Chinese FDI to Ukraine in the context of road and belt initiative

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Abstract

China is the leader of economic development among the countries of the Asian region and given its strong economic expansion it is the key economic center of the Asian and Eurasian mega-regions. The empirical study shows that Chinese investors receive additional incentives to invest in Ukraine if there is a prior positive investment experience, increasing market potential, and openness and economic freedom. As Ukraine is generally perceived as a path to European markets, the signing of the Association Agreement with the EU is a positive factor. However, the readiness of investors from China to support corruption schemes in the Ukrainian economy arouses concern. Therefore, in order to enhance and improve the structure of investment flows from China to Ukraine, it is necessary to take a number of measures to overcome corruption. One of the main priorities of modern Ukrainian foreign policy is joining Belt and Path Initiative

Keywords: China, foreign trade, foreign economic relations, FDI, Ukraine

JEL Code: F130, F210

1. Introduction

Until recently the official key priority of Chinese economic policy was the attraction of inward foreign direct investments (FDI), but gradually there was a shift to the outward foreign direct investment from China. In the early 2000's, the country's government proclaimed the launch of a strategy of “going global” that encouraged Chinese enterprises to invest abroad. Since the mid-2000s, China's

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FDI has increased significantly, and now the volume of investment abroad exceeds the amount of direct investment received.

China is the leader of economic development among the countries of the Asian region and given its strong economic expansion it is the key economic center of the Asian and Eurasian mega-regions. It should be noted that the economic interests of China have long gone beyond the Asian-Pacific Region. Beijing defends its economic interests in Central Asia and Western Europe, in the Baltic and Balkan regions, there is boosting Chinese economic expansion in Africa, Southeast Asia and Latin America, and China is interested in exploring and developing the Arctic. Europe is one of the priority directions of foreign economic cooperation of China.

China is interested in enhanced cooperation with the countries of Central and Eastern Europe (CEE), as well as with the countries of the Eastern Partnership (Georgia can be a bright example, which has become an important transit point for China's foreign trade operations). The "16 + 1" format, which combines China with the sixteen CEE states, the Baltic States and the Balkans, is also of interest (Gerasimchuk& Poita, 2017). In the context of the launch of Belt and Road Initiative, Ukraine's European integration aspirations are an important factor that increases the attractiveness of the state for the Chinese partners.

International trade as part of foreign economic relations of Ukraine with the China is reflected in the research of Halperina & Shapoval (2003), Levkivsky (2013), Makogin (2011), Mokiy at al. (2006), Wang Peng (2005) , Cheng Hongji (2015).

Foreign economic relations in the context of strategic development of cooperation between Ukraine and China are considered in the works of Kurnishova (2010) and Matusova (2011). Some aspects of economic cooperation including foreign trade and investment are highlighted in the researches by Velychko (1999), Holod (2014), Pogorelova (2010). The current state and prospects of the development of trade in services with China were considered by Vysotka (2013) and Ermachenko (2015). However, the current state of bilateral cooperation between Ukraine and China, the problems of further transformation of foreign economic relations, its impact on the country's economic development is not sufficiently highlighted.

2.China in the system of foreign economic relations of Ukraine

China's interest in cooperating with Ukraine is also linked to the Chinese leadership's decision to create "foreign food bases." In particular, it includes the use of agricultural capabilities of Ukraine in conjunction with investment and technological capabilities of China. China's growing political and economic interests in the EU and New Eastern Europe (Belarus, Ukraine, Moldova, Latvia, Lithuania and Estonia) are strongly influencing the current Ukrainian-Chinese relations. China plans to implement its global strategy to increase exports and investments in potential markets located between Russia and the EU. Ukraine can become an important place for promotion of Chinese products and brands, access to new markets and the acquisition of strategic assets.

Thus, for Ukraine China acts as an important partner not only in the field of foreign trade, but also for the implementation of the strategic vector of Ukraine's economic development and its integration into the modern world economy. Accordingly, the expansion of cooperation with China means the emergence of new prospects for foreign economic cooperation with both Asian countries and the EU.

During the years of Ukraine's independence, these relations generally followed the upward trend and reached a peak in December 2013, when the Treaty on Friendship and Cooperation between Ukraine and the People's Republic of China and the Joint Declaration of Ukraine and the People's Republic of China on the further deepening of the strategic partnership relations were signed.

In 2018 the deficit was observed in Ukrainian trade with China ($5.44 billion, an increase of 47.8% compared to the previous year), Russia ($4.43 billion, growth by 36.3%), Germany ($3.75 billion, an increase of 2.0%) and Belarus ($2.48 billion, an increase of 20.6%). The positive trade balance of Ukraine was observed in the foreign trade operations with India and Egypt, with a surplus of $1.56 billion. (see Table 1)

If we look at the data dynamic from 2001, we can conclude that Chinese share in the structure of Ukrainian foreign trade amounted to an average of 5.37% - 3.37% for exports and 7.08% for imports (see Table 2). For reference the share of Ukraine in Chinese foreign trade for the same period amounted to an average of 0.19% (the share in imports was 0.13%, the share in exports was 0.23%).

Table 1. Trade balance of Ukraine with individual countries, 2018 (USD million)

Country	2018	2017	To the previous year,%
Total balance	**-9.448**	**-6.165**	**53.3**
The main sources of the deficit			
China	-5,395	-3,650	47.8
Russia	-4,431	-3.252	36.3
Germany	-3.752	-3,678	2.0
Belarus	-2.481	-2.058	20.6
USA	-1,850	-1.693	9.3
Switzerland	-1,416	-1.413	0.2
France	-940	-1.145	-17.9
Lithuania	-535	-309	73.2
Japan	-505	-505	0.0
Sweden	-395	-356	11.0
The main sources of surplus			
India	1,562	1,645	-5.0
Egypt	1.461	1,754	-16.7
Netherland	822	1,037	-20.7
Spain	742	681	9.0
Moldova	672	605	11.0

Source: Based on the data of the State Statistics Service of Ukraine

Another indicator of the development of foreign trade relations between Ukraine and China is the export-import coverage ratio (see Table 3). During the period under study the predominance of import over exports grew steadily. After 2005 this figure never exceeded 1, and in 2018 it approached to the historical minimum and was only 0.29.

The analysis of the main indicators of the foreign trade relations between Ukraine and China proves the instability of terms of trade, a strong increase in Ukrainian imports, and at the same time, falling of Ukrainian export attractiveness for buyers from China.

3.Chinese foreign direct investment in Ukraine

The inflow of foreign direct investment is an important indicator of the attractiveness of the national economy and ensuring its competitiveness in world markets.

Table 2. Foreign trade in goods between Ukraine and China, 2001-2018

	Total trade with China, bln USD	China's share in total trade of Ukraine, %	Ukraine's share in China's total trade, %	Export of Ukraine to China, billion USD.	China's share in Ukrainian exports, %	Ukraine's share in Chinese exports, %	Ukrainian import from China, billion dollars.	China's share in Ukrainian imports, %	Ukraine's share in Chinese imports,%
2001	0,68	2,12	0,13	0,48	2,95	0,07	0,2	1,26	0,19
2002	0,93	2,66	0,14	0,67	3,73	0,07	0,26	1,53	0,22
2003	1,52	3,29	0,17	1	4,33	0,11	0,52	2,25	0,24
2004	1,56	2,52	0,13	0,82	2,50	0,12	0,74	2,55	0,14
2005	2,52	3,57	0,17	0,71	2,07	0,23	1,81	5,01	0,10
2006	2,85	3,41	0,16	0,54	1,40	0,23	2,31	5,12	0,06
2007	3,74	3,40	0,17	0,43	0,87	0,27	3,31	5,45	0,04
2008	6,15	4,03	0,23	0,55	0,82	0,39	5,6	6,54	0,04
2009	4,16	4,88	0,18	1,43	3,60	0,22	2,73	6,01	0,14
2010	6,02	5,36	0,20	1,32	2,56	0,29	4,7	7,73	0,09
2011	8,45	5,59	0,23	2,18	3,18	0,33	6,27	7,59	0,12
2012	9,68	6,31	0,25	1,78	2,59	0,38	7,9	9,33	0,09
2013	10,63	7,58	0,25	2,73	4,31	0,35	7,903	10,26	0,14
2014*	8,08	7,46	0,18	2,67	4,95	0,23	5,41	9,94	0,13
2015*	6,17	8,15	0,15	2,4	6,29	0,16	3,77	10,05	0,14
2016*	6,49	8,59	0,17	1,8	4,94	0,22	4,69	11,97	0,11
2017*	7,74	8,34	0,18	2,1	4,84	0,24	5,64	11,40	0,11
2018*	9,8	9,40	0,21	2,2	4,64	0,30	7,6	13,37	0,10

* - 2014-2018 excluding the Autonomous Republic of Crimea and the city of Sevastopol.

Source: Calculated on data of Trade Map: International trade statistic

As of December 31, 2018, the economy of Ukraine attracted $32.3 billion of FDI (State Statistics Service of Ukraine, 2019), although according to the calculations of the Ukrainian Ministry of Economy, the total investment need for structural adjustment of the economy ranges from $140 to 200 billion (Kirichenko, 2010, p. 65).

The number of countries that invested in the economy of Ukraine at the beginning of 2019 amounted to 125. The largest volumes of direct investment came from 10 countries: Cyprus, Germany, the Netherlands, the Russian Federation, Austria, Great Britain, France, the USA, the British Virgin Islands, and Sweden, which owns more than 81% of the total direct investment in Ukrainian economy. The number of enterprises involved in foreign investments is almost 19 thousand as of January 1, 2019.

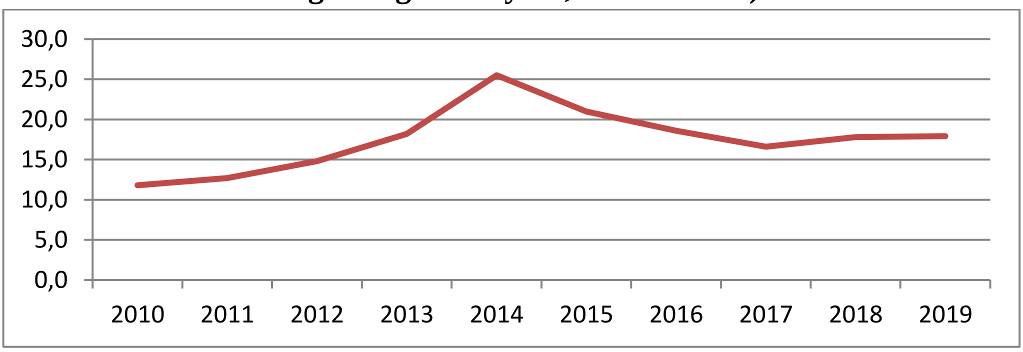
Table 3. Export-import coverage ratio in trade between Ukraine and China, 2001-2018

Year	Export of Ukraine to China, billion USD.	Import of Ukraine from China, billion dollars.	Export-import coverage ratio
2001	0.48	0.2	2.4
2002	0.67	0.26	2.5 8
2003	1	0.52	1.92
2004	0.82	0.74	1.11
2005	0.71	1.81	0.39
2006	0.54	2.31	0.23
2007	0.43	3.31	0.13
2008	0.55	5.6	0.11
2009	1.43	2.73	0.52
2010	1.32	4.7	0.28
2011	2.18	6.27	0.35
2012	1.78	7.9	0.23
2013	2.73	7.903	0.35
2014	2.67	5.41	0.49
2015	2.4	3.77	0.64
2016	1.8	4.69	0.38
2017	2.1	5.64	0.37
2018	2.2	7.6	0.29

Source: Calculated on data of Trade Map: International trade statistic

Unfortunately, China is not among the listed countries, which form the basis of investments in the Ukrainian economy, although the country is considered to be the largest creditor of the world.

Figure 1. Direct foreign investment in Ukraine from China (at the beginning of the year, million USD)



Source: Elaborated by author based on State Statistics Service of Ukraine, 2019

Over last 30 years despite the positive dynamics of investment from China (Fig. 1), their volume remains at a rather low level, indicating that Chinese companies are not aware of the potential investment proposals of the Ukrainian business community.

At the beginning of 2019 Chinese investments in the Ukrainian economy amounted to $17.9 million, which is 0.05% of the total volume of attracted investments. Given China's potential such numbers are not comforting. At the moment the priority areas for Chinese outward FDI is the extraction of natural resources, since China's own raw material base is gradually being exhausted; the financial sector considered by the Chinese business community as an opportunity for quick earnings and a separate brand (Mikheeva, 2005, p.24). In Ukraine Chinese capital is directed to agriculture and wholesale trade (Table 4)

Agriculture accounted for the largest share of investments - 39.6%. In the second place is the manufacturing, which accounts for 19.4% of all investments from China that is $3.53 million. Among them $1.9 million (56.5%) goes to processing industry, while $702 thousand (1.99%) – to the mining industry.

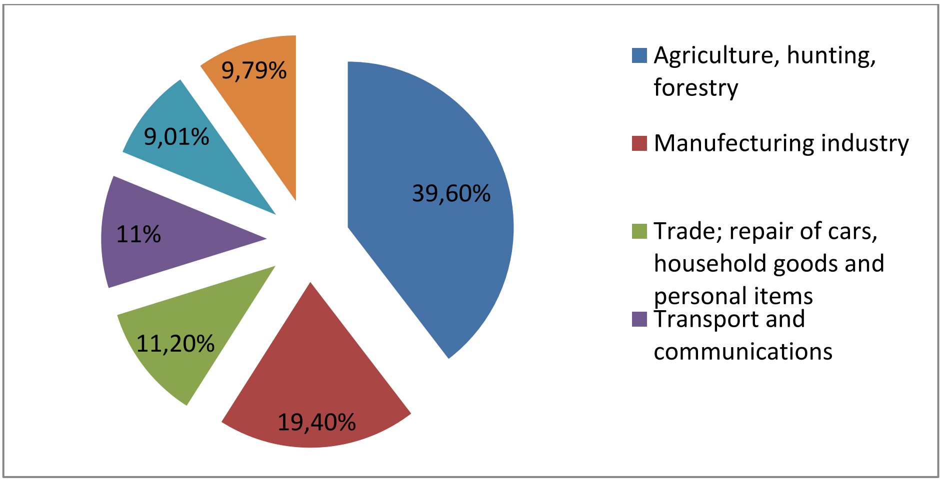
Table 4. Direct foreign investment from China into the economy of Ukraine by types of economic activity (mln. USD)

Areas of engagement	01.01.2018	01.01.2019
Total	16.6	18.2
Agriculture, hunting, forestry	6.57	7.36
Manufacturing industry	3.22	3.53
Trade; repair of cars, household goods and personal items	1.86	2.03
Transport and communications	1.82	2.00
Real estate operations, leasing, engineering and business services	1.56	1.64

Source: *Embassy of Ukraine to the People's Republic of China*

The dynamics of the opening of enterprises with Chinese capital testifies the interest of businessmen in promising investment projects, which, first of all, are oriented to agricultural and industrial regions. From 2014 the situation has changed radically: virtually every region (except Odesa region) feels a decrease in FDI inflows, due to the military conflict in the eastern part of the country and mistrust of Chinese businessmen to the Ukrainian legal framework.

Figure 2. Chinese FDI into the Ukrainian economy by types of economic activity as of 01.01.2019 p., %



Source: *Embassy of Ukraine to the People's Republic of China*

The most attractive for Chinese investments was Dnipropetrovsk region, somewhat fewer investments were attracted in the Kharkiv region.

In the midst of globalization imbalances China's credit and investment policy is aimed at increasing the volumes of outward FDI in Asia and Europe through the creation of joint ventures and the active promotion of their companies to the priority markets. At the end of 2018 more than 10 thousand Chinese companies owned more than 14 thousand foreign enterprises located in 170 countries and regions of the world. In Ukraine, one can find such companies as China Road & Bridge Corporation; CITIC Construction Co.Ltd, a subsidiary of CITIC GROUP; Beijing Construction Engineering Group Co.Ltd, China Gezhouba Group International Engineering Co.Ltd., Chinese Development Bank, Chinese Construction Bank. However, despite the policy of the Chinese government to encourage Chinese entrepreneurs to place capital in such areas of the Ukrainian economy as energy, mining, forestry and agriculture, machinery, household appliances, communication, textile industry and transport, businessmen from China are in no hurry to invest in risky projects, giving priority to preferential lending under government guarantees.

At the political level China has demonstrated its willingness to invest in Ukraine under the Belt and Road Initiative. The agrarian and energy sectors, infrastructure projects, export-oriented processing enterprises and enterprises of power engineering are of great interest to the Chinese companies(Gerasimchuk&

Poita, 2017). Successful projects have emerged in cooperation with *Energoatom*, *Ukravtodor*, the deepening of the ports of *Pivdenny* and *Chornomorsk* .

4. The Model and Findings

Now we try to explain how different factors can influence the investment decisions of Chinese enterprises in relation to Ukraine. Variables that will reflect the relevant factors will be related to macroeconomic indicators, indicators of political stability and a number of dummies. The model for analysis of investment flows from China to Ukraine is as follows:

$$FDI_t = a + \beta_1 FDI_{t-1} + \beta_2 MS_t + \beta_3 IL_t + \beta_4 TO_t + \beta_5 CT_t + \beta_6 HC_t + \beta_7 I_t + \beta_8 Crpt_t + \beta_9 EF_t + \beta_{10} EU_t + \beta_{11} ER_t + \beta_{12} Recession_t \quad (1)$$

$FDI_t -$ is the investment flows from China to Ukraine in time *t.* This is our dependent variable. Data were obtained from the State Statistics Service of Ukraine and the Ministry of Commerce of China for 2002-2017.

Independent variables in the model are as follows:

FDI_{t-1} – lagged investment flows from China to Ukraine. A number of studies (i.e. (Quazi and View, 2007)) prove that the previous FDI implementation in the country directly influences further inflow of investments.

MS_t –size of the Ukrainian market in the year *t.* Calculated as GDP at purchasing power parity. China in recent years have been proven to pay more attention to access to markets, respectively, the bigger the market is, the more attractive it looks for Chinese investors. Data were obtained from the statistical base of the IMF and the State Statistics Service of Ukraine

IL_t – the income level in Ukraine for the year *t*. To measure this indicator we use GDP per capita. The level of income is not only related to effective demand, it also correlates with labor productivity, and research suggests that for Chinese investors in recent years it is also an important factor. Data were obtained from the statistical base of the IMF and the State Statistics Service of Ukraine

TO_t – this is the country's trade openness in the year *t.* This variable is obtained as the import quota. Before Ukraine's accession to the World Trade Organization (WTO), there were more obstacles to the flow of imports, which could have been the reason for Chinese enterprises to invest in Ukraine instead of importing their products there. These data were calculated based on World Bank statistics.

CT_t - the level of corporate tax in Ukraine in the year t. The level of tax burden can be a significant factor for the company when it decides to invest in the country. Relevant data was obtained from World Bank databases.

HC_t – - the variable of human capital in the year t. Studies show that Chinese enterprises value low-cost, but well- educated labor force. As the result of migration processes this indicator in Ukraine has deteriorated for the most part, it can be a significant determinant of Chinese investments. As a measure for human capital, we used R & D expenditures as a percentage of GDP - another indicator that is often used for such researches, namely, the literacy rate of the population, is not indicative for Ukraine. Relevant data was obtained from World Bank databases.

I_t - is an indicator of infrastructure quality in year t. Infrastructure itself is a major factor in making foreign investment decisions, but for China, with its specialization in major infrastructure projects, it can be one of the key determinants. We have received the relevant indicator from World Bank statistics.

$Crpt_t$ - the index of corruption in the country for year t. As shown by the example of African countries (Ukrainets, 2013), corruption has a great impact on Chinese investors, compared with investors from developed countries. The high level of corruption is less frustrating for the Chinese firms, as it provides some protection against competition from developed countries that are not accustomed to acting in such an environment. The data is obtained from Transparency International.

EF_t - the variable reflecting the level of economic freedom for the period t. This index is determined by Heritage Institute and includes many other indicators. This is a good measure of the business environment in the country, which can also affect investment from China.

EU_t - a dummy reflecting the signing of an agreement on a free trade area with the EU. The Free Trade Area provides for the free access of a number of goods produced in Ukraine to European markets that are in the interests of China. This variable equals 1 since 2014, when the provisional application of the Association Agreement between Ukraine and the EU begins to be implemented.

ER_t - a variable reflecting fluctuations in the exchange rate of hryvnia against the dollar per year t

$Recession_t$ - dummy variable that reflects two major recession, from 2008 to 2010 due Global crisis and in 2014-2016 due to the annexation of the Crimea and the military operation in the east of the country.

We analyzed time series models using the least squares method - the most commonly used method for such models. Table 5 shows the results of model calculation.

In the first column, the calculations are based on the basic equation (1), taking into account all independent variables.

As can be seen from Table 5, the investment experience (FDI indicator), market potential (GDP), and income level (GDP per capita) are statistically significant at 10%. Positive and significant impact of these indicators was predicted by the hypothesis of the study.

Tables 5. Results of model analysis for identification of factors influencing FDI from China to Ukraine.

Variables	**Basic equation**	**Corrected equation**
Lagged flows of FDI	0.101 *	0,341 ***
GDP	0.019 *	0.008 **
GDP per capita	0.003 *	-0,001
Foreign trade openness	0.154 ***	0,177 ***
Corporate tax rate	-0.015 *	-0,010 ***
R & D to GDP	0.007	0.002
Infrastructure	0.025	0.020 **
Corruption	-0.011 **	0.012
Economic freedom	-0.019	-0,033 **
Association Agreement with the EU	0.032 *	
Exchange rate	-0.014	
Recession	-0.017 *	
Constant	0,142 **	0,077 **
Adjusted R^2	0.577	0,767
Average square error	0.020	0.032

Note: Significance at level *** < 1%, ** < 5%, * < 10%.

Source: Elaborated by author

The absence of obstacles in Ukraine's foreign trade is very significant and positive. The more open the foreign trade policy was pursued by the country, the more investments came from China. This means that the motive for China in the case of Ukraine is not penetration into the domestic "fenced " market of the country, but the use of Ukraine as a platform for access to other, larger and more affluent markets of neighboring countries.

The growth of corporate taxes has negatively impacted on investments from China, which also corresponds to the hypothesis identified at the beginning of the study. As can be seen from the example of the Baltic countries, low taxes contribute to the improvement of the investment climate and the attraction of foreign investment. This result would probably be even more statistically significant if, instead of the corporate tax indicator, we used an effective tax rate (De Mooij & Ederveen, 2006), but our capabilities were limited by the lack of necessary statistical data.

High corruption, as in the case of African countries (Ukrainets, 2013) can be a stimulus to increase investment from China. Not least this is due to China's desire to reduce its production processes and to avoid harsh environmental and labor protection requirements, which forces the Chinese firms to pay attention to countries with high levels of corruption, including Ukraine. In addition, operating in a corrupt environment, the Chinese firms avoid direct competitive collision with western companies that choose to escape such markets. Of course, this factor cannot be considered favorable from the point of view of the strategic prospects for the development of the national economy: the Chinese investments attracted by high levels of corruption cannot be an engine of economic revival and are aimed mainly at the pumping of resources.

Dummies - the recession and the Association Agreement - also showed some significance for the inflow of foreign investment from China with a sign that coincides with the hypothesis.

In the next column of Table 5, an analysis of the corrected equation (1) was performed: the exchange rate indicator and dummies were dropped out. These variables were removed because they did not show statistical significance when analyzing the model's basic equation. The major difference compared to the basic equation is that the indicators of economic freedom (with a negative sign) and infrastructure (with a positive one) were statistically significant at the level of 5%.

Consequently, from our research it can be concluded that Chinese investors receive additional incentives to invest if there is a prior positive investment experience, increasing market potential increases, and openness and economic freedom. As Ukraine is generally perceived as a path to European markets, the signing of the Association Agreement with the EU is a positive factor as well. However the readiness of investors from China to support corruption schemes in the Ukrainian economy arouses concern. Therefore, in order to improve and improve the structure of investment flows from China to Ukraine, it is necessary to take a number of measures to overcome corruption.

Also, Ukraine should, practically and not nominally, join the Chinese Belt and Path Initiative, which prioritizes Ukraine as an important partner for China. To this end Ukraine should explore the possibility of joining Asian Bank Infrastructure Investments (ABII), which, along with the Silk Road Fund, is the main financial tool within the Belt and Path Initiative. At the Third International Forum of the Belt and Path Initiative, which took place in October 2018, four key objectives were formulated in the formation of the Belt and Path:

1) the creation of a multi-level mechanism for cooperation between people, the construction of new platforms for cooperation and the opening of new channels of cooperation.

2) promoting cooperation in the field of education, expanding the scope of mutual exchange of students and improving the level of cooperation between universities.

3) strengthening the role of "think tanks" and creating alliances and a network of cooperation between them.

4) creation of a new model of cooperation and promotion of specific projects.

With the activation of participation in this initiative, Ukraine will have to focus first of all on the following tasks. They come into sharp focus when taking into account the estimates of Chinese experts who claim that within the framework of the initiative in the near future China can invest 45-50 billion dollars in Ukraine. China, by offering its own concept, not only seeks to create roads and railways, it thinks about the routes for the transportation of goods. It seeks to create an area of economic interaction and development for the countries participating in this project. China is trying to use the globalization and modern interdependence of the countries of the world in order to find a balance of interests for each participant in the project, make it universal. This is a new interpretation of globalization, China's attempt to lead and determine the course of the process, which is already called "globalization 2.0."

5. Conclusions

The empirical study shows that Chinese investors receive additional incentives to invest if there is a prior positive investment experience, increasing market potential increases, and openness and economic freedom. As Ukraine is generally perceived as a path to European markets, the signing of the Association

Agreement with the EU is a positive factor. However the readiness of investors from China to support corruption schemes in the Ukrainian economy arouses concern. Therefore, in order to improve and improve the structure of investment flows from China to Ukraine, it is necessary to take a number of measures to overcome corruption.

In the context of rational prospects for the development of bilateral trade relations with China, development of a strategy of diversification of export-import operations with the partners, aimed at counteracting foreign trade dependence on the EU and the Russian Federation, and the improvement of trade balance through the deepening of trade relations with the countries of APEC, in particular with China, is necessary. The European Union is also interested in conceptualizing and modernizing the strategy of cooperation with China, as this country is a regional leader in Asia and the second EU partner in international trade. Formation and development of the institutional framework for cooperation with the China will improve the competitive position of the Ukrainian economy, provide additional tools for influence during the negotiation process on the European integration process. China should be considered not only as an important partner and participant in integration groups, with some of which Ukraine has economic and political relations, but also as a separate geographic vector of foreign economic activity at the level of the Eurasian Customs Union (EACU) and EU countries. Ukraine can avoid some of the negative effects of Eurasian integration and accelerate its accession to the EU through cooperation with China.

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