

It is better to Remain Small and Invisible. Informal Barriers to the Development of Small and Medium Enterprises in Belarus¹

Part II²

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Abstract

This paper is focused on informal relations between state authorities and business, which exist in a peculiar Belarusian economic system, where the competition remains restricted, and the public sector based on large companies continues to play a crucial role. The author argues that the Belarusian public authorities have developed a broad set of informal rules which allow them to extract resources from small and medium private enterprises (SMEs) and control the expansion of the private sector. He also argues that as long as informal extractive institutions designed and maintained by the state remain in place, the improvement of formal business regulations alone will not produce the expansion of the SME sector. In author's opinion, an extra-legal extraction of funds and informal discrimination against small and medium private enterprises are embedded in the logic of the centrally planned economy, which Belarus has preserved after the fall of the Soviet Union. This paper may also help to understand how SMEs operate in many other economies of the post-Soviet area and what obstacles to the development they face.

Keywords: institutional sociology, informal institutions, small and medium enterprises, Belarusian economic system, economic transition, regulatory reform

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2. Informal Barriers to the Development of Small and Medium Enterprises in Belarus

2.1. Informal Extractive Institutions and the Belarusian Economic System

The lack of motivation for developing business described in the previous part is difficult to explain by analyzing only state regulations and macroeconomic factors. Many entrepreneurs argue that the main obstacles to the business activity reside not in the laws, but in the unwritten rules that state authorities impose on business. Some interviewed entrepreneurs stress that without compliance with complicated set of informal rules any significant business activity in Belarus is impossible.

Belarusian SMEs are confronted to the set of practices which are not formalized, but they are stable, repetitive, and uniform across the country. They are supported by the system of sanctions. The rule breakers are immediately penalized by state officials. In other words, one can tell about important informal institutions that regulate the relations between business and the state. There are strong reasons to affirm that such informal institutions make the expansion of business very costly. At the same time these informal rules ensure the stability of Belarusian economic and political system.

Usually the emergence and persistence of informal institutions in the transition countries is explained by weakness and inefficiency of the formal state institutions. However, several researchers of post-Soviet states (Nureev 2004; Gans-Morse 2011; Darden 2002; Gelman 2004) argue that state authorities can deliberately create informal institutions which contradict or circumvent formal laws. The goal of this deliberate informalization is to keep the power position or to extract rents from the economic system.

This idea, that political leaders may intentionally establish informal institutions and exercise their power in a manner which contradicts their own laws, is continued in the works of Russian sociologists Olga Bessonova (2006) and Simon Kordonsky (2007, 2008). They argue that political and economic systems of Russia and several other post-Soviet countries function in a way very similar to the Soviet command economy. These systems are based on institutions which forcibly extract resources

from different economic actors, including private business, and then redistribute accumulated resources among priority industries and privileged social groups. These extractive institutions survived the collapse of the USSR and reemerged after the state power was stabilized. While in the Soviet times these institutions of extraction and redistribution were formal, now they have rather informal nature. They are hidden behind Western-looking legal norms.

According to Kordonsky (2008), the 'distributive' or 'resource-based' state produces a peculiar social hierarchy. The position of each social group and the share of resources it receives from the state depend on the importance of this group for the state power. Private entrepreneurs in such system are much less important for the state authorities than bureaucrats, law enforcement and army officers. Therefore they have to contribute to the state much more than they get back (Kordonsky 2008: 28).

Belarus fits quite well to the model of 'distributive state' presented by Kordonsky and Bessonova. The institutions inherited from Soviet times (e.g. dominance of the state sector in the GDP, state planning, massive social spending through state enterprises, non-market exchange with Russia) still define the logic of the Belarusian economic system. In Belarusian economy, identically to the model described by Bessonova (2006), the private sector plays only complementary role to the dominant state-controlled economy and the interests of private firms remain subordinated to the interests of state enterprises. Private sector serves as source of rent, produces goods and services that the state does not want produce, and it serves as a source of innovations which the state can borrow. The share of the market in the resource economy increases only in times of crises, when state-controlled sector cannot produce enough resources needed for redistribution (Bessonova 2006: 37). Informal institutions which regulate the relations between SMEs and local authorities in Belarus provide additional valuable information on how the Belarusian 'distributive economy' is working in practice.

1. Instrumental Use of Complicated Regulatory Environment and Application of Fines as Informal Taxation Mechanism

As it has been already noted, the majority of the informal practices identified in this research are aimed at extracting financial resources from private business. Regular fines imposed on SMEs are among the most common tools of which help state authorities to extract funds. About 38 central state institutions and their divisions are entitled to carry out inspections of business in Belarus (President of the Republic of Belarus 2012). The most common are the inspections of tax authorities, ministry of emergencies (fire inspections), ministry of energy, ministry of environment, and

ministry of labor and social protection. As the majority of entrepreneurs argue, state inspection cannot leave enterprise without imposing fine. Only the amount of the penalty can vary. One of the respondents laconically described the nature of inspection procedure in Belarus in the following way:

The inspection comes with a goal to find something and to impose a fine. It is always like this because the inspectors have to fulfill their plans for collecting fines. They come and openly tell that. If you start arguing with them, they will dig deeper; they will find something serious and impose you a huge fine. If you don't argue – they will find just a small thing and impose just a symbolic fine (Respondent No. 17, food products retail, Viciebsk region).

According to the entrepreneurs, inspection bodies at the district level have plans of collecting money for the state budget. These plans are established by executive power in each district. If inspectors do not find a necessary amount of infringements, they are punished. Sometimes they do not even insist on the improvement of the deficiencies they found. It means that their main goal is not to make the entrepreneurs compliant with state regulations but simply to collect funds. Regular fines play a role of informal tax.

It is important to note, that in recent years the frequency of inspections decreased. Since 2011 inspecting bodies are obliged to carry out regular inspections no more often than once a year. However, majority of inspecting bodies preserved the right to organize extraordinary controls. Their number usually rises by the end of the year when local authorities need to catch up with the tax collection plans.

2. Forced 'Corporate Social Responsibility'

Second very important and widespread informal practice is forcing private enterprises to finance or directly realize public projects.

Once you are open, the head of the district executive committee (head of the executive power in the district – main administrative division unit in Belarus– A.P.) will come to you and say: 'You should plant a grass plot in front of your office and repair the pavement. You should finance the construction of a stadium, children's hospital and swimming pool in your town.' We wanted to start the production of windows. After delivering 500 windows to the kindergartens and state officials' houses, we had to close the business. We had no money anymore, and none of the officials paid us (Respondent No. 4, food retail, Minsk).

According to many entrepreneurs, delivering unpaid services to the state is a daily routine of small and medium firms. SMEs have to maintain the territory assigned them by the local authorities. They have to subscribe to the local state-owned

newspapers, to finance the development of infrastructure and construction of the public facilities such as schools or hospitals. In the rural area small businesses are often obliged to support state agricultural enterprises in the times of sowing and harvest. They buy fuel for their own money or even provide their cars.

The assignment of the tasks and amounts of money which should be delivered to the state bodies is done by the heads of local executive power. Entrepreneurs are given orders on the meetings with the head of the district executive committee or his deputy responsible for economic matters.

They say: 'We need to build a church. Or to put paving tiles on the street. Or to pay 500 dollars of salary to each worker. And nobody is interested how you will do it. The head of the executive committee gathers all the entrepreneurs and assigns the tasks. But he does not give us any written document. Everything is unofficial (with the fear in the voice). – What will happen if you refuse? – To be honest, nobody dared to risk (Respondent No. 16, retail trade of construction materials, Viciebsk region).

Many entrepreneurs argue that local authorities may revenge on the reluctant entrepreneur by initiating a set of inspections. Visits of the sanitary inspection, fire inspection, and tax authorities will result in huge fines and may lead to the firm's bankruptcy. However, some entrepreneurs argue that the rule breaker will be just isolated and will lose the access to the lucrative contracts.

In some cases state officials extract necessary resources from business by blackmailing entrepreneurs with their alleged non-compliance with cumbersome regulations.

Trade in electronic parts is the business when you will always find infringements. According to the law, every computer in each configuration should be certified. It is just impossible! If the client does not want, let's say, 10 Gb HDD, he wants 100 Gb on his computer; you will put it there without certification. State authorities use it. Once they came to a certain firm, they arrested the property and said: 'We need 500 computers for the National Library. If you deliver them, you will work'. So the firm did it (Respondent No. 8, software production, Minsk).

Individual entrepreneurs are too small to engage them into the realization of public projects or to extract funds directly. Therefore local authorities extract resources in indirect way. They address the owners of the premises where individual entrepreneurs work. The extraction of money from one-person enterprises happens through the increase of the rent prices.

3. Attack on Property Rights: Extortion of Property and Forced Inclusion into Patron-Client Networks

Another type of barriers relates to the vulnerability of property rights. Many entrepreneurs admit that the state bodies may confiscate their property and their firms may be put under the control of the state officials. These takeovers may be well concealed and carried out under the guise of legality.

As respondents declare, public entities remain the main owners of the premises in Belarus. In the capital, as well as in the regional cities premises are usually in hand of municipalities, state-owned enterprises, or the Administration of the President of the Republic of Belarus. This situation makes SMEs very vulnerable to the pressure of local authorities or competitors having connections with them. Local officials may refuse to extend leasing agreement or cancel it at any time; as a result, an entrepreneur may lose his investments.

Leasing agreement is usually valid for three years. If you have bad relations with the owners, or some more influential competitor finds your premises attractive, they will not extend your leasing agreement. They may find any pretext for this: they may declare, for instance, that your façade is not properly painted, even though it is the owner who is responsible for the exterior. All these risks make you understand: today you have this business, but tomorrow you may lose it (Respondent No. 21, beauty salon owner, Minsk).

The interest of the public authorities to the private business rises with the increase of the firm's size. Entrepreneurs are asked to deliver more and more. As some experts and entrepreneurs argue, after the income of the enterprise rises above a certain ceiling, the firm may become subject of extortionist attack. The goal of this attack is either to extract a big amount of money or to subordinate the firm to the state-controlled structures. In such way public officials transform private enterprise into a stable source of rent for public institutions. According to the entrepreneurs, a firm may attract the interest of the inspection bodies if the income per person employed overcomes 10 thousand USD per months.

One day very competent well-dressed people will come to your firm and will inform you that starting from now you will work according to a new scheme. Now all the goods your enterprise buys will be delivered by the firm they designate. Your enterprise will also sell all its products through the firm they will propose. These firms will take the

biggest part of the profit. They will leave you only the amount of money needed to maintain your previous level of life (Respondent No. 14, financial analyst, Minsk).

According to the expert, the firms included into such patronage networks cease to be enterprises. They do not take entrepreneurial risk; they always work with the same clients. In the other hand, state officials ensure them stable profit. They eliminate competitors and give these firms privileges. Such firms become elements of the state-controlled economic system. They serve as a source of rent for public institutions.

4. Preventing SMEs from Entering Local Markets and Rent Extraction: Capitalization of Power, Parasitism, and Rigidity of Economic Policy on Local Level

The fourth category of informal barriers to the development of SMEs contains various practices of state officials which have a common feature: state authorities close local markets for private small and medium enterprises. The reasons for this ban may be different – from unwillingness to receive corruption rent through intentions to support state-owned enterprises to a simple lack of motivation in the development of private SMEs on the entrusted territory.

Some informal extractive mechanisms take ‘classical’ forms, well described in the studies on corruption. For instance, state officials in Belarus often capitalize their power. They transform the power given them by the office into a source of income. Local authorities can help their relatives to establish enterprises and then eliminate all their competitors from the market. They may issue regulations obliging local SMEs to buy goods and services from the firms included into their ‘resource base’.

In this case the boundaries between classical corruption and the actions in the interest of the state become blurred. By giving some firms monopolistic position on local market state officials may try to ensure stable work of the enterprises which provide funds for public projects. They equally may give preferences to the firms which provide state bureaucrats with personal illegal income. They even may pursue both goals at the same time.

The main goal of standardization initiated by local authorities is to provide the enterprises they control with the contracts. For instance, you are a vendor working in a kiosk. Suddenly local authorities inform you that your kiosk should be of certain type and dimensions. There is only one firm producing such kiosks in the city. Surprisingly enough, this firm is affiliated with an official from the city executive committee (Respondent No. 14, financial analyst, Minsk).

It seems important to describe here another form of extraction of the status rent, although it does not consist in blocking access to the local market. This informal extractive activity might be called 'parasitism.' Bureaucrats often ask entrepreneurs to employ their children or other close relatives. In exchange, state officials set her propose SMEs some protection and more tolerant treatment or threaten entrepreneurs with sanctions. According to some respondents, state officials' trusted people usually occupy positions which are well paid but do not require taking responsibility. Although entrepreneurs who hire state officials' relatives quite logically expect protection, in some cases, such practice may bring opposite results. Several respondents described the cases when the enterprises hiring state officials' trusted people faced the danger of being taken over or pushed out from the market.

I have a very good friend who produces polyfoam. When his business was rapidly growing, an inspection came. One of the inspectors told him: 'We want you to hire my son, to show him how to work. Frankly speaking, we want to set up an identical enterprise. We can even invite you to work for us as a manager, and we are ready to pay you 2000 US dollars per month under the condition that my son will become your deputy.' My friend told them: 'You know what will happen in 6 months? You will tell me that you will not able to pay me 2000 US dollars per month anymore. Your son will get experience and will declare that I am not needed anymore. You will propose me just 200 dollars of salary because you will look forward to me leaving' (Respondent No. 25, catering, Brest).

The goal of the monopolization of local markets is not always a state officials' private enrichment. Often local authorities remove competitors to support local state-owned enterprises and to help their regions and districts to meet plan targets. Private firms competing with SOEs may be removed from the market under the pretext of non-complying with technical standards or sanitary requirements. Local authorities may informally forbid both private and state-owned firms operating in retail to buy products from other regions. Even SOEs may have difficulties in penetrating markets of neighboring regions. These monopolistic practices are especially visible in rural areas where there are much fewer jobs than in cities.

If some goods are produced in one region (oblast), it is very difficult to sell them in another one, except for Minsk. Regional authorities do not like the competition. Every regional executive wants only 'their' sugar factory making profit and paying taxes. The same is with alcohol production; the same is with mineral water. Products from other regions of the country are rarely allowed. The problem is that the retail in regions belongs to state-owned structures. Regional authorities openly forbid them to buy

products from other regions, and they obey (respondent No. 29, business consulting and journalism, Minsk).

Another practice the state authorities use in order to protect SOEs consists of prohibiting state-owned enterprises to cooperate with private firms. Directors of the state-owned enterprises and heads of public institutions are discouraged from subcontracting private firms. They are obliged to buy services and goods only from state-owned enterprises. Entrepreneurs complain that many public procurement bids are designed in a way which gives preferences to the SOEs. In some areas, like agriculture or woodworks, there are quotas on raw materials that state-owned enterprises can sell to private firms. In most of the cases, however, such discrimination of private sector finds no support in official regulations.

The last informal barrier which will be described in this section can be named 'the rigidity of economic policy on the local level.' Local authorities may hamper the development of SMEs if their activity does not correspond to the plans which local bureaucrats should implement. State officials cooperate with private business as long as the plan targets imposed from above coincide with the goals of entrepreneurs and as long as the cooperation with SMEs does not require too much effort, taking responsibility and risks. If a new business activity complicates state officials' life or deteriorates some of their statistics, they will oppose it. A good example of such practice was provided by one of the respondents who wanted to start a production of polymer roof tiles but had to give up due to unfriendly attitude of an environment protection inspector.

I assembled all the equipment, and I decided to invite an environment protection inspector to check my production site. The inspector came, took a look around and left without even entering the factory. ... The next day I came to the district executive committee and received a protocol prescribing me to pay 100 basic units³ (bazovaya velichina) of fine. He told me that I was fined for storing an asphalt pile in the open air on the factory's territory. It turned out that the asphalt needs special storage conditions! I was not the one who put this asphalt there. It used to be a completely abandoned farm. I bought and restored it. This pile had been there for 20 years and would have been for 20 years more if I haven't bought it. I addressed the court, in 6 months they repealed the fine, in the meantime, I removed this pile. The inspector visited my factory once again and again fined me 100 basic units without even entering the production hall. I asked

³ Amount of money used as a reference for the calculation of fines and social security benefits. The value of the basic unit is defined by the Council of Ministers. Since 2004 its amount approximately equals 10 US dollars.

him: 'Why? I have removed everything!' He told me that I did not do it immediately after he ordered me; therefore I had to pay a fine. I went to court again, and this fine was also repealed in 6 months. Then he openly told me: 'I do not need such production on the territory under my control.' Indeed, why should he need a factory recycling the polyethylene waste? It will only cause him troubles. It is easier to close it (Respondent No. 41, retail trade of construction materials, Homiel region).

Surprisingly enough, many Belarusian entrepreneurs do not perceive extortionist activity of the state bodies as particularly painful or abnormal. They accept the rules of the game imposed by the state institutions. It is reasonable to suppose that in exchange for regular rent extraction they receive some privileges. These bonuses may be elimination of competitors, or guarantees of stable and high income.

However, the interviewed entrepreneurs declare that the cooperation with the state authorities do not give any benefits. The only bonus they can get is the opportunity to operate on the market and earn more than average Belarusian citizen does. They may also expect that in exchange of cooperation with local authorities, they will obtain more favorable treatment by inspection bodies and some guarantees of property rights. However, as the majorities of interviewed SMEs argue, such hopes usually remain unjustified. Close cooperation with state authorities cannot protect business people against extortion if the state apparatus feels need in additional resources.

If Belarusian entrepreneurs are still active on the market it means that they found the way to function in the Belarusian economic system. The ways they adjust to the peculiar institutional environment are described in the Chapter 3.

3. Adaptation Practices of the Belarusian SMEs

3.1. Choice of Business Activity

Belarusian small and medium enterprises have developed a set of practices which help them to accommodate unfriendly and risky business environment. These adaptation practices allow to diminish loses resulting from extortive activities of the state bodies, maximize the income and create some protective 'buffers' which can be

used in emergency situations. However, all these adaptation practices do not allow to overcome the challenges the entrepreneurs face.

First adaptation practice is, in fact, the very choice of the business activity. Entrepreneurs are aware of the risks they may face. Therefore they chose the areas where there are less legal obstacles, where do not require a complicated circulation of documents, and which are less vulnerable to macroeconomic risks. They also chose the spheres of activity which guarantee quick return of the invested money. Entrepreneurs usually start businesses where sunk costs are low and which do not require long-term planning. Such sectors are among others, retail, IT or transport services.

One chose the area of activity which will attract less attention of the fiscal structures. Everybody knows that it is better to maneuver, not to go to spheres where the risk of being taken to responsibility is high. People try not to invest in fixed capital: production premises, offices, etc., because under certain circumstances one may easily lose it. Those who start a business first think what they can lose, what problems state authorities may cause to them. Only people having the support of state authorities dare to take a risk and to invest much money (Respondent No. 20, car retail, Minsk).

3.2. Operation in the Shadow Economy

Probably the most common adaptation practice used by Belarusian SMEs is hiding their income from fiscal authorities. According to some experts, about 30%–35% of the Belarusian economy remains in the shadow (Daneyko 2014; Zayats 2015). The entrepreneurs and experts interviewed during this study also declared that about 30% of money earned by small and medium enterprises remains unreported.

Have you ever thought why the economic performance of private farmers in Belarus is so low? The total surface of their fields approximately equals the surface of the fields in every one of 118 Belarusian districts. Their agricultural production also equals the production of state-owned farms in one average district. However, everybody sees that private farms are several times richer than state-owned ones. Why then are the statistics so poor? Because the farmers hide their income. They avoid paying taxes. Every third ruble earned by our people is hidden from the state. According to the statistics, our farmers are poor. However, none of them goes on horse-driven wagons. Everybody drives Mercedes (Respondent No. 6, economist, Minsk).

One of the most popular practices is underreporting the volume of salaries which entrepreneurs pay to their employees. Many firms pay officially about a half of the salary while the rest is paid 'under the table.' Respondents explain that SMEs decide to pay 'salaries in envelopes' (*zarplaty v konvertakh*) because they find the tax burden exaggerated, do not trust the state and do not find the quality of public services adequate to the money they pay.

If you want to pay 100 million of salary to your employees, you have to give additional 50 million to the state. In Sweden, of course, the taxation is higher. However, there they have such high income, that they can live for the share of salary which left. In our country, one can only subsist. Therefore it is more rational to give this part of salary directly to your employee than to give it to the state (Respondent No. 31, wholesale trade in construction materials, Minsk).

As one of the interviewed experts explained, the 'salaries in envelopes' are reduced only in times of crises. Entrepreneurs whose companies have difficulties prefer not to lay off employees, but to decrease their salaries. They reduce the unofficial part of wages in the first place. Therefore official statistics about the decrease in salaries may not reflect the real reduction in population's income.

Another way to avoid taxation is to underreport a firms' income. Some SMEs carry out a significant part of operations in cash. Others try to use the electronic money, which circulates by the channels remaining outside the Belarusian tax officials' control. However, the Belarusian state gradually increases the control over the e-money flow. Many SMEs transform noncash money into cash reserves to hide them from the tax authorities.

Firms' owners spend cash reserves on paying informal part of salaries to the employees. They also serve as insurance against crisis situations. They are spent on fines, on the compensation for damages related to quick changes in the macroeconomic environment. SMEs also use this money to finance public projects on state officials' request.

Another very popular tactics to reduce the tax burden is subcontracting work to individual entrepreneurs. Firms register their employees as individual entrepreneurs, because they have lower taxation and should report individually. The salaries are paid in a form of remuneration for contracts performed by those pseudo-entrepreneurs. Such practice is very common but also dangerous. The boundary between tax optimization and breaching the law remains unclear, and therefore it is arbitrarily identified by law enforcement. An enterprise applying such tactics may easily become a subject of prosecution.

A constant necessity to hide infringement produces a practice which Ella Paneyakh (2002a, 2007) calls 'virtual reporting' (*virtualnaya otchetnost'*). Entrepreneurs create documents which are totally disconnected from the firm's real activity and have the only aim to simulate the absence of infringements. In such way, SMEs try to distract the attention of inspection bodies or to complicate their access to the information about the real functioning of the firm (Paneyakh 2002a: 6).

'Virtual reporting' is not only the tool to avoid paying taxes or hiding illegal operations. It is a way to cope with an extremely cumbersome and contradictory legislation. Often SMEs involved in some transactions are not able to submit all required papers. Therefore their accountants need making 'approximate reports.' This system requires a big amount of skillful bookkeepers, to whom entrepreneurs confer very sensitive information.

Accountants have such practice as a tax planning. At the beginning of the year, the director sets a target: by the end of the year, the company should have net profits (or net losses) of a certain amount. Then the accountants should plan the sales, should decide what to show and what to hide if they want to meet this target. Experienced accountants know how to do it. They are additionally paid for this. They start to manipulate already at the beginning of the year because the taxes are too high (Respondent No. 31, wholesale trade in construction materials, Minsk).

Not only domestic constraints make Belarusian SME soperating in the shadow. As some respondents argue, SMEs working with partners in the Eastern Europe do much more unreported operations than those cooperating with firms from the EU.

If a firm works with Russia, it goes without saying that it works in a shadow, because nobody there works in another way. A common practice there is to establish a firm and to work for three years until the first tax inspection visits you. Then you give up your firm. Tax authorities have questions about your firm, but you are not there anymore. You have established another one and work for next three years. Of course, a continuity of your business, a development of your mark is out of the question. However, if your firm is a part of manipulation scheme, the name of your firm does not matter. For instance, yesterday you were Melchior Ltd. Suddenly you closed your firm down and reopened under the name Melchior+ Ltd. The most important, that you remained in the same scheme. It is the essence of business in Russia. Everybody who works in Russia works in the shadow. Here, in Belarus 50/50. Those who work in Europe are as clean as the business there (Respondent No. 40, wholesale and retail trade in construction materials, Homiel).

Taken into consideration that compliance with all legal requirements in Belarus induces much higher costs than operations in the shadow, one may suppose that mainly big firms can afford to work for the EU market with its legality and transparency requirements. Thus the EU market remains closed for micro and small enterprises representing the majority of the Belarusian SMEs.

3.3. Looking for Protectors and Establishing Personal Connections with State Officials

One of the most obvious tactics to protect an enterprise from the extractive activity of local authorities and inspection bodies is to enlist the support and protection of state officials. Indeed, interviewed entrepreneurs declare that they have to seek for good relations with bureaucrats and law enforcement officers. However, in the Belarusian economic system, such relations are not enough to secure business.

In highly regulated economic systems when state officials have a large discretionary power, stable informal connections with public officials may provide firms with a decisive advantage over their competitors (Kordonsky 2008: 99–109). However, interviews with Belarusian entrepreneurs allow to claim that in Belarus such practices are much more common among big firms than among SMEs.

Looking for protectors among state officials becomes a necessity if a firm wants to grow. Especially it is important for the business with high sunk costs, such as manufacturing, construction or agriculture. More ambitious the plans are, higher the level of protectors should be.

A business should protect itself. If you are a serious firm, at a certain stage of development you will have to find a person who will watch over your enterprise. The position and profession of such person depend on the threats from which you want to be protected. If you want to develop your business alone, without such help, you will never grow (Respondent No. 8, software production, Minsk).

In the case of smaller firms, connections with state officials may ensure more favorable attitude of inspection bodies, may help to obtain premises for the affordable rental price, solve some legal problems or get the access to public procurement contracts.

Let's take as example producers of windows. Those one having connections to state officials responsible for big investment projects may get contracts for delivering windows

to schools and hospitals. It is impossible to get such contract without connections. An entrepreneur who does not have connections may work only with individuals, but the volume will be much smaller: a dozen of windows instead of hundreds (Respondent No. 35, small ware retail, Hrodna).

Small and medium entrepreneurs declare that personal connections are a necessary condition for business development but not a sufficient one. Usually, state officials refuse from breaching the law if they are asked to give favors to SMEs because they are tightly controlled and may easily become the subject of a criminal prosecution. Moreover, they cannot guarantee protection in case of serious problems with law enforcement. State officials of the district and regional level can make an exception only for close relatives, as it has been said earlier, in a section describing the phenomenon of capitalization of power.

Small and medium entrepreneurs argue that only the biggest firms in Belarus can find one or two state officials powerful enough to protect their business from the risks coming from different state actors. SMEs have to establish good relations with a multitude of state officials working for local authorities, inspection bodies and law enforcement. Each of these officials is approached when a firm needs to solve the problem belonging to his or her sphere of competence. The task of securing business is getting even more difficult due to the constant rotation of bureaucrats.

Belarusian entrepreneurs, unlike their Russian colleagues, do not perceive law enforcement officers as the most influential protectors (see Gans-Morse 2011). Mainly, they try to establish connections with state officials working for inspection bodies and local administration.

The system of informal exchange of favors or access to scarce resources known in Russia and other post-Soviet countries as *blat* (Ledeneva 1998) also exists in Belarus. However, as respondents argue, among the Belarusian SMEs and state officials the informal networks based on such exchange are weak. It is difficult to expect from state officials long-term relations and help in crucially important matters. Usually, each favor given by a state official requires an immediate compensation.

I was waiting for my business partner in one town early in the morning. He should have already been there, but he was not. He was not picking up the phone. Finally, I asked for help one of the locals, a woman holding a high lawyer position in the local executive council. She immediately gave a call to the head of the local road police. She was told that this day there were no road accidents and nobody died. My partner contacted me later; he had simply lost his phone. However, this woman told me: 'You see – it was just one phone call, but now I have to invite this road police officer to the

restaurant and set the table (nakryt' polianu), because I used the resource standing behind him' (Respondent No. 40, wholesale and retail trade in construction materials, Homiel).

The most common informal practice SMEs use to protect against unfriendly actions of state bodies is a simple maintaining of 'good relations' with state officials of the lowest level. Entrepreneurs try to earn the goodwill of tax inspectors, sanitary control officers, law enforcement officers etc. to avoid penalties. 'Friendly rituals' are a part of the everyday business of SMEs.

My friends give me a call and say that an inspector will come and they are setting the table for her. I buy some luxury fish; others buy Champaign. After the party, we bring her up to the hotel, which has been paid by some other friends. So we expect that the next day, after having good rest she will be more compliant (Respondent No. 4, food retail, Minsk).

As Ella Paneyakh (2002a) well explained, in a system where the costs of compliance with the law are too high, inspectors are fully aware that the majority of entrepreneurs do not comply with regulations and from the purely legal point of view deserve to be punished. However, in most of the cases, they are not interested in finding serious infringements. Making thorough investigation and conflicting with entrepreneurs may take too much time and effort and might not to bring enough reward. Such situation provides conditions for a compromise. In most of the cases, the amount of penalty becomes the result of informal negotiations between inspectors and entrepreneurs (Paneyakh 2002a:14).

When the survival of an SME depends on state officials' goodwill, the institution of 'good human relations' (*chelovecheskiye otnosheniya*) with them becomes very important. These relations are established thanks to some gestures informing that entrepreneurs are ready to transform purely formal relations with state officials into informal ones (Paneyakh 2002a: 14). Small gifts, such as boxes of chocolates, flowers or even invitation to the restaurant are not, in fact, bribes. They are signals that entrepreneurs are ready to solve the problem in an informal way and to establish with state officials some confidential relations.

There are many loopholes in the regulations on advertising. Therefore we have to constantly visit the Ministry of Trade. With a box of chocolate and flowers, we are going to a woman responsible for issuing permissions to advertising games. The interpretation of law depends on her today's mood. We have a law on advertising which omits advertising activity in the Internet and advertising using digital technologies. Therefore you are constantly thinking: 'In what mood aunty Sveta is today?' If she is in a good

one, she will allow you to launch an advertising campaign. If she is in a bad mood, the campaign will not be allowed, and you will be fined. Auntie Sveta has a very large power (Respondent No. 22, internet advertising and software production, Minsk).

3.4. Resignation from Expanding and ‘Social Camouflage’

A very interesting adaptation practice is a conscious resignation from growing. The strategy of many SMEs is limited to finding a niche in the market and staying in it. Enterprises restrict their investments in fixed assets as well as investments in research and development just to the limits needed for keeping their current position on the market. Some of them even resign from advertising. They find clients through personal contacts. In such way, they establish a network of reliable partners which are not interested in diffusing their business secrets. As some respondents explained, they develop their business until the level which may attract too much attention of inspection bodies or until a further growth requires taking such risks as entering into corrupt relations with state officials. After reaching this point, each entrepreneur takes an individual decision whether to grow further and take more risks or to remain at the already achieved level.

One of my friends was working in the real estate business. He had more than one thousand square meters of property. He reached the level when he started to feel the attention of authorities. Then he decided: ‘I do not need more. I have enough money for living; my firm does not need to grow anymore. I do not want to fight with ‘them.’ He started to spend more time abroad and stopped expanding his firm (Respondent No. 35, small ware retail, Hrodna).

Entrepreneurs combine techniques of self-limitation and hiding their profits with sophisticated techniques of camouflage. As one of the respondents formulated, entrepreneurs ‘do not stand out above the level needed.’

As you can see, everything here looks as it were in the deep 1970s. We do not improve the look of our office on purpose. When, for instance, fire inspection comes, the inspector always says that everything is in a tragic condition. He sets a long list of improvements we have to make. This list just makes us bankrupt. I argue that we are poor and cannot make a lot of improvements. Then he asks what we can do. I pick up some points from his list. If he knew what we were really able to do, this inspection

would have ended by paying a huge fine, making costly improvements or paying a high bribe to the inspector (Respondent No. 7, electronics production, Minsk).

Belarusian entrepreneurs are usually very careful in consumption. According to some business people, the Belarusian tax authorities and law enforcement bodies dealing with economic crimes analyze acquisition of real estate or the imports of luxury cars. They organize inspections based on the information obtained from customs offices and real estate agencies. Therefore entrepreneurs refuse from buying houses and cars which can attract the attention of state authorities and make their firms victims of extortionist attempts.

3.5. Operation in Complicated Spheres, Registration of Firms Abroad

As some interviewed experts argued, the Belarusian authorities do not try to control those business spheres where the extraction of stable rent is impossible or where the state officials do not understand how the profits are made. Such spheres may be financial markets or information technologies.

IT business experience the least formal and informal barriers to development. At great extent, a fast rise of this sector in Belarus is explained by the absence of licensing, standardization and certification requirements. The non-material character of production and integration into global economy allows small Belarusian IT firms to escape from rent extraction organized by state authorities.

We have no waybills (nakladnye), no fire inspections, no sanitary controls, and we do not need certifications ... I have never seen somebody coming to us and asking to do something for free. ... I do not even know how to make an IT firm do this. An IT startup does not even need an office. People may meet in the café with two notebooks and work as efficient as they were in the office. It is impossible to come to them and demand money for an office, for a fire safety...I have no statutory fund, no cars, no machine tools – nothing but my personal laptop. It is very difficult to find me fault with something. I have no amortization of fixed assets, I do not participate in the public procurement, and I do not import any goods. In theory, the government can try to find whom I am working for and what products I deliver. However, in this case, they need to install spyware on my computer. I am a programmer – I will find and remove it (Respondent No. 22, internet advertising and software production, Minsk).

Respondents operating in new sectors of the Belarusian economy (design, web design, software programming, internet advertising), similar to their colleagues working in 'older' sectors do not trust the Belarusian authorities. However, they are much more optimistic due to their young age and good business perspectives. The secret of their success consists in their ability to work for the global market. Domestic constraints affect them very little.

To earn in our country, paradoxically enough, one has to be as less attached to the country as possible. One should work for foreign markets and work in Belarusian rubles as less as possible. ... If you want to earn, you should become independent on the country's policy and ruble exchange rate oscillations. A design studio of one of my friends has three offices: in Minsk, Brest, and Miami. A firm of my other friend from Russia is registered in Phuket in Thailand. We are looking for our partners and distribute our products through international websites for designers. We got our first clients from a specialized social network (Respondent No. 24, design, Brest).

Another popular adaptation practice is a registration of firms abroad with the aim to reduce declared income or protect a firm against the instability of domestic regulations. Such tactics are particularly popular among small and medium IT companies and medium firms working in retail.

Respondents say that IT firms prefer to register companies in offshores. The most popular offshore is Cyprus. Its popularity results from its belonging to the EU common market and a high level of banking secrecy. Belarusian SMEs which are operating in retail, prefer to register subsidiaries in the neighboring countries – Poland, Lithuania or Latvia.

3.6. Division of Business and Regular Change of Legal Names

A very efficient adaptation practice is dividing a business into a group of companies. Instead of developing one large enterprise, some Belarusian entrepreneurs choose to establish a set of SMEs having one owner. Such tactic helps to divert the attention of state authorities and to avoid imposing heavy duties on enterprises. If the authorities expropriate several firms or include them into schemes of rent extraction, entrepreneurs have a chance to preserve at least some part of their business.

Now they solve the problem very easily. There is a proverb: 'Do not store all eggs in one basket.' They register 40 small firms with the same director and the same

accountant. They do it in a similar way as they do it in Russia. It is impossible to close all these 40 firms at once (Respondent No. 8, software production, Minsk).

Similar to the work through subsidiaries registered abroad, dividing a business helps to reduce the amount of taxes the main company pays. Some respondents explain that Belarusian firms often buy a good or a service through the chain of formally independent firms. In such way, they increase the price of this good and reduce the declared profit.

Another tactic which is popular at least in the construction sector is changing of legal names. It may be easily combined with the division of the business.

There are sleeping companies which are registered but do not work. When an entrepreneur is closing an old firm, he immediately activates a new one which was previously sleeping. I know a firm which has changed four legal names in the last 16 years. It is very similar to the Russian tactics; however, they close firms every 3–4 years in order not to pay taxes. Our firms pay taxes, but do not do everything ideally from the legal point of view. To avoid eventual problems, they close the firms and state authorities cannot file a claim anymore. As my lawyer says, the best close down is the guided one. If you know that in 6 months your firm should disappear, you do everything to do it smoothly and register a new one. Such managed close downs are very common (Respondent No. 40, wholesale and retail trade in construction materials, Homiel).

3.7. Unpopular Tactics: the Building of Solidarity Ties, Participation in Business Associations and Addressing Courts

Surprisingly enough, interviews taken with representatives of Belarusian SMEs allow to come to a conclusion that they do not try to organize themselves to oppose the challenges of the unfriendly institutional environment. They do not build formal or informal solidarity ties, do not revolt and often do not even complain about the barriers they face. They perceive the extractive practices of state bodies as natural constraints they cannot influence. Therefore they prefer to adapt instead of struggling for the removal of these barriers. The statement of one of the respondents provides a good illustration of how the Belarusian SMEs perceive their institutional environment:

One cannot avoid fines, but I perceive them as external conditions, as rules of the game. I do not try to fight windmills. I try to earn more. However, obviously, it hurts. You are planning, investing a lot of efforts in your enterprise, but everything suddenly changes, and you suffer losses... (Respondent No. 26, transport and expedition, Brest region)

Self-organization is not a popular tactic of protecting entrepreneurs' interests. The share of Belarusian SMEs participating in business associations is very small. Experts from the Belarusian Institute of Privatization and Management (IPM) assess it at about 10% (Pelipas et al. 2015: 72). The popularity of business associations is low because the majority entrepreneurs do not believe that the associations can protect their interests and influence the government's decisions (Pelipas et al. 2014: 69).

Informal solidarity ties among Belarusian SMEs also remain weak. Respondents claim that entrepreneurs in Belarus do not build informal networks, except for tiny ethnic communities (e.g. entrepreneurs from the Caucasus region). Several respondents even confess that entrepreneurs usually do not inform their colleagues about upcoming inspections or do not help families of arrested entrepreneurs, unless they are close friends. SMEs prefer to build individual coping strategies.

Belarusian mentality can be described in one sentence: 'The best place to live is a hut on edge on a remote farm. It's the same in business. You are working in the country, but you know exactly through which border crossing you will evacuate your family and yourself and through which bank you will evacuate your money. You know exactly that nobody will help you' (Respondent No. 40, wholesale and retail trade in construction materials, Homiel).

As it has been already mentioned, a significant part of entrepreneurs in Belarus tries to establish beneficial relations with local authorities, although such tactics do not guarantee success. Instead of uniting themselves and opposing the government's policies, entrepreneurs compete for a 'power resource,' an access to the decision makers. The weak solidarity of SMEs may also be explained by the very nature of the Belarusian economic system where the bureaucrats have a large influence on the business activity:

Entrepreneurs do not have common interests. They are competitors. They compete for the goodwill of a state official who takes discretionary decisions giving advantages to some actors and discriminating the rest. They are queuing up in front to the state officials' doors (Respondent No. 14, financial analyst, Minsk).

Belarusian SMEs very seldom try to protect themselves against extraction activity of local authorities by addressing courts. It is perceived as useless due to the dependency of courts on the executive power. In the political system of Belarus,

the judges of all levels are appointed by the President of the state. The heads of the district courts remain in close contact with the chairmen of district or city executive committees. Many respondents argue that ‘all judicial decisions are taken even before the court gathers.’

The scheme works as follows: a clerk from the executive committee or some high-level official goes to the head of the district court. The head of the district court sends for a judge dealing with a legal case in question and gives him an order on how this case should be solved. The judge does not decide anything. Each case where private and state interests are conflicting is solved by the head of the district court (Respondent No. 20, car retail, Minsk).

Entrepreneurs argue that the Belarusian courts perceive themselves as state institutions and the defenders of the interests of the state. Therefore entrepreneurs believe that they are not able to win litigation if the interests of state institutions or SOEs are involved.

If a physical person makes a plea against an entrepreneur, the physical person will win. If an entrepreneur is at law with the state or state-owned enterprise, the state will always win. Only in case if two enterprises are at law with each other and none of them is at least partially state owned, the dispute will be judged impartially (Respondent No. 41, retail trade of construction materials, Homiel region).

Some of the respondents argue that even if they win a legal case, local authorities may revenge on them. Finally, addressing legal process may take much time and incur costs. Therefore many entrepreneurs prefer to set disputes in an informal way.

It is important to note that entrepreneurs not only avoid protesting against the authorities, or addressing courts, but they rarely reflect about the legality and justice of the extractive institutions they face. As it has been already mentioned, they try to adapt to the constraints they encounter and perceive them as natural conditions of their environment. Many entrepreneurs analyze the situation only in categories of advantages and disadvantages over their competitors from Belarus or abroad. Avoiding taxation, manipulating documents or establishing connections with state officials many of them perceive as a legitimate way to reduce costs, ensure a better position in the market and increase their profit in a very uneasy environment.

Conclusion: Main Findings of the Research and the Explanation of the Informal Barriers' Phenomenon

The comparison of statistical data on the development of SMEs in Belarus and the EU allows to find significant distortions in the development of the small and medium enterprises in Belarus. SMEs contribution to the GDP in Belarus is about two times lower than in the European Union. SME sector in Belarus employs two times smaller proportion of people than SME sector in the neighboring EU countries. In comparison to the EU, Belarusian small and medium enterprises are disproportionately concentrated in trade. Much smaller number of SMEs is focused on providing sophisticated services. Belarusian entrepreneurs prefer to operate in the spheres which do not require high investments and where sunk costs are low. Moreover, several opinion polls that medium-size business in Belarus lacks motivation for growing.

Majority of the studies on Belarusian SME sector explain these disproportions in the SME development by legal and macroeconomic factors. However, the analysis of the laws and regulations is not enough to explain why small and medium firms in Belarus do not expand. A series of in depth-interviews conducted among the Belarusian entrepreneurs and experts in the business field allow to affirm that the functioning of small and medium enterprises in Belarus is strongly regulated by unwritten rules. Extraction of funds which is realized by state officials through informal channels strongly demotivates SMEs from growing.

Local authorities perceive small and medium enterprises as a source of funds which can be legitimately extracted for the realization of the public goals. State officials extract these resources through regular inspections imposing heavy fines. They force entrepreneurs to finance public projects or use their production capacities in the interest of public institutions. When the income of the enterprise rises above a certain ceiling, public officials may try to extort property or to transform the enterprise into a stable source of rent for public authorities.

The risk of extortion rises along with the increase in the firm's size. In such business environment investment and growing becomes irrational. Some Belarusian small and medium firms elaborate sophisticated techniques of camouflage. They hide

their income, divide their business into smaller entities, develop business activity in the areas what are difficult to control. Others consciously enter into patronage networks established by state officials.

There are several explanations of public authorities' extortionist activity. A direct explanation tells that public institutions are not given enough funds for performing their duties. However, in order to understand the nature of this phenomenon one should look at it from the systemic perspective. The problem is that the public authorities in Belarus feel entitled for illegal extraction of resources from private business. Extortionist activity of the public institution is the result of clear subordination of private sector of economy to the state-controlled one. In other words, the private property in Belarus does not have an absolute character. Private enterprises remain a part of state-controlled economy. They perform only additional, stabilization function in the economic model called by several researchers a 'distributive economy' or a 'resource-based state'.

Small and medium business becomes a victim of the extortionist activity of local authorities not only in Belarus. Such phenomenon is widespread in Russia and other post-Soviet countries. However, unlike in Russia, Belarusian local officials seem to extract resources mainly for the state purposes, not for the private enrichment. Corruption seems to play here less important role. Therefore, the Belarusian economic and political system based on state control over the economy and central redistribution of resources seems to be more stable.

After the fall of communism, Belarusian economic system introduced many formal institutions from the market economy. However, the state did not abandon the idea to control all enterprises and to forcibly extract all the resources it finds necessary. This extraction of resources from private business started to be made through informal channels. The case of Belarus clearly shows that informal economic institutions do not always emerge as a reaction of private actors on a weakness of the state and its inability to ensure formal regulations. Informal institutions may be intentionally produced and maintained by a strong and functional state. When the state perceives legal norms as inefficient, it may find easier not to change laws and regulations, but to complement or substitute them with informal institutions. Such situations occur in the countries where the principles of the rule of law are not fully respected.

Belarusian authorities need private enterprises as long as they allow to maintain the state-controlled economy. The Belarusian government announces plans to increase share of SMEs up to 50% of GDP by 2030 (Belta2016). Within the existing

economic system this goal may be achieved only under condition that the state preserves control over this growing private sector. SMEs will not be allowed to expand over the level where state authorities feel difficult to extract resources needed for the functioning of Belarusian ‘distributive economy’.

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