

# BARRIERS FOR FOREIGN DIRECT INVESTMENTS IN BELARUS

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**Abstract:** *The paper presents current barriers and opportunities for foreign direct investments in Belarus focusing on the field of business logistics. It shortly describes actual economics situation in Belarus and its development since 1991, highlighting current state market socialism doctrine and political situation in relation to FDI. The aim of the paper is to describe current situation regarding Belarusian market entry conditions for foreign investors, and identify barriers for foreign direct investments in Belarus. Special attention is devoted to entrepreneurial opportunity identification for foreign direct investments in the field of business logistics in Belarus and Belarusian industrial market overview.*

**Keywords:** *foreign direct investments, Belarus, barriers for FDI, business logistics*

**JEL Classification:** *E22, F21*

## 1. INTRODUCTION

Analysis of historical development and current state of the Belarusian economy shows that the country has vast untapped potential for attracting of foreign direct investment due to the good geographical location, high level of infrastructure development and adequate human capital [1]. Since 2007, Belarusian government attempts to reform the legislation relating to business activities. First of all the government aimed the reduction of administrative requirements for registration of legal entities, simplifying the conditions for obtaining business licenses, reducing number of taxes and reducing overall administrative costs of doing business. A number of regulatory reforms realized in 2008 simplified doing business in Belarus [2]. Business climate is improving and many foreign investors begin to turn their eyes on the Belarusian market.

Despite attempts of the Belarusian government to improve business climate barriers for foreign investors remain to be significant. The investment climate still suffers from several problems regarding the legal system, tax regime, price controls and lack of independent judiciary [2]. The objective of this paper is to describe actual economics situation in Belarus and its development since 1991, highlighting current political situation, describe Belarusian market entry conditions for foreign investors, and identify barriers for FDI's in Belarus. Special attention is devoted to entrepreneurial opportunity identification for FDI's in the field of business logistics in Belarus and Belarusian industrial market overview.

## 2. THE REVIEW OF THE ECONOMIC SITUATION IN BELARUS

At the time when Belarus was a part of the Soviet Union, level of economics development, including industry and science, was comparable with Eastern European countries or countries in the so-called socialist camp [1]. As a Soviet republic Belarus had a well-developed and relatively diversified industrial base, producing products with the high value added, like electronics, trucks, tractors, and had a GDP per capita value way above the most former Soviet republics [3]. Belarusian economy experiences a sharp

decline in economic activities and gross domestic product in total immediately following the collapse of the Soviet Union. In the period of 1990 to 1995 the decline in production reached in an overall 40 percent [3]. Relatively strong industrial base and continued strong relations with Russian Federation allowed Belarus to overcome initial economic decline after the fall of the Soviet Union, and starting 1995 GDP began to grow, reaching an average of 6.5 GDP growth rate since 1996 to 1999 [4]. Economic growth in the period of 2001-2008 had been impressive, reaching an average annual GDP growth rate of over 8% [2]. Table 1 shows basic economic statistics for Belarus since 1993 till 2013.

The reasons for such an impressive growth are hidden in close economic relationships with Russia. For a long time one of the main sources of income for Belarus were payment for the transit of gas and oil, and incomes from oil refining industry. Since 1991 Belarus was buying crude oil and gas from Russia with the deep discount, while the prices were for a long time reaching the level of crude oil price level in Russia itself, and exported oil-based at market prices to the West. The situation has changed in 2006 when Russia raised the oil and natural gas prices for Belarus, where the price level became closer to the European price level. After series of negotiations Russian state owned gas company Gazprom became an owner of 100% of Beltransgaz company, which operated the pipeline in Belarus in exchange for lower natural gas prices [5].

Current Belarusian economic doctrine is often called a type of market socialism, the strategy that brought stability, but kept desirable foreign capital outside the country [2]. The Ministry for Foreign Affairs of the Republic of Belarus describes the Belarusian model of socio-economic development as "evolutionary, based on active government involvement in overseeing market relations" [2]. Social policy and state control over the main industrial plants are the most important basements for the stability of Lukashenko regime. Government vastly supports costs of citizens housing and communal services social programs, finances medicine and education development, and subsidizes agriculture.

**Table 1.** Economic statistics for Belarus (1993-2013 est.)

Value/Year	1993	1994	1995	1996	1997	1998	1999
GDP (Bill. US\$)	3.662	4.854	3.384	14.5	14.098	15.222	12.138
GDP Per Capita (US\$)	357.589	474.532	332.486	1,429.74	1,396.78	1,515.40	1,211.52
Investment (% of GDP)	72.408	53.462	35.959	21.039	25.134	25.935	26.328
Inflation Rate (%)	1,190.32	2,220.90	709.297	52.688	63.82	73.018	293.733
Unemployment Rate	1.4 %	2.1 %	2.896 %	4.022 %	2.787 %	2.339 %	2.1 %
Value/Year	2000	2001	2002	2003	2004	2005	2006
GDP (Bill. US\$)	10.418	12.355	14.595	17.825	22.716	30.21	36.962
GDP Per Capita (US\$)	1,042.82	1,241.57	1,474.38	1,809.87	2,317.95	3,098.15	3,805.01
Investment (% of GDP)	26.798	24.373	23.227	25.253	29.525	26.516	33.49
Inflation Rate (%)	168.601	61.133	34.792	28.398	18.094	10.336	6.992
Unemployment Rate	2.112 %	2.277 %	2.9 %	3.1 %	1.9 %	1.5 %	1.2 %
Value/Year	2007	2008	2009	2010	2011	2012	2013 (est.)
GDP (Bill. US\$)	45.276	60.752	49.209	55.221	59.735	63.259	72.912
GDP Per Capita (US\$)	4,672.42	6,385.56	5,179.86	5,834.38	6,332.11	6,739.43	7,806.86
Investment (% of GDP)	35.934	39.242	38.969	39.484	39.484	38.927	44.944
Inflation Rate (%)	8.429	14.828	12.95	7.743	53.228	59.218	20.5
Unemployment Rate	1 %	0.8 %	0.9 %	0.7 %	0.6 %	0.6 %	0.6 %

Source: Data was obtained from Economy Watch database.

This socially based market economy was mostly financed by the income from the oil refinery industry, assuming the influence of the rapid growth of the oil prices in this period, which Belarus clearly used to finance the social standard maintenance. Decrease of the Russian support forces government to lower the costs of the social policy.

State ownership of industrial enterprises allows the government to regulate the level of unemployment, which remained extremely low even during the crisis of 1999 or 2009. The fact that 1197 state owned produced 67.1% of all industrial production in Belarus in 2011 perfectly describes the level of state intervention in Belarusian economy [1]. Investors should keep in mind that state currently controls most of the Belarusian industry, including automobiles, tractors, machinery, energy and food processing [5]. State ownership dominates in production, power, transport, extracting, construction, agricultural and bank sectors [1]. Private business in Belarus prevails in retail and wholesale trade and services. Belarusian industrial base in the present time is quite outdated, energy inefficient, and dependent on subsidized Russian energy and preferential access to Russian markets [8]. According to the declared state strategy foreign investors are welcome to modernize industrial sector and bring modern technologies and know-how to the country.

Banking system and financial sector of Belarusian economy remains small and inefficient, and possibly requires stronger governance and new private banks to enter the market [7]. Some foreign financial groups like Raiffeisen International Beteiligungs AG or Vienna Insurance Group are operating in the country. 23 out of 27 banks operating in Belarus have private owners [1].

Current economic situation will probably force Belarus to start privatization process. First steps have already been made. During the period from 2008 till 2012 government announced a plan to privatize 899 state owned enterprises. Unfortunately the selection offered for privatization process was not attractive enough, and did not attract much attention from the foreign investors. Only 48 enterprises were privatized in 2008 and 2011 [6]. This privatization attempt was unsuccessful also because of the strict conditions for investors, requiring keeping full staff of employees. We can expect the offers to be better prepared in the future.

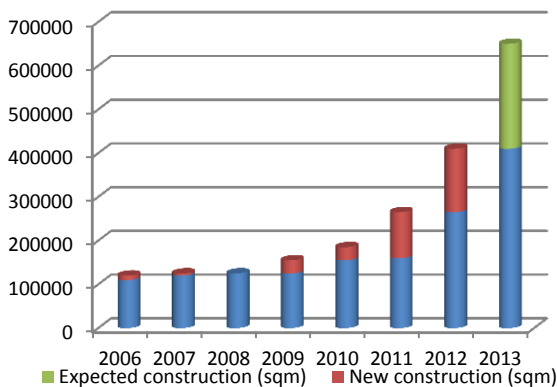
### 3. BELARUSIAN INDUSTRIAL MARKET OVERVIEW

The development of logistics infrastructure belongs to the fields intensively supported by Belarusian government, which realizes that the country will not be able to compete on logistics market by just using its main benefits, including the location between the EU and Russia, Customs Union with Russia and Kazakhstan and the transition of trans-European corridors through the territory of the country. Government support is the reason why the construction of 23 large warehouse real estate objects was undertaken in 2012. A total of 48 new or existing objects that are undergoing modernization and development of warehousing infrastructure are being developed in the country [9].

Belarusian authorities are seeking possibilities to improve country's position in all international business ratings, important for FDI's attraction, including the World Bank's Logistics Performance Index (LPI), where Belarus ranked 91th in 2012 [10]. The improvement of the country's position in LPI can attract new foreign investments and force investors to allocate logistics centers involved in global goods movement system in Belarus. As an example of changes the simplification of the documentation procedures and easier requirements for wholesale and warehousing of alcoholic beverages, alcohol-containing products and tobacco products, which eased the doing business for logistics operators, and was realized by the presidents decree in 2012, can be mentioned [11]. Minsk and Belarus have all chances to become potential centers of distribution in Europe, potentially being incorporated into the global regional logistics system by 2020 [12]. Boom in logistics development in Belarus leads to significant improvement in estimated transportation and logistics centers projects payback period, which is decreasing from average 8 to 5 years due to the quick increase of the workload [9].

Talking about the supply of warehouse space we should state that Minsk and Minsk region attract the biggest part of the new warehousing complexes projects. 13 new complexes with a total area of around 140 thousand sqm were launched in the specified territory in 2012, and more than 240 thousand sqm of new warehousing spaces may be launched in 2013 [9]. Figure 1 shows dynamics of

the launching of modern warehousing facilities in Minsk and Minsk region.



**Figure 1** Dynamics of the launching of modern warehousing facilities in Minsk

Source: Data was obtained from Colliers International

The focus of the investors is changing from building smaller projects to serve existing demand for the warehouse space to modern and technologically well-equipped warehouses projects with large areas. Most of the projects are realized by Belarusian companies. Foreign business logistics projects realized in Belarus mostly origin in CIS countries, with investors more confident in hostile conditions of transiting economies.

After the Belarusian financial crisis in 2011, the demand for warehouses normalized in 2012. Professional distributors and logistics companies (frequently affiliated with investors) were the main tenants for new warehouses, making demand for larger spaces relatively high [9]. While in previous years food products distributors were the main consumers of warehouse space, in 2012 professional logistics companies became dominant on this market.

Rental rates for the space in logistics centers depending on the quality of the logistics center vary from 5 to 12 EUR per square meter. During the crisis rates for class B warehouses slightly decreased, while class A warehouses rates remained stable. Forecasts state that there are no obvious preconditions for a drop in rental rates in 2013, as some objects expected to be launched this year are built-to-suit objects, and others are being built through shared-equity construction projects, which reduces the total volume of rental spaces [9].

The level of vacancy of warehouses remains on the level of 6%. The demand for larger spaces is not quite satisfied, although smaller spaces are available on the market. In the following years the moderate growth of supply due to the launch of the new projects can be expected. Macroeconomic situation in the period of 2012 and 2013 remains stable, so the rental rates will possibly stay on the current level, assuming that the growing supply will be able to satisfy the demand, which is expected to grow due to Belarusian membership in the Customs Union with Russia and Kazakhstan.

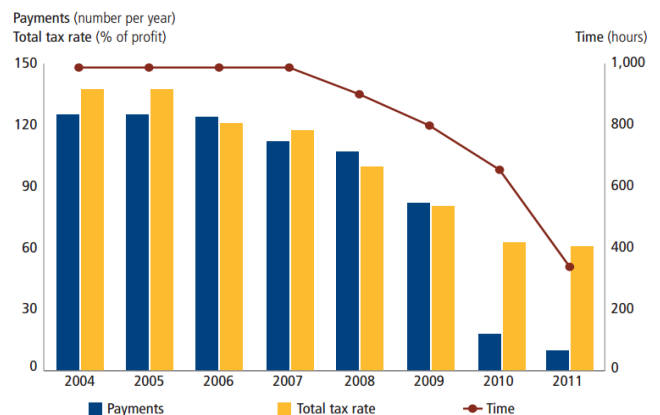
#### 4. BARRIERS FOR FOREIGN DIRECT INVESTMENTS IN BELARUS

As we stated in previous chapters investment climate in Belarus is rapidly improving. In a relatively short period of time Belarus has made tremendous progress in the simplification of doing business. According to the latest data

of the Doing Business 2013 report in just five years Belarus improved its rating in ease of doing business by 52 positions since 2008 being ranked as 58<sup>th</sup> country in rating. For comparison, Czech Republic is 65<sup>th</sup>, Slovak Republic is 46<sup>th</sup>, and Poland is 55<sup>th</sup> [13]. Belarus has the 9<sup>th</sup> easiest business starting process, 3<sup>rd</sup> easiest property registration with just 0.03% cost of property value [13].

Tremendous progress has been made in the simplification of tax legislation. Belarus abolished several taxes, reduced tax rates, broadened the tax base, simplified filing forms and the tax law and invested in electronic systems that make it easier to file and pay taxes (Figure 2). These changes reduced the number of annual payments from 125 to 10, the time from 987 hours a year to 338 and the total tax rate from 137.5% of profit to 60.7% [3]. Reforms were impressive, but the problems prevail in tax field, export and import operations, access to bank credits and infrastructure networks, political situation and investment protection. FDI's are a subject of a long term planning, what makes the economics and political stability to play dominating role in FDI's allocation decision making. The state influence is the biggest barrier for foreign direct investment in Belarus, which is confirmed by 154<sup>th</sup> position in Index of Economic Freedom [14].

Describing political situation in Belarus we should explain how massive influence the current Belarusian president has on all levels of state authorities. Referring to other authors we can state that Lukashenko retains tight control over regional governments, military forces, justice, police forces, and actively uses his power to prevent any opposition leaders to dislodge him from presidents position [2]. Even central bank is fully controlled by the president since he has the power to appoint and remove its chairman and members of the board [16].



**Figure 2** Tax reforms in Belarus [13]

Source: Doing business 2012

Assuming that the state interference is a central issue, we can specify several problematic fields, including direct market interventions, like price-control measures or state interventions in banking sphere [15], control on export and import operations. Poor protection of property rights, high level of corruption and ineffective judiciary are causing problems in investment protection. Political risks for long term investments in Belarus remain extremely high, and this may be the main reason for the actual level of foreign direct investments to be rapidly below its potential [2]. Unpredictable state interventions in private company's management do happen in Belarus quite often. The newest

examples include the problem of forcing the main stockholder of Belaruskali, one of the world's largest, second in the CIS potash fertilizer producer, to sell his share by putting CEO of the company in jail with the fictitious charges, and the preparation of the limitations of the interest rates on loans by direct government decision. The risk of political instability in Belarus is quite low, but the risk of change of doing business rules is remaining extremely high. We assume that in a long term period only political change in Belarus can improve the stability in state interference in business. In case that investor will take these risks into consideration, the investment in Belarus can be profitable.

## 5. OPPORTUNITIES FOR FDI'S IN BUSINESS LOGISTICS

Since Belarus claims to attract FDI's, it is probable that government will try to make changes heading to stabilizing business and economic environment to make it more attractive. Belarusian economy can benefit also from changing its financially repressive policies [4]. Excluding the political risks Belarus has some advantages that can make foreign investors to choose Belarus as their target market. Researches [6] usually mention such advantages of Belarus as geographical position, customs union with Russia and Kazakhstan, stable political environment, state declared support of foreign direct investments accompanied by export oriented economy where export makes up to 60% [17], and well qualified and relatively cheap workforce. Customs union opens Russian and Kazakh markets for the goods produced situated in Belarus. Small concerns can be caused by Russian WTO joining. Due to the authoritative mode of government the political situation is stable for more than 19 years, and with the maximum likelihood the situation will not change in the nearest future. Existence of 6 Free economic zones (FEZ) with the different types of supported activities located in all mail regions of Belarus is an obvious advantage, while FEZ provide exclusive conditions for the foreign investments in the supported fields, including tax and customs exemptions.

Investors, operation in field of logistics may be interested in conclusion of the investment agreement with Belarus, which can provide some security guarantees to their investment. Investment agreements can be used for the investments, which belong to the supported fields, and logistics is one of the priority targets of the Belarusian government. Most of the logistic and warehouses projects realized by foreign investors operate with investment agreements. Investors should take into consideration, that even if they have a positive relation to risk, it doesn't mean that they will be able to achieve higher values of profit by investing in unstable Belarusian economy. Risk maximization is not always synonymous with profit maximization [2].

## 6. CONCLUSION

The objective of this paper was to present current barriers and opportunities for foreign direct investments in Belarus focusing on the field of business logistics. Based on the analysis of current business environment we can state that Belarus carries out steps to facilitate the entry of foreign investors to its market. However, access to the Belarusian market today is still very challenging. Foreign direct investments in the field of logistics are supported by Belarusian government, which resulted in the growth of the number of modern logistics and warehouses projects being currently built in Belarus. The demand for warehouses space is expected to grow due to Belarusian membership in the Customs Union with Russia and Kazakhstan. Investors are advised to undersign the investment agreement with Belarusian state before entering the market to guarantee the long time stability of the project and profit repatriation. Investors should take into consideration higher costs of administrative activities, and be aware of possibility state interventions. On the other hand, the market potential due to the low level of development of Belarusian economy can be huge and potentially very profitable. Belarusian State expressed desire to improve conditions for business, and we can expect further significant improvements in the nearest future. Investors should carefully monitor developments in order to maximize the potential offered by the Belarusian market.

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