Alina Snetkova
Taras Shevchenko National University of Kyiv, Ukraine

FOREIGN DIRECT INVESTMENT IN UKRAINE: PROBLEMS AND SOLUTIONS

The paper considers the main problems and prospects of foreign investment in Ukraine, analyzes statistical data reflecting the dynamics of foreign investment. International investment activity has a special place in the system of modern business, due to changes in global economic processes. International investment activity is set of subjects for investment abroad and attracts foreign investment into the country. Problems of foreign investment related to current issues in the global economy require practical solutions. This is due to current trends of globalization and internationalization of economic relations in modern economies. Currently, international trade and foreign direct investments serve an important function in the economic development of states. The volume of foreign investments is one of the indicators of the degree of country integration into the world community and depends on the attractiveness the investment object. Foreign investment and conditions of their involvement are factors that affect investment activity and further development of foreign economic relations.
Key words: non-current assets, tangible fixed assets, long-term investments, investment property, foreign direct investments, investment climate.

Problem statement. The development of modern Economics is hard to imagine without effective investment. Attracting investment, including foreign, provides the scientific and technological progress, economic growth, create additional employment and preservation of existing places business activity etc. At the same time, the analysis of statistical data shows that the investment attractiveness of Ukraine quite low. To increase the investment attractiveness of the national economy is necessary to create a favorable investment climate.

Analysis of recent research and publications. The problem of Investing activities and their impact on socio-economic development of a state are considered in scientific papers of foreign and domestic economic scholars, namely Lawrence J. Gitman[1], William F. Sharpe[2], A. A.Peresada[3], Borsch L.M.[4] Despite the long and comprehensive coverage of investment activity in existing literature, this subject still remains relevant.

The aim of the article. The purpose of the article is to determine the place and role of foreign investment in the development of the national economy; identify barriers that hinder the inflow of foreign capital in Ukraine; defining the main directions of improving the investment climate in Ukraine.

Key study findings. The development of the economy directly related to its investment attractiveness. For increase the investment attractiveness Ukraine is an important strategic objective and the basis to address socio-economic problems facing Ukrainian society.

In accordance with the Law of Ukraine "Foreign investments regime"[5], foreign investment activity seen as consistent, purposeful activity that is the capitalization of property, in the formation and use of investment resources, regulation of investment processes and international movement of investment and capital goods, creating appropriate investment climate and a for-

1 Gitman, Lawrence J., Joehnk, Michael D., Scott, B. (2010). *Fundamentals of Investing* (11th Edition).
2 Sharpe, William F., Gordon, Alexander J., Bailey, Jeffrey (2000). *Fundamentals of Investments*. Prentice-Hall.
3 Пересада, А.А. (2002). *Управління інвестиційним процесом*. Київ: Фінанси і статистика.
4 Борщ, Л.М. (2005). *Інвестування: теорія і практика*. Київ: Знання.
5 *Закон про режим іноземного інвестування 1996* (Верховна Рада України). Київ: Парлам. вид-во, 19, ст. 80.

profit or a particular social effect. It should be noted, that Ukraine has a great potential to attract investment. The rich natural resources and favorable natural conditions Ukraine significantly contribute to this.

However, Ukraine's security situation in the East continues to negatively impact the perception of political risk associated with the country, especially at corporate headquarters abroad, where the key decisions regarding FDI are taken. Due to extensive media coverage of the conflict in international media, the whole country is to a large extent associated with the military conflict in the East, i.e. no clear distinction is made between different regions of Ukraine. This view is problematic, as e.g. business conditions in Western or Central Ukraine materially differ from those in the conflict area, even though one cannot deny that they are not completely independent, as there is likely some impact (e.g. the military draft, foreign exchange restrictions that were taken in response to confidence crisis originating in the East, etc.).

Besides, Kyiv received the most total investments - 93.7 percent of all foreign direct investment. This direction of foreign direct investment and capital investment in the regional context is not conducive to equitable social and economic development of regions and strengthens further increase the gap in their development.

All these factors led to the fact that in 2016 Ukraine rose in the World Bank's "Doing Business" rankings (see Table 1) to 83 out of 189 countries measured – a consistent, 13-place improvement since the 2014 Maidan Revolution.

Table 1

The position of Ukraine's economy in the global community

Measure	Year	Index or Rank	Website Address
TI Corruption Perceptions index[1]	2015	130 of 175	http://www.transparency.org/cpi2015#results-table
World Bank's Doing Business Report "Ease of Doing Business"[2]	2016	83 of 189	http://doingbusiness.org/rankings
Global Innovation Index[3]	2016	56 of 141	http://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2016.pdf
U.S. FDI in partner country ($M USD, stock positions)	2015	USD 6,698.9	https://www.globalinnovationindex.org/gii-2016-report
World Bank GNI per capita[4]	2015	USD 2.640	http://databank.worldbank.org/data/download/GNIPC.pdf

Source: compiled by the author based on official data of the National Bank of Ukraine

During 2015 the government continued to streamline the process to start a business with registrations having no cost and taking approximately two to three days. Authorities now process construction permits through a risk-based approval system, eliminating requirements for certain approvals and technical conditions and simplifying the process for registering real estate ownership rights. Ukraine continues to facilitate cross-border trade by releasing customs declarations more quickly and reducing the number of physical inspections. Finally, the

1 *Офіційний сайт Corruption Perceptions index.* <https://www.transparency.org/cpi2015/>
2 Doing Business Economy Profile 2016: Ukraine. World Bank, Washington, DC. © *World Bank.* <https://openknowledge.worldbank.org/handle/10986/23429>.
3 The Global Innovation Index 2016: Winning with Global Innovation, Ithaca, Fontainebleau, and Geneva (2016). *WIPO*. < http://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2016.pdf>.
4 Офіційний сайт World Development Indicators database. *World Bank.* <http://databank.worldbank.org/data/download/GNIPC.pdf>.

government introduced an electronic system for filing and paying labor taxes. In addition to the efforts of central authorities, officials at local levels continue looking to attract investment and jobs to their regions.

Ukrainian legislation provides for national treatment of foreign investors, in line with its World Trade Organization (WTO) commitments. Due in part to conflicts in the body of laws that govern investment and commercial activity in Ukraine, and persistent issues with corruption, foreign investors have found it difficult to pursue cases in Ukrainian courts and often seek arbitration outside of the country - judicial reform is still clearly needed.

Over the past three years, Ukraine's economy has experienced rapid capital flight to offshore zones, almost 70 billion USD annually. However, about 94% (see Table 2) of the Ukrainian capital were taken to Cyprus.

Table 2

Direct investment (equity) of Ukraine in the economy of countries in the world, million. USA

	Direct investment on 1.10.2016	In% of total
In all	**6236,9**	**100,0**
including		
Cyprus	5824,8	93,4
Russian Federation	139,2	2,2
Latvia	70,8	1,1
Vyrhynskye Islands (British).	52,0	0,8
Poland	50,2	0,8
Other countries	99,9	1,7

Source: compiled by the author based on official data of the State Statistics Committee of Ukraine[1]

Almost 85% of the total direct investment from Ukraine to Cyprus was formed as a result of some Ukrainian companies to restructure their operations by transferring the assets of the parent company shares in other Ukrainian companies to their foreign affiliates.

Thus, investment of Cyprus and the Virgin Islands can consider funds, that were withdrawn from the budget that were not taxed and are earned on cheap labor.

Cyprus has traditionally been the largest source of FDI in Ukraine (Figure 1). As of January 2014, the share of Cyprus-registered investors in the FDI stock was 32.7%, while currently it equals 24.4%. Three tax havens, Cyprus, British Virgin Islands, and Belize, together account for 29.6% of FDI stock (38.8% at the beginning of 2014).

Investments from Cyprus and other tax havens are usually of Ukrainian or Russian origin. Investors use special purpose entities (SPEs) in those countries in order to pay less tax and to acquire a special legal status etc. For instance, according to a study cited by the OECD Investment Policy Review[2], real Russian investment in Ukraine was at least thrice as large as the official data suggested at the end of 2014 (about $9.9 billion compared to $2.7 billion).

At first glance, such developed countries as Germany and the Netherlands also seem to invest quite a lot in Ukraine. Yet German FDI mostly comes from Indian ArcelorMittal, the largest foreign investor in Ukraine, which uses its Germany subsidiary to control a steel plant in Ukraine. Another large investor, Commerzbank, left the Ukrainian banking sector in 2016.

1 *Офіційний сайт Державного комітету статистики України.* <http://www.ukrstat.gov.ua/operativ/operativ2016/zd/izu/izu_u/izu0316.html>

2 OECD Investment Policy Reviews OECD Investment Policy Reviews: Ukraine 2016. *OECD.* <http://www.oecd.org/investment/oecd-investment-policy-reviews-ukraine-2016-9789264257368-en.htm>.

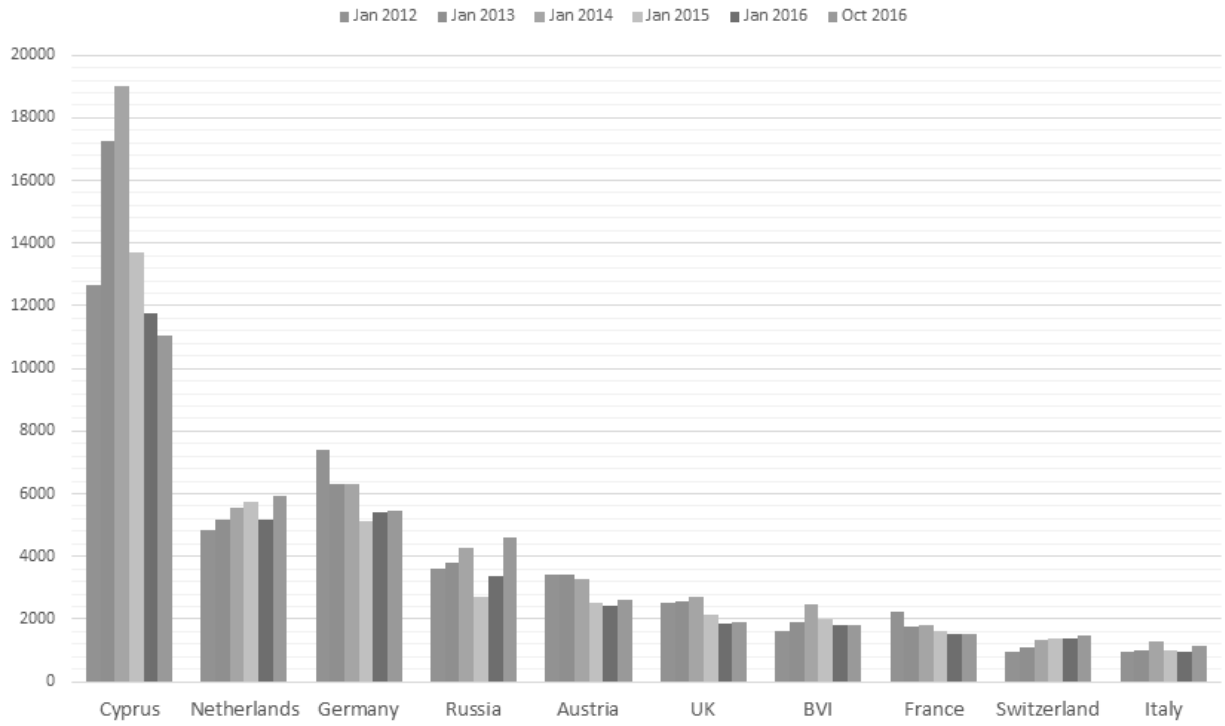

Fig. 1. FDI stock in Ukraine by countries, $ million

Source: compiled by the author based on official data from the National Bank of Ukraine1 and the State Treasury Service of Ukraine

Similarly to Cyprus, the Netherlands is a popular conduit for capital from all over the world and ranks only formally among the largest global sources of FDI. For instance, part of $1.8 billion of its FDI stock in the telecommunications sector in Ukraine comes from Dutch-registered VimpelCom, which owns Kyivstar, the largest Ukrainian cell-phone operator. Yet the largest owner of VimpelCom (through intermediaries) is Russian Alfa-Group. Genuine FDI from the Netherlands is actually not that large and is represented, e.g., by Unilever (Fig.2.).

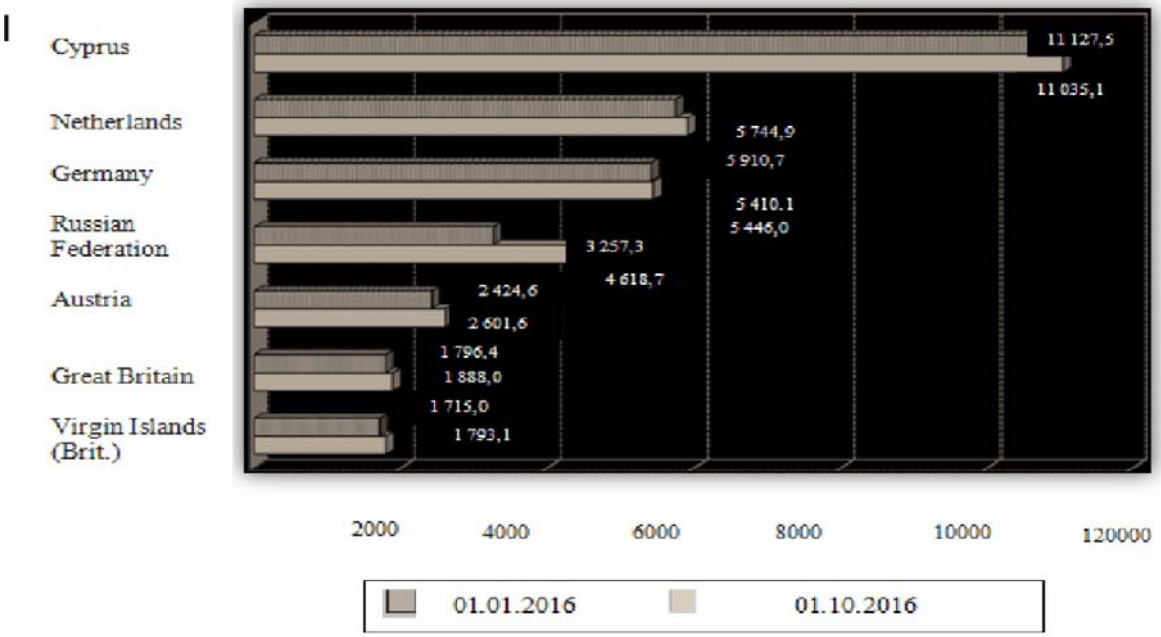

Fig.2. Foreign direct investment (equity) of the world economy in Ukraine in 2016, million. USA

Source: compiled by the author based on official data from the National Bank of Ukraine1 and the State Treasury Service of Ukraine

The origin of FDI in Ukraine becomes even more evident when we look at the sources of the growth of FDI stock in the years immediately before the crisis.

The growth of investment from the Netherlands and Switzerland mostly reflects the reinvestment of Ukrainian and Russian capital. For instance, in February 2016, a Dutch-registered subsidiary of Rinat Akmetov's DTEK increased its share in the largest private gas producer in Ukraine, "Naftogazvydobuvannia", to 55%. At least one of the co-owners of Risoil, a Swiss-registered company that invested $70 million in the construction of a grain elevator in Chornomorsk (former Illichivsk) seaport in 2014-2016, is reportedly a businessman from Ukraine.

Yet the fighting in the East has not scared off some (genuinely) foreign investors. For instance, French Biocodex has invested in the relatively stable pharmaceutical industry. US-based Cargill and Chinese Cofco invest in agricultural logistics. France's Nexans and Japan's Fujikura have built production facilities in Lviv region, finally seizing on such advantages of Ukraine as its educated and cheap workforce, as well as the proximity to the EU market. The success of these investments could become a signal for other potential investors.

Indeed, investors pay attention to a plethora of factors, both of economic and political nature. According to the MIGA survey, the concerns of investors in conflict-afflicted countries are more focused on unexpected and arbitrary changes in government policies in relation to their investments than on security issues. 62% of respondents named "regulatory changes" as their top political risk concern, while only 15% and 4% responded that war and terrorism were the main threats to their investments. In developing countries, more investors have experienced losses after the government intervention than because of a military conflict — through regulatory changes, breach of contract, restrictions on transfer and convertibility of profits and incomes, or non-honoring of sovereign guarantees.

Fig.3. Major obstacles to foreign investment in Ukraine

Source: compiled by the author based on official data from the FBA Dragon Capital[1]

According to a survey by Ukraine-based Dragon Capital, potential investors are less preoccupied with the military conflict with Russia than with widespread corruption and lack of trust in the judiciary. Unpredictable currency and unstable financial system, as well as restrictive capital controls, are only slightly less important than the security issues. The survey might

1 *Офіційний сайт Dragon Capital*. <http://www.dragon-capital.com/en/about/media/press_releases/corruption_and_lack_of_trust_in_the_judiciary_in_ukraine_are_the_largest_obstacles_for_foreign_investors.html>.

underestimate the influence of the military conflict, as the respondents are already interested in investing in Ukraine despite the hostilities in the East. Yet the survey reminds that the military conflict is only one of many factors affecting foreign investment in Ukraine.

Among the most positive actions that the government of Ukraine has to take to attract foreign investment, businesspeople mentioned relaunching the judiciary by vetting existing members and hiring new judges (average score – 7.6 points out of 10 possible), and the prosecution of large numbers of high-level officials and judges for corruption (7.4 points). At the same time, the third most highly ranked government action is ensuring the IMF program remains on track and liberalization of foreign exchange controls (including canceling the dividend repatriation ban) – both received a score of 6.2 points.

Implementation of the IMF programs was ranked as less important for investors with no prior experience of business in Ukraine (8th place, 4.6 points) than streamlining tax administration, which they ranked in 3rd place with 6.4 points. At the same time in general investors worried less about tax rates than about tax administration – with the rates per se occupying last place among the listed obstacles (offering tax breaks is less of an issue than simplification of administration). Lifting the moratorium on land sales is not as important for investors as other possible reforms. However, investors who are actively looking for new business opportunities in Ukraine, evaluate its importance as above average. Cancelation of the moratorium on agricultural land sales is even more important than overhauling infrastructure and establishing an investment promotion office as a one-stop shop for foreign investors.

Fig.4. Possible reforms and steps

Source: compiled by the author based on official data from the FBA Dragon Capital[1]

Conclusions and prospects for future research. The result of the study, found that in Ukraine established certain conditions for effectively attracting foreign investment, but there are still a number of problems that must be addressed by applying modern organizational and economic mechanism of foreign direct investment into the country.

Foreign investors believe that the biggest obstacles for investment in Ukraine are widespread corruption (average score – 8.5 points out of 10 possible) and lack of trust in the judiciary (7.5 points). The military conflict with Russia (6.1 points), as well as unstable currency and financial

1 *Офіційний сайт Dragon Capital.* <http://www.dragon-capital.com/en/about/profile.html>.

system (6 points) were the next most highly ranked obstacles.

Despite the negative factors, Ukraine remains a potentially interesting country for investment and businesses plan to continue their activity.

To improve the investment climate, run a number of priority actions, namely:

- improvement of the regulatory and legal framework to attract long-term foreign investment;
- simplification of the registration process for foreign investments;
- improvement of information support of foreign investors about potential investment opportunities;
- channeling public investment resources to the certain priority areas of the economy only;
- reducing the level of taxation for enterprises with foreign investment when a certain volume of investment is exceeded;
- stimulating the development of the stock market, credit, investment funds and other financial institutions, which should ensure the corporate (general) financing of investment projects by domestic and foreign investors;
- arranging the list of measures to strengthen the responsibility of representatives of executive and local bodies for corruption and other discriminatory practices used with investors;
- introducing the practice of concluding transparent agreements between investors and authorities on mutual obligations in the sphere of competitive business behavior and competitive business policy of the state in certain medium-and long-term markets;
- formation of favorable investment image through organizing and participating in international exhibitions, fairs, investment projects, publications in international printed matters;
- preparing an action plan to ensure a favorable investment climate within the proclaimed priorities of socio-economic development, attracting a large number of experts, scientists, public authorities and representatives of business to its development and discussion;
- development of regional plans to improve the investment attractiveness of regions, taking into account the peculiarities of their current ratings of investment attractiveness, provision of state monitoring of their implementation as a criterion for success of the activities of local administrations;
- development of mechanisms for providing public services to improve the qualification and certification of specialists in the field of investment.

References:

1. *Zakon pro rezhym inozemnoho investuvannya 1996* [The law on foreign investment] (Verkhovna Rada Ukrayiny). Kyiv: Parlam. vyd-vo, 19, st. 80. [in Ukrainian].
2. Gitman, Lawrence J., Joehnk, Michael D., Scot,t B. (2010). *Fundamentals of Investing* (11th Edition). [in English].
3. Sharpe, William F., Gordon, Alexander J., Bailey, Jeffrey (2000). *Fundamentals of Investments*. Prentice-Hall. [in English].
4. The Global Innovation Index 2016: Winning with Global Innovation, Ithaca, Fontainebleau, and Geneva (2016). *WIPO.* <http://www.wipo.int/edocs/pubdocs/en/wipo_pub_gii_2016.pdf>. [in English].
5. Peresada, A.A. (2002). *Upravlinnya investytsiynym protsesom* [Management of the investment process]. Kyiv: Finansy i statystyka. [in Ukrainian].
6. Borshch, L.M. (2005). *Investuvannya: teoriya i praktyka* [Investment: Theory and Practice]. Kyiv: Znannya. [in Ukrainian].
7. OECD Investment Policy Reviews OECD Investment Policy Reviews: Ukraine 2016. *OECD*. <http://www.oecd.org/countries/ukraine/oecd-investment-policy-reviews-ukraine-2016-9789264257368-en.htm>. [in English].
8. *Official site Corruption Perceptions index.* <https://www.transparency.org/cpi2015/>. [in English].
9. Doing Business Economy Profile 2016: Ukraine. World Bank, Washington, DC. *World Bank*. <https://openknowledge.worldbank.org/handle/10986/23429>. [in English].

10. Official site World Development Indicators database. *World Bank.* <http://databank.worldbank.org/data/download/GNIPC.pdf> [in English].
11. *The official website of the State Statistics Committee of Ukraine.* <http://www.ukrstat.gov.ua/operativ/operativ2016/zd/izu/izu_u/izu0316.html>.
12. Official site Dragon Capital. <http://www.dragon-capital.com/en/about/media/press_releases/corruption_and_lack_of_trust_in_the_judiciary_in_ukraine_are_the_largest_obstacles_for_foreign_investors.html>. [in English].