

In this issue:

Social economic situation in Belarus on the eve of 2009: First consequences of the world economic crisis. Main tendencies in foreign trade in January – October 2008. International research: Belarus in the light of EBRD reform indices and the ease of paying taxes from the World Bank. Main changes in legislation that regulates Belarusian business.

Dear Readers!

We are pleased to present the 14th issue of the quarterly survey “Small and Medium Business in Belarus”. It includes the analysis of the main changes in macroeconomic and institutional environment that influence the development of the private sector in the country.

The in the first part we provide the analysis of the social economic situation in Belarus in the eve of 2009. The main channels of influence of the world financial crisis on Belarus, its consequences and possible adjustment measures are analyzed. The main channels of exercising influence of the world economic crisis on Belarus will be the reduction of export and the difficulty of getting external loans to finance trade balance deficit. The main conclusion of this part is that Belarus needs market reforms and considerable liberalization to overcome negative consequences of the crisis.

In the second part we analyze the main tendencies in the foreign trade in January – October 2008. In spite of very favorable trade tendencies in the first half of 2008 in autumn the situation began to rapidly deteriorate. It was due to the decrease of both physical and value volumes of export and arrears. It primarily refers to Russian consumers. In spite of lack of the data for November – December IPM Research Center experts forecast further deterioration in export and even higher trade budget deficit. Consequences keeping the stable exchange rate of Belarusian ruble will be one of the main macroeconomic challenges for the National Bank and the government.

The third part is dedicated to the international research. The main results of the annual report of the European Bank for Reconstruction and Development (EBRD) “Transition Report 2008: Growth in Transition” on the speed and depth of market transformations in CEE and CIS countries are presented. In addition the results of the joint report of the World Bank, IFC and PricewaterhouseCoopers “Paying Taxes 2009” on the ease of paying taxes in different countries of the world are considered.

The authors of “Transition Report 2008” believe that the impact of the state on the economy in Belarus is still very high. The share of private business in GDP in Belarus increased. Other parameters that were improved are big enterprise privatization, management and enterprise structural reforms. At the same time Belarus has not made any progress in indicators of infrastructure reforms (electric energy sector, railroad, automobile roads, and communication, water and sewage systems). The research of the World Bank shows that in spite of some changes in the taxation system Belarus is the last in the world on the ease of paying taxes.

In the first part the anti-crisis plan of the government plans to liberalize and to debureaucratize the economy and to change the legislation that regulates private sector. The recent changes in the legislation on price regulation, licenses, inspections and fines considerably change the parameters of the business climate in the country and can simplify much the activities of private sector primarily for SME and IEs.

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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. SOCIAL ECONOMIC SITUATION IN BELARUS ON THE EVE OF 2009: FIRST CONSEQUENCES OF THE WORLD ECONOMIC CRISIS AND REACTION TO THEM

1.1. Economic situation

In the middle of 2008 the degree of dependency of Belarusian economy on the external world became the biggest in all the country's most recent history, since 1992. The main channels of such dependency are the following:

- World oil prices (if crude oil Urals costs less than USD 84 a barrel export of mineral products generate less hard currency revenues than the costs of buying crude oil, i. e. trade balance deficit in this good emerges;
- The world potash fertilizers price (due to almost quadrupled increase of prices). This good became the second biggest export good of the Belarusian export;
- Economic growth in Russia (as demand for industrial goods in Russia increased considerably);
- Russian gas price: in 2008 it was less than a third of the average European price;
- Russian crude oil price: in 2009 the export duty on the Russian oil for Belarus was just 35.6% of the export duty for third countries. However there is no agreement on its size after 2009;
- External sources of financing of the trade balance deficit (external borrowings and investment in 2007–2008 became the most important sources of external financing of the trade balance deficit).

1.2. Social situation

Before the presidential elections in 2006 Belarus had the model of social policy that can be described in terms of “social contracts”¹. A. Lukashenko's political support was based on the loyalty of different social groups in exchange for

material and intangible benefits that the state provides to different social groups. The degree of paternalism of the state peaked. It was the highest since the times of the Soviet Union. The system of imposing sanctions for the protest covered possible firing from work or from a university, restriction on freedom etc. Finally for those who were no loyal and did not protest the state left the possibility of exit. For example such people could be employed in private sector or he can immigrate or do other things. Quite a high level of loyalty (direct link “president – people”) enabled the top decision maker to remove elites (loyal to the government) from the process of decision making.

The authorities need considerable amount of funds to finance social contracts. The volume of these funds increased alongside with the growth of income and needs of the population. The financing was possible due to very favorable external demand. That is why when it became clear Russian gas price will go up the social paradigm began to change. The state began to gradually revise the conditions of social contracts which inevitably will lead to the change of the degree of loyalty and to the need to revise the authorities of elites. The examples of the social contracts revision² are the following” abolition of a big share of benefits to different social groups (discounts on public transportation, medicine, utility services etc.). the ban for IE to hire employees who are no close relatives, the “reform” of education, the increase of utility and housing tariffs, the decrease of the wage growth rate in the budgetary area etc.

1.3. Political business cycle

The main economic tool of social policy in Belarus is a political business cycle. It means the increase (growth acceleration) of income on the eve of important political events. Historically the situation was that due to low level of trust to the national currency in the 1990-ies and the beginning of the new century it is achieved by setting and meeting the wage target US dollars. That is why the key element of the economic policy is the exchange rate. Belarusian ruble/US

dollar rate of exchange has been stable since 2003. The fluctuations did not exceed 3%. Such policy increases the level of trust to the Belarusian ruble considerably. However such trust was not that high for the population to turn hard currency deposits into ruble ones. The dollarization of the Belarusian ruble money has not decreased lower than 30%. Such policy also contributed to meeting all wage target indicators since 2004.

1.4. Impact of the crisis on the economic situation in Belarus:

- Falling oil prices – reduction of hard currency revenues from export of mineral products (34% of the merchandise export), reduction of budget revenues (revenues from oil refining and selling oil products in the domestic market is at least 10% of the general budget revenues.
- Probable fall of potash fertilizer prices. Belarusian negotiators do not longer have the bargaining power they had in 2006 when the biggest importers – China and India tried to reduce prices. That time “Belaruskalyi” could stop the production for a few months. Now it is not likely to happen as the role of this company in generating hard currency revenues is huge.
- Slowing down the economic growth in Russia (many Russian officials openly talk about possible recession in Russia next year) coupled with falling oil prices in the world market and considerable deterioration of crediting lay the grounds for the worst scenario when external demand on Belarusian industrial goods is likely to fall.
- Export to Russia is likely to will fall even in case of slowing down of economic growth in this country forecasted by IMF (3.2% in 2009).³ Evidently in such case budgetary problems and the foreign trade deficit will be aggravated by the issues of employment and wages.

¹ Social contract is a model of relations between the state and a social agent which unites stable expectations of the agent in terms of benefits that the state provides in exchange of loyalty and the costs that he may have in case of a protest.

² This process was suspended in the middle of 2008 when the economy of Belarus grew fast making the best use of oil and other raw materials price increase.

³ First signals of recession were to reduce working days (Belarusian driveshaft plant), wage arrears, delays with paying wages (glass plant “Nyoman”), rumors about cutting employment and output reduction at Minsk Truck plant and Minsk Tractor Plant. By the end of 2008 Belarusian media wrote expensively about the problems of Belarusian enterprises.

- The price of Russia gas is directly connected with the crisis. In this case the crisis is likely to play a positive role for Belarus as falling oil prices will lead to the reduction of gas prices. However if Russia sticks firmly to the formula agreed upon in the Belarusian – Russian agreement (which is unlikely) the price for Belarus will go up anyway. It will create the additional deficit (price rise by USD10 generates USD 210 m deficit).
- Russian oil prices: the crisis is positive for Belarus. However negative consequences from cheapening oil products are many times bigger than the benefits from cheaper oil. If we assume that since 2010 Russia sets the same export duty on crude oil as for third countries Belarus will have to reduce its export of oil products approximately by 2/3 (export of oil products is about one third of Belarusian export).
- External sources of foreign trade deficit financing in the crisis have been considerably constrained. Actually the only probable source the state debt (the possibility of getting such funds are also quite limited). Attracting portfolio investment in the corporate sector is not possible in the short run (no stock market). Getting foreign direct investment is unlikely (it is very difficult to sell a company for a good price in the environment of the global crisis while attracting investment in new productions will be accompanied by corresponding increase of import. Besides attracting such investment is hampered by unfavorable investment climate.

Hence, the possibilities of external trade deficit financing in 2009 are quite limited. The solution is to increase export and to reduce import.

Possibilities for export growth: 42% of Belarusian merchandise export is oil products and potash fertilizers. 32% of Belarusian export is industrial goods to Russia (excluding oil products and potash fertilizers). Another 6% of export – delivery of industrial goods to other CIS countries. Hence, only 20% of export is the industrial goods exported to non CIS countries including 14% of industrial goods export – to EU. Evidently the re-orientation of export from Russian to other markets is highly unlikely. Consequently the only real possibility of reducing the budget is to cut import.

Possibilities for import reduction scenario: 10% fall of export (in real terms) in 2009 (the assumption is that export and import prices change in the same way). Based on the parameters of the long-term equation of import⁴ 10% reduction of export will lead to the reduction of import by 6.4%. Consequently foreign trade deficit will grow. In order to keep it on **the same level** it is necessary to cut import by 8.5%. The remaining export after the reduction by 2.1 percentage points would require 3.3% reduction of domestic demand. Assuming such indicators GDP in 2009 will increase by 3.2%. **Devaluation will cause the same effect as the reduction of domestic demand.**

Impact on the behavior of the population

Panic of the population in neighboring Ukraine and Russia (outflow of deposits, extremely hot demand for hard currency) and expectations of negative consequences of the global crisis for the economy of Belarus had an impact on the behavior of the population. Nevertheless the National Bank and other state bodies' attempts prevented panic so far. If the situation gets out of control banking crisis will automatically take place. Depending on the actions of the National Bank Belarus will face either sharp devaluation or inflation or an economic downturn.

Impact on the political business cycle

- Without devaluation (extremely optimistic assumption) the government will be able to keep consumption only at the expense of cutting investment. In the environment of deepening global crisis the government will have funds maximum for a year.
- If devaluation takes place the government will lose its power to launch and sustain the political business cycle.

Impact on the social policy:

- The breakup (revision) of social contracts will not lead to serious social tension as some share of the population will have access to exit. Others will be afraid to lose jobs in the time of the crisis. It will be the main

obstacle for protests. Moreover an organized protest of those who will lose jobs is highly unlikely. In 2002–2004 when unemployment in Belarus was about 8% (two times higher than today) there was no such protest.⁵

- The main task in the area of keeping social stability will be the support of key exporters (to prevent wage arrears from accumulation etc.) and the biggest Minsk enterprises.

1.5. Possible directions of change

Directions of change connected with IMF loan:

- Price liberalization (excluding utility tariffs and possibly some goods from the list of “socially important goods”;⁶
- Abolition of the Single Wage Framework for private sector, i. e. partial wage liberalization;
- Freezing income in the budgetary sphere in order to reduce domestic demand (it is hard to say whether it is one of IMF's conditions);⁷
- Interest rate liberalization (abolition of the banking margin);
- At least the reduction of **state programs financing** and cutting real sector support by banks;
- Measures to develop small business, possibly the abolition of the ban on IE to hire non-relatives;
- Tax and budgetary reform (primarily balanced budget, i. e. the reduction of expenditures);⁸
- **Devaluation.**

The direction of changes highlighted by semi-bold font are the main “stumbling block” in the negotiations to get a loan. However the negotiat-

⁵ There were mass protests in 1996 (unemployment was 9%), but the political situation that time was dramatically different from the situation today.

⁶ It has already been done on 12.12.2008.

⁷ Actually this reform has already been launched. The authorities refused to the raise wage framework of the first level of budgetary workers, pensions and scholarships on 12.12.2008.

⁸ The first step was the decision of the Prime Minister S. Sidorsky approved by A. Lukashenko to cut budget expenditures in 2008 by BR 5 trn or approximately by 4% of GDP.

ing position of Belarus does not look strong as firstly it is difficult to find comparable sources of financing and secondly (which is even more important) the refusal of **IMF to give a loan means sharp reduction of possibilities to attract funds from other sources.**⁹

Directions of change connected with the necessity to finance external trade deficit and the increase of national competitiveness

- Privatization (only in need as we have “bad times” for selling state assets);
- Investment climate improvement;
- More liberal employment policies (the rejection of the policy of “full employment”);
- **Employment reduction** (by administrative means, starting with pensioners, those who break working discipline etc.);
- **Administrative measures to reduce import;**¹⁰
- **Freezing wages and social transfers;**
- Other measures that are indicated in the government’s Plan to liberalize economy.

The measures highlighted by semi-bold font can not be described as liberalization measures. Nevertheless the government had to take them. In a certain way they are justified. In any case the economy of the country is waiting for reforms which are quite liberal upon Belarusian standards. In fact covering the activities by liberalization the authorities reject a considerable part of the existing social commitments. Beginning of 2009 a political business cycle is out of the question.

1.6. Conclusions in brief

1. Devaluation (at least the one that is less than 2–3 times) will not solve the

⁹ The fact of appealing to IMF for a loan made almost all foreign banks (excluding Raiffeisenbank) that opened credit lines to Belarusian banks to suspend providing funds within these credit lines.

¹⁰ Resolution of the National Bank on the reduction of purchasing hard currency for import payments is the first step in this direction on 12.12.2008.

problems of Belarusian exporters but only aggravate the economic situation. **Gradual devaluation which is exercised by the authorities will allow to avoid banking crisis. However constant flow of hard currency (at least USD 0.5 bn. a month) is necessary.**

2. If gradual devaluation is accompanied by the measures to reduce internal demand the pressure on the domestic hard currency market will be lowered to some extent. However the key goal which is to increase Belarusian export will not be achieved.
3. In the situation of gradual devaluation it will be necessary to sustain an extremely high attractiveness of deposits in Belarusian rubles and also to continue the policy of reduction of crediting the economy. It will be the final lethal blow to investment.
4. **Hence the Belarusian economy can be boosted only if a) sharp devaluation is done and b) considerable economic liberalization.**
5. Naturally such turn of events is extremely undesirable on the eve of the presidential elections **while keeping the old paradigm of relations “people – president”**. As this paradigm is changing if the authorities fail to attract considerable external resources (at least USD 10 bn) such variant of economic policy is quite likely.
6. Hence:
 - Any organization that is willing to credit Belarusian authorities¹¹ has tools to put pressure on the authorities. **It opens possibilities for political liberalization which however will not threaten the current authorities.**
 - Belarusian authorities began real market reforms. That is why qualitative economic expertise (external) is more and more in demand of the authorities;

Consequences of the economic crisis will be particularly difficult for the popu-

¹¹ Excluding Russians. Lukashenko will not make any concessions to Russia that can potentially reduce his powers.

lation (the biggest problems will be the increase of unemployment (the unemployed are socially very vulnerable in Belarus) and the decline of the workers in budgetary sphere and pensioners. Actually for the whole duration of the crisis the authorities will abolish the majority of benefits that are given to social groups in exchange for loyalty within the framework of social contracts. In fact these contracts will boil down to sanctions for the protest and to the minimal set of benefits provided by the state “by default”. The exception will be the “privileged” groups (some silovikis (enforcement structures’ employees) and top government officials. Their political influence will increase considerably.

2. TENDENCIES IN FOREIGN TRADE IN JANUARY – OCTOBER 2008

According to the data of the trade balance in January – October the value volume of export went up by 52% and import – by 51.3%. The external trade balance deficit was USD 4747.6 m (47% yoy). However the month by month analysis shows that in October compared to August and September the reduction of export (90.3% and 91.8% correspondingly) and import (92.8% and 95.4% correspondingly) happened. Simultaneously the foreign trade deficit increased (by 6.8% and 16.8% correspondingly). It is the evidence of stronger impact of the world financial crisis on the state of foreign trade. The crisis had a particularly strong impact on the export to the Russian market which is the destination of about a half of industrial export and 77% of consumer goods. In October export to Russia decreased not only compared to August (by 19.6%) and September (by 17.1%) but also to the same period of the previous year (95.6% yoy). The average export prices in October compared to September decreased by 4.8% and the physical volume of export fell by 14%.

In October the physical volume of export to the Russian market dropped considerably: road equipment and combustion engines (60% mom), tractors (74.6% mom), trucks (64.1% mom), metal processing machines (85% mom), saddle trucks (89.5% mom). Taking account the sharp decline of industrial output in Russia and terminating investment programs we should expect further reduction of demand for Belaru-

Table 1. Changes in foreign trade (%)

	October 2008 to September 2008	January – October 2008 to January – October 2007
Export	91.8	152.0
Russia	81.9	130.5
outside CIS	100.4	159.8
Import	95.4	151.3
Russia	88.1	156.3
outside CIS	106.3	143.6
Balance (-)	116.8	147.0
Russia (-)	94.1	186.2
outside CIS (+)	76.7	206.8

Note. (+) surplus; (-) deficit.

Source: calculations based on the data of the National Statistics Committee.

sian products. The measures of the Russian government to support its national producers can aggravate the situation even further. For example in 2009 the Russian government is planning to subsidize interest rates on loans directed to purchasing Russian agricultural equipment and machines. This policy will have a negative impact on the competitiveness of the similar Belarusian goods. If the Russian government refuses to provide budget financing to buy imported machines and equipment other machine building enterprises will have problems too. In addition the reduction of real demand of the population has already led to the fall of physical export to Russia of Belarusian household equipment (96.9% mom), meat products (93.8% mom), dairy products (93.8% mom) and also light industry goods.

A few Russian enterprises (for example KamAZ, GAZ) addressed Belarusian partners to reduce prices on spare parts and to increase the payment period. Belarusian enterprise will probably have to agree and it will lead to further reduction of export growth to Russia as its growth by 72% is due to the price rise.

Ukraine which is the second biggest trading partner in CIS has problems with Belarusian sugar deliveries. Ukraine as Russian did earlier stated that the exported sugar is made from raw sugar. It means that sugar and sugar syrups can be temporarily removed from the mode of free trade with Belarus.

In trade with non CIS countries the increase of export was also due to the price rise. There are negative tendencies on these markets too. They are connected with the reduction of demand for the main Belarusian exported goods due to unfavorable demand in the world markets of oil products, potash fertiliz-

ers and metals. For example a few companies from South-Eastern Asia alongside with the requirements to revise contracts to deliver calcium chloride began to delay payments for the delivered fertilizers. It led to the increase of accounts receivables of "Belaruskaliy" since August to the middle October by almost USD 30m. Besides clients from Europe and South-Eastern Asia where prices are formed on the spot basis began to cancel earlier declared volumes of calcium chloride. Under such circumstances Belarusian Potash Company declared that it would cut the export of fertilizers by 700 thousand tons in the fourth quarter. This decision will have a negative impact on the export growth rate outside CIS. This situation can also have a negative impact on the trade in calcium chloride next year as the long-term contract with China that sets the terms of delivery at USD 600 expires in the end of 2008 and with India (USD 625) – in April 2009. It is quite possible that these two countries will insist on the price reduction. It is worth noting that the prices will fall not only on potash fertilizers but also on nitric and phosphoric fertilizers which are also important goods of the Belarusian export.

"Belneftekhim" informed that oil refining plans had problems selling their main export good – oil products through the stock. Gasoline sales to Ukraine also decreased. In addition the difficulty with selling technical threads and cord materials emerged.

The EU's abolishment of export quotas on 13 items of Belarusian textile will not lead to the considerable growth of sales of these goods to the western markets as the decisions refer to only 1–2% of the general volume of export while quoting still applies to 11 categories of the

top priority. It is worth noting that Belarus appealed to abolish all restrictions. Bellegprom representatives informed that in response to such decisions of the European Union Belarus can double the import the size of duties for textiles from EU and to increase import duties on second hand goods from Europe from 12% to 20%.

In October compared to September average export prices in non-CIS countries fell by 11% and though the physical volume of export increased by 12.4% the trade surplus shrank by 23.4% and could compensate the deficit in trade with Russia only by 28% (34.5% in September). For example if physical volume of potash fertilizer export in October went up by 2.9% (mom) its value export went down by 12% (mom). We can expect further deterioration of the situation with export of Belarusian goods to non-CIS countries due to the stable reduction of demand for these goods.

Another negative element was the increase of arrears (for example in trade with Russia they reached USD 2.9 bn) Alongside with export reduction it led to the decrease of hard currency revenue of the enterprises. According to the National Bank's data in October it went down by 24% compared to July. To ease this tension the Council of Ministers passed the resolution that allowed enterprises to sell goods on the prices determined by the demand of the market. Enterprises even got the right to sell good priced below costs of production. In the short term it will obviously help enterprises to sell out inventories but the main problem still remains the increase of competitiveness.

When this issue of the quarterly bulletin was being prepared the statistics for November – December 2008 has not been published yet. However we can assume that in these months negative tendencies in foreign trade will continue to develop. Hence export of Belarusian goods will be one of the biggest channels of influence of the world economic crisis on Belarus.

3. INTERNATIONAL RESEARCH

3.1. Market reforms in CEE and CIS countries

European Bank for Reconstruction and Development (EBRD) published its an-

nual Transition report in 2008.¹² As the research of EBRD analysts shows the previous year was characterized by intense market reforms in many transitional countries. Reform indicators grew oftener in 2008 than in 2007 on the whole. The authors of the Report believe that some of the improved indicators reflect the cumulative results of the reforms carried out in previous years. Consequently it is the consistency in implementing liberalization policies that give the best results.

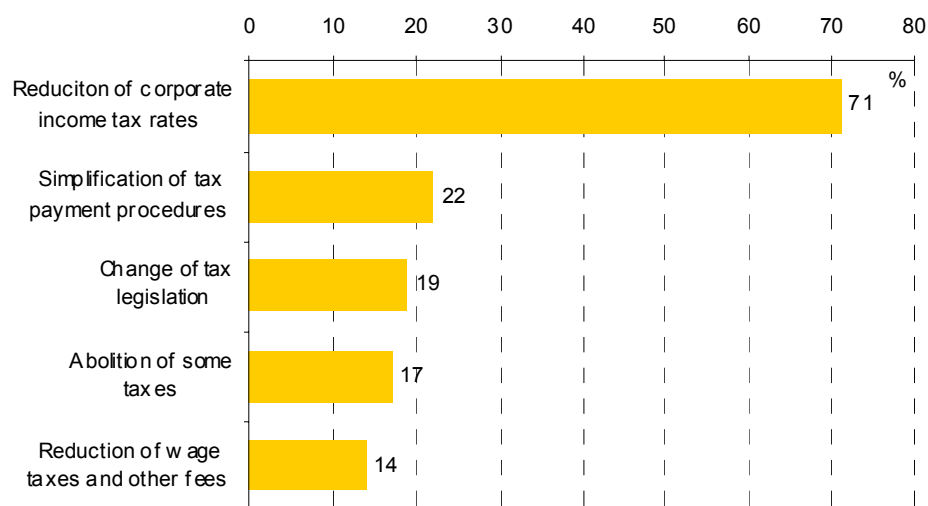
Belarus and Turkmenistan are indicated as the leaders of reforms in 2008 though for many years there were no market reforms in these countries. For example in Belarus the progress was due to the abolition of the “golden share” rule and privatization of some enterprises. However the authors of the report state that the impact of the state on the economy in these countries is still very high. Belarus improved such indicators as the share of private sector in GDP, privatization of big enterprises, administration and enterprise structural reforms. In 2008 Belarus has not changed its low positions on the indicators of infrastructure reforms (electric energy, railroads, automobile roads, communication, water and sewage systems). Indicators of reforms in these sectors in Belarus are still very low (from 1 to 2 points).¹³

In the context of the government’s declarations to liberalize economy and taking into account the fact that in December a few steps were made to improve business climate in Belarus in 2009 its ratings on EBRD methodology will be better.

3.2. Ease of paying taxes

The tax system in Belarus needs a considerable change. Representatives of Belarusian business community, scientific and research organizations keep urging the government to do it. High tax rates and very difficult reporting enhanced by high fines for even minor mistakes are one of the most consid-

Figure 1. The most popular reforms in taxation (%)



Note. The reform can consist of a few parts.

Source: Paying Taxes 2009, World Bank Group and PricewaterhouseCoopers.

erable barriers for business development and attracting investment into the country.¹⁴

The third annual Report of the World Bank, IFC and PricewaterhouseCoopers “Paying taxes in 2009” was published in November 2008 and again named Belarus as the most problematic country in the world from the point of view of paying taxes. The authors of the report study tax burden in 181 countries in 2007–2008 and ranked Belarus the lowest in the world (181st place).

In the previous two years Belarus was also the last in the world: 178th in the report for 2008 and 175th in the Report for 2007. From the point of view of international experts since 2006 there have not been any major changes in the taxation in Belarus. At the same time we observe some reform measures in this area. For example the government made the decision to increase tax reporting periods from monthly to quarterly. Turnover taxes were reduced and some other minor taxes were abolished.¹⁵

In the last five countries of the rating Belarus neighbors Venezuela (177),

Central African Republic (178), Congo (179) and Ukraine (180). Russia holds 134th place. Kazakhstan is the leader among CIS countries. Experts placed it on the 49th position. Maldives islands, Qatar, Hong Kong, the UAE and Singapore have the most attractive tax systems in the world. Dominican Republic became the best reformer of the tax system in the period covered by the report. In 2007–2008 the government of this country reduced corporate income tax from 30% to 25%. A few taxes were abolished and the rate of property tax was reduced. Electronic system of reporting was introduced.

The most popular reform in the tax system was to reduce corporate income tax, to simplify procedures of paying taxes and to increase the effectiveness of electronic systems of reporting and paying taxes (Figure 1).

SMEs in Belarus traditionally criticize both high tax rates and the difficulty of paying taxes. The complexity of the tax system in Belarus is the reason of the difficulties of observing all contradictory and intricate tax legislation. As a result, control bodies find violation of tax legislation practically in all cases. In about 80% of cases inspectors find tax legislation violation by SMEs and individual entrepreneurs. By contrast the world experience shows that in developed countries only 20–40% (depending upon a country) of commercial organizations violate tax legislation. The fact that Belarusian business has twice and four times more violations than the western one is explained by very tough

¹² EBRD (2008). *Transition Report 2008: Growth in Transition*, <http://www.ebrd.com/pubs/econo/tr08.html>.

¹³ Estimations are given in points – from 1 to 4+, where 1 is practically complete absence of reforms and 4+ means the introduction of standards typical of a hypothetical country with market economy.

¹⁴ Rakova, E. (2008). Tax system in Belarus: how to simplify it, *The IPM Research Center policy discussion paper PDP/08/01*, <http://www.research.by/pdf/pdp2008r01.pdf>.

¹⁵ IPM Research center (2008). *Small land medium business in Belarus: Quarterly review, №1(11)*, 1 quarter 2008, <http://www.research.by/pdf/SME2008r01.pdf>; *Small land medium business in Belarus: Quarterly review, №3(13)*, 3 quarter 2008, <http://www.research.by/pdf/SME2008r03.pdf>.

legislation and very broadly defined authorities of inspectors.

“We have too many formal fines. For example for mistakes in filling out documents a commercial organization can pay the fine in the amount of 10% of the deal. It means that the tax system in Belarus is built for the state not for an entrepreneur”, - Chairman of Belarusian Union of Entrepreneurs A. Kalinin commented in August 2008. The expert suggested introducing the institution of the responsible persons in Ministry of taxes and fees for servicing commercial organizations and to pass a part of responsibility for potential violation of tax legislation on tax bodies.

4. MAIN CHANGES IN BUSINESS REGULATION LEGISLATION

4.1. Anti-crisis program and measures to liberalize economy

The world financial crisis turned into the world economic crisis. In spite of the fact that Belarus is a small open economy and it is relatively weakly integrated in the global processes the country quickly felt the consequences of the world crisis. It primarily is observed in the form of the reduction of export and hard currency revenues in the end of 2008 and in the form of deterioration of the terms of crediting in the world financial markets.

In September – November the government tried to deny the possibility of a crisis in the country and in December as the flow of negative information from exporters became much more intense and the situation in the hard currency exchange got worse it began to work out an anti-crisis program.

Though the program itself was not published the information in mass media enabled us to make the following conclusions. Firstly anti-crisis measures that target the real sector of the economy (primarily state enterprises) and state banks are traditional. They are the measure of direct state support which due to the weakness of the economy can not considerable. For example four biggest state banks increased their authorized capital by USD 1.5 bn at the expense of the budget. The government is planning to give the biggest exporters tax holidays (tax loans) and to compensate a part of interest payments for loans to a few entities. In addition the

government is going to set beneficial tariffs for gas, electric and heating energy also primarily to exporters.

The second part of anti-crisis measures include the reduction of government expenditures by BYR 5 trn, reduction of wages for the budgetary sector in December compared to November and the increase of housing and utility tariffs for the population etc. The government has the potential to further reduce expenditures primarily by the revision of a few investment programs.

The third part of the program deals with liberalization and debureaucratization of the economy. As it is the most important part of the reform for SMEs and for the overall improvement of business climate in the country we will analyze it in more detail. It is worth noting that some measures have already been implemented in legislation and others were just declared.

Pricing

In December the government adopted two resolutions that allow enterprises to sell goods below costs of production. The first resolution deals with exporters (it was adopted on December 1)¹⁶ and the second resolution was signed on December 9¹⁷. It regulates the enterprises that sell goods in the domestic market. The sharp increase of inventories after Belarusian export decline to Russia urged the government to adopt such resolutions. In November inventories increased by 9% and amounted to 63.8% to the average monthly output (as of November 1, the inventories amounted to 54.6%). In monetary terms the inventories reached BYR 5.2 trn (more than USD 2.5 bn).

Resolution #1903 sets the order of selling goods in the domestic market (works, services) at prices (tariffs) at the prices that are defined by the demand of the market. They can be set below costs of production and the price of purchasing. The resolution was adopted to

¹⁶ Resolution of the Council of Ministers of the Republic of Belarus #1834 as of December 1, 2008 “On confirmation of Order of selling goods outside the Republic of Belarus at prices that are defined on the basis of world market demand”.

¹⁷ Resolution of the Council of Ministers #1903 as of December 9, 2008 “On the confirmation of Order of selling goods (works, services) at prices that are defined on the basis of the market demand in the Republic of Belarus”.

accelerate the turnover of inventories and money of enterprises. The document comes into force since the date of its official publication and it is valid until January 1, 2010.

The document stipulates that producers can sell in Belarus their goods at the prices that are dictated by the demand of the market. Discounts are also taken into account excluding the goods on which the government sets prices. The document also sets the order of selling goods by wholesale and retail traders at prices that are lower than the price at which they were purchased (excluding the prices that are fixed by the government) at the expense of abolition of trade margins and/or purchasing price reduction based on the agreement between these organizations and producers (suppliers). While private commercial organizations independently make decisions on setting prices below costs of production there are still restrictions to such pricing on the enterprises level (the director of a company should reach the agreement on such prices with state bodies).

Deputy Minister of Economy V. Adashkevich and Ministry of Economy in general informed that they are planning to abolish price registration for new goods. In order to do it they sent a document to the government on amending Decree #285 adopted in 1999. Moreover as the deputy minister said the government is not planning to set price limits for producers in 2009¹⁸ due to the cages in external markets. Nevertheless the limits of price margin for food products are still in force though in the future the government is planning to increase the list of goods (non-food products) that will be sold without any limits on price margins.

In the sphere of price liberalization it is important to note the progressive change in the government's intention to abolish the demand to provide obligatory planned price calculations and reports on them, the intention to abolish price registration on new goods (works, services) and the correction of tariffs in energy, transport, housing and utility sectors by means of reduction of cross subsidization.

¹⁸ Now enterprises can increase prices for their goods and services by no more than 0.5% a month.

Hence the adopted and planned legislative measures in pricing are aimed at the increase of the scale free pricing, the reduction of the scope of price regulation, the increase of the degree of freedom for entrepreneurs and business climate in the country. If the planned measures are implemented Belarus in the area of pricing will be very similar to a country with market economy.

Declarative mode of opening up a business

Ministry of economy is planning to considerably liberalize the sphere of registration of new commercial organizations. One of the innovations will be the introduction of the declarative principle of state registration of commercial organizations. In order to do it is suggested to amend Decree #11 as of 16.03.1999. However other restrictions including the right to register or liquidate a commercial organization in an off-court mode will still be kept. Though on the date of publication of this outlook there was no decree on registration yet we can state on the basis of information in the press that registration on line is not envisaged. The authorities are also planning to keep the norm of obligatory formation of the authorized fund and many other propositions the abolition of which would make the registration procedure in Belarus much closer to the standards of economically free countries.

Licensing

Simplification of the order to give licenses is also among the measures to liberalize and to debureaucratize Belarusian economy. The government structures are working on the document that will unify the rules of giving licenses and simplify all procedures. Ministry of economy considers a possibility to abolish licensing of a few kinds of economic activities including retail trade and catering (cafes, restaurants, cafeteria). They represent 80% of all licenses in the country. Though there are other kinds of state regulation in the country apart from licensing even partial liberalization of licensing is an important and progressive measure of the government.

Certification

On December 16, 2008 State Standards Committee adopted the resolu-

tion¹⁹ that reduced the list of goods and services of obligatory certification by 40%. It is believed that this measure will simplify the movement of goods. The terms of serial certification were increased from three to five years and the validity of protocols from one to two years. The number of documents that commercial organizations have to provide to certify some services was also reduced.

Annual inspection control of certified goods can be done without actual checks of production by means of testing samples of goods provided there are no complaints to the production from customers and no violations of quality and safety were revealed by control bodies.

On the whole considerable reduction of administrative procedures in the sphere of certification including the recognition of international certificates, harmonization of requirements to Belarusian goods with international and European standards takes place. All these measures are aimed at the reduction of temporary and financial costs of enterprises on certification of goods and to increase the competitiveness of Belarusian good on external markets.

Reduction of fines and the number of inspections

On December 19, 2008 the decree that can considerably improve business climate in the country as adopted.²⁰ The document suspended carrying out inspections of commercial organizations until a special decree that regulates the single order of carrying out inspections and the reduction of their number is adopted. During this moratorium within a six month period it is planned to draft a decree that regulates any control and supervision activity in the country. The government is planning to make considerable changes in the order of carrying out inspections and to define a new order of making decisions on carrying them out, on the coordination of their carrying out by all state bodies with

the definition of clear criteria of choosing the object of an inspection.

Nevertheless some kinds of inspections were excluded from the moratorium. These are the inspections that were initiated by a commercial organization itself and inspections that are carried out within criminal cases investigation or administrative processes against commercial organizations and also to prevent crimes and law violations (in strictly define conditions) and also inspections of dangerous objects. At the same time the National Bank still has the right to inspect banks and non-banking institutions.

Within the economic liberalization program it is suggested to revise the size of fines for violation in the sphere of entrepreneurs, accounting and to set them in accordance with the essence of the violation of legislation.

It is also suggested to free commercial organizations from all types of inspections if there are no violations in their activities during 3 previous years of their activities. Moreover if the proposals to change the rules of accounting and financial reporting in accordance with international practices are adopted there will be much fewer mistakes and violations of commercial organizations.

Inspections and the fines that are much higher than the harm done by a violation are a major obstacle for SME activities. That is why the change of legislation in this area is an important and necessary direction in the area of improving business climate in the country.

Reduction of the number of taxes, simplification of the system of tax payment and the abolition of setting limits of some costs

The government is also planning to change a few aspects of tax policy. It is expected to abolish the fee to the republican fund of supporting producers of agricultural products, food and agrarian science, local fees that are paid from profit that commercial organizations get after paying all other taxes and a resort fee.

Decree #662²¹ adopted a list of high tech organizations the profit of which

¹⁹ Resolution of State Committee on Standards of the Republic of Belarus as of December 16, 2008 #61 «On improvement of Order of certification of goods and services that must be certified».

²⁰ Decree of the president of the Republic of Belarus #689 as of December 19, 2008 "On some measures to improve control and supervision activities in the Republic of Belarus".

²¹ Decree #662 as of December 4, 2008 "On taxation of high tech organizations".

(after selling high tech goods of their own production excluding trade activities) will be taxed on the rate reduced in half. The authorities recognized the importance of the simplification of tax administration. In order to do it is proposed to set the term of paying the single tax for agricultural producers, the single tax which is paid once in half a year and once in a quarter for income tax. Moreover Ministry of economy does not exclude the abolition of all restrictions on the limits of costs for the purpose of calculating corporate income tax. It should also become a powerful incentive for business development.

Recognizing the drawbacks of the Belarusian tax system Ministry of economy proposes to adopt the Peculiar part of Tax Code in which the minimal list of taxes and fees will be defined. The document will also define clearly the object of taxation, tax bases, tax rates, tax benefits and clear transparent procedures to calculate, decorate and pay taxes to the budget.

Ministry of taxes and fees promises to gradually reduce and then abolish the system of limiting costs in 2009. In particular since 2009 it is planned to abolish the limits of costs of training personnel and auditor inspections. Earlier the costs on audit inspections could be included into the costs of production only when such audit was necessary. Now costs on all audit inspections will be included into the costs of production and their number will not be limited. Since 2010 the limits on costs of consulting, marketing and advertising services will also be abolished.

Giving certificates and document turnover

The authorities abolished the requirement of commercial organizations and IEs' getting a few certificates from tax bodies.²² In particular it will not be necessary for enterprises with foreign capital to get certificates on the absence of budget and off-budget funds debts to solve the issue of the terms of forming the authorized funds of commercial organizations. Earlier such certificate was given to a tax payer to present in Minis-

try of Foreign Affairs. Now if such company appeals to change the term of forming the authorized fund Ministry of Foreign Affairs itself can appeal to tax bodies the information it needs. Legal entities and IEs will no longer have to get certificates on the absence of budget debts to solve the issue of getting air time on TV and radio at auctions.

In addition the resolution reduced the time of providing the information on legal entities and IEs that procure, store tobacco goods and sell them in wholesale and retail outlets from 15 to 5 working days. The term of issuing certificates on full payment of all taxes, fees and duties in connection with untimely and incomplete payment of taxes for which legal entities and IEs are punished in an administrative way was reduced from 5 to 3 working days. The time of issuing the certificate on other payments of legal entities and IEs with the budget was also cut from 5 to 3 days.

The resolution also envisages the reduction of the number of documents which should be given to tax bodies in connection with certain procedures. As Ministry of Taxes and Fees state all these changes are made in accordance with the proposals of the working group on simplification of the tax system in Belarus. The activities to simplify administrative procedures carried out by tax bodies go on. In the near future it is scheduled to adopt a few other documents that will simplify administrative procedures.

Competition on the financial market

In order to develop the financial market Ministry of economy proposes to free emission income of stock holding company from taxation. It also proposes to further develop the system of insurance and the creation of favorable conditions for attracting foreign investment to this sector.

It will be done by means of abolishing barriers for the participation of private insurance companies (including the ones with the participation of foreign capital) in any kinds of insurance services (in particular obligatory kinds of insurance). Up till now there is a state's monopoly in obligatory kinds of insurance in Belarus. That is why such measure is market oriented and progressive.

Another measure to demonopolize the market of insurance services is planned.

It is to ensure equal access of different kinds of clients to banking services, the abolition of existing restrictions to provide services to state enterprises and organizations in banks that are not controlled by the state. Hence the government is planning to create the environment of free competition among banks of different forms of property. It can become an incentive to increase the effectiveness of their work.

Interactive dialogue between the state and society

The government is planning to accelerate the creation of electronic government. This measure is aimed at ensuring bigger access to information, expanding interactive cooperation between society and the state. It is too early to say how open this cooperation will be. The government proposes to set up comprehensive information internet portals on the activities of the executive power. These portals should be filled out with information. They should be updated regularly. Mechanisms of optimization of communication of enterprises with citizens by means of information technologies (providing statistical reports, requests to the authorities etc.) and the information exchange among state bodies should be ensured.

Private property on land and rent of facilities

The government is going to stimulate the expansion of private property on land. In 2009–2010 it is proposed to introduce the norm of privatizing land that is excluded from agricultural use (including lands in cities and lands that are not used) by means of putting them on the sale via open auction and free trade of land lots that are in private and cooperative property acquired with real estate objects. Including land into the commercial turnover is a very important step towards market reforms as private property on land is one of the most important conditions for entrepreneurial activities in market economy.

Reformed began in traditionally complicated sphere for business – in renting facilities. Up till now landlords did not want to make long-term rent agreements (for more than one year) as it required a rather complicated procedure of state registration. It made it impossible for rent holders to arrange stable work for a few years. Many efforts

²² Resolution of the Council of Ministers #1723 as of November 15, 2008 "On amendments and additions to some resolutions of the Council of Ministers of the Republic of Belarus".

were needed to overcome artificial legislative barriers.

Decree #24²³ introduced the minimal rent term (sub-rent) in state and private buildings and facilities an isolated buildings – 3 years. Agreement can be concluded for the term at least three years but only with the consent of landlords themselves. Such legislative change is a considerable improvement of rent conditions.

In order to remove unnecessary administrative barriers the Decree abolished state registration of rent agreements, sub-rent agreements and sublease of real estate and free use of it as well as amendments and additions and termination of such agreements. Agreements will be considered made since the date of signing them by both parties. In this case a landlord will just have to inform a territorial organization on state registration of real estate on the signed agreement, amendments to it or its termination in any form within 10 days. The fee for such procedure is not charged. One more liberal proposal was suggested. It is to give SMEs that have been renting facilities for 3 and more years an opportunity to sell the rented facilities at the balance price minus depreciation costs. If this rule becomes a reality there will be dozens of thousands of private objects which can be involved in the full-fledged commercial turnover.

Other propositions

The government is going to further expand the application of the principle of “one window” for legal entities that deal with administrative procedures. It is also planned to liberalize foreign trade deals. Passports of commercial deals can soon be abolished.

4.2. Other changes in legislation

Extension of the preferential mode of importing goods from Russia for individual entrepreneurs

Decree #703²⁴ of the president kept for individual entrepreneurs who are payers of the single tax and who operate in

retail business the existing conditions for importing third country goods from Russia. Namely the decree kept the existing mode of paying VAT (fixed sum) without the documents that are required for legal entities. However at the same time the responsibility of IEs for the absence of special permissions (licenses) and the failure to pay the single tax and VAT was increased.

In order to level the conditions of commercial activities for individual entrepreneurs and commercial organizations the government decided to increase the maximum rates of the single tax for IEs. Precise rates are set by oblast and Minsk City Councils of Deputies depending on the kinds of economic activities, location and other conditions. The increase of the range of maximum rates led to the increase of the single tax rates for many IEs.

If in the month proceeding to the reporting one revenues of ISs exceed the sum which is 20 times bigger than the sum of single tax IEs will have to pay additionally 10% from the difference in the two indicators (revenues minus single tax). The decree also sets a factor that increases the single tax rate for imported goods from 1.5 to 2. Evidently IEs will try to compensate this tax increase by means of increasing consumer prices.

Retail trade of automobile spare parts was excluded from the list of activities on which IEs can pay the single tax. At the same time such economic activities as “providing facilities for short-term accommodation” and “driving cars from one place to another”.

Some administrative procedures were also falsified. For example the transition of an IE from the general tax mode to the payment of the single tax will be done without writing an application to the tax body. At the same time a decree that enables private unitary enterprises that switched to this legal status from an IE the conditions that are not worse than exist for IEs in 2009 was drafted. In order to achieve it the government is planning both to improve the existing simplified tax system and to reduce tax rates.

Marking

Since May 1, 2009 marking of goods with identification marks will be introduced. The following goods will be covered by this norm: juice, notebooks,

monitors and printers.²⁵ Fruit juices including must, unfermentable and without alcohol with sugar or without and other sweeteners, in consumer packages will be marked with identification marks. Notebooks, monitors and displays and printers excluding second hand ones will also have to be marked.

In addition the resolution envisages marking of glass detergents in packages, antifreeze (including oils) and antifreeze liquids in packages of any volume will also be marked. Earlier only consumer packages had to be marked.

Belarusian government introduced marking for more and more goods to fight “grey” import. At the same time entrepreneurs and experts doubt the effectiveness of such form of struggle with “grey” import. The fiscal effect is also very small due to low price of marks. Hence the main consequences of such measure will be the increase of costs due to the purchase of such marks and sticking them.

Loans to small business

Belarusian Bank of Small Business (BBSB) got its first credit line from the European bank for Reconstruction and Development (EBDR) for USD 5 m. Its objective is to develop microfinancing for small business in Belarus. The loan is given for four years. Earlier BBSB gave loans to small and medium businesses at the expense of the funds invested by stock holders. The Bank is negotiating with two more of its founders to open credit lines for another USD 16 m. For the first months of operation BBSB made 138 loan agreements with small and medium companies for about BYR 4 bn. An average size of a loan is BYR 28 m (BBSB started its activities in October 2008). BBSB provides loans on the commercial basis from USD 270 to USD 279 thsd. It focuses primarily on the loans limited to USD 14000 for one year. In difficult financial conditions when most of the banks made the procedures of crediting more difficult and loan interests exceed 20% the activities of BBSB can add to the support of SME and IE development in Belarus.

²³ Decree #24 as of December 19, 2008 “On some issues of renting real estate facilities, building and isolated buildings”.

²⁴ Decree #703 as of December 24, 2008 “On making amendments and additions to some decrees of the President of the Republic of Belarus”.

²⁵ Resolution of the Council of Ministers #1508 as of October 13, 2008 “On making amendments and additions to Resolution of the Council of Ministers of the Republic of Belarus as of October 2004 #1280”.