

The digital economy in Belarus: a liberal enclave

The information and communications technology (ICT) sector in Belarus has established itself as a significant source of employment, export revenues and innovation. This is a welcome source of dynamism, as the reform of state-owned manufacturing industries has not progressed significantly.

First established in 2005, the Hi-Tech Park (HTP) offers a special business environment for ICT business in Belarus. The preferential tax and legal regime was further expanded in December 2017, attracting a significant amount of new companies to the HTP.

The challenge over the medium term is to maintain standards in university education and the supply of skilled graduates to a rapidly evolving industry. A local funding base could entice more companies to keep their core operations within the country.

Rapid growth of the ICT sector

The information and communications technology sector is rapidly becoming an important source of growth for the Belarusian economy. Employment in the sector was estimated at about 85,000 in 2017, accounting for over 5% GDP. The ICT sector is almost entirely export-oriented and is now the second largest component in the positive balance in services trade. This is a welcome source of growth, as the typically state-owned manufacturing sector remains plagued by excess debt and low productivity growth.

The ICT sector in Belarus originated from traditional software development services. A leading company of the industry is EPAM Systems. Having been founded in Minsk in 1993, the company has since grown into an international software services provider, with a listing on the New York Stock Exchange, and two thirds of its staff based outside Belarus. More recently, the sector has expanded into technologies such as artificial intelligence, virtual reality and solutions for the agricultural and health sectors. Two notable investments in Belarusian companies in 2016 and 2017 brought the country on the map of international venture capital deals: Masquerade (MSQRD), which had developed a face filter application was acquired by Facebook; and AIMater, a neural network-based AI platform, by Google.

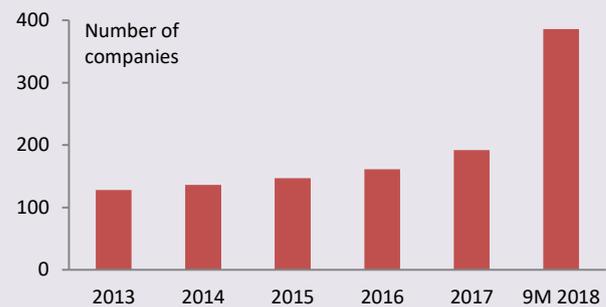
This rapid growth has been underpinned by high standards in secondary and university-level education in science and technology, and a steady supply of software engineers. The country ranks at the top of the World Bank's tertiary enrolment index. The so-called STEM disciplines of science, technology, engineering and

mathematics, are almost exclusively taught by state educational institutions. Despite this strong skills base, companies in their early development often lack commercial skills, such as in marketing and sales, which inhibits their growth.

The regime of the HTP has become more favourable

Already in 2005, Belarus created a favourable regime for the technology sector. The already existing benefits of the so-called Hi-Tech Park regime were significantly broadened through the Decree No. 8, which was enacted in December 2017, and is also known as the Digital Economy decree. In 2018, this attracted a significant number of new residents to the park, which by now harbours 386 enterprises. Those companies can be located anywhere in the country and do not have to be based on the premises of the HTP.

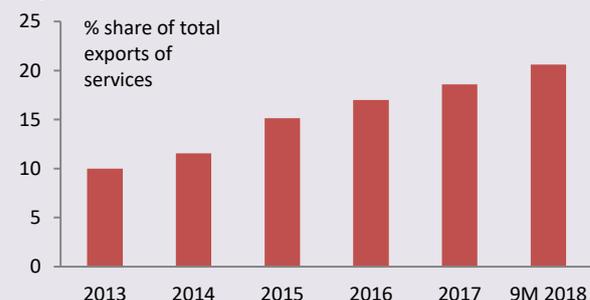
Residents of the HTP



Source: HTP

In 2017, HTP residents employed roughly 32,600 software engineers and other staff; current figures suggest over 35,000 employees. In 2017, the park's export turnover exceeded USD 1 bn and accounted for 91% of total exports of IT services. The total exports of the Belarusian ICT sector (and above all the HTP) continued to grow strongly over 9M2018 (+31%) and accounted for around 21% of total exports of services. This positive development is expected to continue in the future.

Exports of ICT services



Sources: National Bank

Residents can operate in a broader but well-defined set of areas and will benefit from exemptions in personal and corporate tax. The benefits for cryptocurrency activities are significant. Elements of UK law, such as options or convertible loans can be used, which are not generally available in Belarus. Leading international companies, such as Google and General Electric, now cooperate with HTP residents, and an incubator was recently established.

Venture Capital and private equity funding

The favourable regime in the Hi-Tech Park is only relevant for larger and more mature firms which meet specific requirements. For continued growth of the ICT sector in Belarus and the emergence of start-ups it will be important to overcome a number of obstacles in Belarusian regulation.

A key shortcoming is corporate governance, where a recent EBRD assessment found numerous problems in terms of control within enterprises and rights of shareholders. Sound contract enforcement through the courts and the protection of intellectual property are similarly key requirements for the sector.

As of now, the Belarusian start-up scene is predominantly funded through informal channels of finance, and so-called business angels. These are individuals who make industry expertise and networks available alongside their funding. Two funds that are dedicated to seed and start-up phases operate from off-shore bases. Successful companies often relocate to Europe or the US and channel funds back to operations in Belarus. Only one local private equity firm offers funding to growing companies in later stages of development.

Over the long term it will be important to develop local investment funds which are prepared to actively develop companies and take risks. This is not the domain of banks but of venture capital funds and private equity, which are specialised in assessing technologies. These funds also work closely with their portfolio companies to reform governance, and adapt operations to the requirements of international markets.

There is clear empirical evidence for the positive effects that result from the investments by private equity and venture capital funds. These investments will help firms grow, raise capital spending and gain access to credit and skilled staff.

It is essential that local financing in Belarus will ultimately cover a continuum of financing instruments, stretching across all stages of a company's growth, from seed finance to the growth stages of companies with proven commercial concepts. In Europe, the funding of the innovation economy heavily relies on the activities of public sector development banks.

Conclusion

The rapid growth of the digital economy sector is evidence of the strong human capital and skills base in Belarus, and its potential for innovation.

A challenge for Belarus will be to attract venture capital and private equity funds from elsewhere in Europe. As local private and institutional investors emerge, a suitable capital market legislation will need to be defined.

Also, the country's traditional strength in scientific and engineering education within state institutions will need to be expanded and adapted to the requirements of the international market.

The sector benefits from an exceptionally liberal tax and legal regime, to which the government is committed over the foreseeable future. While the sector is still relatively small, ultimately there will be a need to reform the much more restrictive regulatory regime elsewhere in the economy, reflecting the success of the digital sector.

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