the club, Claus Bayer.

The participants of the survey were the heads of 385 enterprises with foreign investments from all branches of the economy and from all regions of Belarus. Compared with the same survey done in 2006, according to Claus Bayer the number of respondents which estimated the investment climate of Belarus as 'good' and 'very good' increased by 12.5%. However, a quarter of respondents still think it is insufficient, and for the first time in some years, 6% of respondents were unable to choose an answer. Mr. Bayer said that the fact that more than half of the participants of the survey in general are satisfied by the results of their economic activities in Belarus indicates a positive development

⁴ Glambotskaya, A., Rakova, E. (2007) Regulatory barriers for SME development in Belarus: the role of price regulation, IPM Research Center Policy paper 04/07; Glambotskaya, A., Kozarzewski, P., Rakova, E., Fadeev, V., Chubrik, A., Shymanovich, G. (2007) Business in Belarus 2007: Status, Trends, Perspectives.

of the process of improving the investment climate in Belarus. Although it should not be concluded that only a few minor problems need to be solved for increasing the investment attraction of Belarus in the eyes of foreign investors.

Among the problems respondents often mentioned are changing legislation; the impossibility of acquiring land in private property, the big number of state organs for controls and the number of controls; high taxes and complex tax system; and complexity of customs procedures. Respondents are willing to speed up the terms of getting permits for construction; terms for getting licenses and certificates; and introduction in Belarus of international accounting standards. Also they mentioned a low effectiveness at the lowest level of the administrative system. And the delays with which decisions are taken. 41% of participants said that a positive decision are taken only with personal agreement with the head of an appropriate state organ one obtains a certain permit. However, 30% admitted "the general improvement of work in Belarus" and 30% hope "for further improvement and development".

Claus Bayer stressed that "improvements in the investment climate don't lead to an immediate FDI inflow". In his opinion, there is a need in Belarus for elaboration of a concept of country marketing that would be aimed at improving the image of the country in the world. He also thinks that the importance and influence of the recently created National Investment Agency should increase.

2. PRIVATIZATION IN BELARUS IN 2008

In 2007, after the double energy shock the country faced, Belarus had to deal with the problem of financing the negative trade balance (for maintenance of macroeconomic stability and a stable exchange rate). The trade deficit could be financed from two main sources – privatization and FDI attraction; and borrowing abroad.⁵ Belarus tried to use both. For example, the foreign debt more than doubled to USD 12.7 billion.

⁵ By the end of the year, due to the price increase for imported gas from Russia by 2.14 times and introduction of a 30% oil duty, the negative trade balance amounted USD 4.3 billion.

The attitude of the authorities to foreign investments attracted to the country in the form of establishing new businesses (green-field privatization) as well as classical privatization also changed. From 1996 to 2007 privatization in Belarus was made in the form of slow, formal corporatization, and the state remained the main owner of shares.⁶ But in 2007 a few substantial sales of enterprises were made, which brought more than USD 1.5 billion to the budget. Among them, one can mention the sale of Beltransgaz to Gazprom (USD 625 million annually in 2007-2010), Mobile operator Velcom (USD 650 million), and a few small banks. Generally, however, all deals can be characterized by low transparency and were determined by personal decisions of the president.⁷

The authorities significantly changed their tone and content of their statements about privatization and FDI. It was expected that relatively active privatization would continue in 2008, but in 2008 the situation changed slightly. Firstly, the price for gas was not significantly increased (at the first half of the year from USD 100 to 128 per tcm), secondly, Belarus received a Russian stabilization credit (USD 1.5 billion for ten years), thirdly, a favorable conjuncture on foreign markets allowed to increase exports by 70% (in money terms). Meanwhile, the negative trade balance is still growing, which means that the problem of financing it remains.

2.1. Corporatization and Privatization

Corporatization is the first step towards privatization of enterprises. During the last years, the rate of corporatization of Belarus was slowing down, which reflected the unwillingness of authorities to implement mass privatization.

In 2008, in the list of enterprises which will be corporatized, are included eight enterprises.⁸ There is only one relatively big enterprise in this list – Baran-

⁶ In 2006-2007 annually less than 6 enterprises were corporatized, where 99.99% of shares belong to the state.

⁷ See "privatization in Belarus: the legal base and real practice", http://www.belinstitute.eu/index.php?option=com_content&task=view&id=177&Itemid=81

⁸ http://www.gki.gov.by/inform/Infond/perchen2008_priva.html

vicheskij 558 Avian Plant (staff is slightly over 1000). Other enterprises are small with a number of employees of less than 1000 people.

Meanwhile, the State Property Committee insists that this list is not final and could be expanded by a government initiative. The enterprises of the Ministry of Industry and concern Belneftechim could be included in the expanded list. So the executive of the concern Belneftechim, M. Ocipenko, said that the concern plans to offer to the government the privatization of JSC Polymir and JSC Naftan before the end of the year. There are active negotiations with Russian investors on corporatization and privatization of the truck plant MAZ. It is to be expected that new (expanded) list, as well as a three year plan of corporatization in Belarus, would be published in September. It is obvious that the results of the negotiations on a new price for gas, as well as investment offers from foreign investors coming to the country would influence on the decision making in the sphere of privatization.

Despite the absence of enterprises that are most meaningful to the economy in the list of corporatization, the government indeed put up for sale the state packages of 74 JSCs shares, declaring the readiness to fully sell their share in the majority of JSCs in the future.⁹ For example, the Ministry of Industry puts up for sale their shares in 16 Joint Stock Companies, Concern Beleftechem - 3 JSCs, Concern Bellegprom - 26 JSCs. The head of concern Bellegprom, E. Narishkin, said that the concern is ready to fully sell all its enterprises to private owners. It is put up for sale the state packages in JSCs that belong to the Ministry of Energy, the Ministry of Transport and Communications, the Ministry of Agriculture, etc. It is worth mentioning that in 2007 the state property committee planned to sell by tenders and auctions, their shares of 23 JSCs, including all state shares in 12 JSCs. However, there were registered less than ten deals with the state packages in 2007 due to complicated investment conditions. In this year, so the state did not declare the conditions on which it is going to sell the packages of 74 JSCs.

2.2. Privatization in selected sectors of the economy

Banking sector

In the first half of 2008, the trend of attraction of foreign investors to the Belarusian banking sector continued. In general, in the first half of the year, a few deals were accomplished, which were connected with change in ownership in Belarusian banks:

- In mid-February, Minsk Transit Bank (MTB) completed the procedure of introducing into the list of shareholders the Cyprus Investment Fund, Horizon Capital. The deal was made through the additional emission of shares and buying by the fund part of this package of shares. As a result, the share of this investor amounted to 33.6% in the bank capital and the capital itself increased by 2.4 times (BYR 95.3 billion).
- In May 2007, Bank of Georgia¹⁰ acquired 70% of shares of JSC Belaruskij Narodnij Bank (BNB). The deal amounted to USD 34.2 million. Besides, according to the written agreement, the Bank of Georgia has an opportunity to buy out the remaining 30% of shares in the next three years.
- In June 2008, the National Bank of Belarus sold to Cyprus company ABH Ukraine Limited (the daughter company of Alfa Bank Ukraine) 38.94% of shares of Belarusian Meghtorgbank for USD 12.266 million. Besides the National bank, other shareholders of the bank also would sell their shares. In general, there would be sold 90% of Meghtorgbank shares to Alfabank Ukraine for USD 31.5 million. All necessary transactions connected with the sale of Meghtorgbank are expected to have been concluded by July 2008.

Besides, the technical work on selling the shares of Belarusian Paritet Bank, which belonged to the National Bank, continued. Also, it is planned that in 2008, the blocking package of Belinvestbank and Belpromstroibank would be sold to foreign investors. The banks are currently in the process of negotia-

tion with several banks. Besides, the head of the National bank of Belarus, P. Prokopovich, said that the biggest Belarusian state bank Belarusbank, is also in the process of negotiations with eastern and western investors on selling 50% of their shares. Also it is expected that the deals on acquiring the blocking packages of shares in Technobank (by Latvian Trasta Commers Banka), RRB Bank (EBRD), Bank Zala-toi Taler (Lebanon Fransabanka) have been concluded.

Nowadays, foreign capital participates in 23 Belarusian banks and amounted to 14% of the capital of all banks. There is 100% foreign capital in nine banks.¹¹

The attraction of foreign capital to the banking system of the country is an important and progressive step, which would strengthen the banking system, make it more competitive, and attract the needed resources to the economy of the country.

Telecommunication

The biggest Russian enterprise "AFK system" negotiates about buying a package of shares in the Belarusian-Russian GSM operator MTS. The Belarusian side owns 51% of shares, while the Russian shareholders have 49%. The government negotiates on selling the package of shares that belong to the state from the end of 2008 (the Russian owner wants to buy at least 2% for creating a blocking package), however, details (the size of package, price, etc) are still unknown.

Also in the Belarusian and Russian mass media the possible deal on privatization of GSM operator Belarusian Network of Telecommunication (BeST) is actively discussed. BeST is the last GSM enterprise in Belarus that is still independent from any foreign company.¹² The Minister of Economy of Belarus, N. Zaitchenko, on May 19, on an annual meeting of the EBRD board of directors said that Belarus plans to get at least USD 500 million from selling BeST to Turkish company Turkcell.

⁹ http://www.gki.gov.by/inform/Infond/OAO_2008_kon.html

¹⁰ "Bank of Georgia" is the biggest Georgian commercial bank. On April, 2008, its assets are estimated at USD 1,856 billion.

¹¹ These are the banks: Moscow-Minsk, BelRos-Bank, Beloruski narodny bank, Technobank, Belvnesheconombank, Meghtorgbank, VTB, Goldener Taler and Belgazprombank.

¹² Velcom was bought by Telekom Austria in November 2007 for USD 1.04 billion.

New foreign investors in Belarus

At the beginning of January, Heineken announced the acquisition of a Cyprus company which is the owner of Belarusian brewing company "Syabr" in Bobruisk. According to the conditions of the deal, Heineken acquired the mother company in Cyprus, the owners of which is consortium Detroit Investments Limited (Cyprus), and International Financial Corporation (IFC, branch of the World Bank). The sum of the deal is undisclosed. The deal would be financed by the own resources of Heineken. In May 2008 a Heineken N.V. spokesman announced the acquisition of 51% of the shares of the Belarusian brewer Rechitsa Pivo for EUR 6.4 million.

The Heineken purchases are relatively big deals in the brewery market of Belarus. Few years earlier, holding BBH, of which co-owners are Danish and English companies, acquired 30% of shares of the brewer Alivaria.

In general, according to the government's plans, 149 investment projects would be implemented with foreign investment attraction in 2008. An approximation of these projects is USD 1.6 billion. The government even determined the measures of state support for enterprises which would implement important investment projects, using foreign credit.¹³

According to the government, Belarus has already received 215 offers on cooperation with foreign investors. 76 from these are in the process of negotiations on further cooperation. The amount of investment within this project is about USD 12 billion. According to the Deputy Minister of the Ministry of Economy, P. Zhabkov, the main projects are the building of high-tech parks by company Lyons Financial Solutions Holdings (PTY) Ltd from South Africa, the district Minsk city by Russian company Iterra, the organization of production of ethanol biofuel by Irish company Greenfield and others. Besides, the representatives of the international company Indesit also had meetings in the Ministry and will conduct further research on the possibilities of organizing production of domestic appliances in Belarus. Also, some investment companies from South Korea and Turkey are interested in working in Belarus.

2.3. Nationalization

Despite all the talk about privatization, the idea of permanent re-nationalization within the scheme "dept for shares" has not been rejected. Therefore, the state share in some enterprises is increasing. For example, by the council of Ministers resolution the share of the Republic of Belarus in the capital of 28 JSCs increased since January 1, 2008.¹⁴ The shares of some enterprises that are part of concerns Bellegprom and Belpicheprom would be returned to state property. Among them are 3 sugar plants, and few machine building companies.

The shares of these enterprises are appropriated by the state after the government had covered their interest rates, after begin unable to pay their interest on bank credits. Mainly, the credits were given for technical modernization and renovation. For example, JSC Kim from Vitebsk received BYR 81 million of government support to pay for interest rates on credit, and therefore, the government received 2.4 million shares. JSC Minsk Margarine Plant received from the budget BYR 121.6 million. As a result, the government will receive 39.426 shares of this enterprise. The government paid the interest rate of the JSC Gorodezcki Sugar Combination which was BYR 1.41 billion and will receive 13.542 million shares.

Therefore, in the first half of 2008, the authorities of the country are not in a hurry to pursue privatization. The first half of 2008 and possibly the entire year would be characterized by a so-called "pre-sale preparation". The legislation has been changed, investment and business climate are being improved, despite the fact that on the official list are only eight enterprises to be corporatized and privatized in 2008, the government is working on a new alternative list which would hold 315 such enterprises. Investors from different countries with various business interests visit Belarus. The government considers the possibility to privatized the biggest truck plant, MAZ (one can foresee that the plant would be corporatized in 2008), to sell few oil and chemistry enterprises, the state share in mobile operators and some state shares in assets of the biggest state banks. The state plans to sell all

or part of its shares in many already corporatized enterprises. Nevertheless, one should keep in mind that all these ambitious plans could not meet reality (as in previous years), as, besides higher prices, any privatization deal is tied to a set of special conditions with which potential foreign investors find it hard to agree.

3. IMPORT SUBSTITUTION POLICIES AND ITS IMPACT ON THE SME DEVELOPMENT

The Ministry of Economy reported about a set of measures being developed to create disincentives for trading with the imported goods. Among these measures are the retail mark-ups limitations on certain imported goods with contract-defined prices (in contrast to marginal indexes). Next, a list of goods of foreign origin is prepared and forwarded for the adoption by the relevant bodies. Prices of goods in the list should be based on a regulated wholesale mark-up. However, it could realistically be expected that price regulation measures would not be efficient to slow down price growth and to trim the volume of imports.

One of the chief arguments of import-substitution policies is the persistence of the merchandize trade deficit. The government is also aware of rising foodstuff imports, while these goods could be produced at home. In a report on the 1st quarter of 2008, the Deputy Prime Minister, Mr. Andrej Kobayakov emphasized that besides seafoods, fruits and sunflower oil (which are not produced in Belarus) foodstuff imports are dominated by chocolates, confectionary products, beer, macaroni, juices, canned fruits and vegetables. According to him, these goods could be produced in Belarus.

However, there is a danger that the state interference into the operation of a market under the banner of the 'need to regulate' or 'to optimize' could result in lower supply and higher prices. For instance, several years ago, the imports of fish and seafood have become controlled by the state via the system of quotas and the introduction of 'special importers' status for the selected companies. As a result, there have been fewer companies on the market, while prices increased considerably. Similar situation was observed at the tobacco market. In 2002, the establishment of quotas led to a shortage of cigarettes falling into certain price range. Initially, imported cigarettes priced less

¹³ Edict #168 on March 21, 2008.

¹⁴ Resolution of the Council of Ministries #507 on April 2, 2008.

than 26 US cents per pack had become unavailable at the market. Later, it happened with the cigarettes priced less than 30 and 35 US cents per pack. In 2005, it has become forbidden to import cigarettes priced less than 80 cents per pack. Finally, an exclusive right to imports cigarettes has been granted to a single company 'Belarustorg', which is controlled by the Executive Office of the Presidential Administration.

In March 2005, a compulsory 'marking' of beer of both domestic and foreign origin has been introduced. According to the expert estimates, this measure helped to streamline the imports of beer from Russia and also to considerably reduce the volume of illegal imports. Again, these measures are currently perceived by the authorities as incomplete, and now the government is discussing the possibility of introduction of 'special importer' institution at the beer market. Besides that, state-run concern 'Belgospisheprom' suggested the imposition of the so-called 'environmental tax' on the importers of beer. The argument is that foreign beer producers are better position in many respects than the Belarusian ones.

New regulations of the beer market are planned to follow the customary pattern (similar to the ones implemented at the tobacco and fish markets), i.e. through granting the exclusive right to a state-owned company to import beer to Belarus. Currently imported beer occupies about 25–30%¹⁵ of the domestic market. According to some bureaucrats and domestic producers, the imposition of restrictions on beer imports should lead to increased sales of domestically-produced beer. However, the administrative measures to increase competitiveness are hardly to be efficient.

In fact, the imports of alcoholic beverages (except beer) are already fully controlled by the state. On June 17, a special state commission adopted a list of 'special importers', or the companies granted exclusive rights to import alcoholic beverages to Belarus.¹⁶

¹⁵ http://neg.by/publication/2008_05_08_9711.html

¹⁶ A Decree of the President of Belarus No.3 adopted on February 29, 2008, abolishes quotas for the imports of alcoholic beverages, inedible alcohol-containing products and inedible ethyl alcohol. The imports of alcoholic beverages are occurred on the basis of tenders to identify those legal entities that are 'capable of supplying goods at the most beneficial terms'.

Only 15 companies have been selected, and most of them are state-owned ones. Strikingly enough, exclusive imports rights have been provided for a period of four months only (from May to September of 2008). Apparently, it spreads uncertainty at the market (the list of companies could be changed after this period is over). Prior to that, the market for imported alcoholic drinks was regulated by the quotas later abolished by the President's Decree in February 2008.

Despite that the majority of imported alcoholic beverages are not produced in Belarus, the new regulations are aimed at protecting the commercial interests of domestic producers. Moreover, these measures fit into the broader import-substitution policies. For instance, the largest Belarusian enterprises are supposed to import wine materials and then to butylate them in order to sell as the wines of foreign origin (from Spain, Chile, France, and so on). Besides that, Belarusian companies are intended to produce martini, vermouth, etc. and also to increase the volume of cognac production.

The importance of import substitution policies is valid for the government, given the growing merchandise trade deficit. Although it is largely driven by the purchases of energy goods, machinery and equipment, the government prefers to fight against imports as such irrespective of its consumption- or investment-oriented character. This results in lower supply of imported goods, higher prices, and even hardships of the technical modernization of existing production facilities along with quality reduction of Belarusian machinery due to the lack of imported necessary component units.

The bureaucrats tend to claim that import-substitution program is of utmost importance for the Belarusian economy because it leads to utilization of domestic production capacities on a larger scale. At the same time, many producers denote that it is impossible to rely only on the domestic production. It is necessary to account for the competitiveness of Belarusian goods and the demand for them both at home and abroad. Moreover, import-substitution measures have not resulted in a reduction in the volume of imports. For instance, over the four months of 2008, imports from China (which is the source country not only for the electrical equipment, but its component units required

to produce Belarusian analogues) increased as against January–April 2007 by 85.7% thus exceeding this indicator for Russia (increase by 74.7%), which is the major supplier of gas and oil at rising prices.

The State Controls Committee concluded this winter that 'a complex system established by the government to implement state import-substitution policies, is incapable of producing considerable influence upon the volume of imports' to Belarus. It was reported at the sitting of the Council of Ministers held on June 10 that boards and sessions had been held at various ministries and government agencies to analyze and discuss conclusions and recommendations of the Committee. In particular, the Ministry of Industry and 'Belneftehim' concern report that a range of measures to tackle the shortcomings identified is sketched. Accordingly, one could realistically expect toughening of import-substitution policies.

By now, the results of the import substitution program implementation are the following. For instance, the tasks set by the Program for development of canned fruits and vegetables production for 2006–2010 had been implemented by 69% and 76% in 2006 and 2007, respectively. At the same time, stocks exceeded average monthly output by 4.2 times by October 1, 2007. As a result, 77 Belarusian companies producing juices were capable to collectively capture 40% of the market. Other domestic producers are very likely to leave the market.¹⁷

Another case concerns the quality of domestic agricultural machinery criticized by agricultural producers themselves. In response, Regulation No. 186 'On Some Measures of Making Officials More Responsible for the Quality of Domestically-Produced Goods' adopted on March 27, 2008. It appears that Belarusian producers are induced to be more competitive by the administrative measures. Nevertheless, inferior quality of Belarusian machinery is admitted by producers themselves. Many of them claim that it is an outcome of demand to purchase domestic components, and not the foreign ones. Therefore, a problem of import-substitution is of compli-

¹⁷ http://neg.by/publication/2008_03_25_9562.html

cated character in the Belarusian economy. Its solution requires market-based methods and not the administrative guidance. In this context, a proper decision is to induce national producers to be more competitive, and not just to shelter domestic market from imports.

4. THE DEVELOPMENT OF MARKET FOR PASSENGER TRANSPORTATION: KEY FACTORS AND DIRECTIONS FOR REFORM¹⁸

4.1. Market dynamics

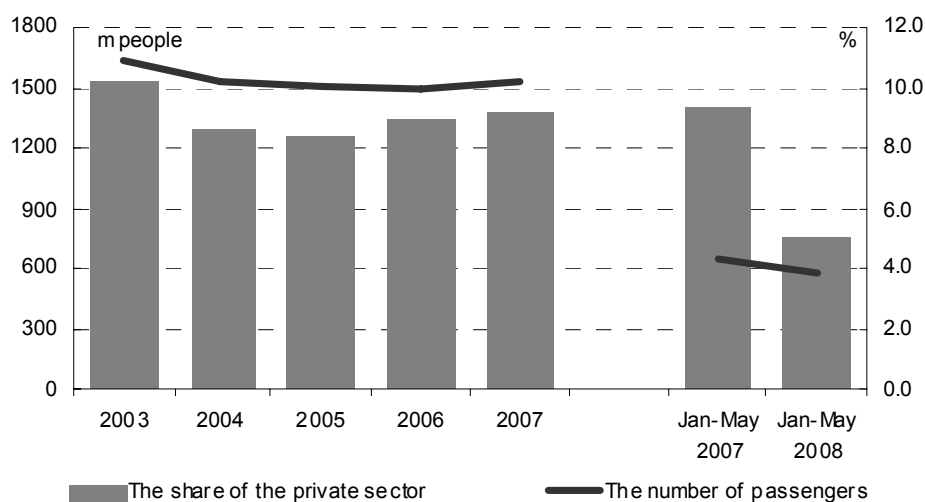
The market for motor transportation of passengers is shrinking since 2004, on average by 2.2% per annum (see Figure 1). It could be explained by higher incomes of the population so more and more people prefer to use privately-owned cars instead. Demography also plays a role (i.e. depopulation), and relatively low geographical mobility of the population. However, in 2007, passenger traffic expanded by 2.4%. Private entrepreneurs (haulers) secured 19.8% of that growth rate.

Since 2006, the positive dynamics of passenger traffic by private companies have been recorded. Over the last two years, their share expanded by 10.8% to reach 9.2% by the end of 2007. However, at the beginning of 2008, it has considerably declined. Over Jan-May, passenger traffic of private actors decreased by 50.3% as against the last year, while the share shrank to 4.8% (in contrast to 9.3% a year ago, see Figure 1). Such reduction impacted the overall volume of passenger traffic (declined by 8.1%), while private actors secured 57.4% of this decline.¹⁹

4.2. Market conditions of private haulers

Private haulers stepped into the market in 1999–2000, and since that time quickly captured their market niche. They have captured up to 20% of regular routes in

Figure 1: Market dynamics and share of private companies



Source: Ministry of Statistics and Analysis.

Minsk and regional cities, and also in smaller cities of Borisov and Bobruisk (and up to 50% in Orsha). However, a further development of private sector share of this market is constrained by regulatory framework. A major problem is that the functions of a client and a market operator are not legally separated. State-owned automobile companies usually play a role of operators, meaning that a fair competition between state-owned and private operators is hardly possible. It is also unclear who is supposed to finance the activities of operators. The existing legislation, including a new 'Law on Automobile Transports and Motor Transportation' adopted on August 14, 2007, has not addressed this issue, so this function is periodically executed by private haulers.²⁰

The position of private companies has deteriorated considerably after the adoption of a Decree No. 760.²¹ This regulation forces haulers to choose between closing down their companies and going into the realm of the shadow economy, and formal registration of drivers as individual entrepreneurs serving operating companies. This choice is informed by higher tax payments and administrative charges related to legal entity registration (usually, private uni-

tary enterprise). This shift to a new organizational form deteriorates the market position of private haulers for a number of reasons that are as follows:

- Heavier tax burden (despite the application of the simplified taxation rules, tax burden is to be increased by two or three times as compared to a single tax paid by individual entrepreneurs);
- Higher costs caused the need to acquire office space;
- Higher expenditures caused by the need to cover bank charges and to pay for machine spares in non-cash form (meaning that the VAT is to be paid at the level of 18%);
- Lease of service center, etc.

Those individual entrepreneurs who have not changed their legal status suffered from the inability to hire employees. As a result, they are now forced to spend a considerable part of their working time on servicing their vehicle and dealing with various state bodies, thereby losing their incomes.

State regulation of tariffs is another factor adversely impacting the economic performance of private haulers. At the beginning of 2008, a maximum charge for a fixed-run taxi has been set at the level of BYR 1,500. At the same time, calculations made by 'Sadrusznast' trade union show that such level allows only 10% of routes to be profit-making. Another 30% of routes turn to be break-even (i.e. zero profitability level). It follows that for 60% of routes tariff limita-

¹⁸ This section is based on the materials provided by the National Council of the Belarusian Trade Union of Entrepreneurs 'Sadrusznast' ('Community'), available at: http://www.fpb.by/ru/menu_left/organization/r_komitet/brk_sadruznast/.

¹⁹ The Ministry of Statistics and Analysis does not account for private haulers registered as legal entities. Some individual entrepreneurs have transformed into Limited Liability Companies or Private Unitary Enterprises, so their share in 2008 should be increased. Accordingly, passenger traffic's decrease appears to be less than observed.

²⁰ See 'Ekonomicheskaya Gazeta', No. 15 (1133), February 26, 2008, available at: http://www.neg.by/publication/2008_02_26_9417.html.

²¹ The Edict No. 760 adopted on December 29, 2006 amended the legislation on entrepreneurial activity. According to the new legislation, an individual entrepreneur is allowed to hire only close relatives (up to three people). In all other cases, a registration as a legal entity is required.

tions allow to cover only operational costs so no depreciation costs are accounted for. As a result, capital assets are not renovated so companies are threatened with the closure in the future.

4.3. Policy proposals for regulation of private passenger traffic

'Sadrusznast' develops a range of measures aimed at improving the current stance of private haulers:

1. *A shift to a free-of-regulation tariff policy for private haulers:* A similar, but still inferior, effect is produced by more regular tariff amount revision. For instance, tariffs could be indexed according to inflation or fuel prices growth only. However, tariff problem is only one of the many. As the experience of 2007 suggests, 20%-tariff increase leads only to 10%-increase of revenue (due to the reduction of passenger traffic). This is the evidence of the relative elastic demand. Consequently, in case tariffs increased by 1.5 times (which is calculated by 'Sadrusznast' to be a break-even point for the currently loss-making routes given the existing passenger traffic), the volume of services provided would decline, being unhelpful for solving the problems of private haulers registered as legal entities.
2. *Reduction of tax burden:* It is important to cut tax rate from 10 to 5% (charged in accordance with the simplified system of taxation) and to increase the threshold allowing the application of the simplified taxation system rules (in case VAT is paid – up to BYR 3.3 billion, and up to BYR 1 otherwise). Also, payments to the Agricultural producers support fund should be abolished for companies serving at urban routes.
3. *Definition of passenger traffic operator status:* The Rules of Carriage of Passengers define operator as 'legal entity carrying out an entrepreneurial activity to organize passenger traffic, while not rendering dispatcher's services and carriage of passengers' In order to separate the function of client and operator. For example, Minsk and Brest City Executive Councils entitled City transport departments to perform the function of operators. Also, source of finance has to be defined legally.

4. *Reduction of a single tax rate for private haulers registered as individual entrepreneurs.*

5. *Cashing fee reduction up to 1.5%:* it is also necessary to increase the amount of money to be used for vehicle-related utility purposes up to 40 base-values, or to make it connected to the number of employees. In particular, the following thresholds are suggested: 50 base-values for enterprises employing less than five people, 100 base values – for enterprises employing up to 10 people, 150 base values – for enterprises employing up to 15 people, 200 base values – for enterprises employing up to 20 people, and 250 base values – for enterprises employing more than 20 people.

6. *License withdrawal practice* in case a driver violates the rules of carriage of passengers or road laws should be substituted by fines imposed on the driver. The company should not suffer, but an individual employee only.

4.4. State policies to induce private sector activity in wayside service

Recently, two-year tax holidays have been granted for entrepreneurs dealing with wayside service. Also, they have been given a right to apply for preferential loans to build relevant infrastructure. Prior to that, taxation rules were too tough to stimulate investment activity. A new Edict of the President stipulates that over two years since the start-up, the objects of wayside services (buildings, structure, etc.) are to be exempted from real estate tax, while profits are exempted from profit tax over a period of five years (for legal entities) and income tax (for individual entrepreneurs).

Building and/or reconstruction of the wayside service objects and related infrastructure are supposed to carry out without providing compensation for the losses incurred by agricultural and forestry sectors caused by the land use.

The banks appointed to service state programs are proposed to provide legal entities and individual entrepreneurs loans for a period of up to five years at the reduced rates (2/3 of the refinancing rate set by the National Bank of Belarus for national currency loans, while for foreign currency loans an 8% rate is suggested).

Besides that, local authorities are invited to implement a twofold cut of real estate tax rates and rental fees for lands available for building and/or reconstructing the objects of wayside service and related infrastructure.

It is believed by the Ministry of Transport and Communication that the adoption of this Edict creates proper incentives for foreign investors. According to the information available to the Ministry, an unnamed large Swiss-based firm expressed strong concern over building 30–50 objects of wayside service. Negotiations are currently carried out.

Earlier, the government of Belarus has adopted a General Plan of Wayside Service Development for the National Roads up to 2010. According to the Program, three service levels are suggested. The first level is about building of lay-bys and parkings; the second one requires arrangement of catering service, flush toilets and showers, guarded parkings, etc. The third level concerns construction of refueling stations alongside with the second-level objects.

It has to be noted that while the Edict has been adopted a month ago, both experts and entrepreneurs are rather skeptical about its benign effects. Expectations are moderate. Indeed, Belarus is a 'transit country', and the traffic is continuously growing (mainly due to cargo transportation). Apparently, this creates a demand for wayside service. However, despite the growing demand and the willingness of both domestic and foreign investors to operate in this sector, the level of wayside service in Belarus is very low. One of the constraints is the over-bureaucratized process of obtaining various permits demanded by the law. Accordingly, even simplification of siting procedures and tax holidays could not solve the problem.

For instance, in order to open up a car wash, it is necessary to do paperwork over a period of three years. Opening of mini-stores or catering service are even more complicated. Violations are severely punished. Quite often, license withdrawal is practiced as a punishment for company so investors are refrained from activism. This environment makes the adoption of the Edict only the first step. Entrepreneurs and investors are waiting for further improvement of the business climate, including changes in

the system of permit provision and punishment. In case wayside service development is induced, spill-over effects could be expected in other sectors of the economy.

5. STATE REGULATION OF WAGE SETTING: MAJOR PROBLEMS (AS SEEN BY ENTREPRENEURS AND BUSINESS UNIONS)²²

5.1. Institutional framework for wage setting in Belarus

Wage setting is regulated in Belarus due to the generally declared socially-oriented character of the economy. In practice, the government is indeed employing various policy instruments to increase real incomes and to reduce income inequality. One of the notable instruments is the announcement of targeted average economy-wide monthly wage, the adoption of minimum wages, and the regulation of inter-industry wage inequality. Such pattern of interference is made possible to the structure of the economy, where the majority of medium-sized and large-scale enterprises are subjected to the rule of branch ministries and government agencies. In their turn, these bodies set a range of indicators to be achieved. In case of incompliance with and the achievement of the planned figures, some administrative punishments could be applied and even termination of the employment contract of managers. At the same time, poorly-performing companies are subsidized at the expense of well-performing ones since more than a half of GDP is redistributed via the state budget. Essentially, wage setting in Belarus are regulated by the state. The regulation covers all companies, irrespective of their ownership.²³

In the developed market economies, wage setting is relatively free from government interference, although the majority of governments determine minimum wages. In Belarus, minimum wage

²² This section is prepared on the basis of the focus-groups comprised of the executives and managers of SMEs and representatives of the business associations (Minsk City Union of Entrepreneurs and Business Association of Entrepreneurs and Employers) on the issue of wage-setting in Belarus.

²³ See the paper by Chubrik, A., Guicci, R. (2006) Wage determinants in Belarus: productivity and wage policies, available (in Russian only) at: <http://www.research.by/pdf/pp2006r04.pdf>.

Table 1: Nominal average wages, January–April 2007–2008

	2007 г.		2008 г.		2008 г. в % к 2007 г.		
	BYR, thd.	USD	BYR, thd.	USD	In the nominal terms, BYR	In the nominal terms, USD	In the real terms
<i>Total</i>	641.0	298.1	790.9	369.6	123.4	124.0	109.0
Industry	714.3	332.2	916.3	428.2	128.3	128.9	113.3
Electrical power engineering	891.0	414.4	1090.0	509.3	122.3	122.9	108.0
Fuel industry	1097.3	510.4	1359.7	635.4	123.9	124.5	109.5
Black metallurgy	1312.8	610.6	1553.7	726.0	118.4	118.9	104.6
Chemical and petrochemical industry	964.4	448.6	1226.4	573.1	127.2	127.8	112.4
Machine-building and metal-working industry	718.4	334.1	959.4	448.3	133.5	134.2	117.9
Timer, wood working and pulp-and-paper industry	565.6	263.1	735.1	343.5	130.0	130.6	114.8
Construction materials industry	764.1	355.4	986.0	460.7	129.0	129.6	114.0
Light Industry	446.7	207.8	555.7	259.7	124.4	125.0	109.9
Food manufacturing industry	651.5	303.0	806.4	376.8	123.8	124.4	109.4
Agriculture	378.2	175.9	468.0	218.7	123.8	124.3	109.4
Forestry	607.8	282.7	723.7	338.2	119.1	119.6	105.2
Transports	744.5	346.3	896.6	419.0	120.4	121.0	106.4
Communications	748.4	348.1	875.7	409.2	117	117.6	103.4
Building	785.2	365.2	991.3	463.2	126.2	126.8	111.5
Trade and Catering	526.3	244.8	668.1	312.2	126.9	127.5	112.1
IT	908.9	422.7	1188.4	555.3	130.8	131.4	115.5
Commercial services	1142.7	531.5	1365.4	638.0	119.5	120.0	105.6
Housing and communal services	632.2	294.0	765.6	357.8	121.1	121.7	107.0
Healthcare	553.2	257.3	629.9	294.3	113.9	114.4	100.6
Education	525.5	244.4	591.4	276.4	112.5	113.1	99.4
Science	878.5	408.6	1119.2	523.0	127.4	128.0	112.5
Finance and insurance	1104.9	513.9	1402.3	655.3	126.9	127.5	112.1
Management (state and judicial bodies)	975.5	453.7	1121.8	524.2	115.0	115.5	101.6

Source: calculations on the basis of the data taken from the Ministry of Statistics and Analysis and the National Bank of Belarus.

is set at the level of BYR 208,000, nearly equal to the budget of the living wage. Over Jan-April 2008, average economy-wide wage amounted to BYR 790,900 or USD 369.3. This is 9% higher in the real terms (23.4% in the nominal terms) than a year ago. The government has set a new target of USD 760 by the year of 2010, while in manufacturing this figure is planned to be even higher. The ultimate goal is USD 1,000 per month (according to the Deputy Prime Minister, Mr. Vladimir Semashko)²⁴. The Table 1 provides the data on wages across different sectors of the economy over Jan-April 2007–2008.

Wage leaders in Belarus are black metallurgy, fuel, chemical and petrochemical industries as well as finance and IT sectors. These industries are dominated by large state-owned, export-oriented enterprises. As for the IT sector, there are many offshore software development companies in Belarus. All of them are private. At the same time, wage laggards are publicly-funded education and healthcare along with agriculture,

trade and catering, and light industry. As for trade and catering and light industry, relatively low wages could be explained by wages being 'paid in envelopes' as a result of informal economic activity of small and medium-sized companies operating in these sectors.

Over the last several years, the government has implemented a number of measures to reduce inter-industry wage differentiation. Although the most recent data over 2006–2008 are currently unavailable, some evidence could be obtained from 2003–2005. In particular, in 2003, the majority of wage earners received wages below the average economy-wide wage, but in 2005, they moved very close to this threshold.²⁵ The gap between wages of high-paid and low-paid sectors has been closing down. In 2007, ratio of wages in agriculture and black metallurgy amounted to 3.47, while currently this figure is around 3.32. At the same time, inter-regional wage differ-

²⁴ <http://news.tut.by/economics/111874.html>

²⁵ For the details of the wage-setting system see Haiduk, K. (2005). Labor Market in Belarus: A Review of Issues, *CASE Studies and Analysis*, No. 313, Warsaw.

entiation has started to grow. This particularly concerns the gap between Minsk and the regions of Belarus. In 2007, the ratio of average wage in Minsk to average economy-wide wage amounted to 1.3, while a year later it turned into 1.34. The official data claim that average monthly wage in Minsk is about BYR 1,063 million, while in the economy as a whole it is BYR 791 thousand.

5.2. Some shortcomings of the tariff policies in Belarus

The existing wage grid²⁶ in Belarus is principally aimed at reducing wage differentiation across and within sectors. The first-rate wage is set nation-wide, while companies employ various coefficients (following formal rules) to determine wages of various categories of workers (differentiated across occupations, skills, experience, nature of work, and enterprise's characteristics). In essence, wages are based on this first-rate wage. In case managers are intended to increase wages beyond the one that follows from the personnel arrangements, the 'base wage' has to be changed, or the first-rate wage. As a result, wages of all employees should be lifted accordingly. This is not always justified on the efficiency grounds. For instance, the recent survey of British companies, wages become more and more individualized, so personal contributions are accounted for. In the private sector, wages are set on the market basis.²⁷

Analysts claim that the application of the wage grid could be reasonable if accounted for a real value of labor differentiated across occupations and skill levels. In that case, the bottom level of the coefficient increment should be 10%. Currently the situation is different. The increment from the 1st to the 3rd grade is 16%, from the 3rd to the 6th is 10%, and from 6th to 23rd is 7% only. As a result, wage differentiation is indeed moderated, but the motivation for skill development is suppressed.

Also, some wage costs (like bonuses above the legally-determined threshold) are to be deducted from profits only.²⁸ In fact, this leads to a double taxation of wage fund. More fundamentally, the unconditional application of the wage grid to private sector companies is against the market principles since these companies are deprived of the ability to decide over wages and financial situation.

According to the results of the focus-group studies on wage issues conducted by the IPM Research Center, the existing wage setting system incurs time losses of economists and accountants due to numerous complications. The specialists are forced to deal with calculating wages while forcing their way through the maze of laws and regulations related to wage-setting mechanisms. The regulatory framework sometimes suffers from ambiguity and shortcomings. But enterprises and firms are often punished for unintended mistakes. As for the latter, these are as follows:

- Incorrect designation of positions of clerks and workers;
- Incompliance with the qualification requirements;
- Incorrect giving of qualification to executives of economic units;
- Illegitimate provision of additional payments for holding of more than one appointment, etc.

Both experts and entrepreneurs are unanimous in their assertion that the complicatedness of wage-setting system and its inflexibility along with relatively high payroll tax rates result in informal payment of wages (being 'paid in envelopes'). There are two ways of doing so. The first one is to underreporting of revenues and the second one is unreported economic activity. The Ministry of Taxes and Dues mention construction, trade, and services as the most problematic sectors in this regard, pointing mostly to private companies.

The problem of unreported wages needs to be solved, but the government

calls for the administrative, and not the market-based measures. The Ministry maintains that minimum wage should be increased so all companies would be obligated to pay a certain basic wage, while responsibility for that should be strengthened. Yet, the new rate is not suggested. According to the Deputy Minister, Mr. Vladimir Kamenko, the new minimum wage level should be about 50% of the average economy-wide wage. However, there are macroeconomic consequences of such step, such as inflation. Also, increased wages mean higher payments to the Social Security Fund (a state-run pension fund of the mono-pillar pension system of Belarus) so instead the amount of wages paid 'in the envelopes' could actually increase.

In general, state interference into wage setting is not positive at both macroeconomic and microeconomic (incentives) level. Entrepreneurs and representatives of business associations suggest a number of policy measures to improve the current situation:

- Grant greater wage autonomy to private companies;
- Increase income taxes at the expense of cutting tax burden being faced by legal entities;
- Revise the government plans towards minimum wage policy;
- Refuse non-economic incentives to preserve excessive employment;
- Revise the logic of the wage grid and make its application voluntary.

6. NATIONAL BUSINESS AGENDA

6.1. Licensing, certification, and permitting

No progress was made in 2007 on simplifying licensing and certification procedures or on making them less expensive, more transparent, or easier to understand. Despite a relaxation of certain licensing requirements under Presidential Decree No. 7, we observed a significant increase in government regulation in the certification of services. The authorities did not make the simplest and most effective decision, refusing instead to eliminate licensing for retail businesses. They did not standardize the list of permits and procedures for obtaining them in one document.

²⁶ The wage grid in Belarus is the major instrument of tariff policy in Belarus. It is comprised of tariff rates and coefficients set for different occupations.

²⁷ See The Chartered Institute of Personnel and Development (CIPD) (2008) Reward Management, www.cipd.co.uk.

²⁸ The Regulation of the Ministry of Labor and Social Protection No. 123 'On the Adoption of the Instruction of the Application of the Wage Grid in Belarus' adopted on September 20, 2002, amended on June 29, 2007.

The system for granting licenses, certificates, and permits continues to reflect primarily the interests of the government agencies and the bureaucrats, monopolies, and large government enterprises. The business community does not see any positive correlation between the complexity and number of licensed, certified, and severely controlled activities and the volume of poor-quality products or the amount of consumer fraud.

Licensing and the issuance of various types of permits and certificates remain a mechanism for discriminating against businesspeople, a source of injustice and tremendous expense, and a barrier to people's creative potential and initiative. While the administrative processes were simplified, it became apparent that in many ministries narrow bureaucratic interests continue to trump national interests.

The current licensing, certification, and permitting procedures seriously increase the cost of business, create an atmosphere of uncertainty and anxiety, and create big risks for long-term investors and for business activity. Even today many ministries and departments have failed to provide a complete list of administrative procedures on their web sites. There is a low level of coordination among various government bureaucracies and local governments in efforts to reduce business red tape in our economy. The closed bureaucracy entails great risk of corruption and bribery. The result is decreased trust in government agencies and the prestige of the government plummets.

We believe that the following steps must be taken in the name of a strong, prosperous Belarus:

1. Reducing the list of activities, which require licensing;
2. Eliminating licensing for retail trade and other types of business that do not directly threaten the life or health of the public, the environment, or national security;
3. Unifying the permitting procedure;
4. Establishing administrative liability for persons issuing licenses (or permits) who demand that licensees submit documents or who impose requirements not provided by the regulations on licensing (or permitting) procedures;
5. Repealing the regulations suspending licenses on grounds not directly related to the performance of the licensed activity by the licensee, i.e. if a licensee or its subdivision or branch systematically violates (three or more times in twelve consecutive months) laws on maintaining and reviewing a suggestion and comment book, resulting in fines, or if a licensee repeatedly violates (two or more times in twelve consecutive months) the prescribed procedure for accepting cash payments for the sale of goods, work, or services and/or uses an automatic cash register and/or a special computer system.
6. Establishing a judicial procedure when a license is suspended or revoked, allowing the licensee a transition period to cease the type of activity for which the license was suspended or revoked.
7. Increasing license terms to the maximum duration provided in Presidential Decree No. 17 on Licensing of Various Activities, dated July 14, 2003.
8. Striking clauses 1-10 and 1-11 under "Violations of Rules on the Use of Automatic Cash Registers" in Presidential Decree No. 40, dated January 16, 2002, from the list of grounds for revoking a retail trade license, except in proven cases where cash is accepted under the table.
9. Adopting regulations that recognize within the Republic of Belarus certificates issued by internationally recognized certifying organizations in other countries, without requiring certification by a certification agency in Belarus.
10. Granting to businesses the right to certify employees at the company to engage in licensed activity required by the labor laws, except in cases when the educational institutions of the Republic of Belarus do not graduate specialists in certain areas.
11. Differentiating between mandatory and voluntary certification when complying with requirements on the certification of specialists. Expanding voluntary certification, including at nongovernmental enterprises.
12. Enacting legislation making mandatory state certification for specialists free of charge.
13. Eliminating the requirement that a company own the equipment needed for licensed activities and allowing companies to lease, rent, or use without charge such equipment after a license has been issued.
14. Instituting differentiated requirements for obtaining certificates to perform work or services, including the fee for issuance of the certificate, based on the size of the business (small, medium, and large companies).
15. Eliminating the requirement for both licensing and certification of a single type of activity for a business entity.
16. Introducing regulations to standardize the duration periods of certificates to perform work or services in the same way as the duration periods for which licenses are issued.

6.2. Audits, Fines, and Penalties

The severe lack of trust between the government and businesses determines the nature of control over the private sector. The number of audits have formally reduced as they are pulled together into 'comprehensive audits'; however, the amount of fines collected across the country is rapidly increasing. According to the Ministry of Taxes, in 2004, 137,800 audits resulted in BYR 136.6 billion of fine revenue, while the 92,800 audits in 2006 yielded 32% more (BYR 200.8 billion). Auditors continue to find violations in 80-90% of the cases. The cost to businesses is not just the fines, but the time spent on the audit. The current procedures for collecting fines destabilize companies and often lead to liquidation. There is still a huge disproportion between infractions and penalties, which greatly reduces the competitiveness of national business. The practices of confiscating goods without a court hearing and direct debiting from bank accounts continue. Over 40 different government authorities have the right to audit any business, including executive committees, tax agencies, government oversight committees, fire and health inspectors, police, licensing agencies, and price-formation agencies. The agency rights,

procedures, and scope of such audits are very vague, which often translate into burdensome sanctions.

The judicial system has been slow to effectively protect businesspeople against bureaucratic abuses of power. The law does not establish equal liability for government representatives and business. The law does not provide a statute of limitations for tax violations, even though there is a maximum term of one year to return excessive withholding to an business. Adopting decisive steps to penalize enforcement agencies for causing harm to a business would be an important contribution to the fight against corruption and destruction of private business potential.

We believe that the following steps must be taken in the name of a strong, prosperous Belarus:

1. Reduce the amounts of fines, given that the current maximum administrative fines are comparable to the fines imposed under the criminal laws. Eliminate the minimum threshold for imposition of fines to allow the regulatory agency to consider the circumstances of a specific violation and the characteristics and economic situation of the violator. Expand the list of extenuating circumstances considered prior to imposition of a penalty.
2. Conduct an expert analysis of legislation to determine whether applicable penalties are commensurate with the seriousness of the violation.
3. Conduct an annual analysis and evaluation to determine the effectiveness of applicable business penalties and fines.
4. Remove targets for revenue derived from fines and confiscations from the Law on the Budget (as enforcement agencies are currently obligated to attempt to meet and surpass targets at any cost). Move the section on revenue from fines and confiscation in the Law on the Budget to the section on "Other Revenues".
5. Calculate fines for officers of a company in Belarusian rubles based on a percentage of the person's salary, rather than base values.
6. Introduce a moratorium on tax audits for one year, during which all tax agency resources would be focused on liquidated business entities. Ban tax raids on retail shops and restaurants.
7. Eliminate fines for unintentional, formal violations of the procedure for performing cash transactions if the government is not harmed.
8. Institute forms of liability other than fines for unintentional violations of formal procedures (that do not harm the government).
9. Limit the maximum amount of administrative fines on officers of a company to no more than 50% (Labor Code) of the person's salary for the corresponding month, in accordance with the existing laws of the Republic of Belarus;
10. Allow banking institutions to make secured loans to companies and organizations based on their credit risk in order to pay taxes, fines and penalties;
11. Eliminate duplicate penalties for violations of accounting and tax laws;
12. End the freezing of bank accounts and the non-contested withdrawal of funds based only on an order from a government agency;
13. Repeal laws on the confiscation of property as a form of administrative punishment, except in cases when a court finds that the property was obtained (or created) illegally or if the company (or entrepreneur) cannot provide proof of the property's origin or lawful acquisition.
14. Enact legislation under which property may be confiscated only if the owner has violated the law. Preclude the confiscation of property if the property owner is not the person who violated the law.