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TRENDS OF FOREIGN DIRECT INVESTMENT IN UKRAINIAN ECONOMY

The paper addresses the factors inducing potential investors, investors from partner countries and demonstrates the entire structure of FDI distribution in Ukraine. Trends of foreign direct investment inflows in Ukraine in 2014 as an important part of national economic growth of the country and a catalyst to its development are analyzed in the article. The problems and weaknesses of investment climate in Ukraine are identified, the ways of its improvement are suggested.

Keywords: foreign direct investment; investment potential; investment attractiveness; economic growth.

JEL codes: F210, O160, G180.

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ТЕНДЕНЦІЇ ПРЯМОГО ІНОЗЕМНОГО ІНВЕСТУВАННЯ В ЕКОНОМІКУ УКРАЇНИ

У статті досліджено фактори стимулювання потенційних інвесторів, інвесторів з країн-партнерів та проілюстровано загальну структуру прямих іноземних інвестицій в Україну. Проаналізовано тенденції прямого іноземного інвестування в Україну в 2014 р. як важливий чинник національного економічного зростання країни і каталізатор її розвитку. Описано проблеми та слабкі сторони інвестиційного клімату в Україні, запропоновано шляхи його покращення.

Ключові слова: прями іноземні інвестиції; інвестиційний потенціал; інвестиційна привабливість; економічне зростання.

Рис. 2. Табл. 2. Літ. 11.

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ТЕНДЕНЦИИ ПРЯМОГО ИНОСТРАННОГО ИНВЕСТИРОВАНИЯ В ЭКОНОМИКУ УКРАИНЫ

В статье исследованы факторы стимулирования потенциальных инвесторов, инвесторов из стран-партнеров и проиллюстрирована общая структура прямых иностранных инвестиций в Украину. В статье проанализированы тенденции прямого иностранного инвестирования в Украину в 2014 г. как важных элемент национального экономического роста страны и катализатор ее развития. Описаны проблемы и слабые стороны инвестиционного климата в Украине, предложены пути его улучшения.

Ключевые слова: прямые иностранные инвестиции; инвестиционный потенциал; инвестиционная привлекательность; экономический рост.

Introduction. Globalization of market environment has led to the intensification of international capital flows. One of its decisive forms is foreign direct investment (FDI) movement as an effective instrument of structural changes and national economies remission. Developing countries, emerging economies and countries in transition have come increasingly to see FDI as a source of economic development and modernisation, income growth and employment (OECD, 2002: 6).

Furthermore, foreign investment can result in the transfer of soft skills through training and job creation, availability of more advanced technologies for domestic markets and access to R&D resources (Slaughter and May, 2012: 4).

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Analysis of international experience confirms that foreign investments help solve the problem of own money deficit, so that a country is able to improve its current condition and effectively inscribe into the world economic system without increasing the volume of debt (Kyrychenko and Yerokhin, 2009: 455). That is why it is important to explore the issues of this nature in more detail.

Latest research and publications analysis. Creation of attractive investment climate of the country and realization of investment potential were explored by many domestic and foreign scientists such as S.K. Reverchuk (2001), O.A. Kyrychenko and S.A. Yerokhin (2009), T.S. Zadnipyryanna (2010) and others. However, the problem of investment climate improvement in Ukraine is not being sufficiently covered and needs a deeper study which makes this article relevant.

The aim of the research is to analyze the dynamics and trends of foreign investment in Ukraine, the legislative basis for foreign investment, define the existing problems with FDI and to search for their possible solutions.

Key research findings. The Organisation for Economic Co-operation and Development (OECD) has recognised the need to agree to a standardised definition of FDI for the purpose of compiling statistics and has produced its own benchmark definition of FDI (OECD, 2008) to which the International Monetary Fund (IMF) refers in its "Balance of Payments Manual" (IMF, 2009). The OECD's Benchmark Definition states that the key characteristic of FDI is the presence of a lasting interest, which implies the existence of a long-term relationship between a direct investor and an enterprise. But to have a significant influence on management and decision-making process in enterprise's activity investor ownership must be at least 10% of the voting power.

Competitive advantages of Ukraine from the standpoint of current and potential state of its development are the following:

1. Advantageous geopolitical location. Ukraine has access to the Black Sea and is located at the crossroads of the transport routes Europe – Asia, North – South.
2. High level of natural resources availability. Ukraine is the second in the world and the first amongst post-soviet countries in proven reserves of manganese ore; the country also owns the reserves of coal, iron ore, kaolin, potash, clay raw for 100–200 years.
3. Cheap and qualified labor-force.
4. Rich consumer basket.

But it also should be noted that unfortunately all these mentioned competitive advantages are not the achievements of domestic economy but are simply provided by natural potential possibilities. Besides this, these advantages are only for foreign investors, but not for Ukrainian people. For example, the availability of cheap labor shows mostly the state's and employers' attitude to people. As a result, intellectual and scientific potential holders tend to go abroad to gain better employment opportunities (Nosova, 2008). In this respect the government should work on improving these advantages so that economic development can truly rely on them. Besides, the infrastructure has to help define the investment environment and thus create favorable conditions for economic growth (Globerman and Shapiro, 2002: 1899).

Despite the relatively large market, Ukraine's performance in attracting FDI has been for below its potential. In 2014 its inward FDI reached 46 bln USD – a volume

equivalent to 24% of GDP, lower than in neighbouring countries (UNCTAD, 2012: 1).

Data on foreign direct investment into Ukrainian economy since 1995 till 2014 is shown in Table 1.

*Table 1. Direct investment (equity capital) 1), mln USD
(State Statistics Service of Ukraine, 2014)*

At the beginning of the year	Foreign direct investment in Ukraine's economy
1995	483.5
1996	896.9
1997	1438.2
1998	2063.6
1999	2810.7
2000	3281.8
2001	3875.0
2002	4555.3
2003	5471.8
2004	6794.4
2005	9047.0
2006	16890.0
2007	21607.3
2008	29542.7
2009	35616.4
2010	39175.7
2011	43836.8
2012	48991.4
2013	53679.3
2014	57056.4
2014 (on December 31 st) ²⁾	45916.0

¹⁾ Data are calculated on accrual basis from the beginning of investment.

²⁾ Excluding the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.

To illustrate the data from Table 1 we created the graphic (Figure 1).

A closer look at the data indicates that the amount of foreign direct investment in Ukraine's economy was growing each year and for almost 20 years (1995–2014) and increased up to 120 times. There is a number of reasons for this to happen but we determine one of the most important to be the current unstable situation in Ukraine.

Total foreign direct investment in Ukraine up to the date 31st of December, 2014 was 45916.0 mln USD. The data generated by the State Statistical Service of Ukraine on the countries investing the most in Ukrainian economy in 2014 is reported in Table 2.

An important fact is that FDI from Cyprus is a "circle of money" coming from Ukraine itself through transfer pricing and come back as foreign direct investment through offshore. The importance of "offshore" problem for Ukraine emphasizes the fact that the total investment of Cyprus (in 2014 – 13710.6 mln USD) is more than twice the volume of investment from Germany (5720.5 mln USD), 4 times – from Russian Federation (2724.3 mln USD), 5 times – from Austria (2526.4 mln USD). Moreover, the amount FDI from Cyprus is higher than the total amount of investments from the abovementioned countries – important investors for Ukraine.

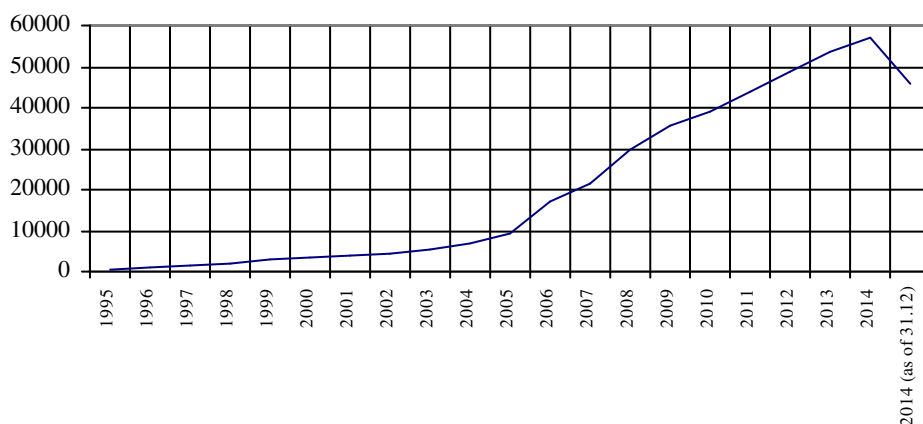


Figure 1. Foreign direct investment in Ukrainian economy (at the beginning of each year), 1995–2014, mln USD (State Statistics Service of Ukraine, 2014)

Table 2. Foreign direct investment (equity capital) from the countries of the world into Ukrainian economy¹⁾ (State Statistics Service of Ukraine, 2014)

Country	Volume of direct investment on 31.12.2014, mln USD	% of the total
Total, of which	45916.0	100.0
Cyprus	13710.6	29.9
Germany	5720.5	12.5
Netherlands	5111.5	11.1
Russian Federation	2724.3	5.9
Austria	2526.4	5.5
United Kingdom	2145.5	4.7
Virgin Islands, British	1997.7	4.4
France	1614.7	3.5
Switzerland	1390.6	3.0
Italy	999.1	2.2
United States	862.3	1.9
Poland	831.2	1.8
Belize	642.4	1.4
Other countries	5639.2	12.2

¹⁾ Excluding the temporarily occupied territories of the Autonomous Republic of Crimea and the city of Sevastopol.

Besides Cyprus, Ukraine receives FDI from other offshore areas, including Virgin Islands, British and Belize. In particular, FDI that came to Ukraine from the Virgin Islands, British excess investment from such countries as France, Italy, USA, Poland. So we can say that more than 35% of FDI into Ukraine economy were received from offshore areas.

In recent years, approximately 80% of investments in Ukraine were made through offshore companies. This trend is negative for the economy of Ukraine, as it does not bring real investment for development and points out to the flaws in the taxation system in the country.

Another fact is that such importance of investment attraction related to rather small number of countries and regions in the world (most of FDI in 2014 came from the EU countries) is quite dangerous in terms of obtaining both long-term and short-term effects on the national economy and investors, because any changes in relations with these countries will negatively affect the amount and regularity of investment inflows to national and private projects.

The structure of FDI distribution by types of economic activity on October, 1st, 2014 (%) is shown in Figure 2.

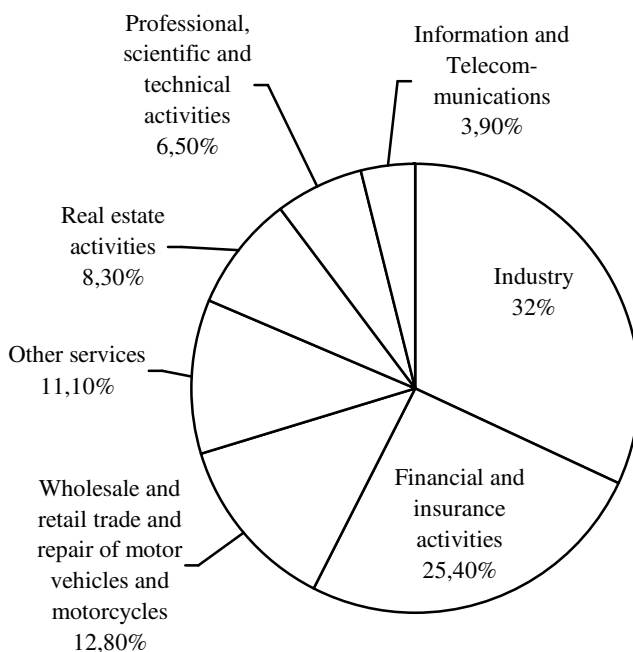


Figure 2. Industry distribution of foreign direct investment in Ukraine in 2014
(State Statistics Service of Ukraine, 2014)

As can be seen from Figure 2 there is an even distribution of foreign investments across the sectors. Much attention is focused on industry (in particular, manufacturing) – 32% of the total foreign direct investment, financial and insurance sector – 25.4%, wholesale and retail trade and repair of motor vehicles and motorcycles – 12.8%, other services – 11.1%, real estate activities – 8.3%, professional, scientific and technical activities – 6.5%, information and telecommunication – 3.9%. One of the most important sectors in Ukraine economy – agriculture – was underinvested as compared to other sectors.

Agricultural sector in Ukraine has a very strong potential and high investment attractiveness to foreign investors. However, its specificity (high risks and a long period of capital turnover) together with a number of macroeconomic factors constrains the inflow of foreign capital. According to the State Statistics Service of Ukraine in 2014 20.5 mln USD were invested in agriculture thus making 0.3% of the total FDI in Ukraine.

The largest investors in agriculture were Cyprus (257,999.8 mln USD), Germany (59,852.6 mln USD), Great Britain (33,885.3 mln USD). However, it should be noted that the structure of these investments in agricultural sector was unsustainable since most of investments (almost 80%) were spent on renting farmland and updating material base and only about 8% of capital has been invested in innovative technologies that indicates predominantly extensive development of the industry.

In the concluding part of the analysis the authors researched problems in the investment climate of Ukraine. Limited inflow of foreign investment in Ukrainian economy and its irrational use are caused by the presence of a number of problems such as:

- continued political and legislative instability. Lack of reliable safeguards against changes in legislation for foreign investors;
- lack of confidence among foreign investors in further cooperation during economic crisis;
- lack of clear government strategy on encouraging investment;
- significant tax and administrative burden;
- financial system instability;
- small size of the stock market;
- inflation rates remain at much higher level than in Western Europe and the United States;
- low purchasing power of most of the population that reduces the possibility to sell widely the goods produced with the help of foreign investment at domestic market;
- high level of corruption and bureaucracy;
- instability and lack of transparency in the legal and regulatory environment;
- underdeveloped infrastructure;
- uneven regional structure of foreign investment.

In today's conditions it is possible to achieve sustainable economic development only making structural changes in national economy. Taking into account that investments are the effective lever of economic restructuring implementation and solving social and economic problems, the government should be focused on improving the investment climate, intensifying investment activities, accumulating the investment resources and focusing them on the priority areas of economic development.

In order to improve the investment climate in Ukraine and activate foreign investment the authors suggest taking the following measures:

- achieving national reconciliation among various social groups and political parties on Ukraine's way out from the economic crisis and political instability;
- development of a clear and reasonable government strategy on attracting foreign investment;
- alignment of economic indicators and fight against inflation;
- development and implementation of an effective mechanism for providing tax incentives to foreign investors engaged in long-term investments;
- implementation of economic mechanism of foreign investment risk insurance;
- establishment of institutions responsible for mobilizing investment resources in effective projects in the priority economic sectors;

- achievement of equal distribution of foreign investment across the country to be able to increase investment potential of not attractive regions;
- promotion of stock market development associated with long-term securities;
- ensuring the stability of legislation in the field of investment and taxation;
- reform of tax system in the direction of reducing taxes quantity and rates;
- ensuring a balanced policy of the government and National Bank of Ukraine in the monetary sphere;
- infrastructure development, in particular, building technological parks;
- intensification of measures to create a positive image of Ukraine abroad.

The authors believe that the implementation of the abovementioned ways of improving investment climate will lead to foreign capital inflow and successful development of the national economy.

Conclusions. Findings of the current study support a thought that as the importance of FDI to the global economy increases, there is a growing need for stable and well-tailored FDI regimes that promote national well-being and sustainability. Using the normative power of the law is one way to achieve this.

The authors conclude that Ukraine has a very powerful, yet unrealized investment potential. Its development is constrained mostly by macroeconomic factors. This demonstrates the necessity of balanced policy grounding and implementation within which it is appropriate to increase investment market transparency, improve foreign investment protection, rationalize foreign investment distribution in different sectors of the national economy, simplify the regulatory procedures for doing business.

Implementation of the above measures will increase the investment attractiveness of Ukrainian economy globally speeding up its for socioeconomic development.

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