PROBLEMS OF ATTRACTION OF FOREIGN DIRECT INVESTMENTS IN UKRAINE

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In this article there is analyzed the foreign direct investments inflows dynamics in Ukraine. It is identified that the main investors in Ukrainian economy are offshore countries and this is the trend for the last decade. It is demonstrated that the most investment attracted spheres of Ukrainian economic activity are economically inefficient. It is presented the dynamics of international ratings estimating ease of doing business in Ukraine and the level of its financial solvency. There are also analyzed the trends in legislative field for Ukrainian economic activity stimulation

**Key words:** Ukraine’s investment attractiveness, investment climate, foreign investors strategies.

Problem formulation. The international movement of capital in the form of foreign investments is a key element of the development of modern world economic relations. Nowadays attractiveness of the foreign investment becomes one of the most important components for the economic development of the country as at the macro as well at the micro level. Additional investments provide not only organic growth of any sector of the economy in which they are invested, but also have a positive social impact reflected in the increased welfare of the recipient country.

Limitation of tangible and intangible resources, as well as a modern global financial instability cause increased competition for investment between countries. The turbulence in the economic system leads to a complication of the financial forecasts for the further development of the countries and regions, and therefore, the process of finding and attracting targeted foreign investment is becoming more difficult.

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That is why it is urgent for the state to create all the favorable investment conditions to attract international investor. Countries that do not participate in active involvement of international funding remain without additional resources for the production and trade and thus reduce the welfare of the nation.


However, the conditions affecting the investment attractiveness of the national economy and the state's role in counteraction the negative impact of individual factors are not entirely revealed.

**Aim of the article** is the analysis of the recent dynamics of investment inflows in Ukraine and main obstacles for national favorable investment climate development.

**Statement of the basic material.** Nowadays Ukraine doesn’t possess its own resources to create a competitive economy. It is caused by deep structural deformation and severe underdevelopment of the country on indicators of productivity and level of social welfare. Most domestic companies are technologically backward, energy-intensive and characterized by poor diversification of products and markets [11, 12]. Definitely, this state of the domestic production is unlikely to be attractive for foreign investors.

Changes in the methods of doing business in Ukraine can be implemented through secure funding and implementation of a series of reforms. Consequently, foreign investment is the main prerogative for national socio-economic growth at this stage. Thus, the main task of not only the government, but also society as a whole is to create a favorable investment climate for foreign investors.

Analysis of the dynamics of foreign direct investment (equity), FDI, inflows and outflows of the Ukrainian economy for 2001-2015 demonstrates that Ukraine is a net recipient of FDI (Figure 1).

![Graph showing FDI inflows and outflows in Ukraine from 2001 to 2015](image)

**Fig. 1.** Dynamics of cumulative FDI (equity) inflows and outflows in and out of Ukraine for 2001-2015, $ mln.
*Source: State statistics service of Ukraine – mode of access: http://www.ukrstat.gov.ua/
** data for 2014 and 2015 are given excluding Crimea and Sevastopol City*

The data in Figure 1 show that the peak values of FDI inflows into the economy of Ukraine in the amount of $58.2 bln. were achieved in 2013. However, the figures for 2014 and 2015 indicate a drastic decline in FDI inflows. The recession was caused by tension and deterioration of the political situation with the Russian Federation in the Eastern region of Ukraine, as well as the annexation of Crimea, the loss of key markets, increase of the imbalances risk in the balance of payments of Ukraine, decline in the credit ratings of Ukraine on the international financial markets [14].
According to the Table 1, the main investors in Ukraine are still the European countries: they account for about 76% of all direct investment in the country. The share of the Russian Federation decreased from 6.9% to 6.3%. This fact is explained by the aggravation of political relations between Russia and Ukraine. In addition, it should be noted that about 40% of investments fell on a country with a favorable tax regime, such as Ukrainian offshore zones, for example, in Cyprus, the Virgin Islands, Belize, etc. During 2013-2015, the investments of these countries have not declined sufficiently. Other investors, such as Austria, Germany, Poland, Italy and the United States have significantly reduced the flow of capital into the national economy. According to authors of this article, the negative fact of this situation is that during the last decade the structure of foreign investors has not changed. Consequently, in recent years the economy of Ukraine haven not attracted new foreign business partners.

Data for the 2005-2015 show that there has been attracted more than $1,000 of FDI per capita. However, it should be noted that the national economy is showing a low degree of integration into the international monetary and financial flows, as the share of FDI attracted to Ukraine is only 0.2% of global FDI during the study period [2, 3] (Table 2).

Table 1

<table>
<thead>
<tr>
<th>Investor country</th>
<th>FDI (cumulative volume starting from the first day of investment), mln. $</th>
<th>Share in FDI by 01.07. 2013, %</th>
<th>Share in FDI by 01.07. 2014, %</th>
<th>Share in FDI by 01.07. 2015, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total, including</td>
<td>55318,2</td>
<td>100,0</td>
<td>100,0</td>
<td>100,0</td>
</tr>
<tr>
<td>Cyprus</td>
<td>17928,5</td>
<td>32,4</td>
<td>31,4</td>
<td>28,6</td>
</tr>
<tr>
<td>Germany</td>
<td>6165,3</td>
<td>11,1</td>
<td>11,9</td>
<td>12,8</td>
</tr>
<tr>
<td>Netherlands</td>
<td>5376,1</td>
<td>9,7</td>
<td>10,7</td>
<td>11,9</td>
</tr>
<tr>
<td>Russian Federation</td>
<td>3822,7</td>
<td>6,9</td>
<td>6,1</td>
<td>6,3</td>
</tr>
<tr>
<td>Austria</td>
<td>3196,3</td>
<td>5,8</td>
<td>5,6</td>
<td>5,5</td>
</tr>
<tr>
<td>Great Britain</td>
<td>2697,2</td>
<td>4,9</td>
<td>4,8</td>
<td>4,6</td>
</tr>
<tr>
<td>The Virgin Islands</td>
<td>2418,4</td>
<td>4,4</td>
<td>4,1</td>
<td>4,4</td>
</tr>
<tr>
<td>France</td>
<td>1808,4</td>
<td>3,3</td>
<td>3,5</td>
<td>3,6</td>
</tr>
<tr>
<td>Switzerland</td>
<td>1183,1</td>
<td>2,1</td>
<td>2,7</td>
<td>3,2</td>
</tr>
<tr>
<td>Italy</td>
<td>1122,7</td>
<td>2,0</td>
<td>2,2</td>
<td>2,3</td>
</tr>
<tr>
<td>Belize</td>
<td>1003,8</td>
<td>1,8</td>
<td>1,5</td>
<td>1,2</td>
</tr>
<tr>
<td>Poland</td>
<td>945,3</td>
<td>1,7</td>
<td>1,7</td>
<td>1,8</td>
</tr>
<tr>
<td>United States</td>
<td>895,4</td>
<td>1,6</td>
<td>1,8</td>
<td>1,6</td>
</tr>
<tr>
<td>Other countries</td>
<td>6755,0</td>
<td>12,3</td>
<td>12,0</td>
<td>10,9</td>
</tr>
</tbody>
</table>

*excluding Crimea and Sevastopol City

Source: State statistics service of Ukraine – mode of access: http://www.ukrstat.gov.ua/

Table 2

<table>
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</thead>
<tbody>
<tr>
<td>Cumulative FDI inflows, $mln.</td>
<td>16375.2</td>
<td>40026.8</td>
<td>49362.3</td>
<td>58156.9</td>
<td>45916.0</td>
</tr>
<tr>
<td>FDI per capita, $</td>
<td>348.93</td>
<td>871.29</td>
<td>1081.71</td>
<td>1280.25</td>
<td>1069.58</td>
</tr>
<tr>
<td>Share in global FDI, %</td>
<td>0.15</td>
<td>0.23</td>
<td>0.24</td>
<td>0.24</td>
<td>0.19</td>
</tr>
</tbody>
</table>

Analysis of the FDI distribution structure by economic activity in Ukraine for 2013, which was the year of historical maximum of attracted cumulative FDI inflows in Ukraine, it should be noted that the largest amount of financial resources was obtained by spheres of processing industry and financial and insurance activities (Figure 2).

![Graph of FDI inflows by economic activity in Ukraine for 2013](image)

**Fig. 2. Structure of FDI (equity) inflows in Ukraine by economic activity in 2013**


It should be noted that there was attracted only 1.5% of total FDI (equity) in Ukrainian agriculture, forestry and fisheries in 2013. The share of agriculture, forestry, fisheries in the GDP of Ukraine composed about 9% in 2013, the share of the processing industry - 11.2%, wholesale and retail trade 14.5%, while the share of the banks and insurance companies - 4.5% of Ukrainian GDP. Thus, the industries which attracted the largest number of foreign capital compose a small share in Ukraine's GDP and therefore they operate economical inefficiently. Such a strategically important area, as the information and telecommunications industry, produces products and services with high added value, and this industry attracted negligible investments in Ukraine. These facts demonstrate or the technological backwardness of the country or the obvious obstacles for the implementation of investment projects in Ukraine.

In recent years, the negative trends are observed not only in the dynamics and structure of FDI, but also in the assessment of the investment climate in Ukraine. According to the European Business Association, which regularly examines the investment climate in the country, the investment attractiveness of Ukraine reached its historical minimum at the end of 2013, however, focus on the reform of the present regime slightly improved the situation in the second quarter of 2015, but it still didn’t allow experts to characterize the investment climate of the country as a neutral or attractive. Positive changes are explained by the definition of the key areas of development associated with the anti-corruption component and expectations of pressure reduction on business [12, 14].

In addition, the level of investment attractiveness of Ukraine decreased due to indecision of the government in the implementation of the promised reforms, the weakness of the banking system, the disastrous state of the external debt, the instability of the national currency, etc.

Results of peer reviews, applying the international rankings of doing business and of competitiveness estimation, demonstrate a low level of attractiveness of Ukraine as the host country (Table 3).
Our analysis shows that under the various international ratings and indices expert Ukraine's place in the last 5 years has insignificantly changed. For example, the Global Competitiveness Index of World Economic Forum shows an increase of 13 points from 89 in 2010 to 76 in 2014. Besides, Ukraine's success in creation of a favorable business environment is reflected in all ratings, however, there is a very rapid change of country's domestic economy position in the ratings of the World Bank in terms of ease of doing business. According to this index, Ukraine took 96th place rising just 16 points in 2014-2015. This rise is caused by significant simplification procedures for the registration of ownership through reduction of the cost of operations for more than twice (in % to the value of the property). In addition, rapid changes are observed in terms of the tax system – an increase of 49 positions. Such a jump was caused by the reduction of the number of payments to 5, and the reduction of the tax rate on income to 9.7%. At the same time protection of the rights of investors is at very low level – 109 out of 189, and during the investigated period, these figures changed for 2 positions. In addition, there are low levels of such ratings: International trade – 154th position, insolvency overcoming – 142, connection to the power supply – 185 [14, 15].

Thus, the overall improvement in the rating of Ukraine is insignificant. The gap between the countries – outsiders and the leading countries has declined significantly. Today, therefore, to carry out a qualitative leap from the country of the third or second world in the first one, to significantly improve the

Table 3

<table>
<thead>
<tr>
<th>Ranking</th>
<th>Assessment components</th>
<th>Years</th>
<th>Names</th>
<th>Countries</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>2010</td>
<td>2011</td>
<td>2012</td>
</tr>
<tr>
<td>Global Competitiveness Index (the World Economic Forum)</td>
<td>The quality of institutions, infrastructure, macroeconomic stability, development of financial market</td>
<td>89 out of 133 countries</td>
<td>82 out of 142 countries</td>
<td>73 out of 144 countries</td>
</tr>
<tr>
<td>Global Competitiveness Ranking (IMD)</td>
<td>Economic performance, government efficiency, business efficiency and state of infrastructure</td>
<td>57 out of 58 countries</td>
<td>57 out of 58 countries</td>
<td>56 out of 59 countries</td>
</tr>
<tr>
<td>Ease of Doing Business (the World Bank)</td>
<td>The ease of launching the company, licensing, staff employment, property register, receiving a loan, protecting investors' interests</td>
<td>147 out of 131 countries</td>
<td>145 out of 117 countries</td>
<td>152 out of 183 countries</td>
</tr>
<tr>
<td>Corruption Perceptions index (Transparency International)</td>
<td>Index of corruption</td>
<td>134 out of 178 countries</td>
<td>152 out of 182 countries</td>
<td>144 out of 183 countries</td>
</tr>
<tr>
<td>Index of Economic freedom (Heritage Foundation)</td>
<td>Business, trade, financial, monetary, investment and labor freedom from the government, corruption, protection of property rights</td>
<td>162 out of 179 countries</td>
<td>163 out of 179 countries</td>
<td>163 out of 183 countries</td>
</tr>
<tr>
<td>Prosperity Index (The Legatum Institute)</td>
<td>Economic situation, level of entrepreneurship, management, education, health protection, security, personal freedoms, social capital</td>
<td>69 out of 142 countries</td>
<td>74 out of 142 countries</td>
<td>71 out of 142 countries</td>
</tr>
</tbody>
</table>

economic well-being of the country, it is necessary to put a lot more effort than, for example 10 years ago. Thus, in 2014, Sub-Saharan Africa has become a leader in the implementation of reforms: 74 (32%) out of 230 businesses regulatory reforms were implemented. In Senegal to start a business you need to spend 6 days for the registration procedures today, not 2 months like it was before. For example, in Norway you need to spend 5 days to start a business. Over the past 10 years, the number of countries in which you can start a business in three weeks increased from 41 to 127. Therefore, today 70% of the business can be started within 20 days. Ukraine is not in this list yet [8].

The instability of the economic and political situation in the country usually affects the level of credibility of foreign investors, which is reflected in the volume of foreign direct investment inflows into the economy. But indecisiveness in implementing reforms and their declarative manner influence more the formation of the investment image of Ukraine. More and more domestic and foreign experts point at the need for immediate change. And the Ukrainian government will have to implement it, otherwise there will be not only financial losses – in the form of the failure of investment, but also political ones – as the loss of international support.

Modern Ukrainian scientists and businesspersons emphasize the need for a more active position of the Ukrainian government to reform the socio-political and foreign economic relations. Thus, the efforts of the authorities should be focused on the implementation of effective reforms, rather than declaration of populist ideas and empty promises [1, 4, 16].

In the context of overcoming the consequences of crisis, all nations of the world, including developed economies, have moved from the liberalization of the economy to a more active implementation of its regulatory powers. In particular, they have not reduced, but rather expanded its powers in the sphere of economy, that is, strengthening the economic functions of the state. Many of them introduced two- and five-year plan of economic development and long-term program for its implementation [14].

In Ukraine foreign investors in order to minimize risks with regard to absence of the state support often resort to specific strategies. For example, Auchan Group to open new hypermarkets in the regions of Ukraine uses such methods:

- independent implementation of projects;
- participation in projects implemented by foreign and Ukrainian developers.

In order to implement the business activity in Ukraine for foreign investors it is preferable to create a strategic alliance or joint venture with a local partner. Such cooperation significantly reduces the risk and accelerates the process of entering the foreign market.

So, Auchan Group entered the Ukrainian market in 2007 through acquiring a 21% of equities of in "Furshet" (local retail operator) for $112 mln. At the same time it was a joint venture, "Auchan Hypermarket Ukraine" (Auchan possessed 66% of equity, and Furshet – 34%, respectively), with the purpose to develop hypermarkets.

This alliance allowed the "Auchan" to implement quickly the first project in 2008, and to open one of the biggest hypermarkets in Ukraine with a store area of 19 ths. m². The other two projects together with "Furshet" were implemented in 2009.

For 8 years "Auchan" has opened 11 hypermarkets in Ukraine, with a store area of over 10 ths. m² (each). Its latest project – urban supermarket with a store area of 5000 ths. m² was opened in Lviv in September 2015.

"Auchan" is not the only example of a foreign investor in the retail sector, which entered into an alliance with the Ukrainian company.

Thus, the Lithuanian BT Invest (Lithuanian supermarkets "Novus"), established by the former shareholder of the Ukrainian largest juice producer company "Sandora" Raimondas Tumenas, has become a major investor in the company "Capital Group" – one of the largest developers in Kiev.

For six years, "NOVUS UKRAINE" has opened 33 modern stores in various formats – with the store area of trading halls of 800 m² to 8000 m². (Novus first supermarket was opened in Ukraine in 2008).

In order to improve the investment climate in the country the Ministry of Economic Development of Ukraine plans to increase business activity for the purpose of state economic growth in 2016. The Ministry launched deregulation that provides for the abolition of excessive regulatory constraints and inefficient control procedures, abolition of excessive licensing, legacy systems certification, monitoring, implementation and other examinations restrictions on business, as one of the most effective tools for this
increase. And it is necessary to mention, that all these actions are done in terms of global strict regulatory of financial flows.

According to the Ministry of Economic Development of Ukraine, abolishing regulatory restrictions and inefficient procedures not only reduces the administrative burden on business, and therefore reduces the level of corruption, as well as gives an opportunity to businesses to concentrate on their core business.

The regulation takes place in three basic stages:
- Cancellation of key regulatory barriers to business;
- "Regulatory Guillotine" – a full review of the regulatory framework, provided that state agencies now need to prove certain constraints to doing business;
- The introduction of a preventive mechanism, which does not allow the recovery of excessive administrative pressure.

In addition, the law was adopted on the simplification of doing business, which canceled 16 inefficient regulatory restrictions, harmonized system of lease of land and created a system of "single window" for business start only for 2 days. Changes were made to the law on licensing, which abolished the licensing of 26 types of economic activity. The government decree on deregulation, which abolished the need for inefficient certificates in the agricultural sector and monitoring of subsoil use was also implemented. The law on the protection of investors led standards of Ukrainian legislation to European standards and provided protection for minority shareholders.

Next Steps of Ministry of Economic Development of Ukraine are to continue canceling another 130 inefficient regulatory constraints identified by government and business, as major "pain point" for its activity. With this purpose the Government has recently adopted the "Action Plan for deregulation" and has already begun to implement it. In addition, a second stage of reform – the "regulatory guillotine" is being prepared to begin the process of a complete revision of the regulatory framework in the near future [15, 17].

Unfortunately, the international and national statistics demonstrate the ineffectiveness of the implementation of the reforms proposed by the Ukrainian government at this stage. According to international experience, Ukraine should focus on:
- providing preferential tax treatment in the implementation of major investment in the Ukrainian economy;
- stimulation of investments in the real sectors of economy through the development of a system of state guarantees provided to investors in the priority areas of investment for Ukraine;
  - increase in total public-private financing of investment projects with foreign capital;
  - implementation of antitrust measures and ensure the internal competitive environment for the development of investment activities;
- organization of tenders and auctions for the provision of strategically important objects in a state concession to domestic and foreign investors [14].

We believe that without the introduction of the above proposed measures the improvement of the investment attractiveness of Ukraine would not materialize.

**Conclusions.** The data of statistics of Ukraine demonstrated a drastic decline in FDI inflows to national economy. This decrease was caused by instability in political issues with the Russian Federation, manufacturing reduction, foreign debt increase, inefficient use of available financial resources, etc. The detailed analysis of FDI structure demonstrated prevalence of partners in offshore countries, indicating at the return of "laundered" money, low investment attractiveness for domestic and external investors.

According to international rates of Ukrainian doing business environment national economy is still at low level of economic development and is not attracted by foreign investors.

In order to minimize and diversify risks while entering the Ukrainian market foreign investors use such strategies as an independent implementation of projects, or participation in projects implemented by foreign and Ukrainian businesses.

In order to improve the economic situation and investment environment Ukrainian government should not rely on populist recitations and should focus primarily on the provision of investment and the economic sovereignty of the country's security. This goal is particularly important because it gives guidelines for the adoption of the basic socio-economic decisions.
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