International Center for Economic Growth
Európai Központ

NEWS OF THE MONTH

March 2006

6/B Dayka Gábor Street, Budapest, H-1118
Tel: +36 (1) 248-1160 *E-mail:* office@icegec.hu *Web-site:* www.icegec.org

TABLE OF CONTENTS

Fluctuant Inward FDI - Slovakia ____ 3

Strengthening Ties Between Russia and China in Terms of Trade and Energy ____ 7

Russian-Ukrainian Trade: Road Not Yet Smooth to CEA ____ 10

Ukrainian Inward FDI Doubled in 2005 ____ 13

FLUCTUANT INWARD FDI - SLOVAKIA

Inward FDI fell back to USD 648 million in 2005 after the promising performance of USD 1122 million in the previous year.

ECONOMIC PERFORMANCE UNTIL THE END OF 2005

After the change of government in 2002 the Slovak economy gained stability and has been put on a dynamic growth course. The main economic indicators of Slovakia (*Table 1.*) confirm the positive trends of economy. Slovakia had the highest GDP growth rate among the Visegrad countries in 2005. This notable growth led to the continuous decrease of unemployment. However, the unemployment rate of 11.4% can be still considered as high thus structural unemployment remains one of the major problems of the government. As Slovakia would like to introduce Euro as soon as possible it can be assumed that downward tendency of the inflation rate and budget deficit will continue.

Table 1. Main economic indicators 2000-2005

	2000	2001	2002	2003	2004	2005
GDP growth (%)*	2.0	3.8	4.6	4.5	5.5	6.0
Inflation rate (%)	8.4	6.5	3.4	9.3	5.9	3.7
Unemployment rate (%)	17.9	18.6	17.5	15.6	13.1	11.4
Government deficit (% of GDP)*	-4.0	-6.2	-6.9	-7.1	-8.5	-3.4

** Estimation for 2005.*
Source: National Bank of Slovakia

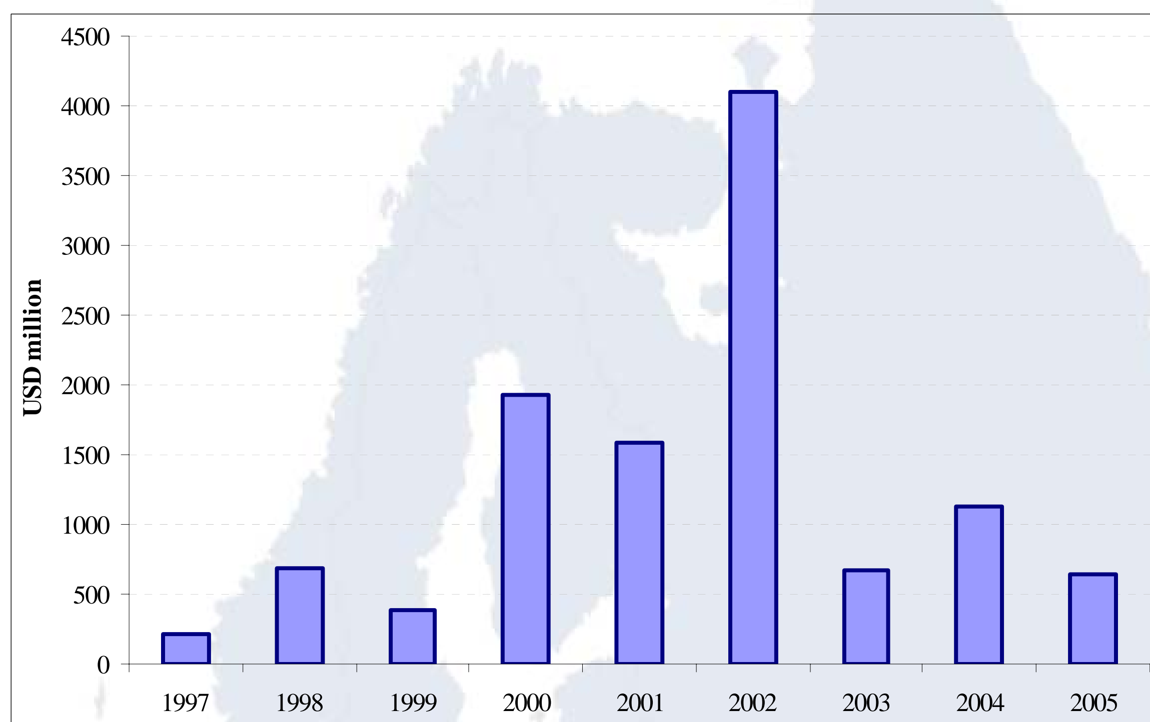
The stability of the Slovak economy was affirmed by several international ratings agencies. Fitch Ratings increased the country's rating from A- to A in May 2004, and with regards to ratings of Standard and Poor's (A) Slovakia became a leader of the region.

TENDENCIES OF INWARD FDI

The performance of Slovakia in attracting FDI was not satisfactory, especially compared to other countries of the region. Until 2000 Slovakia could only get ahead of Slovenia and the inward FDI of the Visegrad countries represented another dimension. From 2000 there was a significant increase of inward FDI in Slovakia (*Chart 1.*) which was enough to overtake Hungary and reach 3rd place in the regional ranking related to FDI inflows. Although Inward FDI remained high in the following years, Slovakia could reach this position only in 2002 because of its accelerated privatization process.

Privatization started rapidly after the country gained independence in 1993. Until the end of 1995 45.1% of public property disposed to privatization was sold. Although the majority of firms belonged to the private sector accounting for some 80% of GDP in 1998, the government continued to have considerable influence on the economy. The privatization process was held by the governmental decision of excluding a group of firms (electricity producers, telecommunication and transport companies) deemed essential from privatization. One of the first steps of the new government was to boost privatization. The diligence resulted in a record inward FDI in 2002. The law on "strategic companies" was amended in 2003 in order to allow full privatization of them.

Chart 1. Development of FDI in Slovakia 1997-2005



Source: UNCTAD

There was a huge fell back of inward FDI in 2003 as almost every public property was sold in the previous year. Since then the tendency of inward FDI was broken only because of the completion of the energy sector's privatization. The sale of Slovakia's main airports and Zeleznicna Spocolnost, the railway freight company could again increase inward FDI in the coming years.

The main investors contributing to the total volume of FDI in Slovakia come from the Netherlands (21.9%), Germany (19.6%), Austria (14.7%), Hungary (7.0%), Italy (7.0%), United Kingdom (6.6%) and the Czech Republic (5.1%) (*Source: National Bank of Slovakia*). Companies such as AHOLD Retail and ING Bank from the Netherlands, Volkswagen, Siemens, Deutsche Telekom, Hypo Vereinsbank and Continental Matador (joint venture) from Germany, Billa, Raiffeisen Zentralbank and OMV from Austria, the Hungarian Gas and Oil Industry Company (MOL), Tesco from the UK, and Danone and Carrefour from France are present in the Slovak economy. The most targeted sectors are manufacturing (40.1% - INA, Whirlpool), financial intermediation (21.8%), wholesale and retail (13%), electricity, gas and water supply (9.5%) and transport and communication (8.7%). A new investor is South Korea (Hyundai-Kia) contributing to 31.2% of inward FDI in 2005.

The business climate has been improved since 2003. A new taxation system was introduced in 2004. All types and all amounts of income are taxed by the same flat tax rate of 19% and the there is no tax on dividends. The new pension reform is also favorable for investors as it is based on individual retirement saving accounts in retirement fund companies. Furthermore market principles were introduced into health care system. The Act on Commercial Registry eased the registration of new companies and the acquisition of trade licenses. The amount of time required to register a new company was cut to max. 5 days and a trade license should be awarded within 7 days.

Thanks to the new Labor Code Slovakia became one of the most flexible labor markets in Europe according to the World Bank. Not only flexibility makes Slovakia attractive for foreign investors but also low labor costs. At identical productivity rate Slovak labor costs (USD 515) are 40-50% lower compared to the Czech Republic (USD 758), Hungary (USD 746) or Poland (USD 706) and 6.5 times lower than in the European Union (*Source: SARIO Slovak Investment and Trade Development Agency*, average wages in 2004; used exchange rate as of April 10th 2006 1 USD = 30.713 SKK). The government puts emphasis on education thus cheap labor force does not mean less quality. Businessmen can choose from highly skilled workforce when investing in Slovakia.

The rules of state aid provision to investors have recently become more transparent. The new support strategy aims to decrease structural unemployment and attract investments using modern technology and providing higher added-value. The government divided the country into three types of zones. Green zones are regions with an unemployment rate higher than 15% (29 regions in September 2005). The unemployment rate in yellow zones is between 10% and 15% (24 regions) and in red zones below 10% (26 regions). On the 15th January of each the calendar year the classification of regions will be updated. Besides these zones an investment project classification was created conforming to the National strategy of direct foreign investment support. Investments in the processing industry or connected to distribution and logistics centers are type "A" projects. Establishing or development of centers of strategic services (human resources, sales, ICT) and strategic investments in high-tech sectors with network externalities (ICT, biotechnology, etc.) are type "B" projects. And last but not least type "C" projects include investments connected to R&D centers and technological centers. Type "A" project implemented in red zones cannot receive state aid. Other investors have to fulfill criteria such as a minimal amount of investment cost (USD 6.5 million for type "A", USD 1.3 million for type "B" and USD 0.95 million for type "C"), structure of employees and structure of investment cost into modern technologies (at least 35% in green and yellow zones, at least 45% in red zones). The form of state aid can be tax relief, transfer of real estate from the state at a price lower than the market value, financial grant to cover investment costs, allowance for newly created jobs or training allowance. The rules set the amount of state aid for each type of projects and zones. Based on these new rules each company can calculate the amount of receivable subsidies.

EXPECTATIONS

Recent figures prove that inward FDI in Slovakia still depends on privatization. The country has excellent performance in those years when state property is sold but lags behind the region in other years.

Table 2. Rankings of Inward FDI Performance and Potential 1995-2003

	Inward FDI Performance			Inward FDI Potential		
	1995	2000	2003	1995	2000	2003
Czech Republic	34	18	19	39	40	39
Hungary	4	26	39	60	43	40
Poland	43	47	72	55	41	43
Slovakia	**64**	**41**	**14**	**51**	**51**	**46**
Slovenia	88	113	49	43	29	28

Source: UNCTAD

The ranking of inward FDI Performance and Potential by UNCTAD backs up this trend. Slovakia became the first in the region concerning FDI Performance in years of privatization but is still in 5th position concerning FDI Potential.

The reforms introduced by the government have had positive effects since 2003. However, inward FDI statistics attract attention to the need of further development of the investment climate. There is almost nothing left from public property thus inward FDI will not increase thanks to privatization in the future. Besides the stable, dynamic economy and low labor costs the new, transparent rules of state aid and the clear strategy of the government provide a more attractive business environment for investors in the future. A further lowering of taxes could boost not only inward FDI but also domestic SME-s resulting in lower unemployment rate which is the main objective of the government.

STRENGTHENING TIES BETWEEN RUSSIA AND CHINA IN TERMS OF TRADE AND ENERGY

INTRODUCTION

Russia and especially China are huge markets, and the economies of the two neighboring states complement each other in many ways. This means that there is a huge potential of mutually beneficial trade between Russia and China. The reason that much of these opportunities have remained untapped is that the economic relations of China and Russia have always been complicated by the geopolitical realities of the day. In recent years, however, a close political cooperation has evolved between the two countries, accompanied by a hefty increase in the volume of bilateral trade and increased cooperation in the field of energy transportation.

RECENT DEVELOPMENTS

After decades of intense hostility during the second half of the cold war, Sino-Russian relations have largely improved in the 1990s. In recent years, however, signs of a more close cooperation (a 'strategic partnership') have emerged. This has much to do with the more assertive foreign policy approach Russia has taken under the presidency of Vladimir Putin: instead of unconditionally accepting the hegemony of the United States, Russia seeks a multi-polar international system, with China as an important partner and counterweight to the US.

Thus, in 2004, China and Russia signed a long awaited agreement on border demarcation. The year 2006 has been declared the Year of Russia in China, and President Putin has paid a high-profile visit to Beijing. Numerous agreements have been signed envisaging increased cooperation in the fields of energy (including nuclear energy), finance, information technology and machinery, civil aviation, space navigation and exploitation, bio-medicine and new materials, agriculture, anti-terrorism and labor services. The need for stronger cooperation between Russian and Chinese banks in investment and financial projects, and the cooperation of large companies of the two states on joint projects has also been emphasized.

The most significant developments, however, concern the energy sector or more precisely, the transportation and trade of oil and natural gas: oil and natural gas make up the bulk of Russia's exports, and the rapidly expanding Chinese economy has an ever-growing and seemingly insatiable appetite for energy. Most significantly, China and Russia have signed agreements on the construction of two pipelines which would carry oil and natural gas from Siberia to northern China. The first agreement, signed by the China National Petroleum Corporation (CNPC) and Russian gas giant Gazprom, concerns the joint designing and construction of an oil pipeline from Skovorodino to the Chinese-Russian border. Another agreement (a memorandum of understanding) was signed by the same two companies concerning the construction of two new pipelines with the annual capacity of 30 to 40 billion cubic meters of natural gas. Also, a third agreement was signed by the CNPC and Russian oil company Rosneft concerning the forming of joint ventures on oil cooperation. Rosneft has also signed a strategic cooperation agreement with China Development Bank on the financing of oil exports from Russia to China and the joint development of two oil and gas fields.

Rosneft has signed a strategic cooperation agreement with the China Development Bank which provide financing for increased oil exports from Russia to China. Rosneft and the bank will also jointly finance the development of two oil and gas fields.

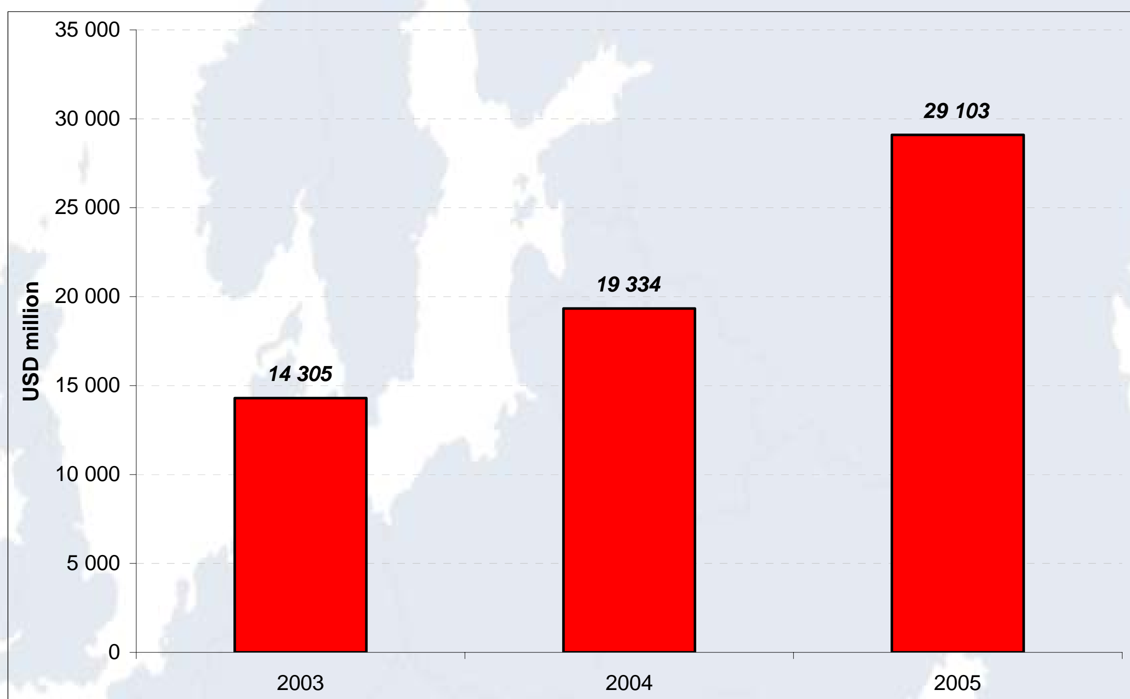
The construction of the new pipelines is a huge diplomatic victory for China over its arch rival Japan, which has urged Russia to bypass China altogether and expand its Siberian pipeline system in the direction of the Pacific coast of Russia. Also, the construction of the new pipelines will enable Russia to further increase the volume of its energy trade with China. (In 2006, Russia plans to sell 15 million tons of crude to China via railway shipments.)

Besides all this, there are also plans to increase cooperation in the field of nuclear energy, with Russian firms taking part in the construction of nuclear plants in China.

The Structure of Sino-Russian Trade

The volume of Sino-Russian trade has expanded rapidly in recent years (*Chart 1*), outpacing the growth rate of China's total foreign trade. In 2005, China was the fourth largest trading partner of Russia, and Russia was the ninth largest trading partner of China (*Table1*).

Chart 2. The Development of Sino-Russian Trade 2003-2005



Source: China Customs Statistics

A closer look at the structure of trade, however, reveals some striking problems. In 2005, 24% of China's total exports to Russia are made up by machinery and electronic goods. The proportion of high-tech products, though growing fast, is still at about 7%. By far the largest segment of exports, however, is still clothing and footwear. As far as Russian exports are concerned, over 80% of total exports to China are made up by fossil fuel (crude oil and natural gas) and raw materials. The share of electromechanical imports, for example, has fallen to a meager 2.2%. In fact, most of the rise in the volume of Russian exports to China is in fact due to the rise in commodity prices.

Table 3. Top Trade Partners of China

Rank 2005	Country	Jan.-Nov. 2005 (USD million)	% Change**
1	United States	191585.5	25.4
2	Japan	166985.6	10.3
3	Hong Kong	120484.6	20.7
4	South Korea	101457.7	24.7
5	Taiwan	82042.8	15.8
6	Germany	57079.4	16.8
7	Singapore	29618.2	24
8	Malaysia	27525.6	15.6
9	**Russia**	**26529.7**	**37.3**
10	The Netherlands	26226.0	38.4

***Percent change over Jan.-Nov. 2004*
Source: US-China Business Council

As far as the dynamics of Sino-Russian trade are concerned, the volume of trade is expected to reach about USD 60 billion by 2010. But whereas China is widely expected to increase the share of machinery and high-tech products in its exports to Russia, Russia so far seems to be reluctant or unable to diversify its exports to China which is thus likely to remain dominated by commodities. The construction of new pipelines only entrenches this situation further. It remains to be seen whether Russia's eventual accession to the WTO and China's professed wish to import more machinery items such as civil aviation aircraft and power generation facilities.

As regarding to foreign investments, by the end of 2005, China's contracted investment (a sign of future investment inflows) in Russia reached USD 977 million, while Russia's contracted investment in China reached USD 1.405 billion. Most of the Chinese investments in Russia are concentrated in the energy industry, mining, forestry, trade, the textile industry, telecommunications, construction and real estate. Russian firms mainly invested in manufacturing, construction and transportation in China.

CONCLUSION

In recent years, trade relations between China and Russia have improved dramatically, partly in tandem with a closer political cooperation. The most important component of this relationship is the Russian export of commodities, fossil fuels and raw materials to China. However, in order to achieve a more healthy trade structure, Russia needs to diversify its export portfolio. There is also a long way to go in foreign investments and joint ventures of Russian and Chinese private firms. In this respect, however, the liberalization of trade and the internal market in both countries would be more useful the high-level talks and political commitments.

RUSSIAN-UKRAINIAN TRADE: ROAD NOT YET SMOOTH TO CEA

Russian-Ukrainian foreign trade deficit (in favor of Russia) of goods in January 2006 grew by 63% compared with the previous year. Ukraine's export to Russia grew by 14.6%. The value of Ukraine's import commodities from Russia was 1.36 fold more than at the same time of the previous year. Meanwhile, import from other countries increased 1.5 fold. The volume of total trade between Russia and Ukraine has been continuously growing since 2000.

Table 4. Ukraine's Foreign Trade in Goods, January 2006

	Exports		Imports		Balance
	USD thousand	in % to January 2005	USD thousand	in % to January 2005	USD thousand
CIS countries	632501.01	110.82	1406432.99	148.27	–773931.98
Russian Federation	***449522.83***	***114.6***	***952690.32***	***136.38***	***–503167.49***
Other countries of the world	1706901.67	88.67	1306419.44	150.0	400482.23
Total	**2339402.68**	**93.73**	**2712852.43**	**150.0**	**–373449.75**

Source: State Statistics Committee of Ukraine

Table 2 shows Ukraine's Foreign Trade in Goods in 2005. As we can see, Ukraine's export to Russia grew by 27.43% from 2004 to 2005. Russian import to Ukraine increased by 5.9%. Trade deficit was USD 5348 million in favor of Russia. Considering the value of total trade of goods one can realize that 31% of Ukraine's export goes to Russia. 67% of Ukraine's import comes from Russia. Russia is Ukraine's most important trade partner; however different affairs have worsened relationship between the two countries. As we cannot separate political relations and historical background from economic relations, we need to take into account them when observing trade relations.

Table 5. Ukraine's Foreign Trade in Goods, 2005

	Exports		Imports		Balance
	USD thousand	in % to 2004	USD thousand	in % to 2004	USD thousand
CIS countries	10739718.76	125,51	1703031.,34	111.98	–6290593.58
Russian Federation	***7495821.72***	***127,34***	***12843419.16***	***105.90***	***–5347597.44***
Other countries of the world	23547029.50	97.67	19110782.60	138.60	4436246.88
Total	**34286748.26**	**104.96**	**36141095.00**	**124.64**	**–1854346.70**

Source: State Statistics Committee of Ukraine

Over the past years Ukraine has been several times in the headlines. Mainly because of the so-called Orange Revolution in 2004 after which Viktor Yushchenko became the President. The revolution also changed the priorities of the Ukrainian foreign policy, Yushchenko started to reduce Russia's influence on the country. Ukraine opts for democratic development, European and Euro-Atlantic integration. But it does not necessarily mean that Ukraine should

emotionally argue with Russia and give up obvious benefits. Ukrainian Foreign Minister Boris Tarasyuk emphasizes that it is necessary to closely cooperate with Russia and that it should become a democratic and predictable partner. This also coincides with Ukrainian national interests. Equal partnership with Russia on mutually beneficial terms will continue to be one of Ukraine's foreign political priorities.

THE CHARACTERISTICS OF RUSSIAN-UKRAINIAN TRADE

Ukraine was the second most important economic element of the Former Soviet Union. Its fertile black soil guaranteed more than one-fourth of Soviet agricultural output, and produced significant quantities of meat, milk, grain and vegetables to other republics. Meanwhile its diversified heavy industry provided the unique equipment and raw materials to industrial and mining sites. After the ratification of independence in December 1991, liberalization started but because of resistance to reforms within the government and legislature the process stopped and led to backtracking. Output by 1999 fell of 40% that of the 1991 level.

Most important Ukrainian export commodities are ferrous metals and nonferrous metals, fuel and petroleum products, chemicals, machinery and transport equipment and food products. The agriculture sector has a major role in Ukraine, wheat is the main crop. Mining natural resources are enormous. The country depends on energy, especially natural gas; it imports machinery, equipment and chemicals as well. Russia exports gas to Ukraine, imports food products, like milk and butter.

A SERIES OF CONFLICTS

Russian-Ukrainian relations seriously worsened after the Russian-Ukrainian gas debate in January 2006. Agreement was reached fast, but as a result Ukraine has to pay higher prices. According to the negotiation between national joint-stock company NaftoGaz Ukrainy and the Russian joint-stock company GazProm, a closed joint-stock company called UkrGazEnergo was created. NaftoGaz Ukrainy and RosUkrEnergo each own a 50% stake in UkrGazEnergo. Ukraine will buy Russian gas at USD 95 per 1,000 cubic meters from the RosUkrEnergo, which in turn will buy Russian gas from GazProm at USD 230 per 1,000 cubic meters. The high price for Russian gas for RosUkrEnergo will be compensated with cheaper gas from Central Asia. The tariff rate for Russian gas transit to Europe was increased from USD 1.09 to USD 1.6.

In December 2005 Ukraine disapproved that Russia's Black Sea Fleet had usurped land that it isn't entitled to in a Ukrainian port. Soon after as a response to gas conflict Ukraine intended to compensate by the revise of the rental of the Russian Black Sea Fleet. Russian Black Sea Fleet is stationed at several smaller bases on Crimea. According to a bilateral agreement Russians can use the base in Sevastopol for USD 93 million/year and can be stationed until 2017.

On December 30, 2005 Russia introduced ban on animal products, which were imported to Russia as transit through Ukraine. On January 1, 2006 Russia imposed limitations to imports of all types of raw meat semi manufactured articles. Russian agricultural ministry launched ban on all animal products from Ukraine on 20th January. They referred to the fact that many imports of animal products from Ukraine had breached food safety standards, and that Ukrainian veterinarian service had not maintained effective controls on meat. The ban includes both dairy and meat imports. Ukraine is the biggest supplier of dairy products to Russia. Approximately 40 per cent of the total imported butter and cheese comes from

Ukraine. Each year Ukraine supplies the Russian market with up to 80 thousand tons of cheese and about 50-60 thousand tons of butter. Russian importers think that Ukrainian-made cheese has the optimal ratio „price/quality" for the Russian market. Political observers suggest that ban, which cost the Ukrainian milk producers an estimated EUR 4 million in the first week is the next punishment for ignoring Russia. Mr. Baranivskiy the Minister for Agrarian Policies Mr. Oleksandr Baranivskiy said "It looks like Russia is focused not on economic, but on political interests in setting embargo".

In response Ukraine did not impose restrictions on imports of animal products from Russia or transit transportation of such Russian products via Ukraine. As of March 3, Russia allowed three Ukrainian companies to resume exporting their dairy products to Russia. As of March 22, Russia lifted its ban on imports of dairy products from Ukraine for five Ukrainian dairy producers, which accounted for 20 percent of Ukraine's dairy exports to Russia.

THE FUTURE OF TRADE RELATIONS

Despite political conflicts between Ukraine and the Russian Federation, the volume of trade in goods was continuously growing in the last three years. The total volume of trade in goods from 2003 to 2004 increased by 36%, from 2004 to 2005 grew by 14%.

Table 6. Ukraine's Foreign Trade with Russian Federation in goods, 2003-2005

USD thousand	**2003**	**2004**	**2005**
Export	4311395.47	5888676.37	7495821.72
Import	8645741.17	11811780.86	12843419.16
Balance	-4334345.7	-5923104.49	-5347597.44

Source: State Statistics Committee of Ukraine

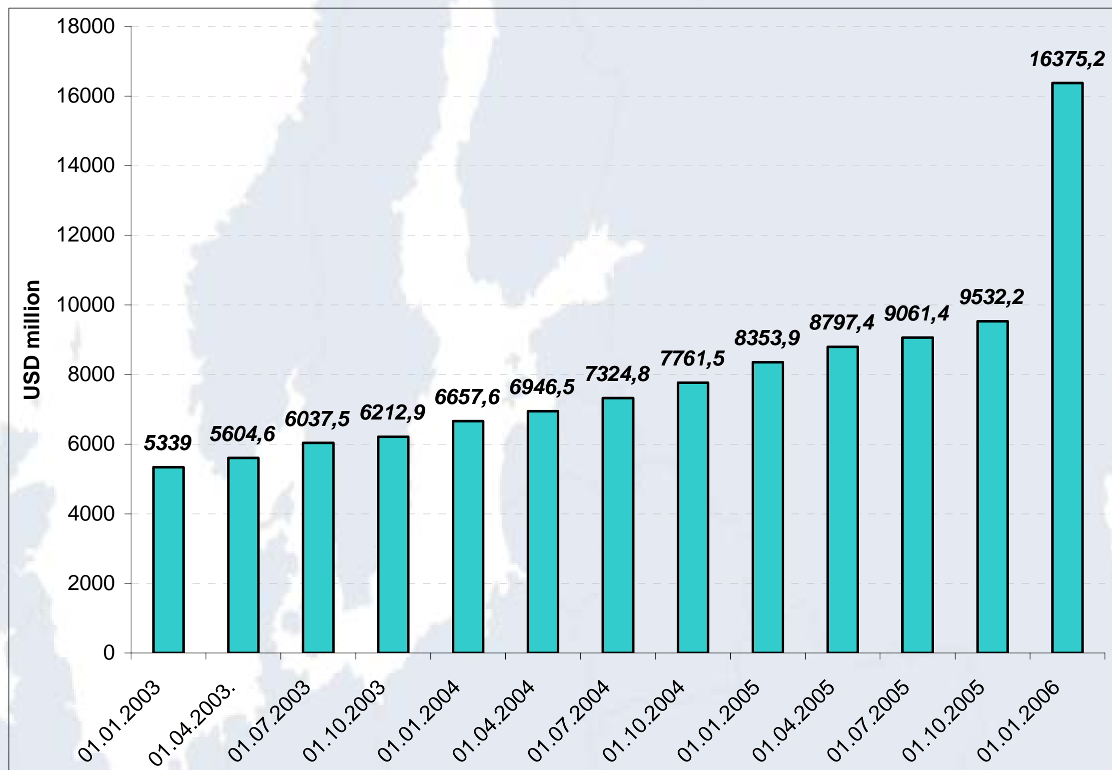
After surviving winter and after the end of the heating season the possibility of re-negotiating Ukraine's natural gas supply deal with Russia arose by energy advisor to President Viktor Yushchenko.

Russia and Ukraine intend to form a Common Economic Area with Russia, Byelorussia and Kazakhstan, but these conflicts do not really facilitate this process. For Ukraine it could guarantee a big market but for political reasons it seems unrealistic in near future. Ukraine continues to participate in drafting the CEA documents, though. Presently it is ready to sign only eleven from already prepared 38 agreements between the countries. However, it is possible that Ukraine may hold national referendum on NATO and CEA accession.

UKRAINIAN INWARD FDI DOUBLED IN 2005

Cumulated Foreign Direct Investment into Ukraine grew by 16% in the last quarter of 2005 comparing with 3 months earlier data. In last three months of 2005 it increased by USD 6843 million and on 1st of January 2006 reached USD 16375.2 million. Ukraine's FDI has been continuously increased in last three years. Meanwhile rate of increase was fluctuating. Whilst the volume of FDI from 1st January 2004 to 1st January 2005 grew by 20%, it increased by almost 90% from 1st January 2005 to 1st January 2006.

Chart 3. Quarterly Development of Foreign Direct Investment in Ukraine 2003-2005



Source: State Statistics Committee of Ukraine

Many people charged the government of Viktor Yushchenko with squandering opportunities to attract more foreign capital after the Orange Revolution. This record high increase in last three months can serve as a demonstrative proof against these charges. The change of Ukraine's political orientation restored investor's confidence in the country and raised the volume of investments.

UKRAINE'S ECONOMIC SITUATION

Ukraine was the second most significant economic factor of the former Soviet Union. In 1991, after the declaration of independence, liberalization processes were accelerated, however this was halted by reluctance to reforms in the government and legislature structure. By 1999 output dropped to 40% of 1991 level. Ukrainians suffered an unprecedented decline in living standards in that period. The country had to deal with a prolonged dilemma from the nuclear disaster at Chernobyl. The nuclear plant was finally closed in December 2000. However, the reverberation on health, agriculture and the economy will continue for several decades.

After almost a decade of uninterrupted decline of GDP, Ukraine experienced first year of output growth in 2000, real GDP increased by 5.9% year-on-year. Ukrainian GDP in 2003 and 2004 grew in real terms by the record high rates of 9.4% and 12.1%, respectively. However GDP growth was 2.4%, as Ukrainian economy's structural problems have been surfaced.

FDI BY COUNTRY OF ORIGIN

Considering country of origin of FDI one can see that the shares have significantly changed in last year. The ranking of first four investor countries is different from one year earlier one. As of 1st January 2005, United States stood at first place (13.8%), followed by Cyprus (12.4%), United Kingdom (10.7%) and Germany (7.6%). As of 1st January 2006, most of foreign investments came from Germany. Its share improved by 26 percentage points, it went up from 7.6% to 33.6%. Cyprus was at second place with a share of 7.5%, followed by Austria's 8.7% and USA's 8.4%. (*Table 2*)The share of UK has reduced by 3 percentage points. Meanwhile, taking into account each country's volume of FDI to Ukraine, numbers have not decreased at all. As we have already seen in *Chart 1,* year-on-year volume indicator of FDI almost doubled from 1st January 2005 to 1st January 2006. Each county managed to increase its volume of direct investments into Ukraine, especially Germany (by USD 4874 million), United States (by USD 1221 million), Austria (by USD 1078 million) and Cyprus (by USD 526.4 million). Russian Federation raised its investment by USD 342.7 million. Behind Cyprus investors there are supposedly Russian and Ukrainian offshore firms.

Table 7. FDI in Ukraine by country of origin (USD million)

	FDI (USD million) 01.01.2006	In % to total
Germany	5505,5	33,6
Cyprus	1562	9,5
Austria	1423,6	8,7
United States of America	1374,1	8,4
United Kingdom	1155,3	7,1
Russian Federation	799,7	4,9
The Netherlands	721,8	4,4
Virgin Islands (British)	688,7	4,2
Switzerland	445,9	2,7
Poland	224,0	1,4
Hungary	191,1	1,2
Korea, Republic of	172,2	1.1
Other countries	2111,3	12.8
Total	**16375,2**	**100**

Source: State Statistics Committee of Ukraine

INFLUENCING FACTORS OF FDI

There are many factors affecting FDI movements, as for example country risk, the return of investment demanded, predictability level, tax system and privatization.

It's obvious that Western countries' image about Ukraine improved after the Orange Revolution in 2004. The volume of EU countries' direct investment in Ukraine grew by USD 6800 million from 1st January 2005 to 1st January 2006. Volume of direct investments from US has increased by USD 1221 million. Furthermore, the increase of FDI is also due to the privatization process. The privatization of Kryvoryzhstal steelworks in late 2005 produced USD 4.8 billion revenue for the country.

On the other hand, many investors complain about the State Tax Administration of Ukraine and selective enforcement of tax policy. STA is often charged with using its investigative authority to advance political or business interests. Political corruption is also high. According to the report of Transparency International on Ukraine parliament is still dominated by powerful business groups. Investors have no confidence in the country's court system, either.

As for the not too far distant future we predict that record increase of Ukraine's FDI is just the beginning of the country's economic boom. However, it is impossible to expect continuous growth of FDI without improving the economic environment, tax policy and laws.