China Helps an Ailing Autocracy

On 8 November Minsk signed a deal with Dagong Credit Rating Co Ltd, China's largest credit ratings agency, to assess its sovereign credit rating. State-owned Dagong may issue a more favorable rating than the US agency Standard & Poor's, which downgraded Belarus from B to B- in late September.

The deal is part and parcel of Beijing's bailout for Belarus – in September, China inked a deal to provide a $1 bn bailout loan by end of 2011, on more favorable terms than the Russia-led Eurasian Economic Community and the IMF. Beijing is willing to help a fellow autocracy off its knees, but the support comes with a price: stakes in Belarus's strategic state-owned companies.

At face value, Beijing seems to be exploiting a downturn in the Belarusian economy. One could argue that China pursued similar acquisition strategies in Western Europe in the aftermath of the 2009 crisis, although China's impact in Belarus is greater and the political implications are more significant. This version of events jives well with the view that Chinese investors are "neo-mercantilists". But this picture is too facile.

Chinese investment comes in diverse clusters of coordinated projects. Belarus is no different. Large Chinese delegations that visited Minsk in March 2010 and September 2011 have initiated investment projects in up- and downstream industries, comprising several modes of entry. In the power sector alone, the value of investment projects carried out and planned amounts to $3 bn. Not all of that capital may be registered as FDI, since China often lends capital to Belarusian firms, who are then obliged to contract Chinese firms. Nonetheless, with Belarusian FDI averaging less than $2 bn per year, China’s investments would make a big impact even without equity investments.

China is set to make its biggest mark in power generation, and the main investments have gone into revamping four coal-fired thermal plants. Among the thermal plants is 5-Minsk, a key source of power for the nation’s capital – capacity will increase nearly fourfold to 610 MW. The air pollution this will cause for Minsk is considerable – CO_2 emissions are set to quadruple. Equally controversial is China’s foray into nuclear power. It is entering a bidding process to build twenty 110-330 kWt substations to distribute electricity from the Belarusian Atomic Energy Station. The proposed site remains contested on environmental safety grounds. The Fukushima catastrophe and the ensuing nuclear debate in Western Europe this year have increased Western pressure to abandon the plan. This is why the implicit support from China is welcome news to Lukashenka.

However, China is also promoting clean energy in Belarus. According to an agreement signed last month, a new 40 MW hydropower plant is to be built at Vitsebsk by 2015. A further $500 m in investments could flow into a cascade of smaller hydro plants. On a smaller scale, China is breaking ground on wind power with a 1.5 MW farm in Grodno region. China today is the world’s top producer of wind turbines and has installed considerable capacity in its less populous western regions.

Beyond the power sector, a shining example of technology transfer is in telecoms. According to a bilateral agreement signed in September, China will help Belarus launch its first communications satellite within the next 30 months. Belarus will become the seventh country to carry out such a project with China.

Further downstream, China is engaging in several areas of manufacturing. On the one hand, China National Machinery

Industry Corporation (Sinomach), China’s largest machinery producer, is keen on acquiring prized assets in the machinery industry, which form the core of Belarus’s export capacity. On the other hand, joint ventures are underway at chemical plants for sodium carbonate, nitrogen fertilizer, cellophane, and paper. China might be interested in using these industries as a platform for exports to Russia and the EU. In a sense, China is supporting dirty industry on Europe’s “periphery” — though it might help to bring in more modern, less polluting technologies.

The emergence of such diverse investment activities since 2009 underscores the coordinated nature of Chinese investment. Not surprisingly, there is talk of a new industrial park for Chinese companies. Beijing Fandian, a luxury hotel chain, has begun construction on a new branch in Minsk to be inaugurated in 2013, which will cater to Chinese businesspeople and officials. The hotel might play into Lukashenka’s explicit efforts to create a “Chinatown” in Minsk.

Indeed, some hope that Minsk may become a new center for the Overseas Chinese community. Chinabelarus.net, a Chinese-language site established in 2008, is already a popular networking tool for Overseas Chinese. The breadth and scope of Chinese engagement in Belarus could be impressive. But Beijing is likely to monitor each step of the way. The Chinese companies entering Belarus illustrate the importance of what is at stake. At least five of them have a market cap of over $500 m and are publicly listed (either directly or through their parent).

At a time when Belarus is mired in crisis, Beijing’s commitment to investing extensively with top companies is quite bold. As an emerging power, China now has sufficient capital, technology, and know-how to contribute, particularly in telecoms and clean energy. In the process, it can serve as an engine for employment, productivity gains, and technological progress, which in turn can stimulate economic growth. Large industrial projects could exert a centrifugal effect on corollary industries. In the short run, moreover, China’s vote of confidence could attract other investors to enter Belarus, allowing FDI inflows to shore up the country’s balance of payments.

But China is exporting some of its negative practices as well. It is supporting potentially hazardous projects in nuclear power, thermal power, and chemicals production. More importantly, while the West is intensifying its boycott of Minsk – most recently Deutsche Bank and BNP Paribas – Beijing is helping a fellow autocracy off its knees. As President Lukashenka so aptly put it: “We will always remember that our Chinese friends stretched out a helping hand to us in times of crisis.”

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(This is the second article of a three-part series)

Chinese FDI in Belarus: Investing in a Backwater?

Last week, a delegation led by Sinomach, the largest state-run machinery manufacturer in China, met with Economy Minister Nikolai Snopkov. This follows a visit by Wu Bangguo, head of China's National People’s Congress, to Minsk last month.

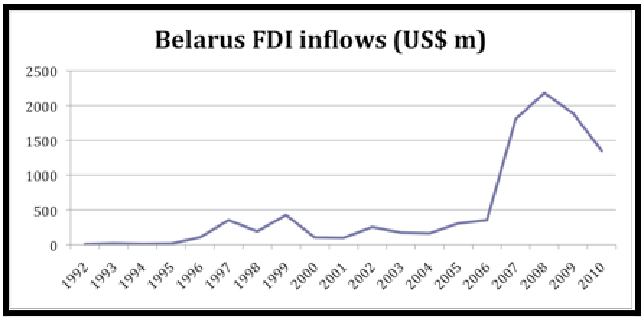
Beijing will issue a $1 bn soft loan to help Belarus out of its current account crisis. Minsk will reciprocate by granting China equity stakes and joint ventures in strategic sectors, such as machinery and power generation. This follows $15 bn in loans issued by Chinese banks to Belarus over the past two years.

These developments are emblematic of China’s global expansion. With foreign exchange reserves at half of GDP, China is looking to reinvest surplus capital overseas. Since 2009, it has poured more money into developing economies than the World Bank. In the process, Beijing is expanding diplomatic influence, securing resources and markets, and promoting the globalization of state-owned firms. Like other low-income countries, Belarus is eager to obtain Chinese capital and technology on preferential terms. But Belarus is unique in several respects.

China is entering just as the Belarusian economy faces severe challenges. China sympathizes with a post-socialist country ruled by a strong state. If China, as opposed to Russia or the EU, becomes Belarus’s major investor, this could have major implications for the country’s future. Belarus may also become a geostrategic node for China in Eastern Europe. This could trump the EU’s efforts to isolate Belarus, as well as challenge Russia’s attempts to control its smaller neighbor.

Historically, Belarus has not been a popular place to invest. In 2000-10, the average share of FDI to GDP was below the level for post-Soviet states, even though Belarus’s economy is very small. In the industrial sector, firms with foreign investment account for less than a tenth of total output and employment. China thus appears to be venturing into an investment backwater.

But conditions for foreign investors in Belarus are a lot better today than ten years ago. FDI inflows increased markedly in 2007, from less than one percent to four percent of GDP. Unlike exports, which plummeted after the crisis in 2009, FDI inflows have remained high.



FDI growth is likely to continue with or without the Chinese. Belarus is an extremely open economy, with trade volume at 101 percent of GDP in 2010. Theory and empirics dictate that foreign investment follows trade. More importantly, the government, in spite of excessive interference in the economy, has implemented measures to attract investment. In an April 2008 speech to the National Assembly, President Lukashenka announced the target of making Belarus one of the 30 countries with the best business climate. This is echoed in a report by the cabinet's Foreign Investment Consultative Council, which also aims to increase FDI to one fifth of GDP in the next decade.

Even if Belarus does not meet these targets, its investor environment has certainly improved. Last year, it ranked 68th among 183 countries on the World Bank's "Ease of Doing Business" survey, ahead of China and Russia. On several indicators, such as the time it takes to start a business and the cost of registering property and enforcing contracts, Belarus does better than average for post-Soviet states. It has also been one of the region's most prolific signatories of bilateral investment treaties (BITs); the bulk of these have been with countries outside the region.

Nonetheless, investor-friendly policies are not useful without economic stability. Judging by Belarus's recent performance, Chinese investors will face considerable risks. The Belarusian ruble, on a crawling peg with a basket of currencies, has not withstood severe inflationary pressures. The first major devaluation came in January 2009, followed by several more this year. Due to excessive borrowing and plummeting exports, Minsk can no longer service its current account deficit. One could argue that the upside of a poor country fraught with debt, inflation, and currency risk is its growth potential – GDP did expand at eight percent per year in 2000-08. But in light of the current crisis, the IMF forecasts just four percent annual growth for 2011-16. In the meantime, the structural reforms necessary to improve the economy – such as more flexible labor markets, a smaller public sector, and less welfare spending – will take time.

The Chinese don't seem too concerned though. During his visit, Wu Bangguo sought to shore up investor confidence by blaming Belarus's misfortunes on Western sanctions and the global economy. His statement was politically motivated. Even when the global economy recovers, Belarus's exports are unlikely to return to previous levels, because they are losing their principal advantage: subsidized oil and gas inputs from Russia.

Economic recovery may be less relevant for Chinese companies in Belarus. Because most are owned by the state, they face less pressure to make quick profits and can turn to state-owned banks for refinancing. As latecomers, the Chinese often leverage risk propensity to explore opportunities in markets that Western investors avoid. The question is: what opportunities does Belarus, a small country without natural resources, really offer?

From China's perspective, there are plenty. Currently, the bulk of FDI is flowing into trade and services rather than manufacturing and infrastructure. As a result, FDI has countributed little to fixed capital formation. So Belarus is lacking FDI precisely in those areas where Chinese companies are strongest.

Much has been made of China's bid to acquire state assets. But the Chinese are equally keen on forging new industries. During

Wu Bangguo’s visit, Prime Minister Myasnikovich expressed interest in establishing an industrial park for Chinese firms, referring to the success of Singapore’s industrial parks in China. He might have mentioned that the Chinese now have ample experience with independent economic zones in developing countries, such as Pakistan and Zambia. Implicit in Myasnikovich’s comment was also disappointment in Belarus’s own Free Economic Zones (FEZs) – established in the 1990s, they have failed to attract notable investments.

In sum, Chinese firms see opportunities and downgrade risks. Chinese investment is likely to increase in the medium term, through good times and bad. Whether and how Chinese investors will benefit Belarus, however, is another matter.

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(This is the first article of a three-part series)