Poland and Ukraine: Trade and Investment Opportunities

Michael Bleyzer

Where Opportunities Emerge
Ukraine’s International Trade

*Developments of Ukrainian Foreign Trade in Goods and Services*

- The volume of Ukrainian foreign trade has been steadily increasing.
- Growing exports were supported by favorable external conditions with strong external demand for Ukrainian products and increasing prices of metals.
- Imports have been increasing supported by growing consumer income, strong national currency, surging investment demand and growing prices of energy resources.
- The balance of foreign trade was on a good track, registering significant surpluses in 2000-2005, but with a “reasonable” deficit in 2006.
FSU countries continue to be the principle trading partners of Ukraine due to the traditionally strong economic links and high dependence of the Ukrainian economy on imported oil and gas from Russia and Turkmenistan.

At the same time, the integration of Ukrainian economy into Europe is high, with overall trade with the EU representing about 30% of total Ukrainian trade.
Ukraine’s Exports of Goods to EU (% of total) and Poland (% of total exports to EU)

<table>
<thead>
<tr>
<th></th>
<th>EU</th>
<th>Poland</th>
</tr>
</thead>
<tbody>
<tr>
<td>2003</td>
<td>34%</td>
<td>9.7%</td>
</tr>
<tr>
<td>2004</td>
<td>29.9%</td>
<td>10%</td>
</tr>
<tr>
<td>2005</td>
<td>26.8%</td>
<td>11%</td>
</tr>
<tr>
<td>H1 2006</td>
<td>27.9%</td>
<td>11.6%</td>
</tr>
</tbody>
</table>

Source: State Statistics Committee of Ukraine

- The EU is an important market for Ukraine as almost 1/3 of Ukrainian exports are absorbed in the EU area
- Poland is one of the key markets in the EU for Ukrainian products taking about 11% of the exports to the EU
- The share of Poland in Ukrainian exports to EU has been growing and has large potential
Ukraine’s Imports of Goods from EU (% of total) and Poland (% of total imports from EU)

Source: State Statistics Committee of Ukraine

- The demand for EU products in Ukraine is strong as more than 33% of Ukrainian imports was originated in EU zone
- The contribution of Poland to Ukrainian imports from EU is significant and on an upward trend
### Composition of Ukrainian Exports to Poland by Principal Commodities in 2005, % of total

<table>
<thead>
<tr>
<th>Commodity</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>Metals</td>
<td>32.5</td>
</tr>
<tr>
<td>Food and agricultural products</td>
<td>6.9</td>
</tr>
<tr>
<td>Mineral products</td>
<td>24.8</td>
</tr>
<tr>
<td>Chemicals and related products</td>
<td>19.0</td>
</tr>
<tr>
<td>Wood &amp; wood products</td>
<td>6.3</td>
</tr>
<tr>
<td>Other manufactured goods*</td>
<td>4.0</td>
</tr>
<tr>
<td>Machines, equipment, &amp; transport vehicles</td>
<td>3.9</td>
</tr>
<tr>
<td>Miscellaneous</td>
<td>2.6</td>
</tr>
</tbody>
</table>

* Include textiles, apparels, footwear, leather goods, fur, etc.

Source: State Statistics Committee of Ukraine

- The composition of Ukrainian exports to Poland is dominated by chemicals, mineral products and metals, which are relatively low-value added commodities.
- To a large extent this reflects the structure of Ukrainian industry, which has a domination of low-value added commodities.
The structure of Ukraine’s imports from Poland is much more diversified than Ukraine’s exports to Poland.

The share of high-value added goods (i.e., machinery and equipment, vehicles) in the total imports from Poland into Ukraine is high.

Ukrainian demand for Polish products is strong for the wide range of commodities.
# FDI to Ukraine – countries of origin

<table>
<thead>
<tr>
<th>FDI stock to Ukraine, % of total</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>1H 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Germany</td>
<td>6.6</td>
<td>7.6</td>
<td>33.6</td>
<td>29.9</td>
</tr>
<tr>
<td>Cyprus</td>
<td>11.7</td>
<td>12.4</td>
<td>9.5</td>
<td>11.1</td>
</tr>
<tr>
<td>Austria</td>
<td>3.8</td>
<td>4.1</td>
<td>8.7</td>
<td>8.2</td>
</tr>
<tr>
<td>UK</td>
<td>10.3</td>
<td>10.7</td>
<td>7.1</td>
<td>7.8</td>
</tr>
<tr>
<td>USA</td>
<td>16.1</td>
<td>13.8</td>
<td>8.4</td>
<td>7.2</td>
</tr>
<tr>
<td>The Netherlands</td>
<td>7</td>
<td>6.6</td>
<td>4.4</td>
<td>6.4</td>
</tr>
<tr>
<td>Russia</td>
<td>5.7</td>
<td>5.5</td>
<td>4.9</td>
<td>4.9</td>
</tr>
<tr>
<td>British Virgin Islands</td>
<td>5.7</td>
<td>6.5</td>
<td>4.2</td>
<td>4.2</td>
</tr>
<tr>
<td>France</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>2.4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>4.8</td>
<td>4.9</td>
<td>2.7</td>
<td>2.4</td>
</tr>
<tr>
<td>Poland</td>
<td>na</td>
<td>2.3</td>
<td>1.4</td>
<td>1.4</td>
</tr>
<tr>
<td>Hungary</td>
<td>na</td>
<td>2.1</td>
<td>1.2</td>
<td>1.2</td>
</tr>
<tr>
<td>Korea</td>
<td>2.6</td>
<td>2.1</td>
<td>1.1</td>
<td>na</td>
</tr>
<tr>
<td>Other countries</td>
<td>25.7</td>
<td>21.4</td>
<td>12.8</td>
<td>12.9</td>
</tr>
</tbody>
</table>

Source: State Statistics Committee of Ukraine

- EU countries are principal sources of FDI into Ukraine
- Polish businesses are among the largest investors to Ukraine. However, FDI flows from Poland into Ukraine are still moderate as Poland ranks only 11th by the share of Polish FDI in the total FDI stock in Ukraine
- Current share of Poland in FDI stock to Ukraine highlights the potential for significant growth of Polish businesses’ participation in Ukraine
### FDI from Ukraine – main destinations

<table>
<thead>
<tr>
<th>FDI stock from Ukraine, % of total</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>1H 2006</th>
</tr>
</thead>
<tbody>
<tr>
<td>Russia</td>
<td>53</td>
<td>53.8</td>
<td>47</td>
<td>47.1</td>
</tr>
<tr>
<td>Poland</td>
<td>na</td>
<td>na</td>
<td>9.3</td>
<td>9.7</td>
</tr>
<tr>
<td>Panama</td>
<td>11.6</td>
<td>10.8</td>
<td>8.7</td>
<td>8.3</td>
</tr>
<tr>
<td>Vietnam</td>
<td>9.7</td>
<td>9</td>
<td>7.3</td>
<td>6.9</td>
</tr>
<tr>
<td>UK</td>
<td>na</td>
<td>na</td>
<td>6.4</td>
<td>6.1</td>
</tr>
<tr>
<td>Spain</td>
<td>8.5</td>
<td>7.9</td>
<td>6.3</td>
<td>6</td>
</tr>
<tr>
<td>USA</td>
<td>3.3</td>
<td>3.2</td>
<td>2.6</td>
<td>2.5</td>
</tr>
<tr>
<td>Hong Kong</td>
<td>3.3</td>
<td>3.1</td>
<td>2.5</td>
<td>2.4</td>
</tr>
<tr>
<td>Switzerland</td>
<td>2.6</td>
<td>2.7</td>
<td>1.8</td>
<td>1.8</td>
</tr>
<tr>
<td>Austria</td>
<td>na</td>
<td>1.7</td>
<td>2.1</td>
<td>na</td>
</tr>
<tr>
<td>Latvia</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>1.5</td>
</tr>
<tr>
<td>Georgia</td>
<td>1.4</td>
<td>1.3</td>
<td>1</td>
<td>1.1</td>
</tr>
<tr>
<td>Cyprus</td>
<td>1.2</td>
<td>1.1</td>
<td>0.9</td>
<td>na</td>
</tr>
<tr>
<td>Armenia</td>
<td>na</td>
<td>na</td>
<td>na</td>
<td>1.1</td>
</tr>
<tr>
<td>Uzbekistan</td>
<td>na</td>
<td>1.1</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Greece</td>
<td>0.7</td>
<td>0.6</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Estonia</td>
<td>0.7</td>
<td>0.6</td>
<td>na</td>
<td>na</td>
</tr>
<tr>
<td>Other countries</td>
<td>3.7</td>
<td>2.8</td>
<td>4.1</td>
<td>5.5</td>
</tr>
</tbody>
</table>

*Source: State Statistics Committee of Ukraine*

- **Poland** is the second important destination for Ukrainian investments abroad
- **The interest of Ukrainian businesses in exploring investment opportunities in Poland has been steadily growing**
- **Poland is an important base for Ukrainian investors to launch their operations in EU zone**
FDI in Ukraine from EU (% of total) and Poland (% of EU total)

Source: State Statistics Committee of Ukraine

- Ukraine’s financial flows to and out of the country are heavily oriented for EU zone
- EU is the largest investor to Ukraine with Poland being one of the key investors from EU area, although the share of Poland is still small
- Poland is a main destination for Ukrainian investments into EU
Poland is a “bridge” to EU area

- **Exports in 2005**
  - 27% of Ukrainian exports are directed to the EU
  - Share of Poland in Ukrainian exports to EU was 11%

- **Imports in 2005**
  - 33% of Ukrainian imports was originated in EU
  - Share of Poland in EU originated imports to Ukraine was 12%

- **FDI in 2005**
  - More than 70% of FDI stocks to Ukraine belongs to EU countries with around 2% of which belongs to Poland’s businesses
  - More than 25% of FDI stocks from Ukraine was directed to EU countries and 1/3 of them to Poland
Where Opportunities Emerge

Steps to improve

- Poland and Ukraine are important trade partners. Moreover, Poland is an important gateway country for Ukraine to other EU states.
- Both countries actively invest in each other.
- Poland as a key EU member state and can play a significant role in the integration of the Ukrainian economy into the European Union.
- Due to strong economic ties of between Ukraine and Poland further facilitation in economic bilateral relations should serve as a step stone for deeper integration and closer relation of Ukraine with the EU.
- Improving investment climate in Ukraine should facilitate FDI inflow to the country and serve to increasing prosperity and stability in Ukraine and in the region as a whole.
- To improve situation in Ukraine and increase influence of Poland in the region further efforts from both Polish and Ukrainian sides are required.
Ukraine is an attractive country for investments

- Highly educated labor force
- Low workers’ wages
- Borders on the EU, with increasing trade potential
- Large domestic market (large population with growing purchasing power)
- Great agricultural potential
- Industrial and high-tech potential
- Likely prolonged period of significant economic growth
- Inefficiently run companies provide significant opportunity for value creation
- Growing interest in the country by multinationals and financial investors.
- According to Freedom House, Ukraine is the only post-Soviet county (in addition to the Baltic states) where civil and political freedoms are developing. Thus, Ukraine is now rated by it as free country.
Despite positive inflows, cumulative FDI in Ukraine is still low compared to other economies....further actions from both Ukrainian and Polish sides are required.
Investment attractiveness defined…

The quality of investment climate in Ukraine should be significantly improved:

SigmaBleyzer's Aggregate Investment Climate Index – Country Ratings
In order to improve investment climate in Ukraine, reforms in nine key areas are needed.
TBF Investment Drivers

1. Implement Public Administration Reform to improve Public Governance, and Decision-Making, and reduce government interference in businesses.
2. Improve Macroeconomic Stability to reduce inflation and foreign exchange risks.
3. Make the Legal Environment more stable and predictable by adopting necessary laws, granting more independence to the judiciary and reforming the court system.
4. Deregulate Business Activities to facilitate the formation/growth of enterprises.
5. Improve Corporate Governance to protect property rights and minority shareholders.
6. Remove Restrictions to International Trade and Capital movements, join the WTO and enter into free trade agreements.
7. Strengthen the Financial Sector by enforcing banking regulations and supervision and further developing the non-banking sector.
8. Reduce Corruption particularly through preventive measures.
Public Governance

- Redefine the Government's Role towards Supporting Private Sector Activities.
- Undertake a comprehensive “audit” of all government programs, with a view to decentralize, eliminate or subcontract some activities and improve efficiency.
- Carry our civil service reform and increase information access and transparency.
Macroeconomic Stability

- Pursue sustainable fiscal budget policies, including improvements in tax administration and expenditure controls, reform of the pension system, and decentralization of financing/execution of some government activities.
- Pave the way for adopting monetary policy based on inflation targeting.
Stability and Predictability of the Legal Environment

- Improve the practice of thorough consideration of any legislative act to be adopted, including their correspondence with existing legislation.
- Ensure the independence of the Judiciary by further improvement of the financing of courts and enhance commercial courts for settling disputes.
- Improve court administration and enforcement procedures.
Liberalization and Deregulation of Business Activities

- Increase stability of the existing legal system by avoiding frequent changes in legislation concerning business activities.
- Improve coordination between central and local government bodies on regulatory policy issues by avoiding conflict of interests between different levels of executive power and making clear distinctions in the area of their responsibilities.
- Secure effective implementation of the second phase of the quick deregulation strategy.
Corporate Governance

- Accelerate the adoption of the Joint Stock Company Law, complying with international corporate governance standards.
- Speed up the adjustment of Ukrainian accounting standards to international accounting standards.
- Remove inconsistencies between the Civil and the Commercial Codes by eliminating the Commercial Code and passing some of its provisions to the Civil Code.
- Develop corporate governance codes.
Liberalization of Foreign Trade & Capital

- Ensure entry into the WTO as soon as possible.
- Promote signing free trade agreements with the EU, CIS and the US.
- Continue streamlining customs procedures and formalities to ensure prompt consideration and to avoid opportunities for rent seeking behavior.
- Soften export restrictions and eliminate import non-tariff restrictions.
- Ease the system of certification and standardization to acknowledge international standards.
Where Opportunities Emerge

**Development of Financial Sector**

- Better enforce banking regulations and supervision
- Ensure equal "playing conditions" for domestic and foreign banks.
- Provide mechanisms to deal with risky unsecured debts issued by commercial banks.
- Encourage stock market transactions to be made on the organized market.
- Stimulate development of nonbanking financial sector by introducing a framework law on nonbanking financial institutions.
Corruption

- Implement a corruption prevention program, including public administration reform to improve transparency of decision making process and procurement procedures.
- Reduce the ambiguity and discretion of government regulations and raise accountability of the public servants for their decisions by introduction of e-governance resources.
- Strengthen the capacities of the internal audit and make it fully accountable for public.
Strengthening an Investment Promotion Agency and implement specific activities for large investors (identify major projects, carry out targeted promotional campaigns, identify niches/sectors) and for small firms (access to bank credit, better information on laws, etc).

Take measures to eliminate power abuses at different levels of government.

Resolve outstanding investment disputes with foreign investors; ensure fair treatment of foreign investors in courts.

Engage the country's embassies and other missions to disseminate up to date information on Ukraine and its business opportunities.
Public Policy Recommendations for Ukraine to Accelerate Ukraine-Poland Cooperation

- Prepare a special promotion program to induce Polish investors to consider Ukraine as a suitable investment location.
- Identify specific sectors in Ukraine that could be of interests of Polish investors (prepare in-depth sector reports that identify the existing investment niches and advantages from such Ukraine).
- Provide reliable information about Ukrainian business environment.
- Open several regional branches of the Ukrainian Investment Promotion Agency in Poland (possibly using potential of the Ukrainian diplomatic services to Poland).
- The Ukrainian Investment Promotion Agency should identify large Polish businesses interested to expand their operations in Eastern Europe and actively work with these companies to convince them to invest in Ukraine.
- Organize special promotional field trips for Polish large business representatives to Ukraine to enhance them establishing close ties with Ukrainian business community.
Policy Recommendations for Ukraine to Accelerate Ukraine-Poland Cooperation

- Actively invite Polish business representatives potentially interested to invest into Ukraine for participation in different public events targeted to stimulate investment activity in the country.

- Strengthen the role of Free Economic Zones (FEZ) on Ukrainian-Polish boarder as important means of further deepening of bilateral cooperation. Ensure that infrastructure within these zones is developed on appropriate level. Make sure that FEZ will not create any kind of market distortions with unwarranted subsidies.

- Improve customs service on Ukraine-Poland boarder by implementing Western type standards and procedures. For these purposes international expert agencies, which have an extensive world wide experience in this field, can be hired (i.e., British Crown Agency and others).

- Improve customs administration on Ukraine-Poland boarder by ameliorating customs clearance procedures. For these purposes widely introduce internet based resources for fulfilling all required documents requested for crossing the boarder and transferring all necessary fees.
Policy Recommendations for the Polish Side

- **In Ukraine**
  - Poland should continue efforts to advocate further economic reforms in Ukraine through its involvement into different public initiatives (i.e., public hearings, seminars/conferences).
  - Poland should support the implementation of public administration reform in Ukraine through bilateral consultation and sharing own experience in this area with Ukrainian governmental institutions by organizing special exchange/training programs for government officials.
  - Poland should expand integration with Ukraine not only in the areas defined by the Agreement between Ukrainian Cabinet of Ministers and Government of the Republic of Poland signed on March 15, 2006 (i.e., construction, technical modernization, infrastructure development, and tourism) but in other sectors as well.
  - Polish government agencies should ensure that their investors operating in Ukraine are treated equally and receive proper informational support from the Ukrainian side.
…Policy Recommendations for Polish Side

- **In Poland**
  - Poland should ensure functioning of the currently existing system of ‘fast track procedures’ for Ukrainian citizens applying for Polish visas.
  - Poland should organize special exchange/training programs for Ukrainian government officials in Poland’s governmental institutions using the ‘learning-by-doing’ scheme.
  - Poland should secure high quality informational provision of EU customs rules to Ukrainian companies exporting to Poland and other EU member states.
  - Poland should provide Ukrainian investors with detailed information on possible opportunities in Poland and EU.
Policy Recommendations for Polish Side

- **On the international arena**
  - Poland should continue its support Ukrainian initiatives in its Western integration.
  - Continue Polish efforts on lobbying Ukrainian interests in EU.
  - Support Ukraine in its efforts for signing a Free Trade Agreement with EU that would put Ukraine in the “supply chain” of products to Europe.
  - Promote Ukrainian image in EU.
  - Initiate a development and following implementation of the join EU-Ukraine energy safety strategy.