

Foreign direct investment: Realising Belarus's potential

Although Belarus is in great need of additional foreign direct investment (FDI), it is the beneficiary of less foreign direct investment than most other transition countries in the region. Foreign direct investment can be used to keep pace with international industrial technological development. Moreover, FDI contributes to the stabilisation of the balance of payments. In order to increase foreign direct investment, Belarus should focus on two key measures. First, it needs to improve conditions for investors, ensuring macroeconomic stability and improving the regulatory environment. Second, investment should be promoted in a more effective and efficient manner in order to fully realise the existing potential.

Untapped potential

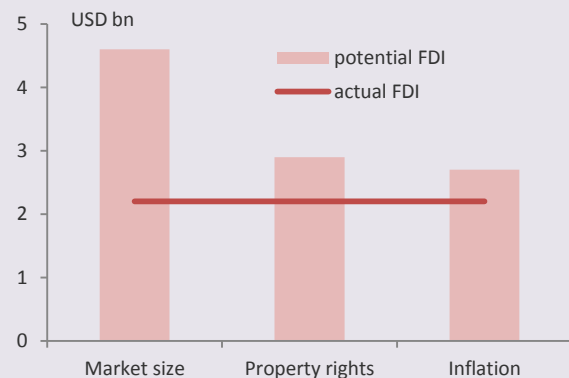
The amount of real capital in Belarus that can be attributed to foreign direct investment is far below the international average. At the end of 2014, it amounted to only 1,870 USD per capita. Although the Czech Republic and Hungary found themselves in a similar economic situation as Belarus after the collapse of Soviet economic space, they have since been able to attract more than five times the foreign direct investment, relative to population, that Belarus has. A similar picture emerges when comparing Belarus to other countries in the region, such as Lithuania and Latvia.

Neither low quality infrastructure, nor low industrial development, nor an inadequate education system can be blamed for the Republic of Belarus's relative lack of attractiveness. On the contrary, Belarus is industrially developed. Its infrastructure is competitive in the region. Its education system has been admired since Soviet times. International investors see Belarus as unattractive for two main reasons. The first is its lack of macroeconomic stability, particularly its high and volatile rate of inflation and the related exchange rate risks. The second is the unfavourable regulatory environment, specifically intense pressures resulting from strong bureaucracy, occasional interventions in the entrepreneurial freedoms, and somewhat insecure property rights. For this reason, many international studies, rankings, and benchmarks that examine legal and administrative frameworks around the world come to very mixed conclusions regarding Belarus. The fact that Belarus was not able to show a significant improvement since 2010 in any of the eight rankings we examined weighs even more heavily against Belarus from an investor's perspective. The situation is not only challenging for investors, but there is also little

reason for optimism regarding the development of regulatory frameworks.

But even given the difficult conditions described, one would expect the level of foreign direct investment to be higher than it is. Our statistical analysis compares the level of foreign direct investment in Belarus with that in other countries with similar inflation and a similar position in the ranking of regulatory frameworks. According to this analysis, Belarus remains behind its potential, as illustrated in the following figure.

Potential and actual FDI (2013)



Source: Author's calculations

Insufficient promotion of investment

The Belarusian state does not effectively promote investment. Most countries in the world have an investment promotion agency. In Belarus, the National Agency of Investment and Privatization (NAIP) should assume this role, but its success is limited. While in other countries investment promotion agencies have grown beyond their original missions of marketing locations in the country and supporting investors to successfully advocate for an improvement of the investment environment, the NAIP cannot even manage to fully realise the potential that exists in Belarus. This is due to insufficient resources, a lack of political support, ineffective strategies, and inefficient operation.

Foreign direct investment is important

Additional direct investment is particularly important to the economy of Belarus. First, it can help to modernise the industrial base and to ensure its sustainability. Although Belarus is industrially developed, its industry is at constant risk of losing its ability to compete technologically on a global level. Since production

processes are increasingly distributed and networked around the world, isolated national efforts are ineffective in improving competitiveness. Cooperation with technology companies that operate on a global level is the most effective means of ensuring competitiveness. Second, foreign direct investment stabilises the balance of payments and thus helps to ultimately stabilise the exchange rate. Moreover, foreign direct investment generally creates new, attractive jobs, spurs regional development, and can help diversify economic structures. Therefore, we suggest that greater efforts be made to attract foreign direct investment.

Recommendations for realising potential

We recommend that Belarus better tap its potential for foreign direct investment by improving its methods of promoting investment. Two pragmatic measures—easy to implement and associated with a low cost—can be undertaken to this end.

Institutional separation of investment promotion and privatisation

The NAIP does not have the capacity or instruments to execute either one of these tasks effectively and is clearly overwhelmed with both together. We recommend that an investment promotion agency be established in accordance with international best practices, with its focus primarily on new, ground-up projects—so-called “greenfield FDI”. A separate institution should be responsible for privatisation efforts.

Focus on the efficiency in promoting investment

We recommend focusing on supporting investors both before and after their investment. The support of existing foreign investors is currently insufficient. This has two negative consequences. Firstly, the possibility of attracting expansion investments is being neglected. Secondly, an important promotional channel is neglected, as satisfied investors are an important resource in marketing a location. Expensive, large-scale events and international travel should be avoided, as they strain budgets and have not shown significant success to this point.

Conclusion

Belarus must take immediate steps to make better use of existing potential for foreign direct investment. In addition, measures should be taken to increase that potential itself, that is, to increase the country's attractiveness for investors. We recommend reducing investment barriers. On the one hand, this means macroeconomic stabilisation. On the other hand, the regulatory framework must be improved. This includes

providing investors with protections in line with international standards, reducing bureaucracy, and forgoing state intervention in private business decisions. These challenges must be taken up simultaneously and with resolve, in order to ensure Belarus's future competitiveness on the global market.

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Note:

A more comprehensive analysis of the topic is provided by the Policy Paper PP/04/2015 "Attracting foreign direct investments – Recommendations for Belarus for tapping its full potential"

Download at: www.get-belarus.de

German Economic Team Belarus (GET Belarus)

GET Belarus has been engaged in political dialogue with reform-oriented decision-makers from the Belarus government since 2003. It is funded by the Federal Ministry for Economic Affairs and Energy (BMWi) as part of the government's TRANSFORM successor programme.

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