

## Reforming the free economic zones in Belarus

In Belarus there are currently six free economic zones (FEZs); the first one was established in 1996. Companies in these zones have a number of tax and customs benefits, even though the latter will be cancelled from 2017 onwards due to agreements within the Eurasian Economic Union.

Looking at the economic performance of the FEZs, the results are mixed at best. The number of residents and jobs created is going down, there are no real impulses in terms of export diversification away from traditional CIS markets, and the existing focus on import substitution is not in line with best international practice.

What can be done to improve the performance of FEZs in Belarus? We propose a strategic repositioning of the zones towards a cluster-oriented model with a strong focus on FDI-attraction. The attraction of small business should play a more important role than right now. Also, the positioning and differentiation of FEZs should be based on services and infrastructure, and less on fiscal incentives. Target-group oriented investment promotion efforts should be intensified and after-care services expanded. Finally, it should be assessed if public-private partnerships (PPP) can be used for the proposed upgrading of FEZs.

### What is a free economic zone (FEZ)?

The free economic zones (FEZs) of Belarus are an economic policy instrument that falls into the group of special economic zones (SEZs). While there is no generic definition of what comprises an SEZ, the term usually denotes the concept of a spatially delimited area (often including industrial infrastructure) that is operated under an administrative, regulatory and fiscal regime that differs significantly from the rest of the national territory. Depending on how broad the definition and criteria are applied, there are estimations of up to 4,300 special economic zones of various types worldwide.

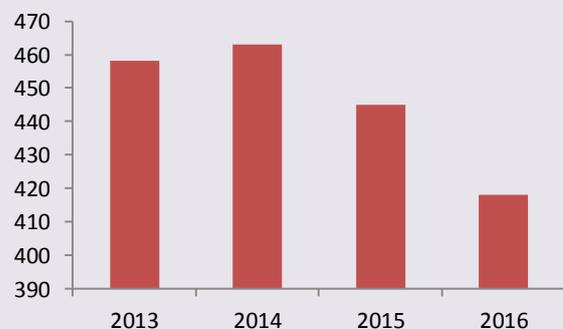
The first FEZ in Belarus was established in Brest in 1996. Over the following years, other zones were created, bringing the total number of FEZs to six currently operating. The “Law on Free Economic Zones” set up the legal framework for the creation, operation and liquidation of such zones. While originally several tax and customs benefits were granted to residents of FEZ, the zones will lose their customs benefits from January 2017 onwards due to respective agreements in the framework of the Eurasian Economic Union.

### FEZ performance in Belarus

What can be said about the recent economic performance of FEZs? Below we would like to highlight some developments.

Number of residents. Since 2014, the number of active residents has decreased significantly to 418 across all zones. This trend is mirrored in almost all zones. Also the number of new jobs created has fallen over recent years. In total, 3% of the total employment in Belarus is located in FEZ.

#### Number of active FEZ residents in Belarus



Source: Belstat

Foreign investments. 5% of Belarus’ total FDI stock is invested in FEZ, with a significant variation between the zones. The biggest investor is Cyprus (34%), which raises questions about their true origin; Germany is also very active with a second place (14%) before Russia (7.3%) and Poland (6.5%).

Export orientation. The share of export-oriented products is roughly between 50 and 65% of revenues and quite constant over time. This share is lower than international experience suggests; furthermore, most of these exports (80-90%) go to traditional CIS export markets, and not to new markets. As an instrument of regional export diversification, FEZs have brought some results only in Vitebsk (non-CIS share of 40%) and Gomel-Raton (26%). Another point criticism is the heavy focus on import substitution in the FEZs, which is not in line with best international practice.

Innovative products. The objective to boost the output of innovative products in FEZ has not been reached, as the share of such products is in most FEZ zones significantly below the national average.

### Policy options and recommendations

Overall, the mixed performance and rather moderate impact of FEZs in Belarus compared to successful schemes at the international level suggest that this policy instrument is not yet used to its full potential. One key reason seems to relate to the economic model of the FEZs and its positioning within the policy and incentive framework of Belarus. Despite similarities between the FEZs in Belarus and schemes in other countries in terms of incentives, services and the regulatory framework, the economic model applied and inconsistencies in the policy and incentive framework in Belarus pose significant obstacles for success.

In light of these findings, the following recommendations have been brought forward:

1. The FEZ scheme should be repositioned towards a cluster-oriented model with a strong focus on FDI-attraction. Based on an assessment of the cluster and investment potential as well as the competitive position of the individual FEZs, the most promising zones should be selected for the targeted upgrading of infrastructure, services and incentives, while the remaining zones would be phased out.
2. In line with the cluster oriented model, the focus on SME development should be strengthened as SMEs play an important role in cluster development. Facilities and services should be upgraded and adapted to the needs of SMEs.
3. The positioning and differentiation of FEZs should be based on services and infrastructure and less on fiscal incentives. Based on international experience, fiscal incentives should be reformed and targeted towards specific types of activities and clusters, while target group oriented infrastructure and services should be upgraded and expanded. A reduction of fiscal incentives would further relieve the pressure on public budgets.
4. Target-group oriented investment promotion efforts should be intensified and after-care services expanded. In order to unlock the investment potential, a more proactive and systematic target-group oriented approach is needed with concerted and coordinated efforts addressing the entire investment attraction cycle.
5. It should be assessed if public-private partnerships (PPP) can be used for the proposed upgrading of FEZs. This could increase the efficiency and customer orientation, while reducing the burden on public resources.

### Way forward

The findings of the research and in particular the review of international best-practice strongly indicate a need to realign the economic model and key design features of FEZs in Belarus as well as the positioning of the scheme within the policy and incentive framework. In order to refine the proposed reform and to prepare a policy decision, a survey-based analysis of the needs of residents and investment potentials of FEZs should be carried out. The survey should, for instance, cover investment location decision criteria and key preferences regarding FEZs features. This would help gain a better understanding of the underlying investment patterns and potentials.

Based on the findings, the proposed reforms could be further refined. Additional site and cluster analyses could be carried out for the most promising zones as well as corresponding implementation plans could be developed.

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Note: A more comprehensive analysis of the topic is provided by the Policy Study PS/01/2016 "Policy Options to Reform Free Economic Zones in Belarus"

Available at: [www.get-belarus.de](http://www.get-belarus.de)

### German Economic Team Belarus (GET Belarus)

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