

Russian investments in Belarus

1 Introduction

Russia is the largest foreign investing country among the Commonwealth of Independent States (CIS), and the 15th largest investor in worldwide comparison. Russian companies have been particularly active in investing in the neighbouring CIS countries. The expansion of Russian enterprises to the developed markets is a more recent phenomenon. With a focus on strategic sectors of the target economies, Russia is the largest foreign investor in most of the CIS countries. The leading Russian energy companies such as Gazprom and Lukoil have equity investments in virtually all the CIS countries. In addition, the leading Russian companies dominate the energy sectors of several of its neighbouring countries.

Until recent, Russia and Belarus have been the closest allies among the former Soviet Union countries. Given the huge trade imbalance between the two countries¹, the relations between Russia and Belarus have traditionally been far from market-based but, to a large extent, built on intergovernmental agreements and close political relations. The Belarusian authoritarian President Aleksander Lukashenko had vowed his political support to Moscow in exchange to receiving Russian energy supplies at preferential prices. Until 2007, Belarus

¹ In 2005, Russia accounted for 36 percent of Belarusian exports and 61 percent of Belarusian imports (Ministry of Statistics and Analysis of the Republic of Belarus, 2007). In contrast, the respective shares for Belarus in Russia's foreign trade were 6 percent for exports and 4 percent of imports (Goskomstat 2007).

received Russian crude oil and natural gas practically at Russian domestic prices, leading to huge annual subsidises to the Belarusian economy².

Until the end of 2006, the development of relations between the two countries envisaged further economic and political integration. However, the relations between the countries begun to deteriorate in 2006 after a dispute over energy prices, similar to that witnessed between Ukraine and Russia a year earlier.

Along with the recent deterioration of the relations between the two countries, the issue of Russian investments in Belarus and related control over the country's industrial assets has significantly gained on importance. As the advantageous geopolitical location of Belarus³ is its strongest trump card in negotiations against Russia, the control over major Belarusian infrastructure assets appeared as a key issue in the recent dispute over the energy supplies from Russia.

Against this background, the current article discusses the Russian foreign direct investments (FDI) and acquisitions in Belarusian economy, with insights into overall FDI trends in Belarus. By presenting the cases of largest Russian FDI in Belarus, the article aims to elaborate on strategic importance of Russian investments in the country and assess the future prospects for Russian companies in Belarus. As the recent deterioration of the

² As stated by the Russian President Vladimir Putin, the Russian energy subsidies for Belarus will reach US \$ 5.8 billion in 2007. In contrast, amid the recent energy dispute, his Belarusian counterpart Aleksander Lukashenko has dismissed the claims on subsidizes as "ridiculous" (RIA Novosti 2007a/b).

³ Some 20 percent of Russian natural gas and up to two thirds of the crude oil deliveries to Europe run through Belarusian territory.

relationships between Russia and Belarus is bound to have an impact on economic co-operation and FDI flows between the countries, the origins and outcomes of the energy dispute will be discussed in connection to Russian business presence in Belarus.

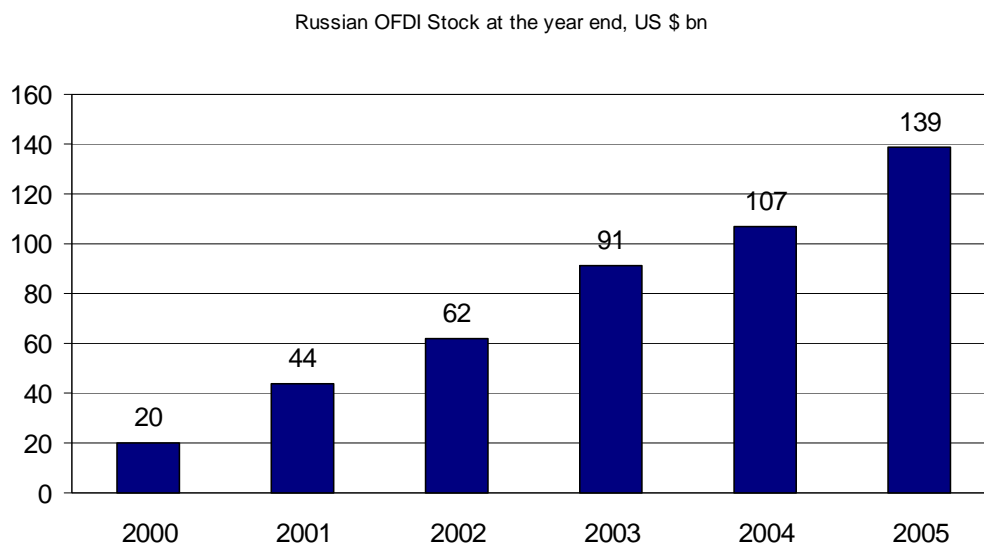
The article is structured as follows. Chapter 2 provides a brief overview on Russian outward foreign direct investments (OFDI) with a focus on the CIS (Chapter 2.1). In Chapter 2.2, a statistical overview on Russian investments in Belarus is provided in a context of overall inward FDI in the country. Chapter 3 discusses the activities and investments of the largest Russian companies in Belarus. Chapter 4 presents conclusions and future outlook for Russian FDI in Belarus.

2 Overview on Russian OFDI

2.1 Russian OFDI in a global context

Russian OFDI have grown rapidly during this millennium, from mere US \$ 20 billion in 2000 to nearly US \$ 140 billion in 2005 (Figure 1). While the rapid rise in Russian OFDI can largely be attributed to increasing international activities of the Russian transnational corporations (TNCs), the recent improvements in OFDI data registering by the Central Bank of Russia are partly responsible for the dramatic increase in the investment statistics.

Figure 1 Development of the Russian OFDI stock, 2000-2005.

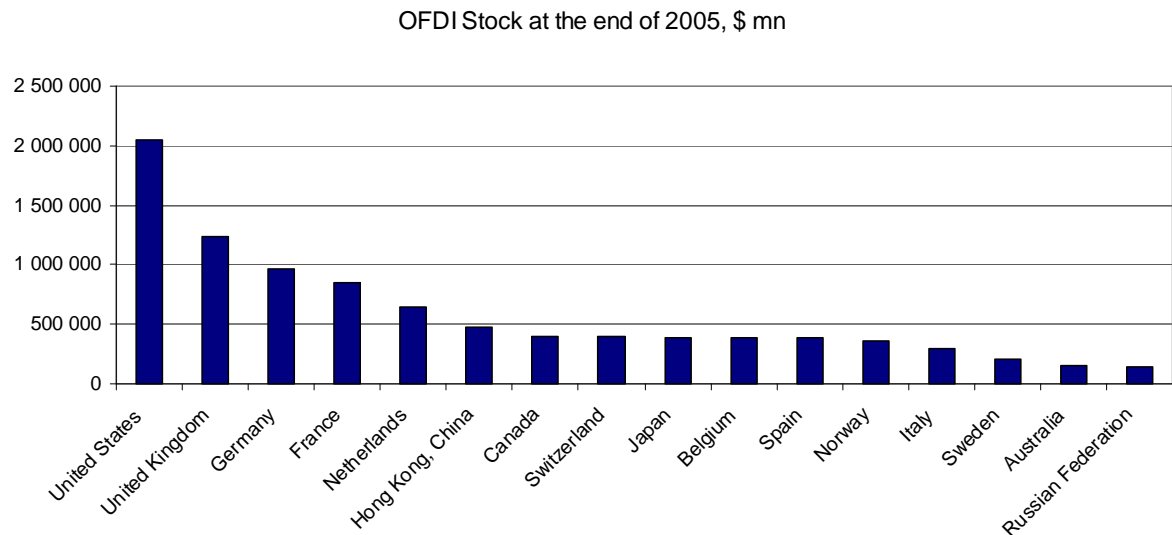


Sources: UNCTAD (2006a), Central Bank of Russia (2006).

At the end of 2005, Russia ranked as the 15th largest foreign investor country in the world (Figure 2). With its OFDI stock nearing US \$ 140 billion, Russia is the second-largest investor among the emerging economies after the South-East Asian financial hub, Hong-Kong, China. Besides the official FDI, massive amounts of capital have left Russia as unregistered capital flight. Although widespread controversy exists concerning the total amount Russian investments and capital abroad⁴, it is widely acknowledged that the actual figures are considerably higher than suggested by the official data on OFDI.

⁴ Various estimates are provided on additional capital flight from Russia. According to the European Commission, the non-recorded capital flight from Russia totaled US \$ 245 billion in 1992-2002. In addition, the composition of capital outflows from Russia highlights widespread misreporting and undervaluation of revenues from abroad. Put differently, Russian companies systematically undervalue their export earnings and report remittances against fictitious imports and transactions in securities. Only in 2005, this item on the balance of payments of the Russian Federation accounted for US \$ 27 billion, according to the Central Bank of Russia.

Figure 2 **World's largest foreign investing countries in 2005**



Sources: UNCTAD (2006a), Central Bank of Russia (2006).

During the past years, the leading Russian TNCs have pursued an aggressive strategy in acquiring foreign assets. Besides the increased number of foreign acquisitions, the value of asset purchases by Russian companies abroad has soared. Table 1 presents the largest foreign acquisitions by Russian companies during 2004-2006.

Table 1 The largest foreign acquisitions by Russian companies in 2004-2006 (planned and realised)

Acquiring company	Target company	Country	Nature of business	Share, %	Value, US \$ mln
Altimo	Turkcell	Turkey	Mobile telecommunication	13	3 200
Gazprom	Beltransgaz	Belarus	Natural gas distribution	50 ⁵	2 500
Evrax Holding	Oregon Steel Mills	USA	Steel production	100	2 300
Lukoil	Nelson Resources	Kazakhstan/ Canada	Oil exploration & production	100	2 000
Norilsk Nickel	Gold Fields Ltd	South Africa	Gold mining	20	1 200
Evrax Holding	Highveld Steel	South Africa	Steel products	79	678
Evrax Holding	Palini & Bartoli	Italy	Steel products	75	650
Severstal	Lucchini Group	Italy	Steel products	62	574
RusAl	Queensland Alumina Ltd	Australia	Alumina refinery	20	460
VimpelCom	Kar-Tel	Kazakhstan	Mobile telecommunication	100	425
Evrax Holding	Vitkovice Steel	Czech Republic	Steel products	100	287
VimpelCom	Buztel and Unitel	Uzbekistan	Mobile telecommunication	100	275
Lukoil	Teboil and Suomen Petrooli	Finland	Petroleum marketing	100	270
Lukoil	-	USA	795 petroleum stations from ConocoPhillips	100	266
VimpelCom	Ukrainian Radio Systems	Ukraine	Mobile telecommunication	100	254
RusAl	Alscon	Nigeria	Aluminium production	78	250
MTS	Uzdunorbital	Uzbekistan	Mobile telecommunication	74	121
Evrax Holding	Strategic Minerals Corporation	USA	Steel production	73	110

Sources: Company information; authors' calculations.

Majority of the Russian companies' foreign mergers and acquisitions have taken place during this millennium, indicating the growing international activeness of the Russian firms. The leading Russian energy and metal companies have already become truly global majors with the telecommunication companies following the suit by expanding actively in the CIS region. Backed by the soaring energy revenues, the Russian oil and gas majors have been in recent years active in searching for foreign acquisition targets. More

⁵ By 2010, Gazprom will gradually acquire 50 percent of the company. The first transfer of 12.5 percent of the Beltransgaz shares is due in June 2007.

importantly, the geographical scope of their activities have expanded from the traditional CIS region to cover the whole world as proved by acquisitions by the leading Russian oil company, Lukoil, in North America, the world's largest natural gas producer, Gazprom, in the European Union, and the metal giants Norilsk Nickel and RusAl in Africa, among others. In large, Russian outward FDI remains heavily concentrated in the natural resource-based sectors. Further, few leading companies account for significant majority of outward investments from Russia.

Regarding the geographical distribution of Russian OFDI, the recent development has largely been twofold. On one hand, the scope of Russian investments has expanded dramatically in recent years covering practically the whole globe. Increasingly, Russian companies engage in asset purchases in the established markets of the EU and the USA, among others. On the other hand, as suggested by the UNCTAD (2006b) data on cross-border M&A purchases by Russian companies, the share of CIS among the Russian OFDI has again grown in recent years. Measured by the number of deals, over a half of the Russian M&A purchases have taken place in the CIS region, whereas the developed countries account for around 40 percent.

In addition, the value of foreign acquisitions in the CIS region has grown dramatically in recent years. The days of cheap asset stripping belong to the past and one may already have witnessed several multibillion acquisitions in the region. Moreover, the assets controlled by Russian companies in the CIS countries tend to be highly strategic in nature, such as the energy or infrastructure assets. The Russian companies also hold prominent positions on

the CIS markets, whereas in developed economies they have considerably smaller leverage in key industries of the target countries.

A closer look to Russian investments in the CIS reveals several problems in producing reliable estimations on Russian FDI in the region as the official statistics on Russian investments in the CIS tend to be highly misleading. Table 2 presents an overview of the Russian FDI flows to the CIS, as reported by Goskomstat.

Table 2 Russian annual FDI flows to the CIS, 2003-2005

	2003		2004		2005	
	<i>US \$ '000</i>	<i>%</i>	<i>US \$ '000</i>	<i>%</i>	<i>US \$ '000</i>	<i>%</i>
Total	544 141	100	713 016	100	620 522	100
Azerbaijan	1 613	0.0	2 379	0.3	6 734	1.1
Armenia	7 650	1.8	1 033	0.2	138 185	22.2
Belarus	243 355	41.0	280 193	39.3	102 438	16.5
Georgia	1 182	-	284	0.0	60	0.0
Kazakhstan	27 135	2.6	84 104	11.8	204 314	32.9
Kyrgyzstan	608	0.6	628	0.1	1 247	0.2
Moldova	372	0.1	6 600	0.9	4 904	0.8
Tajikistan	18	0.0	3 067	0.4	496	0.1
Turkmenistan	857	0.4	1 865	0.3	-	-
Uzbekistan	582	0.8	138 547	19.4	6 968	1.1
Ukraine	260 769	52.7	194 316	27.3	155 176	25.0

Source: Goskomstat 2007.

As shown in Table 2, the Russian investment flows to the CIS, totalling US \$ 620 million in 2005, are relatively negligible on the face of total OFDI from Russia in 2005, amounting to over US \$ 13 billion. Further analysis of somewhat differing Russian and CIS statistics shows that the region accounts for between 1 and 5 percent of Russia's total OFDI. In this respect, one might regard Russia as a negligible investor in the CIS. However, one only

needs to take a brief look on some of the largest individual investment projects by Russian companies in the CIS to see that the FDI statistics alone are insufficient in portraying the actual presence of Russian companies in the region⁶. In this article, the focus is upon the role of Russian companies in Belarus⁷ and their distinct leverage on the country's economy.

2.2 *Russian FDI in Belarus*

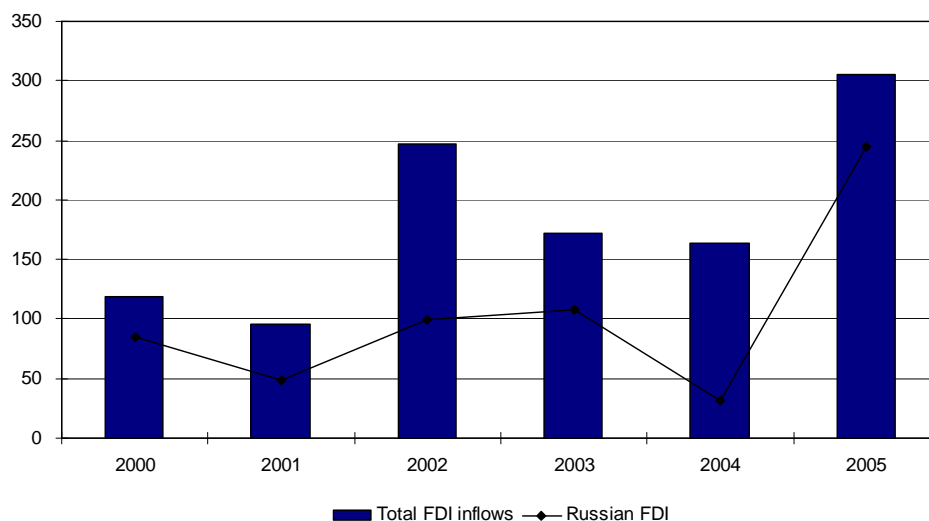
According to Goskomstat (2007), Belarus has been the leading CIS country in attracting Russian investments⁸. Similarly, according to the National Bank of Belarus (2007), Russia has been the leading foreign investor in Belarus throughout the 2000's. In the peak year of 2005 Russia accounted for over 80 percent of Belarusian FDI inflows (Figure 3). One must note, however, that although the level of Russian investments in the country may seem high at first glance, this is mainly due to the fact that the overall level of inward FDI in Belarus remains extremely low.

⁶ The statistical discrepancies occur for mainly three reasons. First, major Russian companies invest abroad through offshore investment units or third countries (investment trans-shipping) and the investments are not registered as of Russian origin in the recipient countries. The registration practices understandably vary from one country to another, but the essential problem of identifying the ultimate beneficiary behind the investment is shared by all the countries in the region. Second, in many instances, the investments by Russian companies are not regarded as FDI by definition. In particular, this goes for the massive investments in the exploration and infrastructure projects, operated by existing subsidiaries or joint ventures in the host countries. After a company or joint venture is established, the further investments or ownership changes in this company are not regarded as FDI, but often categorised as 'other investments' in the balance of payments of the host economy. It is claimed here, however, that this statistical treatment, however, does not lessen the investor company's leverage in the target market. Third, the inconsistencies may partially root to the operations of Soviet enterprises abroad, where most of these assets are inherited by contemporary Russian enterprises. Complications in valuation of these assets clearly add to the problem of statistical inaccuracy and inconsistencies.

⁷ For case studies on other CIS, see e.g. Vahtra (2005, 2006).

⁸ It will be argued later, that the actual level of Russian investments is considerably higher in countries such as Ukraine and Kazakhstan, despite their lower statistical performance of attracting Russian FDI.

Figure 3 FDI inflows in Belarus, 2000 – 2005, US \$ mln.



Source: National Bank of Belarus 2007.

According to the Belarusian sources, the Russian FDI in the country amounted to US \$ 245 million in 2005 and US \$ 32 million in 2004. Significantly different figures are posted by Goskomstat – according to the Russian statistics, Russian FDI flows in Belarus amounted to US \$ 102 million in 2005, down from US \$ 280 million in 2004. As one may easily perceive, there is evidently a considerable divergence in FDI registering practices between the two countries.

Despite the obvious inconsistencies and shortcomings in investment registering practices discussed above, the author claims that Belarus is, to some extent, an exception among the CIS countries regarding the explanation value of FDI statistics and FDI from Russia in particular. There are several reasons to this.

First, the number and value of assets controlled by the Russian companies in Belarus are relatively low compared to those in for instance Ukraine and Kazakhstan. Although the official statistics suggest the Russian investments to be larger in Belarus than Ukraine or Kazakhstan, the latter accommodate significant amount of trans-shipped investments of Russian origin, which can be perceived by looking into individual FDI projects in the countries. In contrast, the value and strategic importance of Russian FDI in Belarus has thus far been significantly lower. This naturally lowers the probability for statistical errors as there are no realised multibillion FDI deals in Belarus, which could result from trans-shipped investments of Russian origin. We argue that, besides the lack of attractive investment targets in Belarus, one of the main reasons for the lower level of Russian FDI in the country originates from the exceptionally close political and economic relations between the two countries. It has been put forward by a number of scholars, that the motivations behind Russian FDI may often be linked to the country's foreign policy objectives, and even more so in the CIS region (e.g. Heinrich 2003; Liuhto & Jumpponen 2003 a/b; Vahtra & Liuhto 2004; Vahtra 2005). As Belarus had a tradition of being the most loyal ally to Russia among the CIS, there has been less need for Russia to secure its leverage in the country through large-scale FDI in strategic sectors of the economy, as it has done in many other countries in the region.

The second major reason for somewhat higher reliability of FDI statistics is the fact that there has been virtually no political resistance towards Russian investments in Belarus. In many countries in the region, political resistance considerably lowers the reliability of FDI

statistics causing the Russian companies to invest through third countries and hide their true identities.

Despite the above reasoning, the official statistics alone remain insufficient in providing information on actual Russian business presence in Belarus. In following, we provide a company-level analysis on the largest Russian investments in Belarus in order to achieve a more comprehensive picture on Russian investments in the country.

3 The largest Russian companies in Belarus

As of 2005, there were roughly 600 registered enterprises in Belarus with Russian equity capital, accounting for some 20 percent of foreign investment enterprise population of the country (Guide.Export.By 2007). In the current chapter, we concentrate on three sectors that have strategic importance on the Belarusian economy and accommodate the largest Russian investments. In the last subchapter, a brief overview is provided on the Russian investments in other sectors of the Belarusian economy. The key role in the current chapter and in the subsequent discussion is acquired by the energy issues, which, to large extent, dominate the current economic dialogue between the two countries.

3.1 Natural gas

Gazprom, the world's largest natural gas producer and the leading Russian company by foreign assets, controls an extensive gas distribution network throughout the CIS. Currently, the company primarily targets the Western-European infrastructure and downstream assets, seeking to expand its business empire on its main target markets of the Western EU. With prominent market positions throughout the CIS and most of the CEE, and an increasing grip over the Western European downstream sector, Gazprom is one of the most influential and fastest-expanding business empires in Europe, if not globally.

In Gazprom's European conquest, Belarus occupies a key role as a major transit country of Russian natural gas to the European markets. In Belarus, two major gas pipeline systems

are in operation. The majority of Russia's natural gas exports through Belarus are shipped through Yamal-Europe pipeline, the Russian and Belarusian stretches of which are owned by Gazprom. The Belarusian part of the 4000 km-pipeline, connecting the Russian Yamal Peninsula with Germany, was built in 1997-1998 and the construction was fully financed by Gazprom. The Russian gas giant holds the property rights for the pipeline and has a long-term lease agreement on the land beneath the pipeline⁹.

The issue of control over the other gas pipeline, Beltransgaz, became an integral part of Russian-Belarus energy dispute in late 2006. As Gazprom and Russia demanded an end to the preferential price on gas supplies to Belarus and moving to a cash-based supply contracts, the two countries were drawn into a widespread energy dispute similar to that between Russia and Ukraine a year earlier. Referring to the Union State agreement, Belarus strongly opposed the raise in its heavily discounted gas price¹⁰. Under the threat of supply cutoff starting from 1 January 2007, the deal was stroke at the last moment with what can be considered as significant concessions from the Belarusian side. A five-year contract on Russia's natural gas deliveries to Belarus was signed, at US \$ 100 per 1000 cubic meters in addition to the right for Gazprom to acquire 50 percent of Beltransgaz, the Belarusian gas-transit pipeline and the country's most valuable industrial asset. In many respects, the deal can be considered as a major success for Gazprom, seeking to end the subsidised supplies to the former Soviet Republics. In addition, gaining control over one of the key gas

⁹ Despite the agreements in place, the Belarusian President Lukashenko announced a demand for Russia to pay rent for land under gas and oil pipelines in its use running through Belarusian territory (RIA Novosti 2007b).

¹⁰ US \$ 47 per 1000 cubic meters, compared to the EU average of US \$ 265 per 1000 cubic meters.

infrastructure assets in the region is a major step forward in expanding Gazprom's gas distribution empire in the CIS and the EU.

According to the agreement, Gazprom is to gradually acquire a 50 percent-stake in Beltransgaz by 2010. The total price for the stake was set at US \$ 2.5 billion. Despite the seemingly high price tag, one should take into account the additional revenues from the raised gas prices, exceeding US \$ 1 billion only in 2007. The first transfer of 12.5 percent of shares in the company to the Russian gas giant for the price of US \$ 625 million is scheduled to June 2007.

3.2 Oil and oil products

The preferential pricing of crude oil deliveries from Russia and the high refining profit margins have made Belarus a lucrative operative location also for the Russian oil producers. Until the end of 2006, all the major Russian oil companies used to process crude oil in Belarusian refineries. In the beginning of 2007, however, Belarus cancelled all refining contracts of the Russian companies with Mozyr and Naftan refineries. Most likely, the issue of Russian operational and equity participation in Belarusian oil refining industry will be an integral part of the continuing energy negotiations between Russia and Belarus.

Russia is the sole supplier of crude oil to Belarus, having traditionally subsidised the Belarusian economy through a highly preferential pricing. The recent energy dispute between the countries, however, marked an end in the preferential pricing policy. Following the dispute over the gas prices, Russia and Belarus entered into a bitter row over

oil export and transit duties. When Russia demanded Belarus to pay oil export duty for Russian supplies to the country in the beginning of 2007, Belarus reacted by introducing a transit fee on Russian oil exported to Europe through Belarus. After heated negotiations and a three-day shutdown of Russian oil supplies to Belarus and Europe, Belarus lifted the transit duty and Russia cut the export duties from US \$ 180.7 to US \$ 53 per tonne.

Despite the lower export duty settled, the outcome was a major blow for Belarus. Previously, Belarus had received crude oil deliveries to its refineries without Russian export duties¹¹, and sold the refined products further to the Western European consumers with considerable profit. Due to significant overcapacity in the major Belarusian oil refineries in relation to domestic demand, large quantities of refined products were sold to the European customers. On estimation, Belarus saved over US \$ 3 billion in unpaid Russian export duties and collected more than US \$ 1 billion in governmental export duties in 2005 (ReAKKT 2007). According to the Economist Intelligence Unit, the increase in exports of refined oil products in 2004-2005 accounted for nearly 3 percentage points of GDP growth in these years. In 2005, one third of the country's export revenues originated from the exports of petroleum products.

Gazprom has recently gained control over Belarusian oil assets through a series of ownership arrangements in the Russian oil sector. Based on a joint decree by Russian and Belarusian governments, a Russian-Belarusian joint oil company, **Slavneft**, was established in 1992. In 2002, the Belarusian Government sold its share package in the company, with

¹¹ US \$ 180.7 per tonne at the end of 2006.

subsequent privatisation of the Russian Government's shares. Through the privatisation process, the Russian-British joint venture TNK-BP and the Russian oil company Sibneft, became the joint owners of Slavneft. In late 2005, Gazprom acquired majority ownership in Sibneft, which controlled 49.48 percent stake in Slavneft. Subsequently, Sibneft's assets were incorporated in Gazprom's oil producing subsidiary, GazpromNeft.

At present, Slavneft controls 45.2 percent in the second-largest oil refinery in Belarus, the Mozyr refinery. The company is a major producer of a wide range of petrochemical products for the Belarusian markets and has been going through considerable modernisation process during the recent years. In addition, Slavneft owns 72 petroleum stations in Belarus.

During the heated negotiations over the energy prices between Russia and Belarus in late 2006, an option was reportedly discussed, to include in the deal a block of shares in the largest Belarusian oil refinery, the state-owned Naftan, in exchange to lower price for natural gas. As it was eventually agreed that Gazprom will get hold on 50 percent of Beltransgaz as a part of the agreement, the Naftan deal was withdrawn from the agenda for a time being. However, both the Russian oil company Lukoil and Gazprom have set their eyes on Naftan for a long time ago, and the Russian ownership in the company is likely to resurface on the agenda between the two countries in the near future.

The leading Russian oil producer and one of the Russia's most transnational companies, **Lukoil**, operates extensive production, refining, and retail networks in the CIS. Lukoil is

also the leading company in the Belarusian oil sector. Providing nearly 15 percent of Belarusian oil imports, the company is the largest single supplier of oil to the country. In equity investments, Lukoil owns 52 petroleum stations in Belarus through its subsidiary, Lukoil-Belarus.

In May 2006, Lukoil announced plans to form a joint venture with a Belarusian partner for the production of additives to engine oils (Belarus News... 2006a). According to repetitious statements by the Belarusian President in 2006, Lukoil was welcomed to expand its operations in Belarus beyond only operating the network of petroleum stations in the country. In the same vein, Lukoil was invited to expand its equity investments in the country. The deteriorated relations between the two nations at the end of 2006, however, have reportedly prevented further negotiations on the issue. Nevertheless, it remains obvious that Lukoil, keen to expand its refining capacity near the end markets of the EU, would be more than interested in wrestling control over Belarusian oil refining and infrastructure assets.

3.3 *Mobile telecommunication*

Russia's largest telecommunication service provider, **Mobile TeleSystems (MTS)**, expanded its operations to Belarus in 2002 through a 49 percent participation in a joint venture MTS Belarus. The controlling stake of 51 percent in the company is held by the Belarusian state-owned company Intercity Communications. At the end of 2005, the value

of MTS' equity investment in Belarus totalled over US \$ 100 million with prospective investments in 2006 amounting to additional US \$ 100 – 150 million.

With nearly 2.5 million subscribers, MTS Belarus is the market leader in the country. In 2006, the company's Belarusian subscriber base grew by one quarter. Due to entries of two competitors on the market in the end of 2005, the market share of MTS Belarus diminished from 50 percent to around 40 percent during 2006. At the end of 2006, the mobile penetration rate in Belarus was 50 percent, which, although low on Western European standards, is considerably higher than in most of the CIS. For MTS, thus, the Belarusian market primarily offers growth possibilities in the value added services, rather than through explosive growth in subscriber base as is the case on many other immature CIS markets.

As the telecommunication sector in Belarus has tradition of heavy regulation, the operations of foreign companies have, in large extent, been dependent on the attitude of the government (Lisitsyn et al. 2005). Previously, no foreign majority ownership has been allowed in Belarusian telecommunication sector. During 2007, however, the antimonopoly legislation in the Belarusian telecommunication sector is expected to take effect, after which MTS is likely to seek the controlling stake in MTS Belarus. The move was pre-approved by the Belarusian Communications Ministry already in the beginning of 2006.

MTS is not the only Russian telecommunication company that has sought to tap the Belarusian markets. Back in 2004, both VimpelCom and MegaFon, the second and third largest telecommunication companies in Russia, participated in a tender for 49 percent in a

new telecommunication joint venture with the Belarusian fixed-line monopoly, Beltelecom. Although the tender was eventually won by another Belarusian state-owned company, VimpelCom has repeatedly announced its interest in the country's mobile telecommunication sector. Prospective future privatisations of the Belarusian telecommunication assets could provide an option for the company to expand its operations to this market.

3.4 Other sectors

The Russian investments in other sectors of the Belarusian economy are rather limited. Besides oil, natural gas, and telecommunication, the Russian companies have invested in the Belarusian food, chemical, and textile industries. In many occasions, the investments date back to the Soviet era, meaning that the Belarusian assets were inherited by the present-day Russian companies after the disintegration of the Soviet Union.

In addition, the more unconventional sectors of the Belarusian economy, such as the newsprint industry, have accommodated Russian investments. To a limited extent, also the Russian information and communication technology (ICT) companies have outsourced their operations in Belarus. Despite the limited investments thus far, however, the Belarusian ICT sector has a potential of becoming a promising outsourcing market for the Russian (and the European) ICT companies due to its relatively mature technical infrastructure, reputable educational system, and proximity to the EU markets.

The advantageous geographical location of Belarus has attracted additional investments from the Russian transportation companies. Amidst the recent developments in the Russian-Belarusian relationships, the strategic importance of the Belarusian rail and road transportation assets is likely to increase, and along with it the interest of the Russian companies towards the sector.

Besides the industrial companies, the Belarusian banking sector is likely to attract considerable Russian interest in the upcoming years. The leading Russian banks have in several occasions announced their interest to increase their so far limited participation in the Belarusian banking sector in the event of privatisation of the country's banking assets.

4 Conclusions and future implications

Russia is the largest foreign investor in Belarus with a share of up to 80 percent of the Belarusian annual FDI inflows during the recent years. Despite their high share in Belarusian inward FDI, the Russian investments in the country have remained relatively modest compared to these in many other CIS countries. The largest Russian investments in Belarus are in oil, natural gas, and telecommunication sectors. Until now, virtually no major acquisitions by Russian energy companies serving Russia's foreign policy objectives have been witnessed in Belarus due to the traditionally close economic and political relationships between the two countries. The recent energy dispute and subsequent deterioration of the relationships between Russia and Belarus, however, are likely to yield more strategic acquisitions by Russian companies in Belarus. As a part of the bitter solution

for the energy dispute, Gazprom already wrestled control over 50 percent of the Belarusian national gas pipeline network, Beltransgaz.

The embedded US \$ 2.5 billion acquisition of this single most valuable industrial asset of Belarus by the Russian gas giant marks a clear change in Russian policies towards its most reliable ally in the former Soviet bloc. Apparently, the new reality sees the dominance of economic priorities over the political ones. The days of political rhetoric determining the relations between the two countries are evidently over as Russia fruitlessly deemed the actual implementation of the terms of the Union State agreement from Belarus. Blaming the Belarusian President Lukashenko for not living up to the promises made on harmonising the economies of the two countries, Russia eventually exerted its political influence through its most powerful bearer, Gazprom. The latest dispute only confirms the tendency that has been visible in Russia's foreign economic policy for already some time now – maximising the country's international competitive advantage and political leverage by employing its most powerful asset, the energy resources.

Despite the seemingly beneficial agreement on gas prices, the future for Gazprom's operations in Belarus remains far from secure. The Belarusian Government retained control over 50 percent of Beltransgaz, leaving room for unexpected future policy decisions regarding foreign ownership similar to those recently witnessed in the Russian oil and gas sector. In addition, Belarus will remain one of the key transit regions for its natural gas deliveries for years to come, since the Nord Stream pipeline in construction under the Baltic Sea will only be operational by 2010 at best. Moreover, the plans of constructing the

second section of the Yamal-Europe pipeline on Belarus territory appears increasingly complicated in the face of the recent rent demands by Belarus on the assets on its soil.

In the oil sector, the future of rising export duties on the Russian crude sold to Belarus foresees considerable economic challenge for Belarus, but also for the Russian oil companies. In case the oil supplies to Belarusian refineries are cut as a result, the Belarusian budget revenues will diminish even further. Nevertheless, around one third of the Russian oil exports continue to flow through the Belarusian territory (Druzhba pipeline). The planned expansion of Baltic Sea Pipeline and the Primorsk seaport on the Baltic shore are to decrease the Russian dependency on Belarus transit, but do not provide an immediate alternative to oil deliveries to the Western European customers through Druzhba pipeline.

As indicated by the above examples, the complicated mutual dependency of Belarus and Russia on their key economic sectors promises no simple solution for the confrontation. In the event of increasing distrust between the two countries, it is likely that Russia will look to strengthen its economic leverage in Belarus through acquisitions of strategic assets in the country. On the other hand, the Russian companies will face considerable political resistance in Belarus, compared to the previously welcoming atmosphere. Although the effects of the deteriorated relationships hit hardest the Russian energy companies, the entrance of Russian firms to other strategic sectors of the economy, such as telecommunication, is also likely to be banned for time being.

From the European viewpoint, the increasing Russian business presence in Belarus holds increasing stabilisation on one hand, but increasing dominance of Russia over its energy supplies, on the other. However, the growing uncertainty over Russian energy deliveries and supply disruptions similar to those witnessed in the beginning of the previous years, are hardly in the interest of the EU. In this context, the key issue to be considered by the European policy-makers is at which point does the stability provided by Russia's control over its energy supplies and assets in the region turn into economic and political supremacy.

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