FOREIGN INVESTMENTS: FOCUSING ON LOANS

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Summary

Foreign capital inflows in Belarus were quite insignificant in 2012. The government continues to perceive privatization only from the fiscal point of view and is unwilling to sell state property. Therefore, there were no major property sales in 2012 to attract additional investments in the economy. This stance of the government turned external borrowing into the main source of investments.

In 2012, Russia remained the financial pillar for the Belarusian economy. China also became an increasingly important foreign partner extending loans to Belarus. The country took steps to regulate the privatization process, which have the potential to discourage foreign investors. On the one hand, Belarus cancelled privatization lists, which can both simplify privatization and make it less transparent. On the other hand, probable changes in the degree of the state influence on decision-making in open joint-stock companies may increase risks and make investors doubt the effectiveness of property rights protection.

Trends:

- Foreign capital procurement pace remains low;
- Privatization is perceived as a last-resort measure rather than an instrument to facilitate structural changes in the economy;
- Loans become one of the main sources of external financing;
- Modifications in privatization rules affect the country's investment appeal.

Investment plans and sovereign debt

In 2012, the government had planned to raise about USD 1.2 bn in net foreign direct investments (FDI), not including external loans, and at least USD 2.5 bn from privatization of state assets. According to official statistics, net FDI inflows amounted to USD 1.163 bn[1] in the first nine months of the year, meaning that the target had been met before the fourth quarter started. However, compared to the same period of 2011, when net FDI were reported at USD 1.268 bn, a slight reduction was observed.

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1 http://nbrb.by/statistics/BalPay/Comment/2012_3.pdf

Belarus saw a current account surplus of USD 859.2 million in the first three quarters of 2012, whereas in the same period of 2011, a deficit of USD 4.711 bn was reported. Therefore, an outflow of foreign capital was logged in 2012, mostly caused by the reduction in the level of external liabilities to non-residents and closure of the swap deal with China in September 2012. At the same time, the external debt edged up by 0.1% in January-September 2012, or by USD 88 million, to reach USD 32.966 bn as of October 1, 2012, or 59.5% of GDP. As of October 1, 2011, the external debt stood at USD 32.878 bn, 71% of GDP; therefore, the external debt trend is obviously positive. However, the expansion in the external public debt raises concerns — it went up by approximately 7.5% from USD 11.9 bn on October 1, 2011 to USD 12.8 bn on October 1, 2012, or 22.7% of GDP, with the threshold set at 20%. Belarus will have to make most of the payments to service its external public debt in 2013—2014. In 2013 alone, the country will have to pay USD 1.7 bn, whereas in 2014, an additional USD 1.4 bn will have to be paid. In this context, further increases in the external public debt will place efforts to seek new sources to service the debt higher on the agenda.

FDI and privatization

Belarus raised USD 1.163 bn in net FDI in the first three quarters of 2012, according to official statistics, whereas the annual target had been set at USD 1.2 bn. However, the structure of the raised FDI requires additional comments.

The planned USD 1.2 bn was supposed to be attracted by the real economy — the process was supervised by ministries and concerns based on a resolution of the Council of Ministers.[2] Statistical reports show that only Administration of the High Technologies Park (HTP) managed to exceed the target for attracting external capital. The organizations registered as HTP residents are mostly IT companies focusing on export of services, hence a high competitive capability of the Park in foreign markets and willingness of foreign investors to contribute to the Belarusian IT sector.

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2 http://www.government.by/upload/docs/file3b53175765bf4e89.PDF

The situation does not look as bright in most of the other sectors, though. According to *Belstat*, in 2012, the share of foreign investments channeled into the manufacturing sector amounted to approximately 10%, which is clearly not enough given the need for sustainable economic development and modernization of the industrial sector, as well as creation of high-tech productions capable of independently making money in both the domestic and foreign markets. Of the total, 57% was injected into the real economy, the banking sector accounted for about 33% of total FDI, and sales of property belonging to individual residents of Belarus to nonresidents accounted for the remaining 10%. The significant role of Belarusian banks in raising foreign capital can be attributed, on the one hand, to the increase in authorized capital requirement to EUR 25 million based on a resolution of the National Bank of Belarus (NBB).[3] On the other hand, in August 2012, the central bank increased reserve requirements for foreign exchange deposits, which resulted in a larger share of commercial banks' reserves with the NBB.

When it comes to privatization, the 2012 privatization plan failed, and there were only sporadic transactions to sell state assets. Those few sales included the purchase of the state shareholding in OJSC *Orsha Aircraft Repair Plant* by Ukraine's *Motor Sich* JSC and Belarus' ZAO *Systems of Investments and Innovations*. The amount of the transaction totaled BYR 20 bn; the Ukrainian and Belarusian investors bought 60% and 40% in the company, respectively.

Belarus-based *Interservis* bought *Vyoska-EmulBit*, a producer of bitumen, for BYR 37 bn. German VGH *ViktoriaGarten* acquired 50% plus one share in KUP *Zhlobinskoye okhotnichye khozyaystvo* [Zhlobin hunting farm].

There were quite many transactions envisaging lease of land for the construction of new facilities. Lithuanian *Norfa Mazmena* leased a site in Vilejka to build a vegetable processing plant. Investments in the project are to amount to USD 5 million.

Russian developer company *Amtel Properties* looks to invest about USD 15 million in the construction of a three-star hotel in Minsk. Swiss *Stadler Rail AG* and Holding Management Company

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3 http://www.nalog.by/tax-news/a743eb7d904f2f88.html

Belkommunmash OJSC holding plan to build a plant to produce municipal electrical transport in Dziarzynsk District, Minsk Region. The Swiss partner will contribute 60% of the charter capital in monetary assets, whereas the Belarusian side will pay the remaining 40% as a non-monetary contribution and provide a plot for the construction at the premises of the holding in the city of Minsk.

Some BYR 400 bn will be invested in the construction of a bacon pork facility in Valozyn District of Minsk Region. The project is carried out in association with Cypriot and Danish investors. Italy's *Ansaldo Energia* plans to invest EUR 415 million in construction of the first privately-owned thermal power plant in Belarus, to be located in Brest.

Russian Sodruzhestvo group of companies plans to develop a chain of agricultural logistics complexes in Belarus. Investments in each facility are projected to reach USD 10—15 million.

Belarusian *Amkodor* plans to invest BYR 388 bn in the construction of a foundry in Zodzina, and about USD 100 million in equipment and infrastructure of its new production site in Kalodziscy. OOO Triple will invest USD 15 million in the construction of an ethnographic complex in the village of Sabali in Biaroza District. Furthermore, 35 investment contracts have been signed with Lithuanian *MartInnFood LTD* and *Glera LTD* for the construction of a retail network. Finally, the Economy Ministry of Belarus and China CAMC Engineering Co., Ltd. have signed an agreement on the construction of the Chinese-Belarusian Industrial Park near Smalavicy (Minsk Region). The ministry hopes that investments in infrastructure alone will amount to USD 5—6 bn during the first 10-15 years; the total investment requirement is estimated at USD 30 bn.

Last year, both the corporate and public sector raised investments by making IPOs. *EPAM Systems* became the first company with the Belarusian origin to successfully trade its shares at the New York Stock Exchange (NYSE). On February 8, 2012, the company opened its first trading session. Originally it was planned that as many as 7.4 million shares of the company at the estimated price of around USD 16-18 would be offered to investors; however, it was finally decided to reduce the company's IPO to 6 million shares, which were sold at USD 12 apiece.

Prices peaked in mid-April, reaching USD 23.25 and stabilized at the end of the year at USD 19.

In May 2012, the so-called "people's IPO" was launched to sell an additional issue of shares of OJSC *Minsk Sparkling Wines Factory* amounting to 25% of the entire stock. About 68.63% of the total number of shares offered to potential investors was sold. The results of the first people's IPO were quite positive, especially given the poor track record of OJSC *Borisov Plant of Medical Preparations*, which last year sold BYR 105 million worth of its shares, an insignificant part of the BYR 59.7 bn offering.

The year 2012 remained quite tense in the country's relationship with the investors that came to Belarus previously. In the summer of 2012, the Minsk authorities warned Lithuanian investment group *Ukio Banko Investicij Grupe* (UBIG) that they looked to terminate the investment agreement signed five years before. UBIC suffered losses estimated at approximately USD 30 million. The dispute will be addressed by the Stockholm Arbitration Court.

In early 2012, Belarus terminated the contract with Russian *Itera* for the construction of the business center Minsk-City. At the preliminary phase of the project, the investor spent about USD 15 million on Minsk-City. Furthermore, a conflict occurred between Russian Manolium-processing and Minsk City Executive Committee. In all cases, the failure of the investor to meet the deadlines of the project in the wake of the global recession or as a result of disputes over cost calculation methodology was the main reason behind the conflict.

Finally, in October, the government decided to liquidate the supervisory boards of OJSC *Kommunarka* and OJSC *Spartak*, the country's largest confectioneries, in a bid to reestablish control of the two producers. The reason for the move is the violations of the denationalization and privatization procedures back in 1993–1994. Other reasons for the nationalization of the confectioneries include the removal of profits from the territory of Belarus and reduction in the companies' presence in foreign markets. As of today, it is obvious that the move regarding the major confectioneries had quite objective reasons behind it. However, when it comes to the investment appeal of the country, it will have negative consequences, because the problem of investors' rights becomes relevant once again.

Portfolio investments

In 2012, investors did not recover completely from the shocks of the global meltdown, which is why Belarus had no chance to float its bonds in foreign markets to raise investments as actively as it did in 2010. Prices and yields were volatile throughout 2012 — this applies to both Belarusian bond issuances, maturing in 2015 and 2018. Prices fell in the first half of the year because of the economic troubles and sour relations with the European Union; however, the policy of the government and the National Bank, targeting macroeconomic stability, and timely repayment of foreign debts boosted the price of Belarusian Eurobonds. The prices and yields were as follows at the end of December 2012: the bonds maturing in 2015 — USD 103.0 and 7.44%, and the ones maturing in 2018 — USD 102.79 and 8.27%, respectively.

In the second half of 2012, the government and central bank redoubled their efforts seeking to float another issuance of Eurobonds. In November, Belarus had a roadshow of its bonds in Singapore and Hong Kong, supported by VTB *Capital* and *Sberbank* SIB, and similar roadshows were held in Europe in February 2013. Belarus looks to float USD 600—1,000 million worth of bonds. The new issuance will not exceed the previous ones, given excessive liquidity in international markets.

Other foreign liabilities

In January-September 2012, other foreign liabilities markedly fell, by USD 1,285.1 million, whereas in the same period of 2011, an increase by USD 3,785.6 million was registered. The drop is attributed to the reduction in the Central Bank's liabilities under non-residents' accounts and deposits, as well as repayment of a part of the external debt. Specifically, in September, the NBB closed the swap deal with the People's Bank of China, because the money available as a result of the transaction that took place in 2009 has not been disbursed.

In June 2012, Belarus received the third installment of the EurAsEC Anti-Crisis Fund (ACF) loan, amounting to USD 440 million. In December 2012, the ACF approved a fourth installment; the money was transferred to Belarus in late January 2013.

In 2012, despite the receipt of the third and approval of the fourth loan installments, Belarus failed to meet its commitments and privatize USD 2.5 bn worth of state property. Therefore, the results of the talks over the two final installments of the loan will depend on Belarus' privatization progress. In 2013, Belarus thus needs to sell at least USD 2.5 bn worth of state property to have access to the ACF money.

Finally, in December 2012, China committed a USD 1 bn untied loan to Belarus. As of today, a USD 15 bn credit line of the Chinese government and leading commercial banks of that country is available to finance projects in Belarus; however, most of this money can be disbursed as tied loans. The credit line is therefore a way for China to encourage its export to Belarus by promoting the use of Chinese workforce, materials and equipment for Belarusian projects.

Arrangements to raise foreign financing and improve investment climate in 2012

In 2012, there were no landmark reforms to enhance the investment appeal of the country; however, there were some regulatory acts that caused a mixed response from investors.

1. Decree No.8 *On amendments to Decrees of the President of the Republic of Belarus No.3 of March 20, 1998 and No.7 of April 14, 2008*

On September 10, 2012, the president signed decree No.8 to amend decrees No.3 of March 20, 1998 and No.7 of April 14, 2008.[4] The decree introduces a norm to privatize state property without making privatization plans, which were introduced by the law of the Republic of Belarus dated January 19, 1993 *On privatization of state property and transformation of state unitary enterprises into open joint-stock companies*. Furthermore, the document abolishes mandatory coordination with the State

[4] http://president.gov.by/press139628.html

Property Committee of additional issues of shares in open joint-stock companies that service strategic sectors of economy. The decree also strips the Committee of its right to make decisions on sale and reduction in the initial price of shares in open joint-stock companies in possession of the Republic of Belarus.

2. Bill *On amendments to the law of the Republic of Belarus "On privatization of state property and transformation of state unitary enterprises into open joint-stock companies"*

The bill comprises amendments to the Law of the Republic of Belarus dated January 19, 1993 *On privatization of state property and transformation of state unitary enterprises into open joint-stock companies*. The document envisages modifications in the management procedure, additional regulation of the legal status of open joint-stock companies created as a result of the transformation of leased, collective, state and state unitary enterprises, and as a result of privatization of leased enterprises. Specifically, it is planned to strengthen state control, appoint state representatives at companies and introduce the right of state representatives to attend meetings of supervisory boards in order to increase the effectiveness of businesses and protect the interests of the state.

Forecast for 2013

The privatization plan for 2013 includes sales of state property worth at least USD 2.5 bn. This amount will be enough for Belarus to take the next installment of the EurAsEC ACF loan. However, because privatization is still treated as a purely fiscal instrument, there will be no dramatic changes from the privatization pattern observed in previous years. Deals to sell larger enterprises will be sporadic, and with a sole purpose of meeting EurAsEC requirements.

On the other hand, the cancellation of privatization lists and probable adoption of the bill *On amendments to the Law of the Republic of Belarus "On privatization of state property and transformation of state unitary enterprises into open joint-stock companies"* will discourage investors to acquire assets, in which either the state owns a stake or the population acts as a minority shareholder. Therefore, the demand for enterprises of small and medium-sized state ownership will be weak, while the demand for businesses created with *greenfield* investments will grow, as these companies are considered better protected.

In 2013, Belarus will continue issuing and floating its Eurobonds. The current market situation suggests that yields on new Belarusian sovereign bonds will not exceed those on previous issues.

There is no reason to expect a breakthrough and quality changes in Belarus' efforts to raise foreign investments in 2013 compared with previous years. The need to reform the economy and boost the competitive ability of domestic producers in foreign markets remains; if the administration fails to introduce reforms and encourage competitiveness, the economy will have a low investment appeal, which will affect its stability.