

National Strategy to Increase Foreign Direct Investment in Ukraine

Section 3: Vision and Goals

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The Vision

The Vision describes the ideal situation that Ukraine could approach over the next ten years, provided the assumptions described in this document are met.

The year is 2030. Ukraine has become a country that, after the crisis in 2020 and stabilization in 2021, has managed to become a magnet for foreign direct investment (FDI).

The turn from an underdog to a frontrunner was achieved mainly by the Ukrainian authorities treating the inflow of foreign investment as a strategic priority and having a clear vision, will and courage to push for the necessary reforms and changes.

The National Strategy to Increase FDI Flows to Ukraine has provided the necessary fundamentals for comprehensive stakeholders discussions and achieving a consensus leading to this turnaround, in particular focusing on:

- ❑ Mid-term operational, legal and communication priorities
- ❑ Prediction of the post-pandemic economic and investment environment in Europe and around the world
- ❑ Identification of areas in which Ukraine possessed comparative advantages under the new circumstances
- ❑ Obstacles that needed to be removed so that the potential comparative advantages could be translated into a real inflow of FDI

The most important prerequisite for a successful turnaround has been a changed image of the country. This was primarily due to the active policy of the Ukrainian authorities in removing the main obstacles to the inflow of investments in the past.

A change in the perception of the country in the eyes of investors was achieved by changing the policy of the Ukrainian authorities in two directions.

First, the government's efforts focused on eliminating those systemic shortcomings that were perceived by investors and entrepreneurs as the most serious. These included pervasive corruption, mistrust of the courts and the judiciary, and the monopolization of markets and the seizure of power by oligarchs.

Although these are areas where the results in the functioning of the system itself did not come quickly, the obvious will, courage, and determination of the Ukrainian authorities to achieve change in these areas were important for the change in perception. This change of approach was based not only on promises but also on specific steps and measures and the first visible results.

Secondly, the government actively and effectively communicated its commitment and its first results in changing the functioning of the system. Both within the country and abroad, for which it also used international institutions and its allies overseas.

To this end, the government has prepared a comprehensive communication strategy and has also increased the capacity and efficiency of the Ukrainian Ministry of Foreign Affairs, as well as foreign investment promotion agencies.

The Vision

Changing the image of the country was a profoundly big challenge¹. However, the Ukrainian authorities did so because they realized that a change in perception of the country was the most important, albeit not sufficient, precondition for increasing foreign investment inflows. Foreign investment, in turn, was a precondition for high and sustainable growth and development of the Ukrainian economy, leading to a higher standard of living and quality of life for an average Ukrainian in the long run.

The government was aware that the country has been operating well below its potential for a long time and that FDI is a typical example of a win-win strategy to fulfil Ukraine's potential. At the same time, the use of Ukraine's potential, in close proximity to the EU, offered an unprecedented precondition for a high return on FDI.

At the same time, without a significant inflow, it would in no way be possible to use the potential that Ukraine has. This potential is not only untapped, but its usability may also expire without effective changes.²

While critical, a change of the country image was not the sole sufficient requirement for a turnaround in the inflow of foreign investment. In addition, it was necessary to focus on those reforms and changes that ensured confidence in macroeconomic stability, reduced the intervention of law enforcement agencies in the economic environment, improved the business environment and reduced the size of the 'grey' economy.

The government met all the conditions of the Stand-by programme with the IMF from June 2020. During the second half of 2021, it successfully negotiated a new, ambitious program for 2022-2023.

It included fundamental reform of the:

- ❑ judiciary;
- ❑ de-monopolization and deregulation of energy and rail transport;
- ❑ creation of an independent and professional regulator of transport infrastructure;
- ❑ the next stage of land market opening;
- ❑ a major acceleration of large-scale privatization;
- ❑ strengthening central bank independence;
- ❑ reform of the tax system, which, together with the reform of the tax and customs administration has significantly reduced the shadow economy.

The government has significantly accelerated Ukraine's fulfilment of its obligations under the Association Agreement with the EU.

In addition to the above-mentioned first and second level system reforms, which changed the perception of the country and created a business environment based on law enforcement and equal rules for all (level playing field), the government also prepared tactical short- and mid-term measures to ensure rapid progress in improvement of Doing Business environment for foreign investors and modernization and expansion of sectors and industries with the highest potential and desirability for FDI.

As a result, within 5 years, Ukraine outperformed the core peer group of countries competing for global investor attention and generated double-digit cumulative growth rates of net FDI inflows.

The Vision

A critical element of this resounding success was a concerted push by the government and private sector 'champions' to transform Ukraine's economy to high added value generation across a multitude of sectors.

To achieve that, amongst other measures, the government together with the private sector focused on strengthening and developing its (until then) strongest advantage - human capital. Despite overall limited resources, education has become a budgetary and factual priority. The problem of emigration of educated people was gradually solved thanks to the dynamic growth of the Ukrainian economy, which brought with it an increase in wages and opportunities, as well as a steady return of many of those who left Ukraine in search of better wages and opportunities in the past³.

Following this approach, Ukraine has managed to simultaneously attract investors to the following four key areas:

- ❑ transport infrastructure (roads, railways, airports, ports), especially in the form of concessions and PPP projects
- ❑ mass industrial production (heavy and light engineering, automotive industry, energy) especially through the sale of large state-owned enterprises through international tenders and greenfield investments
- ❑ high value-added agriculture
- ❑ new, promising areas (digital infrastructure, new building materials, batteries for electric cars, hydrogen energy, IT sector and more)

Ukraine has become a fast-growing economy thanks to a successful shift from an underdog to a frontrunner in attracting foreign direct investment. Foreign investment in infrastructure has brought about the rapid modernization of a dense but outdated network of roads, railways, airports, and ports (sea and river).

Investors also brought about a rapid modernization and restructuring of the industry, which, like the transport infrastructure, was characterized by considerable but obsolete and unused capacities. New investors have brought not only modernization and new technologies, but also new markets and greater involvement of Ukrainian industry in global supply chains.

In the area of agriculture, foreign investors brought its uplift to a higher level of processing and higher added value.

Along with the development and modernization of infrastructure and traditional industries, Ukraine has succeeded in rapidly developing new technologies and new industries. Digitalization and the green economy have become a defining direction in all areas of life. But mostly in new, promising areas based on new scientific research.

Thanks to reforms and a turnaround in the inflow of foreign investment, Ukraine has succeeded in modernizing and restructuring the "old" sectors of the economy, while also building "new" sectors and connecting them so that the Ukrainian economy finally became a true European economic tiger.

FDI Enhancement – Strategic Goals

A fundamental change requires a clear definition of priorities and a focus on limited capacity, political energy, and political capital on these priority objectives⁴.



A. First-level systemic reforms that are key to changing the country's perception and gaining the trust (not only) of foreign investors:

- ❑ Judicial reform, protection of property rights and law enforcement
- ❑ Fight against corruption and abuse of power by law enforcement agencies
- ❑ Demonopolizing markets and limiting the power of oligarchs



B. Second-level systemic reforms necessary for changing the business environment and establishing a level playing field (which strengthen investor confidence):

- ❑ market opening and deregulation (opening competition wherever possible and creating or strengthening independent and professional regulators wherever competition and market opening is not possible)
- ❑ guaranteeing the independence of the central bank
- ❑ responsible fiscal policy guaranteeing the sustainability of public finances
- ❑ real opening of the land market
- ❑ large-scale privatization, including the privatization of state-owned banks
- ❑ reform of the tax system and customs administration with the aim of significantly reducing the size of the shadow economy
- ❑ accelerating progress in implementing the Association Agreement

FDI Enhancement – Strategic Goals



C. Sectoral reforms and measures that remove obstacles and increase Ukraine's strengths in selected areas where Ukraine could have the upper hand over its regional competitors in the fight for the confidence of foreign investors:

- ❑ Transport infrastructure
- ❑ Energy
- ❑ Advanced Manufacturing (Engineering, electronics and automotive industry)⁵
- ❑ High value agriculture
- ❑ Digital infrastructure



D. Long-term focus on global trends and sectors that could be developed in Ukraine over the next decade:

- ❑ These areas respect the three most important megatrends identified by the "Strategy" for the post-pandemic era, which are digitization, environmental sustainability, and supply chain transformation. At the same time, Ukraine has created (potentially) good and comparative advantages for these areas. These are also areas whose development is conditioned by the inflow of FDI.



E. Comprehensive Communication Strategy to ensure a) a systemic change in perception of Ukraine from a 'high-risk/unpredictable reward' to a 'robust and competitive investment destination' and b) support of increased foreign capital presence in the country by general public.



F. Implementation of effective and competitive investment incentives and strengthening the capacity and performance of investment promotion agencies:

In December 2020, Ukraine adopted a law on the promotion of major investments, which provides an outstanding legislative framework in this area. It will now be important to finalize the implementing rules and, particularly, to implement the whole process adequately. UkraineInvest is a high-quality institution. It will be important to strengthen its capacity and increase its efficiency based on best practices from the countries, which are successful in FDI influx and considering the changes that will occur in the investment environment in the post-pandemic era.

The Vision (Footnotes)

1. As the example of Slovakia has shown, changing the image is a formidable but feasible challenge. In the second half of the 1990s, Slovakia was considered a "black hole in Europe" (Madeleine Albright, 1997). Unlike its neighbors in the V4 (Poland, Czech Republic, Hungary), the country was isolated and excluded from integration into the EU, NATO and OECD. There was a high level of corruption and zero inflow of foreign direct investment. At the end of 1998, a political change took place. The new government of M. Dzurinda adopted an ambitious reform and integration plan, which resulted in EU accession in the first wave on May 1, 2004, and a change in image from a black hole to the most reform country in the world (World Bank, 2004) and the "Tatra Tiger" (New York Times, Dec.2004). The result was also an enormous growth in the inflow of foreign direct investment. Based on which Slovakia became the world leader in the production of passenger cars per capita.

2. An analysis of 56 successful countries that have grown at a rate of more than 6% per year in at least ten consecutive years during recent decades has shown, that each has a fixed investment of more than 25% of GDP. Mostly between 25% and 35% of GDP (Source: Ruchir Sharma: The Rise and Fall of Nations, W.W. Norton & Company, New York, 2016, pg. 203). It is, of course, a total investment, both private and public, domestic, and foreign.

If Ukraine really wants to kick-start rapid and sustainable economic growth, it should move from a pre-crisis level of investment to GDP ratio of around 18% (in 2019) to at least 25% to 28% of GDP. This means increasing the volume of investments by 11 to 15 billion USD annually. As domestic public investment resources are limited by budgetary constraints and domestic private ones, in turn, by high-interest rates and a high burden of non performing loans (NPL) in banks, the only real rapid source of the necessary investment growth is foreign direct investment.

3. This was also the experience of Ireland (as well as other successful reform countries). Ireland suffered from high emigration for decades until the early 1990s. Economic reforms were started in 1987 and after a few years, since 1991, they have brought a turnaround in this area as well. The number of immigrants began to outweigh the number of emigrants, peaking in 2007, when the share of foreigners in all employment in Ireland was 16.2%.

4 The National Strategy to Increase FDI Flows to Ukraine is primarily focused on the analysis and proposal of measures in the area of reforms and measures in selected sectors, new promising areas, communication, incentives and support activities (points C, D, E, F). The fundamental problem, however, is that without real progress in first and second-level systemic reforms, partial sectoral and support measures cannot be expected to deliver positive results in line with the efforts made.

5 The example of Slovakia and Ukraine shows that the existence of specific past production does not have to be a prerequisite for attracting foreign investment and the sustainable development of such production. While Ukraine produced around 200,000 passenger cars a year during the 1980s, no passenger cars were produced in Slovakia. Today, Slovakia is the number 1 passenger car per capita producer in the world. With almost twice the number of cars produced (202 per 1,000 inhabitants in 2019) compared to the Czech Republic, the second-largest producer per capita (126 per 1,000 inhabitants). In Poland, it is 12 and in Ukraine 0.15. More important prerequisites than a specific specialization are the systemic conditions for the inflow of foreign investment (Strategic goals of the first and second level / A and B / in this text) and the overall industrial tradition and peoples qualification.

FDI Enhancement – Key Operational Objectives (Introduction)

The operational objectives for the first and second groups of systemic reforms needed to substantially increase the inflow of foreign investment are not the subject of this document. Accordingly, our focus is on the most important measures and changes that may be effectively implemented in the short- and mid-term perspective and may have a material impact on enabling and unlocking systemic FDI flows and/or long-term perception of Ukraine's investment potential.

Details of the actions and measures we are proposing are provided in the Action Plan for the Strategy. That Action Plan is divided into three distinct streams: Operational, Legal and Communication. The three streams are inter-connected and cross-referenced, where applicable, and provide the fundamentals for a substantial yet tangible and implementable roadmap of actions.

The following pages provide a summary of the most important general and sectoral actions stated in the proposed Action Plan.



FDI Enhancement – Key Operational Objectives (non-sectoral)



Strengthen business operation regulatory environment



Ensure 'investor-friendliness' of the judicial system



Uphold key 'rule of law' provisions regarding international investments



Direct efforts at reduction of perceived country risk



Develop and adopt a Depopulation and Labor Force Flight Mitigation Strategy



Develop and adopt a comprehensive SOE Governance and Privatization Strategy



Develop and adopt the new Export Strategy with a special focus on FDI-through-trade activation



Implement long-term budget and financial obligations planning



Increase business relevance and STEM+English focus of education at all levels



Direct efforts at creation of necessary framework for effective capital and commodity markets



Develop and implement the concept of public and public-private investment funds



Align all investment promotion efforts within the public sector and provide vocal support to promotion efforts by the private sector

FDI Enhancement – Key Operational Objectives (Transport Infrastructure)



Set up the Airport Development Fund and Railway Development Fund



Make legislative and institutional changes necessary for the full-scale launch and operation of the inland water transport market



Adopt legal framework for the multimodal transportation



Develop and approve the CMU procedure for application of FIDIC standards



Approve the aviation rules for access to handling services market



Create a National Transport Regulatory Committee



Implement a mechanism for compensation of the private investments in public infrastructure objects



Complete the reform of Ukrzaliznytsia and adopt a modern law on railway transport



FDI Enhancement – Key Operational Objectives (Energy)



Complete the shift from commodity model to financial model of Public Service obligations



Set electricity tariffs for households at an economically reasonable level



Facilitate the formation of flexible and rational balance of maneuverable capacity



Solve the problem of accumulated debts at the electricity and natural gas market



Increase the liquidity and transparency of natural gas market in Ukraine



Establish energy storage regulation



Simplify access to land plots under energy facilities



Develop and adopt the new Code of Ukraine on Subsoil

FDI Enhancement – Key Operational Objectives (Digital Infrastructure)



Development and implementation of the National Strategy for fixed and mobile broadband infrastructure



Development and implementation of the cloud services and cloud infrastructure strategy



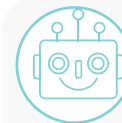
Development, piloting and implementation of the Smart Cities strategy



Development and implementation of the national strategy of digital skills



Development and implementation of the national strategy of digital social services



Implementation of e-Residence for digital innovation entrepreneurs



Development and implementation of electronic citizenship services



Adopt legal framework on cybersecurity



Enforce interoperability (interconnection) between state registers

FDI Enhancement – Key Operational Objectives (Advanced Manufacturing)



Complete customs reform



Solve the problem of Import and usage of aged and damaged cars



Provide a quick and affordable connection to the power grids



Execute the ACAA agreement for three priority sectors and further approximate legislation for other sectors



Increase capacity of the Export Credit Agency (ECA)



Incentivize local producers and customers to buy locally manufactured vehicles



Improve protection of local manufacturers from dumped and subsidized import



Incentivize creation of industrial parks and tech manufacturing clusters across the country



FDI Enhancement – Key Operational Objectives (High Value Agriculture)



Creation of favorable conditions for foreign investments into agricultural land



Development and implementation of an affordable and effective agricultural weather risk insurance system



Continuation of efforts to eliminate tariff and non-tariff barriers for the export of Ukrainian HVA products



Implementation of phytosanitary and veterinary standards, as well as food safety standards that fully comply with EU standards



Develop and enforce legal and technical mechanisms of digitalization in SPS area (services and reporting)



Fostering infrastructure development for HVA (freezers and installations, laboratories, slaughterhouses, biological waste processing stations)



Improve legislation on land consolidation



Streamline the mechanism for obtaining land needed after privatization of real estate objects or shares

FDI Enhancement – Key Operational Objectives (Communication)



Change the general public perception of the FDI concept



Enhancing investment promotion through effective cooperation with the private sector



Solidifying the role of UkraineInvest as a leadpoint on investment promotion



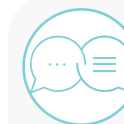
Changing the image of the country for the global investors' community



Reorganizing and enhancing promotion through official channels



Balance investment promotion efforts between inviting fresh equity and effective support of investors present in the country



Engaging regions in effective investment promotion

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