German Advisory Group Ukraine

INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING

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German Advisory Group Ukraine / Institute for Economic Research and Policy Consulting
Press release

New empirical study shows strong positive economic effect of FDI on Ukraine

Recent research by the German Advisory Group and the Institute for Economic Research and Policy Consulting shows that Foreign Direct Investment (FDI) strongly benefits Ukraine. Although only relatively few companies in Ukraine are fully or partly owned by foreign investors, these companies are on average much larger and productive than purely domestic companies and pay higher wages. Raising the limited FDI stock of Ukraine by attracting more FDI would lead to faster growth of the Ukrainian economy and better living standards with higher wages of Ukrainian workers.

Foreign direct investment (FDI) designates ownership of at least 10% (often much more) of a company by a single foreign investor with a "lasting interest" in the company. The German Advisory Group in cooperation with the Institute for Economic Research and Policy Consulting has conducted an in-depth analysis of the economic effect of FDI in Ukraine using a unique, comprehensive dataset containing the performance of FDI and purely domestic companies by Ukrstat.

Main results

1. The stock of foreign direct investment in Ukraine is relatively low

The value of the FDI stock in Ukraine is low compared to other countries in the region. In 2016, the last year with good data availability, the FDI stock of Ukraine according to IMF methodology was worth USD 27.5 bn. This translates to ca. USD 650 per citizen of Ukraine and is below the values for Moldova (USD 740), Belarus (USD 1,960) and far lags behind Georgia (USD 4,430), Poland (USD 4,930) or Estonia (USD 14,760).

2. The FDI stock has decreased in the past years

Between 2013 and 2016, the value of the FDI stock has decreased by ca. 60%, from USD 67.3 bn to the USD 27.5 bn of 2016. This was not due to FDI leaving the country, but due to value losses of the existing investments. Roughly half of the decrease was due to the depreciation of the Hryvnia. The other half of the decrease was due to the losses of companies, especially in the financial sector where much capital had to be written off. Since 2016, FDI inflows have been positive, but limited. For 2017 and 2018 no further decrease, but a slight recovery of the FDI stock value should be expected.

3. FDI companies are larger than purely domestic companies

Among the nonfinancial corporations of Ukraine, only 4.6% of companies in Ukraine are FDI companies. Yet these few FDI companies employ 20.4% of employees and produce 34.9% of total Gross Value Added (GVA), a measure of output. The average FDI company in Ukraine hence produces 11 times as much output than the average domestic company.

4. FDI companies are more productive than purely domestic companies

FDI companies have a labour productivity that is on average twice as high than that of purely domestic companies, implying that an FDI company produces twice as much GVA per worker than a domestic one. This conclusion also holds if controlling for the value of capital stock per company. Foreign investors hence bring knowledge, technology and networks (e.g. of suppliers or buyers) that enhance the competitiveness of the companies they invest in.

5. FDI companies pay higher average wages than purely domestic companies

Labour costs per employee of FDI companies are 57% higher than for domestic companies. This indicates that the average wage per employee in an FDI company will be around 60% higher than in a purely domestic company. Hence, workers earn higher wages in FDI companies.

6. Attracting more FDI will lead to faster growth and better living conditions

Our analysis clearly shows that Ukraine benefits strongly from existing FDI. FDI improves not only the productivity of FDI companies but also leads to higher wages being paid by them. Efforts should be made to attract more FDI. Also, protectionist reflexes, which run high at present, should be resisted. Economic openness hence benefits Ukraine and its citizens.

David Saha, member of the German Advisory Group Ukraine and lead author of the analysis:

> *"Our research shows that FDI attraction has tangible benefits for everyone in Ukraine: FDI does not only lead to higher economic growth, it also immediately benefits workers through higher wages."*

Vitaliy Kravchuk, Research Fellow at IER Kyiv:

> "*Only around 5% of companies are partly owned by FDI investors. That these few companies employ 20% of workers and produce 35% of output shows that FDI already at present plays an important and positive role in the Ukrainian economy."*

Robert Kirchner, Deputy Team Leader of the German Advisory Group Ukraine:

> *"The results of our study should encourage the authorities to double their commendable efforts to attract foreign investments to Ukraine"*

German Advisory Group Ukraine: The group advises the Government of Ukraine on economic policy issues since 1994. It is funded by the German Federal Ministry for Economic Affairs and Energy and implemented by the consulting firm Berlin Economics.

Institute for Economic Research and Policy Consulting: Institute for Economic Research and Policy Consulting (IER) is the leading Ukrainian analytical think tank focusing on economic research and policy advice. The IER was founded in October 1999 by top-ranking Ukrainian politicians and the German Advisory Group Ukraine.

Policy Study: "The economic impact of FDI on Ukraine"
Policy Briefing: "The economic impact of FDI on Ukraine – Summary of Conclusions"