Small and Medium Business in Belarus

QUARTERLY REVIEW

No.4(5), 4Q2006

In this issue:

Major macroeconomic trends; Major legal changes regulating entrepreneurial activity; Business environment of Belarus: entrepreneurs' viewpoint.

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Dear Readers:

We are happy to draw your attention to the fifths issue of 'Small and Medium Business in Belarus'. It contains our traditional sections: analysis of macroeconomic trends in the real sector of the economy and its institutional environment. In addition, it includes some survey data on small and medium business (SMB) in Belarus.

Macroeconomic indicators display positive dynamics. However, over the three quarters of 2006, there have been some downward trends registered what concerns GDP, output, investment, and real wages. Deterioration of trade balance along with Russia's intention to increase gas prices and to introduce of duties on oil supplied to Belarus are the major challenges that the Belarusian economy have very likely to deal with in the next year. At the same time, liberalization policies and measures aimed at creating a more business-friendly environment for private small and medium-sized enterprises have been continuously substituted by protectionism and favoritism to the domestic, mainly state-owned, enterprises.

The study of the business environment has shown that the major impediments towards the development of entrepreneurship have not essentially been removed. They are still in place: taxes, inspections and fines, the need to apply for various permits; price regulation; and excessive paperwork. The reduction of these barriers would stimulate the development of domestic SMB.

Editors

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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 Research Center.

1. SOME OF THE RESULTS OF FUNCTIONING OF THE BELARUSIAN ECONOMY IN 2006

1.1. Economic Growth

According to the official data, GDP has grown by 8.6% yoy in the 3rd quarter of 2006, or by 1 percentage point less than in the 2nd quarter. Deceleration of GDP growth has been observed over the two quarters. In contrast to the previous years, it can be considered as tendency. First, there is a deceleration of domestic demand driven by investment and household consumption (although the contribution of these factors to the GDP growth is still substantial). Second, it can be expected that GDP dynamics would be impacted by changing terms of trade with Russia (like the measures to limit imports of some items from Belarus), growing gas prices, and imposing of duties on the imported oil[1]. Taken together, these factors, would adversely impact the rate of GDP growth in 2007. According to our estimates, it could go down by 6–7%.

From a supply side, GDP has decelerated due to the output decline in agriculture (by 0.2%yoy) caused by corn failure. It is possible that the data on the rate of agricultural output growth would be revised (by the middle of the next year). Such revision could likely reveal that a decline is deeper than it has been calculated. This is because over the last several years, similar revisions have demonstrated that output decline was more profound, especially in the third and fourth quarters. As for the contribution of other sectors of the economy to GDP growth, no significant changes have been recorded.

In 2006, population income growth has slowed down because of the dynamics of real wages. Over the three quarters of 2006, a significant deceleration of investment growth has been observed (from 36.9% yoy in the 2nd quarter to 25.5% in the 3rd quarter). Nevertheless, investment is still the second major demand component of GDP growth.

[1] Russia has introduced duties on crude oil supplied to Belarus. This measure has been implemented after protracted negotiations with Belarus. The latter had been pressurized to increase its export duties on oil products supplied to the countries outside the Eurasian Economic Community (EEC) and to transfer 85% of revenues from these duties to the Russian budget. The refusal to do so has led to the imposition of duties by Russia.

1.2. Real economy

Over the 1–3 quarters of 2006, fuel industry has secured almost half of industrial output growth, or more than 20% of GDP growth (2.1 percentage points). A year ago, this branch of industry had been rather modest (about 0.8 percentage points). At the same time, the role of machine-building, another important contributing factor, has declined. It contribution has decreased from 1.1 percentage points over 1–3 quarters of 2005 to 0.8 percentage points over the same period of 2006.

The dynamics of GDP and output can be largely explained by exports. Belarus has continued to increase its production and exports of oil products. At the same time, growth of machine-building exports has been sluggish. The goods produced in Belarus have demanded less at a Russian market. Russian consumers of investment goods have begun to switch to Western or Russian substitutes.

The machine-building industry has been 'saved' by domestic investment demand. Investment in industry and agriculture has been growing over January–September 2006. Contribution of these two sectors into growth of investment in fixed assets amounted to 31.2 and 22.7%, respectively, followed by housing construction (13.5%) and the budgetary sector (healthcare, physical culture and social services – 7.4%). Investment has been funded by funds of enterprises' funds (38.4% of investment growth) and the state budget (31.2%) as well as bank loans (23.3%). Population savings have contributed at a level of 4.8% only.

Between January and September 2006, the volume of agricultural production accounted for BYR 11.8 trn, while budgetary expenditures on agriculture were BYR 2.5 trn. Given that agricultural units produce about 60% of the agricultural output, the budgetary support appears to be equal to 35% of the total output. In addition, loans to agriculture amounted to BYR 0.8 trn. These loans have been provided at a rate twice as little as an average economy-wide interest rate. Also, agricultural enterprises have not transferred parts of their profits to the state budget (thus allowing them to acquire implicit support about BUR 0.3 bn). Last but not least, agricultural sector is provided with preferential electricity tariffs, etc. It follows that in this sector economic growth has largely been achieved due to subsidization policies implemented at the expense of other sectors of the Belarusian economy.

1.3. Foreign trade

Over January-September 2006, merchandise trade deficit reached USD 1.38 bn (USD 0.09 bn a year ago). Deficit had been growing in the first half of the current year. In the 3rd quarter imports growth slowed down, while exports growth revived (Figure 2). In comparison with the 3rd quarter of 2005, merchandise trade deficit went down by USD 130 m (in the 1st and the 2nd quarter of 2005 – by USD 609 m and USD 545 m, respectively).

One of the major export and imports items in the above-mentioned period were mineral products (their contribution was 18 and 16 percentage points, respectively). At the same time, imports appeared to be diversified. In particular, such industries as machinery and equipment, chemical products and non-precious metals have contributed to the growth of imports most substantially (at 6.4, 4.5 and 3.7 percentage points, respectively). In contrast, non-mineral exports have accounted for 9.3 percentage points of exports growth. At the same time, over the three quarters considered, none of the commodity groups have 'exceeded' the borderline in 2.5 percentage points.

Nevertheless, in the 3rd quarter, exports of mineral products have slowed down. This can be explained both by lower world prices and smaller physical volumes of exports. Specifically, in the 3rd quarter of 2006, mineral products had been responsible for 14.8 percentage points of exports growth. Despite that, there has been no export decline due to revival of foreign sales of potash and nitrogenous fertilizers. Accordingly, in the 3rd quarter of 2006, chemical products accounted for 4.7 percentage points of increase in exports in comparison with the first half of the year (0.2 percentage points).

Trade deficit with Russia remained decently high at USD 4.86 bn. At the same tine, the physical volume of exports has been lagging behind imports. But the Russian government is intended to limit government purchases of the Belarusian goods (particularly agricultural machinery purchased within the framework of the National project on agricultural development) and also to withdraw goods of the Belarusian origin from domestic market. Although this decision would incur the similar reaction of the Belarusian government, trade deficit with Russia is very likely to increase.

1.4. Labor market

A steady output growth has been accompanied by stable employment pattern and a reduction of registered unemployment. In September 2006, unemployment rate was just 1.3% (of the economically active population). However, the Minister of Labor, speaking at a November sitting of the Council of Ministers, has admitted that the actual rate of unemployment is significantly higher than official figure (that includes only those who are officially registered)[2]. For the first time, there has been a Labor Survey conducted in Belarus. It has been considered that about 364,000 people are currently unemployed (while the number of those officially registered is about 60,000 people). As for economically active population, its volume has appeared to be also higher than the official data suggest not only at the expense of the unemployed, but also the employed. According to the official data, at the beginning of this year, the size of economically active population was above 1.6 m people (27% of the able-bodied population in Belarus), while the Labor Survey has provided a figure of 0.4 m people (6% of the able-bodied population). The unemployment rate has been 6%. So the Labor Survey has revealed that employment is actually higher than it is registered officially (by 960,000 people more). At the same time, another set of data (obtained from the Household Surveys), the number of unemployed at the beginning of the current year was 300,000 people, while the number of employed was not higher than the official figure of 560,000 people.

The Labor Survey data presented by the Minister of Labor suggest that almost one-third of the 'inactive' population (117,000 people) is going abroad for a job (of them, 98,000 people – in Russia). This figure does not account for those who are employed abroad on a permanent basis, while not being registered with the Belarusian migration office. Other data claim that up to 300,000 Belarusian citizens work in Russia. It appears that of 960,000 employed, but not captured by the official statistical service, approximately 200,000 people work outside Belarus, and another 760,000 people – in the 'grey' sector of the economy.

2. INSTITUTIONAL ENVIRONMENT FOR THE SMALL AND MEDIUM BUSSINESS

Over January-December 2006, there have been no significant changes in the regulatory framework for SMB. Only slight modifications have been introduced to deal with some shortcomings and gaps that exist in the legislation.

As for the positive changes, these are as follows:

The government has abandoned the requirement to have a certain share of goods (of the Belarusian origin) in a range of goods as a precondition for obtaining a license since September 1, 2006. Prior to that, every single mercantile enterprise had been obliged to have from 70 to 90% of the domestically-produced goods (including alcoholic beverages and tobacco). While in Minsk controls over this requirement had been rather formal, in regions of Belarus, the violation of this rule incurred a thereat of license withdrawal. In general, this requirement had been limiting the development of private business (especially the medium-sized one), and particularly the development of a network of super- and hyper-markets. The barriers seem to be abolished from this time onwards. Nevertheless, the creation of large retail networks and businesses could undermine competitive advantages of small business, and, in the first instance, individual entrepreneurs.

An Edict No. 574 issued on September 16, 2006 'On Some Aspects of Charging State Due' has reduced expenditures on registration of new business. Various charges and fees have been unified into a singular notion of 'state due'. In some cases, the latter has been substantially reduced. As a result, the costs of registration procedures enacted for 'individual entrepreneurs', 'unitary private enterprises' and other economic units has been cut as well (including account opening, charter registration, etc.).

The Edict No. 569 has abolished an all-republican charge for the use of vehicles by entrepreneurs and legal entities. In fact, this edict has made obsolete the one issued in 2004 (No. 140). The previous edict established an all-republican charge for the use of vehicles by entrepreneurs and a transfer of a right to use vehicles brought in by natural persons for a private use by legal entities and individual entrepreneurs. It has to be noted that a change had been introduced *post factum*, while its violation meant additional fines up to several tens of US dollars per vehicle. Entrepreneurs have been strongly opposing this tough regulation. Many of them have been compelled even to resort to a hunger-strike. However, the adoption of a new regulation (for the purpose of simplification of taxation of legal entities and individual entrepreneurs) has not decreased the costs of doing business by transportation companies. This is because customs duties on cars imported by natural persons have been increased. Also, charges and fines would not be paid back to entrepreneurs.

Some changes in legal and regulatory framework have been aimed at increasing the transparency of functioning of private enterprises and providing greater protection of consumer rights (in the sense of protecting consumers from substandard and low-quality goods and unfair competition practices). However, these modifications have worsened the conditions of conducting business by SMB and individual entrepreneurs trading with some of the imported goods.

In particular, since December 8, the government of Belarus has expanded the list of commodities that have to be labeled by special 'control' (or 'identification') mark. The new list includes such items as coffee, tea, footwear, audio-cassettes, CDs and DVDs, etc. Besides that, since December, there has been a two-fold increase of customs duties on footwear. All these measures would imply growing costs that, consequently, push retail prices up.

Some specific changes in the regulatory framework have injected a dose of inequality between state-owned and private enterprises what concerns business operations. Also, there has been some worsening of financial indicators of construction companies.

[2] According to the information obtained from 'Belarusian News' (www.naviny.by).

In particular, the Council of Ministries of Belarus has issued an Edict No. 1161 'On Some Matters of Internet Shopping' (or, literally, 'Sample Shopping by using the World Wide Web') on August 8, 2006. This regulation has changed the rules of e-trade in Belarus. In particular, websites of e-shops are now required to be hosted by the Belarusian servers only. In turn, domain names have to be registered at a domain zone controlled nationally (e.g. www.domainname.by). Besides that, the above-mentioned edict has changed the licensing procedures concerning retail trade. For instance, e-shop's address has to be provided at a license form. It is only this address that can be used for commerce. The use of any other, unlicensed web-address is treated as a serious violation of retail trade requirements by license holder. This violation can lead to a license withdrawal and heavy fines. Therefore, customer rights related to e-trade appear to be better protected. Nevertheless, the existing tax system and various permission procedures are becoming increasingly burdensome both for entrepreneurs and their customers.

This autumn the Belarusian government has introduced some changes and made explanations to much-discussed compulsory contributions to innovation funds for construction companies. Prior to that, a President's Edict No. 499 'On Some Measures on Renewal of Fixed Assets in Construction Industry' (issued on August 4, 2006) has established increased allocation rates for innovations funds created by the Ministry of Architecture and Construction, other republican public authorities and organizations subordinated to the government.

This governmental decision is in the interest of the Ministry and other public authorities since they can secure their access to additional funds to modernize their fixed assets used in production. However, this regulation is hard to follow for those construction companies, and particularly private SMB, that invest into and conduct maintenance works of their fixed assets. This is because of some complicated financial and legal issues attached to compliance with the above-mentioned regulation. The Edict has been introduced since July 1, 2006 (i.e. at the middle of the year *post factum*). Also, there have been no provisions concerning the possible sources to cover the costs caused by increased allocations to innovation funds.

It is only since September 7, 2006, the Ministry of Architecture and Construction has adopted an Instruction on setting up innovation fund[3]. According to this Instruction, 'funds allocated are included into prime costs compensated by customers depending on the allocation rates provided for all participants of construction project'. As for the Innovation Fund of the Ministry of Architecture and Construction, the allocation rate is set at 13.5%, implying a turnover tax for subcontractors at a rate of approximately 10%.

In general, over the three months, a number of construction companies have incurred losses amounting to several hundreds of millions of rubles. This sum is equal to about 50% of the fund allocated to the Innovation Fund of the Ministry of Architecture and Construction. In the first half of 2006, building and assembly works had been conducted by more than 4,000 enterprises, including more than 700 of those subordinated to various public offices. All these entities have been forced to make allocations since innovation funds are in fact state budgetary funds. This makes allocations compulsory and the failure to comply with this norm is punished by fines.

Experts claim that increase in the volume of allocations in the Innovation Fund of the Ministry of Architecture and Construction would require expenditure increase on investment and repair and construction works by BYR 170 bn. However, investment programs, including the State one, have already been adopted along with the volumes and sources of their financing. Accordingly, the introduction of compulsory allocation to innovation funds has created a number of unsettled issues related to fulfillment of numerous contracts and loan agreements.

In addition, the decision adopted by the Ministry (concerning adding of these allocations to prime costs) has not inhibited cost reduction. In fact, it implies a subsequent price increase on construction and erection, meaning an adverse inflationary impact. At the same time, differential allocation rates established according to profitability indicators have not only 'punished' highly remunerative enterprises, but also encouraged inefficient work and created preconditions for unfair competition.

It appears that the abolishment and/or reduction of (the rates of) these allocations would stimulate the development of SMB, and especially economic units working in the construction industry.

3. REGULATORY ENVIRONMENT FOR DOING BUSINESS: A VIEWPOINT OF BELARUSIAN ENTREPRENEURS[4]

During October-November 2006, the IPM Research Center has conducted a regular study of the business environment of Belarus. It is based on a Survey; the representative sample included 250 small and medium businesses. The results of the study are discussed below.

3.1. Economic situation

Real incomes growth (by 16% in 2005 and by 17% over January-September 2006) positively influences purchasing capacity of the population. Besides that, there have been policies implemented over the last several years aimed at supporting domestic producers, given that investment activity has been induced by administrative, top-down measures. In particular, in 2006 investment has increased by more than 30%. All these factors also lead to a growth of effective demand for the output produced by SMB.

According to the Survey, it is only 17% of MSB's heads claimed that performance of their enterprises had deteriorated over the last two years (significant deterioration had been denoted by only 3%). For another 45%, performance

[3] The Edict No. 23 issued on September 7, 2006 On adoption of the Instruction on Procedure of Setting Up of the Innovation Fund of the Ministry of Architecture and Construction of the Republic of Belarus'.

[4] This section is prepared by Piotr Kozarzewski (CASE) and Elena Rakova (IPM Research Center) on the basis of a research on the regulatory environment for doing SMB in Belarus. It has been conducted within the framework of a project 'Support for Development of Small- and Medium-Sized Enterprises in Belarus by Improving Entrepreneurial Climate and Developing Business Infrastructure' imple mented by Center for Social and Economic Research – CASE Foundation, IPM Research Center, and Business Union of Entrepreneurs and Employers, and supported by the Polish Ministry of Foreign Affairs.

had improved, while for 38% no changes had occurred. The best performance has been registered at companies working in such sectors, as housing construction, industrial production, transports and communication. Despite the growth of real incomes, the majority of companies, whose heads asserted a deterioration of economic performance, are in trade, catering, and domestic service (table 1).

As for enterprise size, the best-performing companies are the medium-sized ones (the number of employees ranges from 51 to 300). Both old and newly created firms have displayed a roughly identical performance.

It is only one-third of SMB that require borrowing, while only 68% of them actually borrow. The funds borrowed are then used to increase the volume of circulating assets (63%), to purchase new (42%) or a used one (25%), and to apply new technologies. Bank loans and leasing are the major borrowing routes.

Relatively favorable market conditions and high market entry barriers for new companies[5] make the majority of businessmen feel optimistic. No one has expected a predetermined and significant deterioration of economic performance, while only 6% have foreseen some deterioration. At the same time, 11% of medium-sized firms and 4% of small ones foresee deterioration of their economic performance. The most optimistic companies' heads are in such industries as industrial production, housing construction, transports and communications (more than 60%). It is hard to indicate whether these forecasts are based on confidence in the future success indeed backed up by real business-plans or a product of a mere ignorance of the possible threats emanating from changing terms of trade with Russia[6].

Table 1: Distribution of answers to the question: "How has your enterprise economic performance changed?" depending on the area of activity of SME

	Trade and catering	Social amenities	Industry	Construction	Transport and communications	Other services*
Substantially worsened	2.1	6.7	2.1	--	5.9	2.4
Slightly worsened	17.0	13.3	10.4	14.8	5.9	19.0
Has not changed	39.4	40.0	41.7	37.0	29.4	35.7
Improved slightly	34.0	40.0	39.6	40.7	52.9	40.5
Substantially slightly	7.4	--	6.3	7.4	5.9	2.4
Total:	100.0	100.0	100.0	100.0	100.0	100.0

* Other services include education, tourism, consultancy, audit and other services of "non-material" sector.
Source: IPM Research Center.

Table 2: Distribution of answers to the question: "How has your enterprise economic performance changed?" depending on the size of SME

	Less than 10 persons	11–50 persons	More than 50 persons
Substantially worsened	6.0	1.2	5.7
Slightly worsened	10.0	15.3	17.1
Has not changed	52.0	36.8	25.7
Improved slightly	28.0	43.6	34.3
Substantially slightly	4.0	3.1	17.1
Total:	100.0	100.0	100.0

Source: IPM Research Center.

Nevertheless, it is due to these possible price and structural shocks, the development of SMB is of increasing importance for the country. The private sector is the only actor that allows to reduce energy consumption substantially and to make the use of the imported energy much more efficiently. Also, it could 'absorb' workforce made redundant at enterprises that are very like to experience increased costs. It follows that by raising the government's awareness of the most complicated problems of the regulatory environment, the government could then be assisted in devising the most urgent and efficient policy proposals and documents for development of SMB (particularly from its perspective). The analysis of the most urgent problems in the business environment is conducted in the next section.

3.2. Major barriers in the regulatory environment

As before, the major barriers have remained unchanged. These are taxation issues, numerous inspections and fines, extensive paperwork, licensing and permission requirements, price regulation and registration (Figure 1). It is only a very small number of the respondents who estimated these barriers as 'insignificant', while more than 40% treated them as 'very significant'.

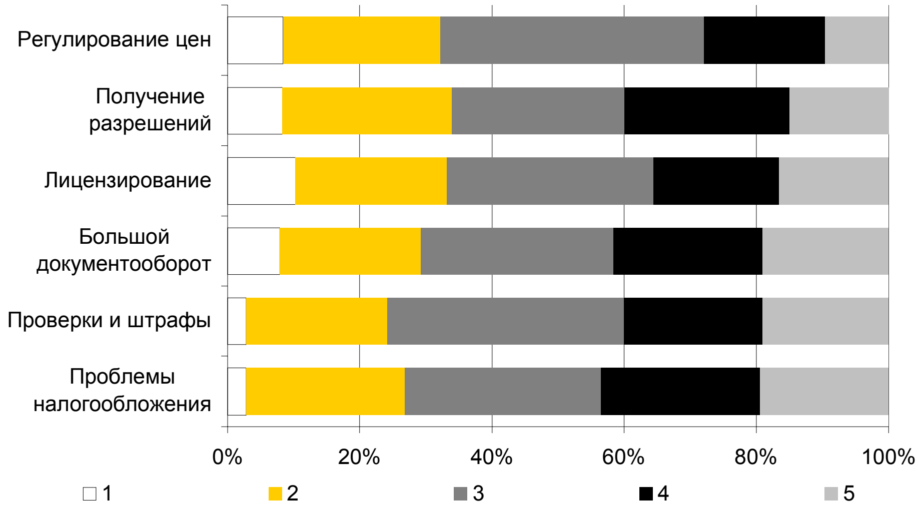
Despite their specificity (e.g. high tax rates or over-regulation of the pricing procedures or change of prices), the majority of these problems have some commonalities:

1. **Legal shortcomings** – complexities, contradictions and frequent changes; this makes their observation more complicated, if not impossible.
2. **Excessive regulation** – there is the very detailed and rather tough regulatory procedures stipulated to control over virtually every sphere of enterprise's activity; this does not allow to choose among the most efficient strategic options and implemented related tactical decisions.

[5] At the beginning of 2006, the number of small enterprises was only 60% of the 1995 figure, while for individual entrepreneurs this figure was 80%. The total number of small enterprises – 3304 companies – is unchanging over the last four years.

[6] At the time of conducting a survey, state-owned media had either concealed or ignored the demands and intensions of Russia to increase gas prices and to change the terms of oil supply to Belarus. In the meantime, it is expected that simultaneous price increase on imported gas (by two–four times) and change of the terms of oil supply (oil products account for 40% of the Belarusian exports) could produce a number of price, structural, and currency shocks (given the dominance of the state sector in the economy). Without a doubt, purchasing capacity of the population would be adversely affected as all as of enterprises. The consumption of 'non-essentials' produced by small and medium-sized enterprises is very likely to decrease because of cost (and, hence, price) increase. More information about the possible consequences of growth of prices on imported energy and the economy's ability to withstand price shocks can be found at http://research.by/rus/seminars/2006/d7e0148285e27927.html.

Рис. 1. Оценка отдельных барьеров в области развития МСП (1 – не является проблемой, 5 – очень серьезная проблема)



Источник: Исследовательский центр ИПМ.

3. **Costs of various stripe**, these are both formal and informal material costs (taxes, fines, charges, informal requisitions, bribes and wages of those who make sure that all these control, report and permission requirements are satisfied, etc.) and non-material ones (time and effort sacrificed to fulfilling the requirements set by the law and local government).

4. **Insufficient access to information and low employee competence**, working for control bodies of the public administration; as a result, it is almost impossible to follow all changes in numerous rules and requirements related to enterprise functioning or to obtain correct and up-to-date information.

5. **Inspections and fines** that can be considered as a separate issue. There are such issues, as heavy fines, excessive punishment, a duty-oriented character of numerous inspections, difficulties that entrepreneurs face when trying to protect their rights and interests, the need to devote time and effort to attend inspections, etc. All of them have been scored by the respondents by 3 or more points.

It can be observed that the perception of the regulatory burden has an impact on the economic performance of SMB and their business plans for the future. There is a reverse relationship: the less the estimated quality of the business environment, the better the economic indicators. It is illuminating that those representatives of SMB who made the lowest quantitative estimate of the regulatory burden (measured as an arithmetic average of all 16 indicators offered for estimation), the frequency of cases of improved economic performance and an optimistic forecast for 2007 is relatively higher (Figure 2).

The analysis shows that there are differences in the attitudes towards various impediments to doing business depending on company's age, size and sphere of activity. Nevertheless, all these differences are not really significant and can be explained relatively easy. In particular, these differences are caused by factors specific to enterprise's activity, mainly branch-related ones. Apparently, sanitary inspection would check merchandise or public catering companies more often than construction ones. Also, the importance of such barriers as price regulation or permission acquisition varies across branches.

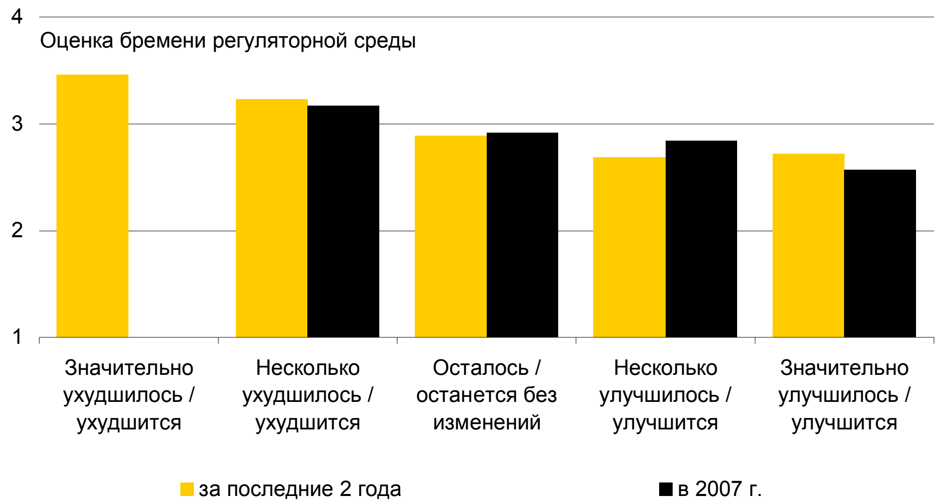
In general, smaller companies estimate the regulatory environment of Belarus more positively than larger ones. The same divide is observed in case of 'younger' and 'older' enterprises, although statistically the link is much less significant. As for branches of the economy, it is construction companies that are most seriously affected by various shortcomings of the regulatory framework, while domestic service companies are relatively the least seriously affected. These observations can be treated and explained in a variety of ways. First, given the relationship to enterprises' characteristics, it is hard to claim which of them – its size, age, or branch of industry – is the most significant. However, it can be maintained – following the opinions expressed by heads of SMB – that the business climate is the least 'healthy' for the largest enterprises of the construction industry with the longest market history. In similar fashion, the least favorable it is also estimated from a viewpoint of the heads of the 'youngest' small firms working in the domestic service sector.

The 'age' difference in estimation of the regulatory burdens can be additionally explained by the following factors. The newly created companies have not yet been facing all these barriers that their 'older' counterparts have already been dealing with. However, a reverse situation is possible. Over the last several years, enterprise's founders are much more rational in their expectations of the business environment. Therefore, the adverse influence of the external environment is mitigated as soon as a relatively less 'troublesome' activity is opted for or numerous accountants and lawyers are employed. Also, companies try to improve their management, marketing abilities, etc. and use other factors to improve competitiveness. Larger enterprises (employing more than 50 people) tend to have bigger paperwork (certificates, permits, etc.) and to confront with a greater 'duty-oriented' interest of inspectorates, etc. Accordingly, heads of these companies tend to estimate the regulatory environment as more significant than others tend to claim.

3.3. Negative consequences of the existing barriers

It has to be noted that such a 'suppression' of private entrepreneurship is a rather inefficient economic policy tool. First, it leads to a creation of a very unfriendly business climate that begets numerous barriers to development of entrepreneurship. As a result, the costs of doing business tend to be very high. Resources are diverted instead of being (potentially) employed to implement efficient business strategies. All these factors undermine SMB's competitiveness, impede the development of some

Рис. 2. Общее восприятие силы препятствий ведению бизнеса в зависимости от оценки и прогноза изменения экономического положения предприятия (1 – не является проблемой, 5 – очень серьезная проблема)



Источник: Исследовательский центр ИПМ.

of SMBs, and even lead to their closure. Therefore, a task of a sharp increase in the share of small and medium business in the Belarusian economy is unrealistic, given the current (low) quality of the regulatory environment.

Second, all these recommendations, orders and prohibitions are inefficient in terms of their abidance. Enterprises are physically unable to follow all these changes in rules. It is also very costly: sometimes even the existence of a company as such is threatened. According to our estimates, every fifth company is trying to fulfill all of the ever-changing rules of the regulatory framework. Others merely try to counteract in many ways, both actively and passively, and by using both legal and informal methods.

Third, the complexity and excessive regulation of the business environment along with the arbitrariness of administrative bodies have not promoted the spread of respectfulness, law-abidance, and the will to obey the 'rules of the game' among entrepreneurs. On the contrary, the latter opt for 'economic dissent', 'legal nihilism', being intended to evade prohibitions and limitations. This leads to a perception of the state as an alien and hostile external force. There is a possibility of failing into an 'institutional trap', that is, even if the state would try to make the domestic business climate healthier, the result would be far from expected. This is because entrepreneurs tend to be in a grip of destructive stereotypes and are not intended to quickly adjust their behavior and mental frames evolved in the distorted business environment.

Fourth, the existing regulatory environment has contributed to a somewhat negative perception of the country and its domestic business climate. As a result, Belarus attracts low volume of foreign direct investment.

It appears that the task of improving the environment for doing business and stimulating the development of SMB is a very important and urgent one. Major arrangements necessary to make the business climate healthier and cut much of the 'red tape' have been outlined by various experts and representatives of business associations.

3.4. Policy recommendations for development of small and medium business

In order to find a way out of the current situation, it is first necessary to point to the main factors 'responsible' for the formation of the unfavorable business environment.

First, there are economic policies conducted by the government is based on the 'manual fine-tuning' of the major economic processes. Private entrepreneurship is seen as a *de facto* alien actor.

Second, it is the low quality of the legal system. The latter tends to be excessively complicated, unstable, and contradictory. This is a product of economic policies aimed at 'keeping an eye on' every single aspect of economic activity and also the lack of professionalism in lawmaking.

Third, many of the local governments distrust private business. The latter is often seen by them as a source of both material and non-material resources.

Fourth, the behavior of entrepreneurs also plays a role. This behavior helps to entrench the dysfunctional character of economic relations in the country. However, entrepreneurs themselves can be hardly blamed for that; they are merely the victims. Nevertheless, entrepreneurs have not been often using all the opportunities available for them to increase the degree of their protection from the unfavorable impact of the business environment and thus to secure the development of their business.

The provision of the detailed recommendations on each of the above-mentioned areas is not the aim of this publication. Instead, we stress only two major directions that have to be followed.

First of al, it is necessary to remove two main barriers to the development of private entrepreneurship, namely ideological and legal-administrative. The attitude towards entrepreneurship has to be changed and systemic contradictions and conflicts between entrepreneurs and the state have to be resolved. Entrepreneurs have to break with their image of potential criminals to become of the pillars of the country's development. Also, profound changes are required in the legal framework like adjusting the legal system properly and cutting the lengthy 'red tape'. These measures would allow to turn entrepreneurship into an economic force able to increase the efficiency of the domestic economy as a whole.

Second, being informed by the cases of the most developed market economies, Belarus has to implement policies of active support of entrepreneurship. 'Laissez-faire' policy (that is currently often supported by the Belarusian entrepreneurs claiming that 'the best form of support is non-intervention'[7]) seems to be in a way an inferior policy option.

[7] See *Belarusian Business in 2006: State, Trends, and Perspectives*. Available at http://research.by/pdf/Business2006e.pdf.

Without a doubt, the consequences of the lightened regulatory burden would be notable in the short run. However, over the longer term, entrepreneurs are likely experience more troubles caused by new challenges to their development.

This is because Belarus has an open economy sensitive to the influence of international competition. As development based on favorable terms of trade with the neighboring countries would reach its limits, domestic producers are likely to loose their competitive advantages. The support of domestic entrepreneurs should not mean protectionism. Rather, measures to improve innovation capabilities and competitiveness both at home and abroad are needed. These measures include, for instance, a system of skills upgrade for managers and ordinary employees, technology transfer, loan provision, support for innovation networks and the best entrepreneurial practices, and so on.