



Regulatory barriers for SMEs in Belarus: The Role of Price Regulation

Summary

Belarusian small and medium-sized enterprises (SMEs) face several administrative and regulatory barriers that halt their development and divert considerable resources of into the unproductive use. Among the barriers, regulation of prices plays considerable role. Although price liberalization has been formally conducted in Belarus in 1990th – 2000th, price setting it is far from free. Several measures of price regulation in the economy preserve and impede their free setting. Besides time and resource consuming, price regulation per se, as claimed by SME representatives, is not efficient. This paper provides stance of the SME representatives on price regulation in Belarus, and includes some rough calculations of its costs for an average SME, and for the economy in general, as well as suggests several policy recommendations for the deregulation of prices.

Contents

1. Introduction	2
2. Regulatory environment impediments to the Belarusian SMEs	2
3. Price regulation for SMEs: costs and efficiency	3
3.1. Legislation in the field of price regulation.....	3
3.2. Price regulation as viewed by entrepreneurs	4
3.3. Costs of price regulation for SMEs	6
4. Conclusions and policy recommendations	7

1. Introduction

Regulatory impediments for the business development preserve in Belarus. Taxation, inspections and fines, excessive paperwork, licensing, provision of permits, price regulations, registration are troublesome and costly for the majority of small and medium-sized enterprises (SMEs). According to the IPM surveys price regulation is ranked relatively high in the list of different problems, concerning the business climate in Belarus¹. The aim of this paper is to analyze the costs and efficiency of the current state of policy on price regulation in Belarus, and to provide policy recommendations for improving the business environment.

The second section deals with the analysis of regulatory environment impediments for Belarusian business, and place of price regulation in this context. The third section provides the data from the IPM Research Center surveys concerning the attitude of SME executives to the existing practices of price regulation by the state. It also provides approximate calculations of possible losses for the economy, coming from rigid price regulation. Forth section provides some conclusions, and policy recommendations for encouraging SME development and improving business environment.

2. Regulatory environment impediments to the Belarusian SMEs

Belarusian business faces several regulatory barriers in its functioning that negatively affect economic state of SMEs. According to the IPM Research Center survey, only 1.6% of enterprises stated that impediments from the regulatory environment in Belarus do not affect their business. Quite the opposite, most responding SMEs among the negative influences of regulatory environment named considerable losses of time and energy on settling administrative procedures, absence of the opportunity to increase production and services provision, considerable increase in financial expenses as the result of excessive regulation etc. The government works on the simplification of administrative procedures and improvement of business climate (in particular, several regulations have been adopted recently aimed at reducing time and financial expenses of SMEs for registration and permits), but the pace of improvements lags behind the business needs, and often appears to be insufficient and inconsistent.

The negative influence of judicial and administrative barriers on the functioning of the majority of small and medium-sized enterprises is supported, in particular, by the presence of statistically significant correlation between the perception of the magnitude of the regulatory burden (calculated as the arithmetic average of several SME regulations' burden estimations) and estimations and projections concerning the dynamics of economic state of enterprises. More negative estimations concerning the economic state of enterprises during the last years and less optimistic (more pessimistic) forecasts for the future, comparing to other responses relate to the sharper perception by the enterprises to other responses relate to the sharper perception by the enterprises of the negative influence of the regulatory burden.².

Moreover, for the majority of small and medium-sized enterprises all the regulatory barriers are interdependent. There were just a few cases in the survey when the participating small and medium-sized enterprises negatively estimated only separate governmental regulations of entrepreneurial activity. It is supported by the strong correlation of estimations of all kinds of barriers with the very high significance of corre-

¹ Paper is based on the information from the surveys of SMEs, conducted by the IPM Research Center in November 2006 and February 2007. The first one included 253 SMEs executives and owners, the second one – 410. For more information look at <http://www.research.by/eng/surveys/>.

² Kozarzewski and Rakova (2006) , *Regulatory environment and the tendencies in the SME development* (in Russian) http://www.case.com.pl/upload/publikacja_plik/12860255_332r.pdf.

lation coefficients³. Still, some of the barriers are more problematic for the enterprises than others.

Regulatory burdens vary depending on the rate of negative influence on business. Taxation, inspections and fines, excessive paperwork, licensing, provision of permits, price regulations, registration receive most negative estimates by the respondents. Average estimates of the negative influence of these barriers for business, thus, exceed "3" (table 1).

Table 1. Complexity of certain elements of the regulation of SMEs' activity (%)

Problems	Estimate					Average score
	1	2	3	4	5	
Taxation	2.8	24.1	29.6	24.1	19.4	3.3
Inspections and fines	2.8	21.4	35.7	21.0	19.0	3.3
Excessive paperwork	7.9	21.4	29.0	22.6	19.0	3.2
Licensing	10.3	22.9	31.2	19.0	16.6	3.1
Provision of permits	8.3	25.7	26.1	24.9	15.0	3.1
Price regulation	8.4	23.9	39.8	18.3	9.6	3.0
Registration	10.4	27.9	29.5	19.1	13.1	3.0
Statistical reporting	7.1	28.2	36.5	20.6	7.5	2.9
Weak protection of assets and interests of private business	11.6	28.0	33.2	15.2	12.0	2.9
Wage regulation	14.2	27.3	33.6	19.0	5.9	2.8
Unequal conditions for conducting business compared to public sector companies	16.2	27.7	23.7	20.9	11.5	2.8
No access to financial resources (or a complete lack of them)	18.7	33.5	23.9	17.1	6.8	2.6
Administrative intervention by central inspection authorities	20.7	34.7	25.9	13.9	4.8	2.5
Administrative intervention of local authorities	18.7	33.9	25.5	17.9	4.0	2.5
Employment regulation	22.4	35.6	23.2	14.0	4.8	2.4
No access to micro credits (or a complete lack of it)	25.6	31.6	23.2	14.0	5.6	2.4

Note. 1 – 'this is not a problem'; 5 – 'this is a very serious problem'.

Source: Own calculations based on the data collected.

Regulation of prices, in particular, as mentioned above, is ranked 6th in the list of 16 chosen obstacles for the development of SMEs named above. About 70% of all respondents estimated the administrative burden, coming from the price regulation with the marks "3" and higher (meaning that this problem is essential) (table 1). It receives average mark 3.0, not much lower than the most troublesome regulatory impediments (taxation, inspections and fines, excessive paperwork, licensing, provision of permits, which take average estimates 3.3-3.1). Comprehensive price legislation and high penalties for not meeting its norms, hamper the functioning of Belarussian SMEs. As we will show later, according to our research, price regulation causes the diversion of labor, time and financial resources, increases costs and prices, and does not lead to the prices' growth retardation, as aimed by the government.

3. Price regulation for SMEs: costs and efficiency

3.1. Legislation in the field of price regulation

Governmental agencies in Belarus conduct price regulation by fixing prices⁴, setting price and tariff limits, maximum markups (discounts), maximum standards of profitability, used for the estimation of profit included in the regulated price (tariff), establishing the method of setting and using prices (tariffs), and price registration. The above mentioned regulatory measures apply to separate types of enterprises depending on the goods they produce, status they have in the market, type of ownership

³ In the majority of cases of pair correlation (Spirman's) coefficients exceeded 0.25 at the probability level 0.001.

⁴ Price (tariff) fixing in Belarus refers to the state-owned enterprises, that are not part of the analysis in this paper, and, thus, will be put aside.

they belong to. Still, some measures of price regulation apply to all types of enterprises, including SMEs.

Administered prices (tariffs) are used, according to the Belarusian legislation, for the enterprises with the market share dominance (monopolies)⁵, as well as for the enterprises that produce separate 'socially-important' products (goods and services). Therefore, big enterprises, producers of 'socially-important' goods and monopolies suffer the most from the existing price regulation system. But in fact, this system has the negative influence on all kinds of enterprises, including SMEs and foreign companies. An enterprise could be only formally dominant⁶, and fall under price regulation. It also can be regarded as a monopolist in the local market and fall under the regulation of prices and profitability. Regulation of prices (and profitability) for enterprises, producing 'socially-important' goods limits the operations of SMEs in this field.

Besides all the mentioned above measures of price regulation, prices of any enterprise in Belarus can be increased only by the size of the maximum index, determined by the Council of Ministers. If the index (about 6-8% per year) can not be maintained, economic agents are obliged to register the new price and justify the reason for not keeping up to the fixed limits. Exception from this rule is made for self-employed entrepreneurs (sole proprietors), paying unified tax or falling under the simplified taxation system, as well as for the enterprises with foreign capital.⁷ All enterprises are also obliged to provide economic justification of prices and calculations in special forms, fixed by law.

Breaking the rules of price registration, or the absence of economic calculations of prices leads to fines for SMEs, up to 30% of the cost of sold goods. Fines increase in case of repeated violations of price registration.

All the above measures demand considerable time, labor and financial resources of enterprises. And, thus, hamper their competitiveness and development. Beside that, rigid regulation of prices in the country negatively affects the business climate.

3.2. Price regulation as viewed by entrepreneurs

The main goal of price administration in Belarus is to restrain the general level of prices and control inflation. However, according to the surveys, conducted by the IPM Research Center such measures are not efficient. Most participants of the focus groups in the Belarusian regions, representing small and medium-sized enterprises stated that if the prices are deregulated, the prices of their produce and general level of prices in Belarus are not expected to increase. Some entrepreneurs anticipate separate short-term outburst of prices, but, according to their view, several months after, competition and effective demand would bring the prices down to the initial level; and, probably, in some cases, would lead to the decrease of prices.

The growth of prices and inflation indicators in Belarus currently depend mostly on the current policy of the National Bank. SMEs (and most of other enterprises, including state-run) don't have sufficient influence on the inflation parameters. The main factors, determining the price level, according to the survey, are taxation, prices of com-

⁵ They are included in the State Register.

⁶ Antimonopoly legislation is rather rigid in Belarus. It includes the provision on the dominant position of an enterprise, measured not only by the share in the whole Belarusian market, but also, in the local (regional) markets (more than 50%, including local or regional level). Moreover, incomplete statistics and 'grey' imports turn enterprises, operating at competitive markets, as well as innovating (since any company that produces innovative goods is treated as having a dominant or even monopoly position in the market) into 'monopolists'.

⁷ President Decree «On some measures for price (tariffs) stabilization in the Republic of Belarus», 19.05.1999, №285, with amendments 1999-2007, Council of Ministers Decree, 18.06.1999, №944.

petitors, costs of production, and consumer demand. Pricing and profits legislation as a factor determining the level of prices, comes only eighth (table 2).

Table 2. Major determinants of prices set by your company for goods produced (services offered)

	The number of SMEs	%
Taxation	192	46.8
Prices of competitors	177	43.2
Production and sales costs	175	42.7
Consumer demand	151	36.8
Rental payment	135	32.9
Wholesale prices, supply prices	134	32.7
Public utilities (tariffs for electricity, heating, etc.)	90	22.0
Legislation regulating profits and prices	68	16.6
Other	4	1.0
No answer	3	0.7
Total	410	100.0

Source: IPM Research Center.

Therefore, high tax rates and their numerosity in Belarus is one of the major factors, affecting the level of prices set by SMEs, and it comes upon the ultimate consumers. Prices are also primarily determined by the level of consumer demand and competition, not so much by the legislation in the field of price regulation. Besides, as focus group and discussions with entrepreneurs show, the existing legislation contains provisions that make some manipulations with costs and prices possible; and enterprises are able to set the prices at the desired level, complying with the law. At the same time, SMEs are obliged to follow the requirements of complicated price regulation and divert resources to it.

Only 8.4% of the surveyed by the IPM Research Center in 2006 entrepreneurs consider limitations caused by the price administration insignificant for their activity. Among the obstacles caused by price regulation respondents have named unstable and unpredictable legislation in the field of price setting, contradictions in legislation, and considerable paperwork needed to meet the requirements of price administration by the government (table 3)

Table 3. Major problems of pricing regulation, (%)

Problems	Complexity estimate:					Average score
	1	2	3	4	5	
Instability of legislation, frequent changes in legislation	6.0	23.5	29.1	25.1	16.3	3.21
Inconsistency of legislation	8.4	23.2	30.4	26.4	11.6	3.08
Excessive paperwork necessary to follow price regulation procedures	6.8	29.5	31.1	18.3	14.3	3.02
The need to use state-provided prices	11.2	24.7	35.5	17.1	11.6	2.92
Unequal opportunities for price increases between private and state-run enterprises	11.6	28.7	28.3	18.7	12.7	2.92
Calculation of target and reported calculations	8.4	28.7	39.0	18.3	5.6	2.84
Profitability regulation	10.8	31.1	29.1	19.9	9.2	2.84
Regulation of discounts and price decrease	10.4	31.5	29.1	21.5	7.6	2.83
Determination of cost items (i.e. expenditures that can be accounted as costs)	12.9	26.9	32.5	18.9	8.8	2.83
Regulation of price increases	9.2	27.9	40.2	16.7	6.0	2.82
Considerable expenditures of time and labor to calculate prices and follow the requirements of price regulation	8.0	31.6	34.8	18.8	6.0	2.81
The need to register new prices	9.6	31.9	34.7	15.9	8.0	2.80
Difficulties with obtaining information	28.4	36.4	22.0	8.4	4.4	2.25

Note. 1 – 'this is not a problem'; 5 – 'this is a very serious problem'.

Source: Own calculations based on the data collected.

The three above mentioned obstacles (unstable and unpredictable legislation in the field of price setting, contradictions in legislation, excessive paperwork necessary to follow price regulation procedures) have received the highest number of negative estimates by the respondents. The total number of respondents, for whom these three administrative barriers caused considerable problems, amounted 30-40% (columns

with the estimates 4 and 5 in the above table). These barriers characterize the general legal framework of price administration.

Factor analysis allowed grouping the price administration obstacles into 5 factors, which sum up the interrelations between the price regulation burdens. They can be named as follows⁸:

1. Separate provisions in regulation and calculation of new prices (regulation of price increase, regulation of discounts and price decrease, the need to register new prices, calculation of target and reported calculations);
2. Unequal conditions in price setting and excessive paper work (the need to use state-provided prices, unequal opportunities for price increases between private and state-run enterprises, excessive paperwork necessary to follow price regulation procedures);
3. Inconsistency and instability of legislation (inconsistency of legislation, instability of legislation, frequent changes in legislation);
4. Cost and profitability regulation (determination of cost items (i.e. expenditures that can be accounted as costs), profitability regulation, considerable expenditures of time and labor to calculate prices and follow the requirements of price regulation);
5. Lack of information in the field of price regulation (difficulties with obtaining information).

The obtained factors explain 79.5% of the total variance, which indicates high significance of analysis. It also confirms that the problem of price regulation is complex. As such, it can not be reduced to the absence of opportunity to set prices freely. Bulky, unpredictable and non-transparent price regulation is a great obstacle for business development in Belarus. It brings high costs of several types.

3.3. Costs of price regulation for SMEs

The most problematic price regulation procedures are preparation of cost-information reports (mentioned by 50.1% of respondents), registration of new prices (43.3%), preparation of routine calculations (38.5%), and others. These procedures 'consume' lots of SME resources. Numerous calculations and reports as well as the registration of new prices require specific knowledge of specialists, involved in these procedures. Moreover, they take time and other resources of SMEs (e.g., part of profits should go for the salary for specialists, involved in price setting, administration and registration). Tough price regulation also makes some enterprises less flexible, and more vulnerable in front of foreign competition. Besides, fines for all kind of mistakes in the field of price regulation are also high.

Taking into account all the resources and costs needed for meeting the requirements of price regulation, and the low effect it has on the final prices, one can conclude that price regulation, at least for SMEs, unproductively diverts their resources. These resources can be invested in other SME activities or to lower price levels.

Another important issue is how much resources price regulation takes. According to the survey, 2.75 workers at an average SME deal with the calculation of costs, price setting and registration at the relevant governmental bodies. Each of these employees spends about 46 hours per month (or about 6 working days) on performing these functions. Naturally, these figures are averages and tend to vary depending on the size of the enterprise and industry (table 4).

⁸ Chubrik, Fadeev, Glambotskaya, Kozarzewski, Rakova, Shymanovich (2007), <http://www.research.by/pdf/business2007e.pdf>

Table 4. SMEs costs to fulfill the rules of pricing regulation legislation

	How many people calculate costs and prices at your enterprise?	How many hours per month are spent to fulfill the rules of pricing regulation legislation?	Imagine that the administrative regulation of prices is abolished in the country. What would be time saved by your company? (number of employees)	Imagine that the administrative regulation of prices is abolished in the country. What would be the savings on costs at your company? (USD per month)
<i>Field of Business</i>				
Trade	2.77	39.73	2.29	907.34
Catering and domestic services	2.19	52.52	2.07	560.00
Industrial production	3.19	43.17	2.44	1170.41
Construction	3.14	72.49	2.44	1062.33
Transport and communication	2.76	70.94	3.33	872.73
Other	2.34	26.65	2.00	929.17
<i>Size of the company</i>				
From 1 to 10	1.60	31.17	1.28	473.71
From 11 to 50	2.73	52.15	2.10	900.81
From 51 to 100	3.84	50.07	3.26	1785.90
From 101 to 200	5.79	62.40	5.91	960.00
Above 200	8.80	112.00	9.00	933.33
<i>Average</i>	<i>2.75</i>	<i>46.00</i>	<i>2.31</i>	<i>841.00</i>

Source: IPM Research Center.

In industrial production and construction (due to specifics of these branches of industry, complexity of costs and prices' calculations) comparatively more workers deal with price calculation and administration than in other fields. Respondents, belonging to these economic branches also expect higher time savings in case of price deregulation.

Bigger SMEs also spend more time on average on meeting the requirements of price regulation. Accordingly, there could be higher, on average, saving of time and other resources in case of price deregulation.

Abolition of price administration by the state, according to the survey, could give the saving in costs expressed by 2.31 workers that currently deal with the calculation of costs and prices, and meeting the requirements of price regulation. In financial terms saving in costs could total USD 841 per month on average. Thus, cost saving for an average enterprise from abolishing regulation of prices per year could give USD 841*12 months = USD 10 thsd. At the operating Belarusian SMEs⁹ cost saving for the economy as a whole could total USD 350 m per year, or about 1% GDP.

Of course, the calculations of costs of excessive price regulation are rather approximate and should be approached with care. Nevertheless, there is no doubt that financial and labor resources employed by private business to fulfill the bulk of legislative rules could be diverted to a more productive course. Such diversion could then help cut costs, bring additional volume of investment, and/or reduce prices, strengthening competitiveness of national SMEs.

4. Conclusions and policy recommendations

In common with the other regulatory barriers for Belarusian business (complicated time- and cost-consuming procedures of licensing, certification, high taxation and instability and uncertainty of legislation, etc.) price regulation appears to be a considerable obstacle for the SME development. Numerous norms and requirements, limits and procedures require lots of resources from Belarusian producers in terms of time and money, and, therefore, puts price legislation on the 6th place among all kind of administrative barriers. Noncompliance with the norms of price regulation incurs high penalties.

⁹ Their number is 35 thsds.

Meanwhile, the tough price regulation, for the production of SMEs in particular, has little (if any) influence on inflation rates in the country. Rather on contrary, expensive regulations and taxes cause price increase. In some cases prices in Belarus are higher than in the neighboring countries. The level of prices and inflation in Belarus depend mostly on the monetary policy of the National Bank.

As our analysis shows, procedures performed by SMEs to follow the requirements of price regulation are rather costly. According to our data, 2.75 workers at a average SME deal with calculation of costs and prices, meeting just the requirements of the legislation in the field of price setting. Abolition of governmental price administration in Belarus could give the saving in costs for an average enterprise around USD 841 per month. If we extrapolate this number to the whole economy, saving in costs from the deregulation of separate norms of price administration could give around 1% of GDP. These resources, currently involved in fulfilling the requirements of the price legislation could be used more productively in other fields of SMEs businesses (marketing, exporting etc.) or directed towards lowering the existing level of prices.

Thus, reforms in the field of price regulation, allowing enterprises independently set prices for their production, simplification of price registration and price alteration procedures up to their abolition, are necessary. In this context the following measures could be considered by the government:

- Simplification of price registration and price alteration procedures, up to their abolition; price declarations should be abolished, calculations of prices should be left for internal use by the SMEs;
- More individualized approach should be applied in determining the dominant position of an enterprise in the market for the respective enterprises, SMEs in particular.

Liberalisation of prices should lead to decreasing costs, inspections and penalties, simplification of business environment in Belarus. It should lead to increased efficiency of SME operations, as well as to their increased competitiveness in the internal and external markets.

Authors: Anastasiya Glambotskaya, Elena Rakova.

Lector: Irina Tochitskaya

Minsk, October 2007