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**Maryia Akulava**

**Summary**

When it comes to Belarusian efforts to attract foreign investments, the year 2010 looked a lot like the previous year. Foreign capital inflow kept growing at a slow pace; there were no major privatization deals, as the state is still unwilling to put up for sale large property units and is reluctantly ready to cede control only in insignificant enterprises.

Nevertheless, the year 2010 was marked by the country's successful debut on European stock markets with issuing Eurobonds, listed at the Luxembourg Stock Exchange in summer. Furthermore, important steps were made to increase the investment appeal of the country: in 2010, the government abolished licensing of many business activities and lifted the ban on sale of Belarusian joint-stock companies' shares, a move contributing to a recovery of the domestic stock market.

Tendencies:

- FDI does flow into the country, at a very slow rate though; privatization is pursued on a case-by-case basis and looks like a forced measure rather than an instrument to introduce structural economic changes;
- New financial instruments are tested; the country enters international stock markets with its debut Eurobond issue;
- Loans still dominate in the foreign financing structure;
- A number of regulatory documents are adopted to enhance the investment attractiveness of the country.

The state pinned high hopes on the year 2010 when targeting external sources of financing. Belarus planned to attract USD 5.6 billion in foreign investments, USD 2.8 billion, or exactly one-half, in FDI. By October 1, 2010, FDI inflow reached USD 1.27 billion, which was short of the target [1]. Against the first three quarters of 2009, when FDI inflow amounted to USD 1.22 billion, there was a slight increase in the share of FDI in the overall volume of external financing, from 23% to 26%; however, in January-September 2010, gross foreign investments shrank 5.3% year-on-year.

Also in January-September 2010, Belarus' foreign liabilities expanded by 16%, or by USD 3.533 billion, to reach USD 25.593 billion on October 1, 2010, or 48.8% of GDP. Although the country's foreign liabilities stood only at USD 6.844 billion, or 18.5% of GDP, back in 2007, last year's increase was well within permissible limits, especially compared with neighboring countries. However, it is not the amount of the debt that is alarming, but the growth rate. As of October 1, 2010, state foreign debt, including the debt of the government and corporate debts guaranteed by the government, was at USD 9.97 billion. It increased by USD 1.607 billion from the beginning of the year, or by 19.2%, and reached 19.5% of GDP (with the permissible limit previously approved at 20%). Taking into account that Belarus will soon have to repay the loans it took in 2008 and 2009 and pay interests on Eurobonds, this pace is truly alarming, as it is not quite clear how the government plans to service this debt.

As is known, foreign investments in Belarus are divided into *three categories* – FDI, portfolio investments and other foreign liabilities of the country. Practice shows that now when corporate bonds market is underdeveloped, only the capital coming as FDI is capable of facilitating modernization and enhancement of competitiveness. The remaining types of financing aim at tackling other problems: they help to improve current situation and to shore up gold and foreign exchange reserves with a view to further foreign debt servicing and balance of payment deficit covering.

The structure of foreign investments in the first three quarters of 2010 indicates that "other foreign liabilities", that is credits and loans of the government and banks, as well as commercial loans, accounted for 54% of overall investments. FDI made up 26% of gross capital inflows in January-September 2010, and portfolio investments made up 20% of the total.

**Foreign Direct Investments**

2010 was not a breakthrough year in Belarus' efforts to attract FDI compared with the previous year. As it was mentioned above Belarus attracted just USD 1.27 billion of FDI in first three quarters of the year. FDI in Belarus may be split into *two* groups: *Greenfield* investments, or new enterprises and facilities financing, and *mergers and acquisitions*. The latter currently dominates in Belarus. The relatively slow increase of FDI inflows in January-September 2010 may be explained by several factors. *Firstly*, the presidential election in late 2010 and likely economic reforms that were supposed to follow stopped potential investors from making hasty decisions. *Secondly*, relations with the Russian Federation remained cool as never before throughout the year. Given the direct dependence of Belarus on its eastern partner, the tensions increased investment risks and prompted investors to take a pause and see what happened. *Thirdly*, the government gave half-hearted consent to privatization transactions considering privatization only from the fiscal point of view. As a result, there were very few privatization deals.

The key *M&A* transactions included first of all the fourth and final transfer of USD 625 million installment by Russian gas giant JSC *Gazprom* for the remaining 12.5% shareholding in JSC *Beltransgaz*. In spring 2010, Belarus sold a 52% stake in JSC *Minsky Chasovoy Zavod* to *Swiss Franck Muller* for USD 12.6 million. Russian JSC *Katren* paid around USD 30 million for 51% stake of pharmaceutical company *Dominantapharm*. Furthermore, Lithuanian distributor company *Ipsun* acquired 90% share of leasing company *Belfin* for USD 5 million. In autumn 2010, Danish brewery *Carlsberg* bought 25% stake of Belarusian brewing company *Olivaria* for USD 10 million and increased its' shareholding in the company to 55% from 30%. JSC *Gomelsteklo* and *AG German Hom Glass Industries* reached an agreement on supplies of equipment for *Gomelsteklo* modernization priced at EUR 35 million. Finally, in late 2010, Turkish *Turkcell* transferred USD 100 million tranche to Belarus under 2008 agreement to buy 80% stake of CJSC *BeST*.

As for *Greenfield* investments, one of the major transactions of 2010 was an investment agreement between *Belgospischeprom* concern and Cypriot *Lebortovo Capital Partners Limited* signed in February on logistical center construction in Minsk totaling to approximately EUR 15 million. In summer, Lithuanian *Vakaru Medienos Grupe* in association with Swedish *IKEA* signed an agreement with Mogilev region administration on the construction of a vertically integrated woodworking complex, including factories producing veneer and other products from wood chips in the free economic zone of Mogilev with a total value of EUR 64.3 million. In 2010 German *Enertag* and Minsk region administration signed an agreement on a wind farm construction totaling to USD 360 million. In addition, *Alutech* and the *International Finance Corporation* (IFC) signed EUR 22 million deal on aluminum plant construction financing.

Besides, III Belarusian Investment Forum in Frankfurt am Main held in November 2010 was also quite successful. Compared with the first forum of this kind in London back in 2008, the German forum attracted not only much more projects and guests, but also more agreements. The fact that deals were signed in many sectors of economy proves that Belarus has lots of perspective areas to develop in future. However, since most of the agreements signed during the forum were statements of intent, their further successful implementation will depend on the economic situation in the country, political and economic risks, as well as the general investment climate. In other words, it will take time to see whether the investment forum was efficient or not.

As can be seen from the above, there were some sporadic successful transactions in 2010. However, the government was not able to take a chance of structural privatization of any large significant enterprises, the foreign investors are really interested in, and instead was trying to minimize losses by selling less substantial entities. These few attempts to privatize state-controlled enterprises were not successful, though. In order to get the final installment of the IMF loan under the *Stand-By Arrangement* (SBA) supported economic program, competitive tenders to sell state stakes in five companies were opened: JSC *Bobruisk Engineering Plant* (starting price set at BYR 16.75 billion), JSC *VolMET* (BYR 2.54 billion), JSC *Barkhim* (BYR 32.97 billion), JSC *Lida Casting and Mechanical Plant* (BYR 12.26 billion), and JSC *Rechitsa textile* (BYR 23.9 billion). There were several attempts of state stakes selling in those five companies by auction, however there were no bids from potential buyers.

Why were foreign investors not interested in the Belarusian companies? The main reason was, as always, the price, as well as long lists of additional conditions and requirements that buyers were supposed to meet. The price of state assets remained the main obstacle impeding fast privatization. Belarusian regulations disallow privatization of enterprises in which the market value of assets is below the balance sheet value, and, naturally, investors are not ready to pay pre-crisis prices for Belarusian enterprises given the current market situation, competitiveness of the companies that are currently put up for sale and risks inherent in Belarus, both economic and political. In addition to high prices, the authorities also demanded from future investors to preserve the number of working places and the core activity of the companies and to contribute with specified sum of money to companies' development. As a result, potential investors were not interested, there were no bids, and the auctions were frustrated.

Two more issues that still remain undecided are JSC Belinvestbank and equity interest of JSC Belaruskali sale. The government made up its mind on the bank's sale long time ago, whereas Belaruskali has always been the country's contingency plan for the worst-case scenario: no one wants to give up one of very few country's blue chips. The government has not reached price agreements with investors on either project: JSC Belinvestbank was put up for sale at USD 530 million (the government cited its systemic role as one of Belarus' five largest banks). However, BPS-Bank, which is larger than Belinvestbank, was sold for USD 280 million in 2009, so it will be very hard for the government to find an investor ready to pay almost twice as much for a smaller bank. The same applies to JSC Belaruskali: in 2010, Belarus was ready to sell 25% of the potash maker for USD 6-7 billion, but there have been no specific proposals from concrete investors so far: potential buyers believe that Belarusian administration has set an unreasonably high price.

**Portfolio investments**

As for portfolio investments, the year 2010 differed radically from previous years. In summer, Belarus completed its debut placement of five-year Eurobonds totaling to USD 1 billion with an 8.7% average weighted coupon yield and biannual coupon payments [2]. In addition, Belarus placed two-year bonds on the Russian market, worth RUR 7 billion, at a rate of 8.7% and quarterly coupon payments [3]. Country's clear benefit is the new financing instrument assimilation, which enables long time borrowing. The country's entering the global stock market increased investors' interest and awareness, which means that further cooperation is facilitated in case of right economic policy implementation. Moreover, Belarusian debt securities buyers on foreign stock markets are not supposed to demand structural reforms in Belarus; the only thing they are genuinely interested in is the profit, while loans issued by the International Monetary Fund (IMF) required certain commitments of the borrower under the agreed programs. Since the Belarusian government is intimidated by any sort of change, this peculiar feature of deals with debt securities makes bond offerings a favorable instrument. The high price of borrowing through bonds placement is a major disadvantage, though, because the coupon rate of 8.7% is quite high (especially given the fact that pre-default Greece placed its Eurobonds at a rate of 6.2%). Unfortunately, there are no indications now that prices will come down soon. On the contrary, the events that followed the presidential elections of late 2010 will likely result in higher rates. The new USD 800 million seven-year Eurobond emission at a rate of 8.95% in January 2011 proved this [4].

**Other foreign liabilities**

Other foreign liabilities decreased by 30.5% year-on-year in January-September to USD 2.708 billion as of October 1, 2010. The main channels of "other foreign liabilities" were inflows of foreign credits and loans (71.8%) and foreign trade credits (38.7%), whereas non-residents' bank accounts and deposits with Belarusian banks, as well as "other liabilities to non-residents" shrank to -1.8% and -8.7%, respectively, indicating outflows of investments.

Most of the foreign credits and loans were from commercial banks and the final installment of the IMF loan under an economic program supported by SBA, which reached USD 638.5 million. Commercial banks borrowed USD 1.241 billion, including USD 832.6 million in short-term loans. Significant loan deals performed by Belarusian banks included a EUR 103 million subordinated loan to Belarusian CJSC *Trade Capital Bank* from Iranian *Tejarat* and two syndicated loans taken by JSC *ASB Belarusbank* in early and late 2010, amounting to USD 60 million and USD 145 million respectively. Both loans were taken in order to support- export-oriented Belarusian producers, credit domestic investment projects, finance modernization and upgrade of productions and construction operations. It should be mentioned that Belarus observed a totally opposite trend in the first three quarters of 2009, as banks' liabilities under foreign loan agreements decreased by USD 322.8 million. This dramatic change in the situation with foreign loans is attributed to the National Bank policy in 2010, which required from commercial banks to reduce their loan rates for companies. Such claims were quite reasonable, because the National Bank had to take measures to encourage the real sector development using facilitating lending by commercial banks. On the other hand, concessional lending to inefficient and bankrupt companies increases both the banking system burden and the economy's debt to banks.

**Arrangements to attract foreign financing and improve the investment climate in 2010**

Last year was not really rich in terms of economic reforms or arrangements aimed to encourage foreign investors. Nevertheless, some progress was reached, meaning the situation may change for better in the future.

*1. Establishment of the government institution "National Investment and Privatization Agency"*

On May 25, 2010, decree #273 on the establishment of the government institution "National Investment and Privatization Agency" (NIPA) was signed by the president [5]. The objective of the new structure is to increase the efficiency of privatization in Belarus and promote constructive dialogue between potential investors and state authorities of Belarus, which is expected to increase the overall level of Belarusian investment appeal abroad.

As of today, none of the NIPA objectives has been attained. Although the decree was approved back in May 2010, the documents required for its functioning are still discussed and reviewed by authorities. Furthermore, it is not clear yet what the NIPA administration will be guided by when identifying state entities for sale. The State Property Committee is responsible for privatization now (however, it is not a secret that all decisions regarding privatization transactions in Belarus are approved personally by the president). The relevance of the newly established privatization institution under these circumstances is somewhat doubtful.

*2. Abolition of some business activities licensing*

On September 1, 2010, decree #450 on licensing of some activities was signed by the president [6]. Given the propensity of the state authorities to exercise total control over all types of business activities in Belarus, the document is supposed to have a major positive impact on investment inflows. Starting from January 1, 2011, list of business activities that can be practiced without any licensing was considerably expanded. Licensing was abolished for woodworking, minerals extraction, fishing and hunting business, auditing activities, travel services, transport and shipping business, geodesic and map-making activities, and retail, except for tobacco goods and alcohol retail. The president also abolished investment funds' activity licensing, which should foster the development of the financial and stock markets of the country.

*3. Abolition of the moratorium on sale of shares.*

On January 1, 2011, Belarus lifted the moratorium on joint-stock companies' shares sales [7]. That measure will intensify the Belarusian stock market activity, which was rather passive in the past few years. The interest of potential buyers of Belarusian companies' shares is also expected grow, as they obtain the possibility to expand their part in most attractive businesses. Furthermore, the decision will very likely result in an increase of domestic investments, because households, entrepreneurs and companies receive additional instruments to improve their well-being or gain additional profits through acquisition or sale of the shares.

*4. Directive № 4 on liberalization.*

On December 31, 2010, directive № 4 "On the development of entrepreneurial initiative and encouragement of business activity in the Republic of Belarus" was adopted [8]. The document aims at enhancing the investors' and entrepreneurs' property rights protection and will definitely boost business initiative in the country. The directive stipulates more liberal price-formation and labor compensation methods, preferential tax treatment or even abolition of taxation depending on the type of business activity, reduction of the number of documents required for business conduction. On the other hand, some problems still remain. One of them is the implementation timeframe; besides, the country's stock market development perspectives were not addressed as well as treatment equalization of state-owned and private companies in the insurance market.

**Forecast for 2011**

2011 will be rather tough given the current uneasy situation, which is further aggravated by the events that took place following the presidential elections in late 2010. On the one hand, the discrepancies in Belarusian-Russian relations that entailed a reduction in support from the eastern neighbor make further concessional lending and resources' supplies at relatively low prices quite unlikely in the near future. On the other hand, the harsh response of both the US and EU to the events of December 19, 2010 and forthcoming non-recognition of the election results will definitely affect the investment attractiveness of the country.

Furthermore, the state's decision to adopt the operational administration scheme at CJSC *Pinskdrev* in early 2011 became another controversial step increasing investment risks, as investors concerns regarding the real degree of investor rights' protection in Belarus raised. The country should not expect a lot of investors to come in order to acquire or establish an enterprise. Under these circumstances, foreign capital will only be interested in the so-called "blue chips" - larger strategic companies of the Belarusian economy, especially JSC *Belaruskali*, JSC *BelAZ*, JSC *MAZ*. It looks like Belarus will have to sell at least one of them eventually, even if potential investors offer lower prices.

Belarus will definitely continue offering Eurobonds on European and Russian markets. However, given the current attitude of the West to the Belarusian administration, the coupon yield of 8.7% of the debut Eurobond issue seems quite lucky, and further placement will be much more expensive.

The chance of loan attraction from the IMF or any other international organization is very small, due to the fact that even after the final tranche of the loan was received, Belarus failed to meet its commitments, and in order to apply for a new loan, the Belarusian authorities will have to implement the economic reforms that were originally expected by the West. There is another possibility to borrow from Russia or China, however, unfortunately, there is a threat to get into their deep influence nowadays.

The Belarusian authorities will have to respond to very serious challenges in 2011. Although the situation still remains stable (it is not 2012, when the country will start to make large payments for the foreign debt service), there is too little time left for the authorities to persuade investors to get back into the country. It looks like the government will have to make concessions in order to receive foreign financing, and continue liberalization and start economic reforms implementation. Otherwise, they will have to put state property up for sale at distress prices. Last year's liberalization and stock market development arrangements will have a positive effect; however, as things stand now, they are simply not enough.

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