

Composition of FDI in Ukraine: A long-term analysis

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Executive Summary (I)

Main messages:

- The composition of FDI in Ukraine across sectors and regions changed consistently between 2009-2018. DCFTA introduction in 2014 appears to have accelerated the flow to some sectors, but has not changed overall trends.
- FDI allocation contributes to structural change in the Ukrainian economy from a model based on heavy industry in the East towards a model emphasising services and light industries, focusing the region around Kyiv.

Aggregate value of Ukraine's FDI stock

- Value loss of FDI stock after 2014 due to UAH depreciation and valuation changes
- Positive net FDI inflows of USD 12 bn 2014-2018

Regional dimension

- The capital region (Kyiv city, Kyiv oblast, Chernihiv, Poltava) increased its share of FDI from 46% (2009) to 62% (2018).
- The FDI share of eastern oblasts (esp. Dnipro, Kharkiv, Donetsk) has fallen from 38% (2009) to 17% (2018).

Executive Summary (II)

Sectoral dimension

- Growth of FDI shares of services sectors (trade, ICT, admin. and technical services)
- FDI share of manufacturing declined from 2009 (35%) to 2013 (22%) mainly due to decline of FDI in metals, which continued to decline after 2013.
- Financial sector FDI share fell after 2013 due to the banking crisis.

Impact of DCFTA on FDI composition

- Although DCFTA introduction in 2014 did not change overall trends, it may have contributed to strengthening FDI share growth in some regions and industries:
 - Growth of FDI share of food production and wood/paper industry
 - Gain in FDI share of Ivano-Frankivsk after 2013 was due to manufacturing FDI, probably car industry suppliers

Contribution of FDI to structural change

- Changing FDI shares of sectors and oblasts correlated with the respective GDP shares.
- Reallocation of FDI helped service sectors, light industry and capital region to strengthen their contribution to Ukraine's GDP.

Structure

1. Introduction
2. Development of the aggregate FDI stock in Ukraine
3. Changes in the shares of source countries
4. Changes in shares of destination regions
5. Changes in the shares of destination sectors
6. Does FDI allocation contribute to structural change?
7. Conclusions

1. Introduction

Background and main question:

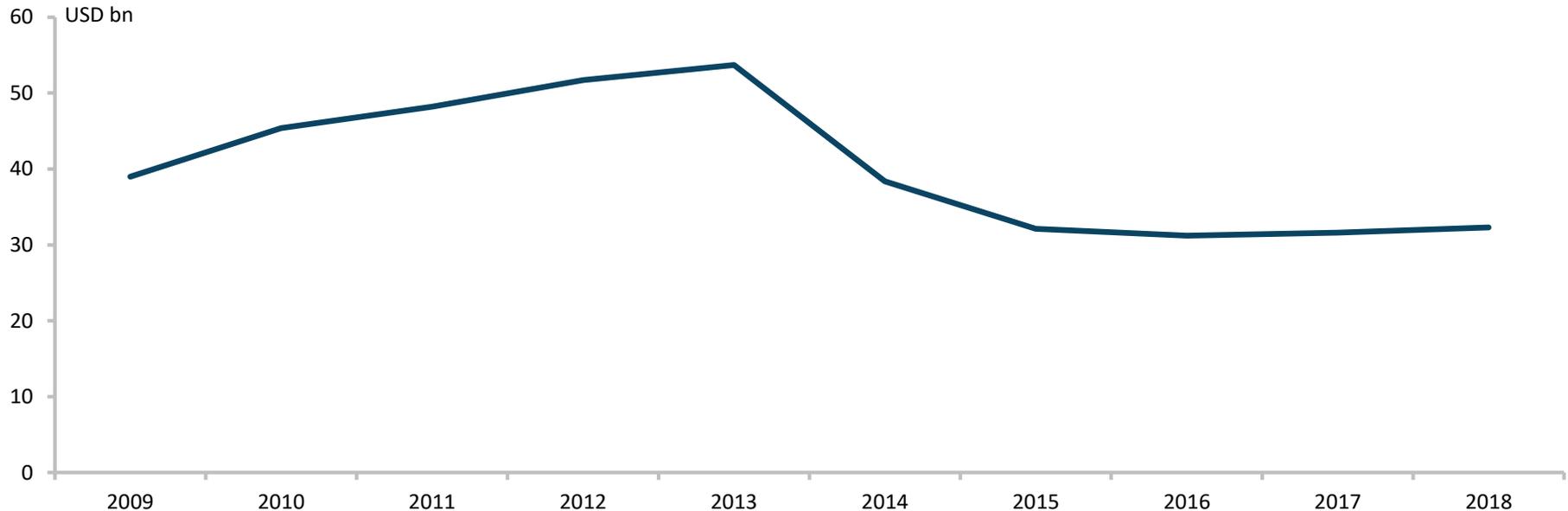
- Much attention has been given to reduction of FDI stock value since 2014.
- But how has the FDI composition of Ukraine changed in the last ten years?
- Has FDI followed the same patterns as general structural change?
- Did trends in FDI change around the implementation of the DCFTA in 2014?

Content of this Policy Briefing:

- Analysis of inward FDI to Ukraine 2009-2018
- Analyse trends in the FDI shares of
 - Source countries
 - Regions/oblasts
 - Sectors/industries
- Comparison of change of FDI shares with GDP shares: Did FDI play a role in supporting structural change in Ukraine?

2. Development of the aggregate FDI stock in Ukraine

Value of inward FDI stock in Ukraine, USD bn



Source: Ukrstat

Note: Equity FDI only, stock value at end of each year

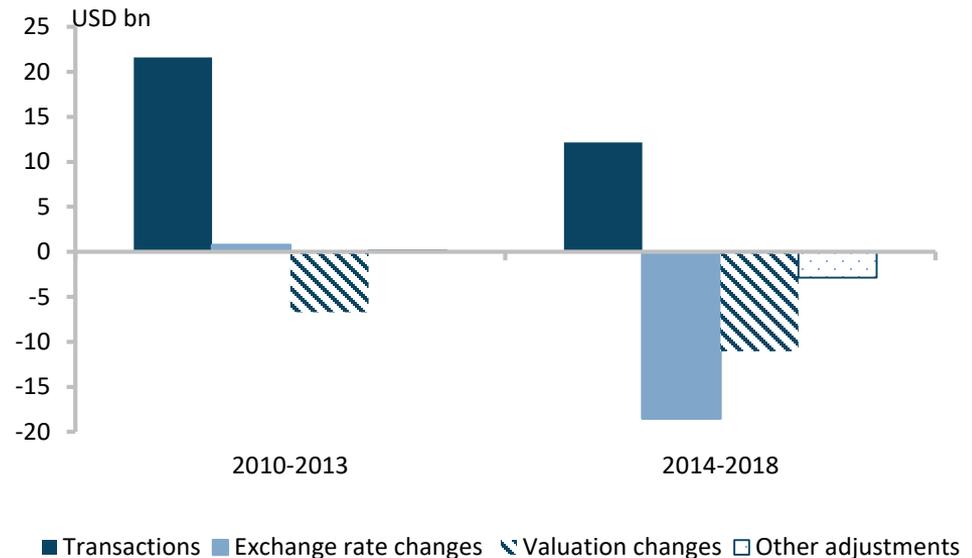
- Aggregate data suggests two very different FDI “episodes” 2009-2013 and 2014-2018
 - Rising FDI stock value until 2013
 - Decline in FDI stock value after 2013, almost flat trajectory after 2015
- **But is the “split” in the aggregate figure also reflected in different trends in the FDI composition (regional, sectoral, countries of origin) 2009-2013 and 2014-2018?**

Drivers of the aggregate FDI stock value

Components of FDI stock value change

- Reasons of value decline post-2014:
 - Exch. rate (UAH depreciation)
 - Valuation changes (writeoffs)
- Net transactions remained positive throughout 2010-2018!
- Whereas exchange rate will have affected all FDI equally, valuation changes and transactions may have led to changes in FDI composition.

Components of change of FDI stock value



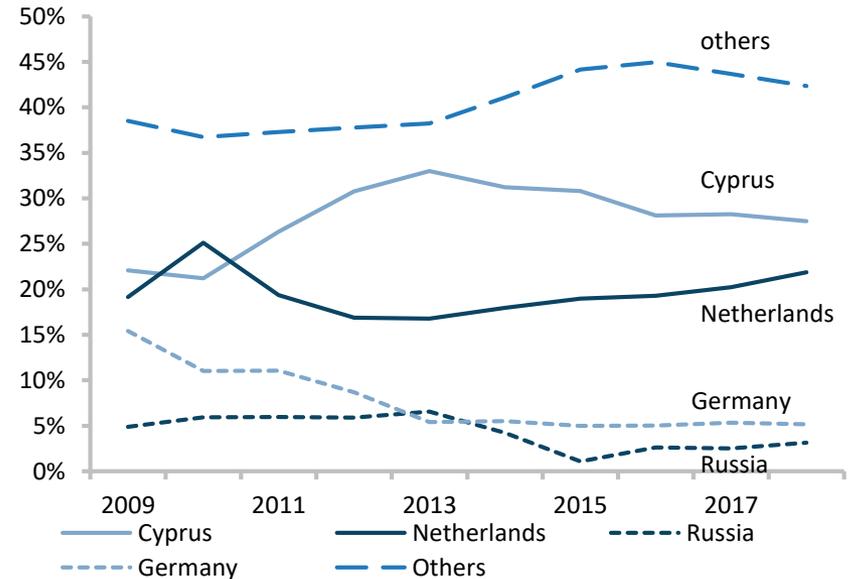
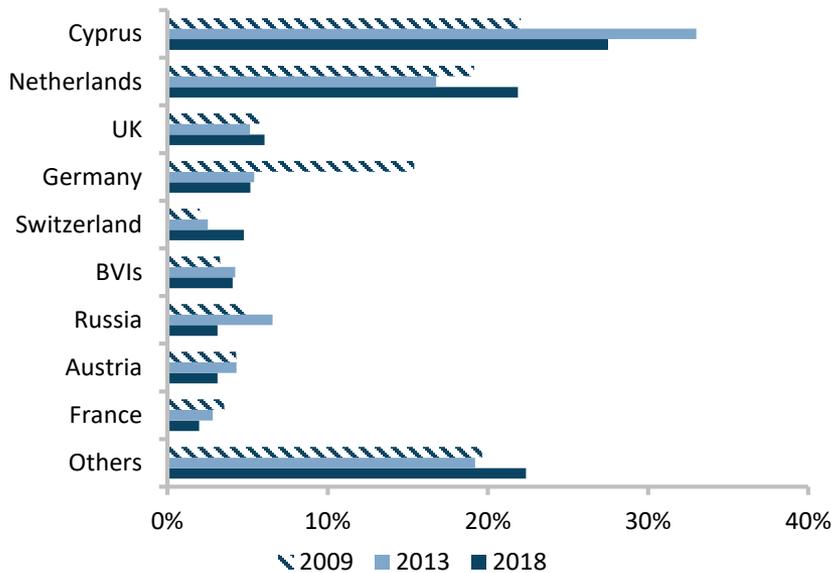
Source: Ukrstat

Implications for analysis:

- Analyse changes in the share of total FDI in Ukraine to avoid confusion due to exchange rate driven absolute decline in FDI value:
 - Of source countries, destination oblasts/regions, destination sectors
- Mainly look at 3 points in time: 2009 (earliest year in data); 2013 (before DCFTA/UAH depreciation), 2018 (latest year in data)

3. Changes in the shares of source countries

Shares of major source countries in total inward FDI stock of Ukraine

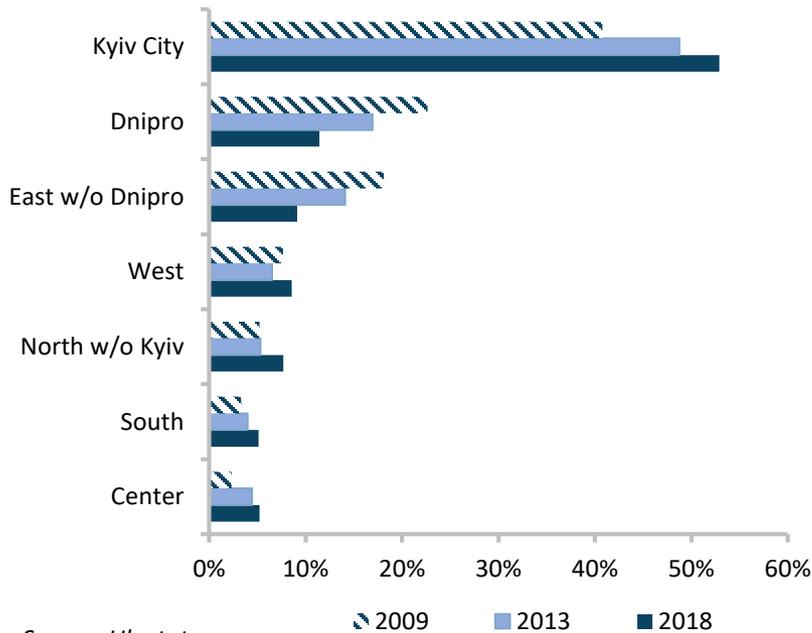


Source: Ukrstat

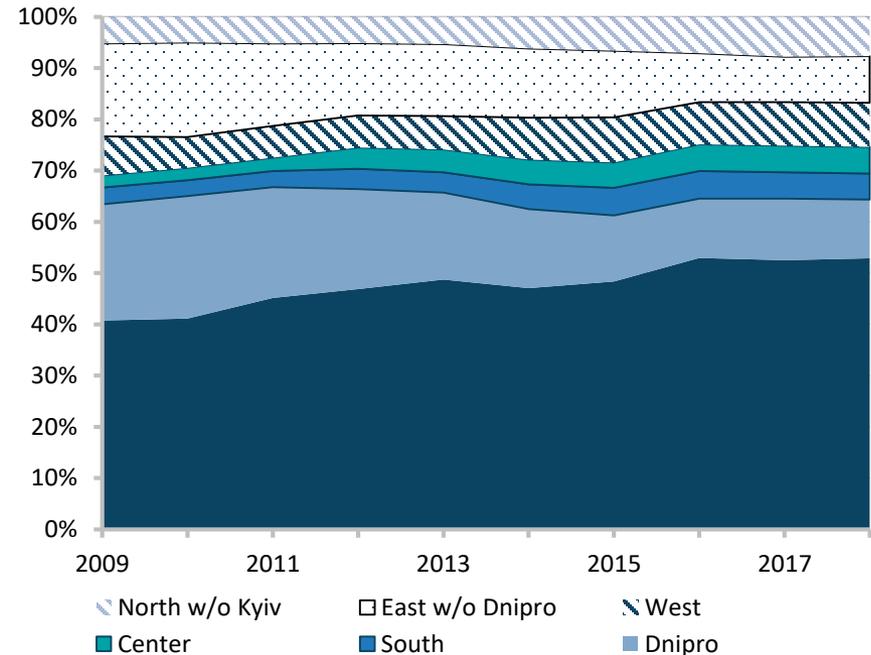
- Cyprus and Netherlands (as FDI „hubs“) together account for ~50% of FDI to UA
- Main change in 2009-2013 : Decline of German FDI share (ArcelorMittal)
- Role of Russia declined post-2013
- FDI hubs probably conceal most real changes between source countries

4. Changes in shares of destination regions

Shares of regions (+ Kyiv city and Dnipro) in total inward FDI stock of Ukraine



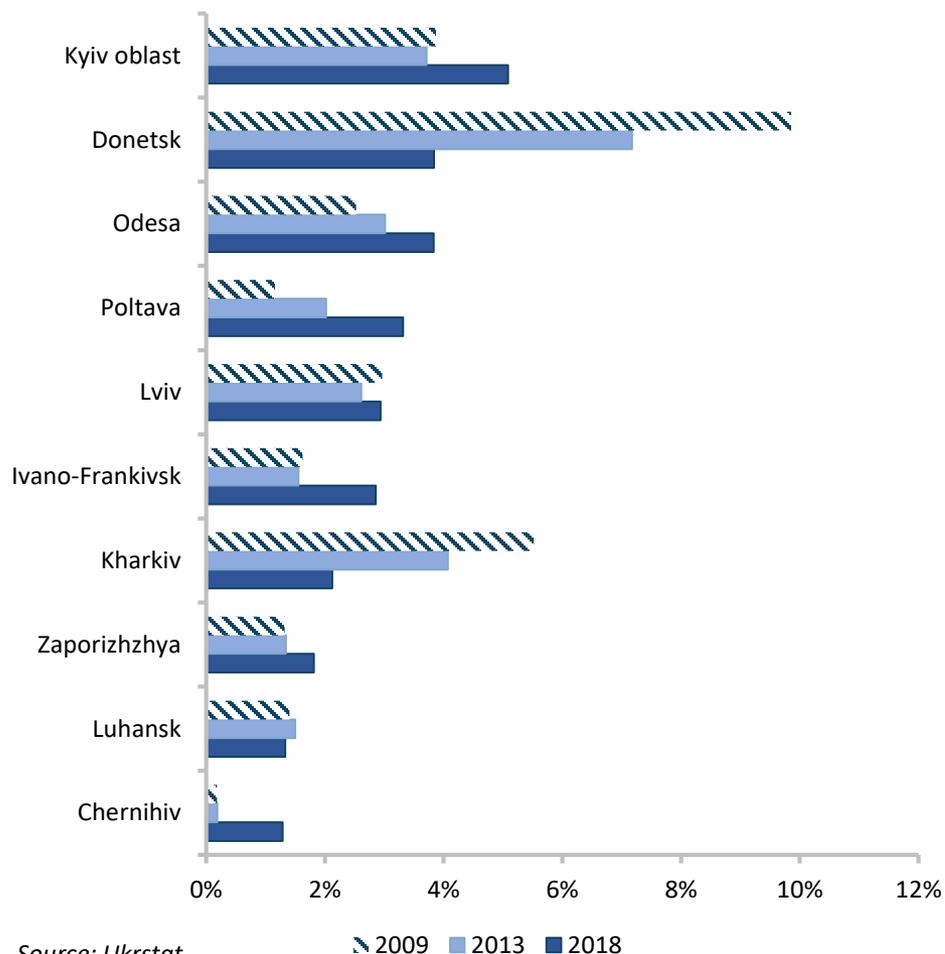
Source: Ukrstat



- Constant trends 2009-2018:
 - Reduction of the share of East (incl. Dnipro) from 41% (2009) to 21% (2018)
 - Increase of FDI share of Kyiv city from 41% (2009) to 53% (2018)
- FDI shares of Kyiv and Dnipro will be partially driven by company HQ registrations.

Changes in the shares of destination oblasts

Shares of top 10 oblasts (ex city and Dnipro) in FDI stock of Ukraine



Source: Ukrstat

▨ 2009 ■ 2013 ■ 2018

Oblasts with increasing FDI share

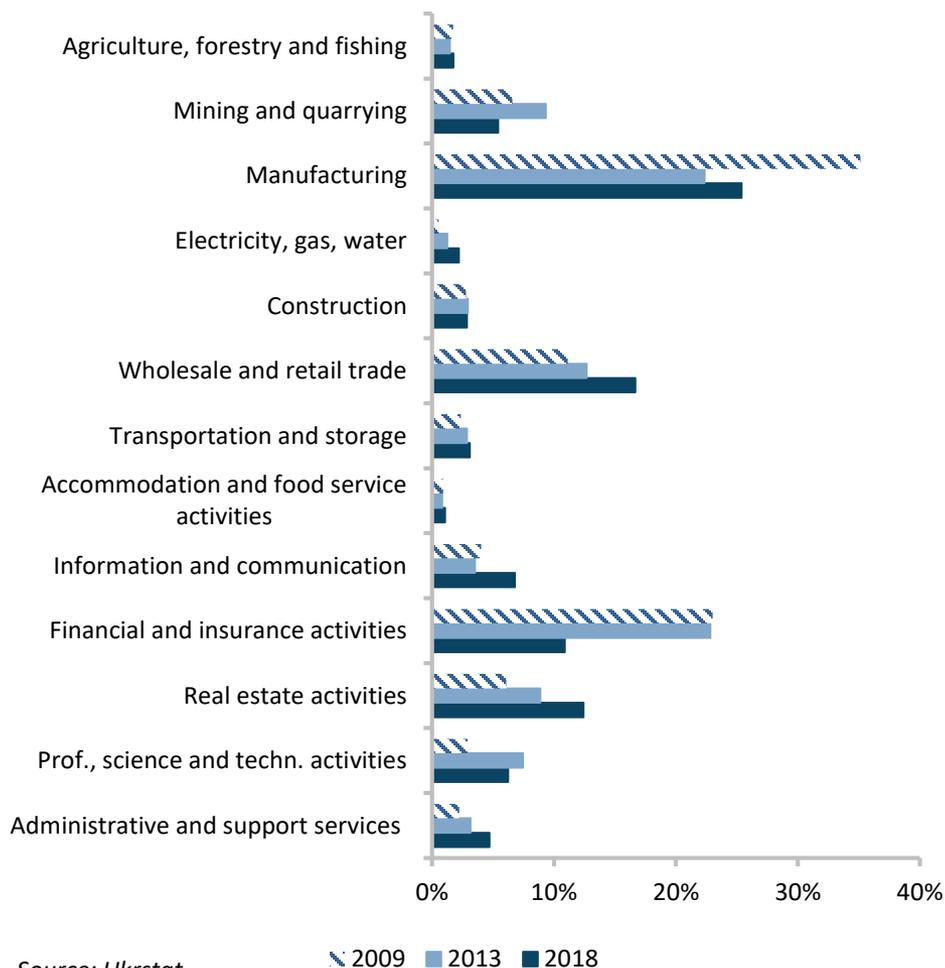
- “Capital region” - Kyiv city + oblast, Poltava, Chernihiv - grew from 46% (2009) to 62% (2018) of total FDI.
- Ivano-Frankivsk (West) gained FDI share after 2013, perhaps due to DCFTA-related investment.
- Odessa (South) constantly grew from 3% to 4% of total FDI.

Oblasts with declining FDI share

- Decline of East concentrated in 3 oblasts: Donetsk, Kharkiv, Dnipro down from 38% (2009) to 17% (2018) of FDI.
- Mainly constant trend since 2009
- Strengthening of the Capital region, decline of the East

5. Changes in the shares of destination sectors

Shares of FDI destination sectors (above 1% of FDI)



Sectors with increasing FDI share

- Administrative and prof./technical services: Constant growth of share 2009-2018 from 5% to 11%
- Real estate: Constant share growth from 6% to 12%
- Growth of FDI share of trade (possibly including agriculture-related FDI) especially after 2013 from 11% (2009) to 17% (2018)
- Growth of ICT only after 2013 from 4% to 7%

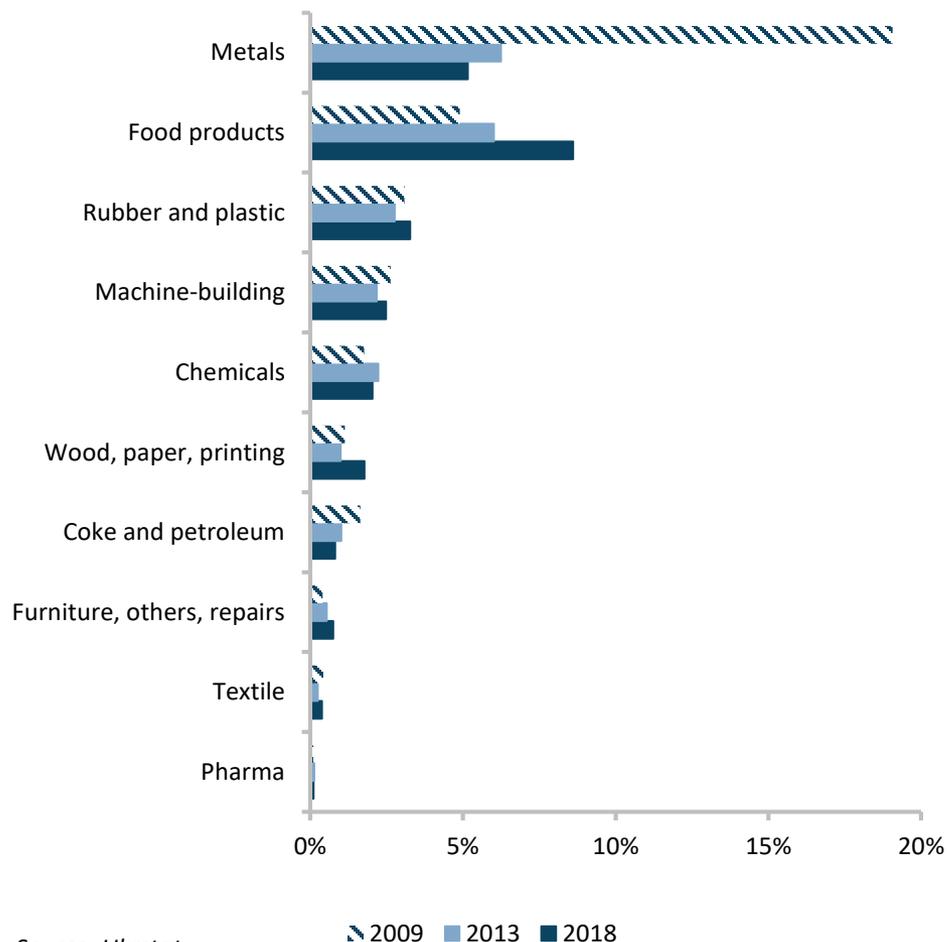
Sectors with declining FDI share

- Decline of manufacturing sector FDI share from 35% (2009) to 22% (2013)
- FDI share of financial sector dropped 2013-2018 from 31% to 9%.
- Mining sector FDI share rose 2009-2013 but dropped afterwards.

➤ **Shift from manufacturing to services**

Developments within the manufacturing sector

Shares of total FDI of manufacturing subsectors



Source: Ukrstat

Subsectors with increasing FDI share

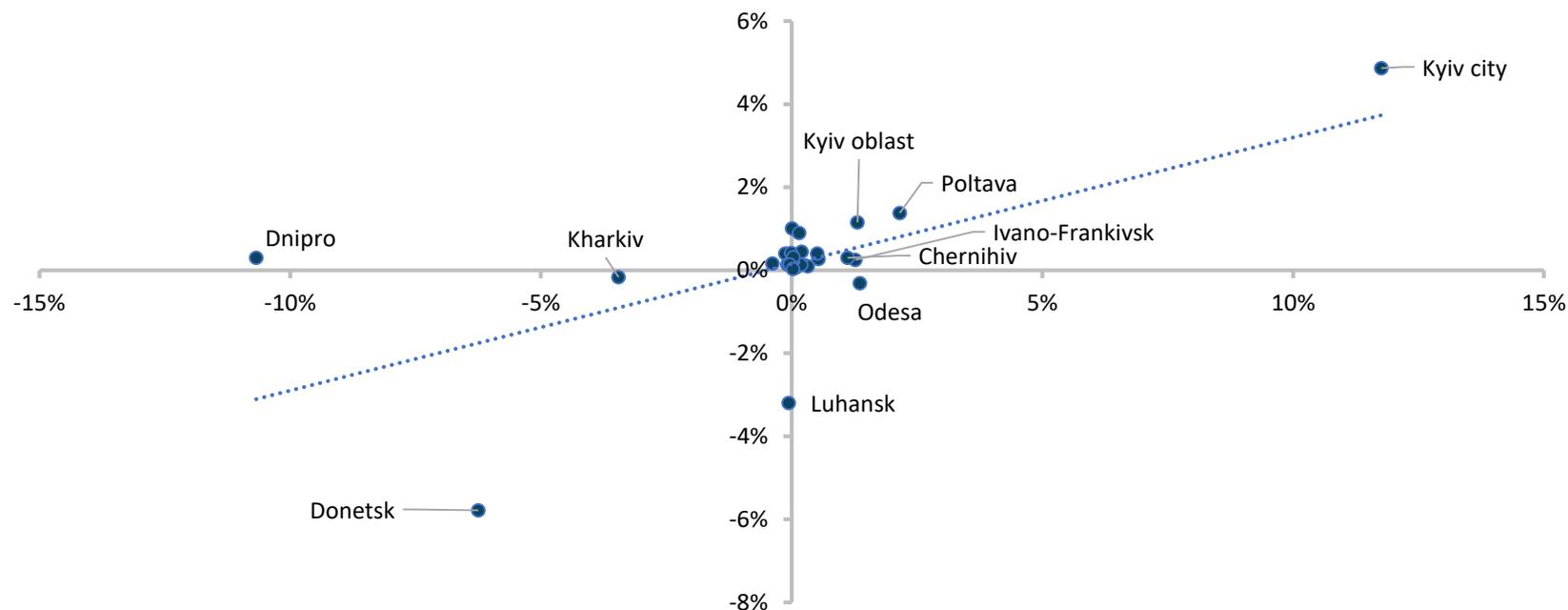
- Food products grew from 5% to 9%, especially 2013-2018, now largest manufacturing subsector.
- Wood, paper industry grew after 2013 from 1% to 2%.

Subsectors with declining FDI share

- Drastic decline of share of metal industry in FDI since 2009
 - Probably large role of ArcelorMittal/Kryvorizhstal investment in this series
- **Steep decline of metal industry importance in FDI since 2013**
- **Rising share of food products & wood/paper may be partially due to DCFTA**

6. Does FDI allocation have economic effects?

Change in FDI share vs. change in GDP share of oblasts, 2009-2017

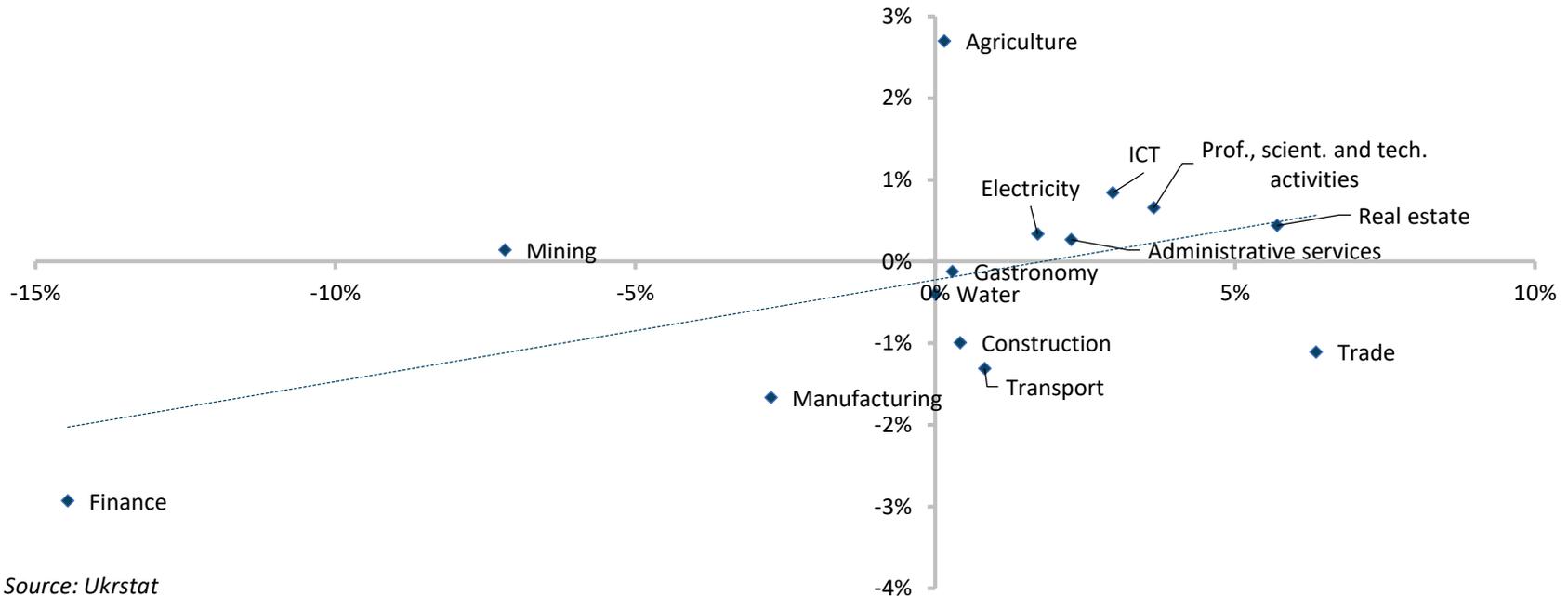


Source: Ukrstat

- Main question: Did the changing FDI allocation seen in previous graphs have a substantial economic effect?
- Due to Donbas conflict, decline of the East may be somewhat overstated in data
- **Still, clearly positive correlation between FDI and GDP share development: Changing allocation of FDI contributed to change in GDP shares of oblasts**

Impact of FDI on structural change between sectors

Change in FDI share vs change in GVA share 2010-2018 by sector



Source: Ukrstat

Note: Sectors with minimal FDI involvement (Public admin., education, health, arts & entertainment and other services) excluded

- FDI share gains in ICT and services sectors are correlated with gains in the share of national Gross Value Added
- Agriculture and trade sectors probably connected with regard to FDI as trade companies often serve as vehicles for foreign investment in agriculture
- **Changes in FDI support the ongoing change in the Ukrainian economy**

7. Conclusions

- Despite a reduction in the headline figure of value of the aggregate FDI stock, FDI allocation plays an active role in shaping the economy of Ukraine.
- Trends in FDI reflect structural change and have not substantially changed after the DCFTA implementation and the crises/conflicts post-2014.
 - A sectoral shift towards services sectors and „light“ manufacturing
 - A regional shift from the industrial east to the capital region around Kyiv
- However, there is some evidence that DCFTA implementation may have accelerated the FDI shift towards some industries and regions.
 - FDI shares of food production, wood/paper industry and the agri-trade complex rose faster after 2014
 - Ivano-Frankivsk in the west gained substantial FDI share after 2014
- FDI was contributing to the structural change in Ukraine’s economy: FDI shares of sectors/oblasts are positively correlated with their resp. GDP shares.

8. Possible extensions

- If desired, the data can be explored in more detail:
 - Comparative profiles
 - In which sectors or oblasts is FDI from key source countries located
 - Sectoral profiles of FDI in main receiving oblasts
 - Regional profiles of FDI in key sectors
 - Localisation of gains and losses, e.g.
 - What sectors drove the increasing FDI shares of Kyiv city, Poltava, Odessa etc?
 - In which oblasts or regions did the increase in the FDI share of services sectors, trade/agri or light industry occur?
 - In which oblasts did the vast losses of FDI in metallurgy occur?

About the German Economic Team



The German Economic Team (GET) advises the governments of Ukraine, Belarus, Moldova, Georgia and Uzbekistan regarding the design of economic policy reform processes and a sustainable development of the economic framework. As part of the project we also work in other countries on selected topics.

In a continuous dialogue with high-level decision makers of the project countries, we identify current problems in economic policy and then provide concrete policy recommendations based on independent analysis.

In addition, GET supports German institutions in the political, administrative and business sectors with its know-how and detailed knowledge of the region's economies.

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