

ICPS newsletter

Land privatisation will encourage more FDI

Stalled land privatisation is frequently cited among the impediments to foreign direct investments in Ukraine. The new issue of ICPS's Policy Studies journal contains the report from a survey titled "Enterprise Land Privatisation: Appraising Its Impact on Foreign Direct Investment in Ukraine". The survey authors—the Ukraine Enterprise Land Sales Project and the Velox Company—investigate whether or not land privatisation status is a consideration for foreign direct investment (FDI) decisions in Ukraine. The survey findings showed that land status has the greatest importance for smaller firms working in sectors where land is an important input, while the significance of land ownership is weaker for global multinational enterprises (MNEs). The study also proved that most foreign direct investors in Ukraine are in favour of land privatisation, anticipating either direct or indirect enhancement of their business climate, while some would also respond with an increase in their FDI commitments to Ukraine. In other words, a rigorous effort of the Ukrainian authorities to boost land privatisation should pay off in higher FDI inflows

Land ownership is never explicitly mentioned as an FDI motive in the mainstream literature on FDI. Yet the issue of land privatisation in transition economies, and Ukraine in particular, does fit in the orthodox framework of FDI motives, as it helps to limit the risks of government intervention and political/regulatory instability. The empirical evidence across CEE/CIS countries and bottom-up evidence of other studies are supportive of a positive link between land tradability and the level of FDI in a recipient country.

By undertaking a survey, the study attempted to collect empirical evidence for the following two hypotheses:

1. In a transition economy setting, land tradability, achieved by land privatisation, has a positive impact on FDI inflows. The less limited land tradability is, the more FDI are going to flow in.
2. When investing in sectors/enterprises where production is more land-intensive, foreign investors are going to be more sensitive to land tradability/ownership than in sectors with a negligible role of land in the production process.

To test the hypotheses formulated above on the Ukrainian ground, the authors designed a survey of foreign investors who entered or sought to enter Ukraine's market. The survey was conducted by means of mail-out questionnaires and personal interviews with senior executives of foreign companies.

However, the sample was deliberately selected with a bias toward those industries where land should be *a priori* important, e.g., food

processing, catering, real estate/construction. The sampling bias to food processing is also justified by its top ranking among Ukraine's sectors that has attracted the largest amounts of FDI: this sector accounts for over 21 percent of the cumulative FDI in Ukraine. Other sectors of significant FDI weight—engineering, chemicals/pharmaceuticals—were also represented in the sample.

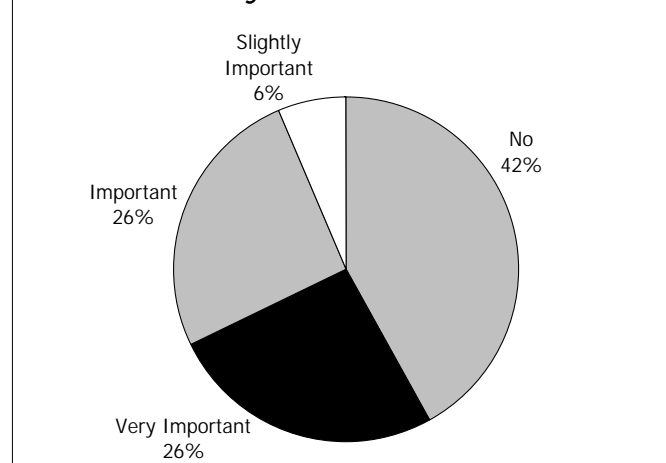
The authors contacted 50 companies and ended up with 31 whose responses formed the basis of the study.

To get a more meaningful idea about the survey findings, the authors attempted to identify patterns within the sample by grouping the respondents by investor type (e.g., multinational vs. entrepreneurial/other and invested vs. prospective) and sector (land intensive that includes food, agri, catering, beverages, real estate, and construction versus industries with low relevance of land as an input, e.g., engineering, chemicals, pharmaceuticals).

The survey findings yielded generally supportive results for both assumptions. The majority of survey respondents (18 out of 31) acknowledged the importance of land in their business (see Figure 1). One might notice that within those 18 firms which admitted the importance of land for their business, the majority is concentrated in land-intensive sectors. MNEs tend to ascribe smaller weight to the importance of land vis-a-vis entrepreneurial firms. This is probably due to the difference in bargaining power of a global multinational and a small entrepreneurial venture. In addition, land appeared to be a bit more important for committed investors vs. prospective ones.

With respect to current land ownership status, long-term leasing turned out to be the prevailing form of land use for 58 percent of

Figure 1. Is Land an Important Input in Your Business Activity?



survey respondents. Three firms managed to secure full ownership of their land plots. Those which fall under short-term lease and other arrangements are mostly prospective investors who have not yet moved beyond establishing a rep office in Ukraine.

Among the 31 surveyed firms, the strongest preference for complete land ownership was expressed by smaller entrepreneurial firms (6 out of 9), while only 4 out of 22 MNEs indicated this preference. Predictably, firms in land-intensive sectors also exhibited greater willingness to purchase their land into full ownership. Again, firms which already have launched their business in Ukraine were more willing to buy their land plots.

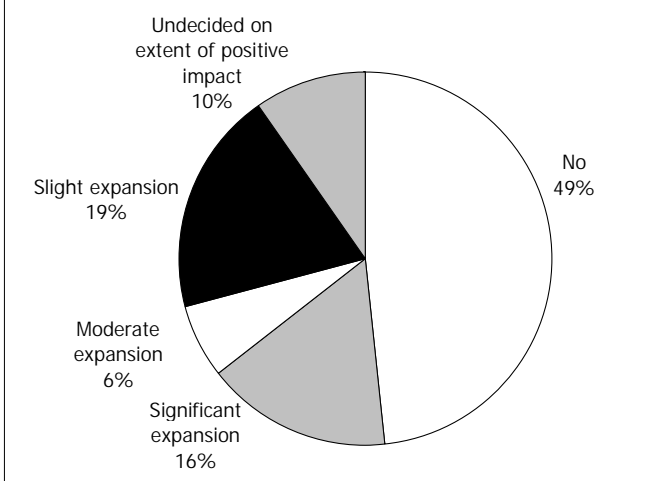
Eighteen firms, or 58 percent of respondents, admitted the importance of land ownership status for their investment decisions.

Again, firms in land-intensive sectors like food/agri processing, real estate, and construction were almost unanimous about the significance of land ownership for their investment decisions. Entrepreneurial/other and committed/invested groups of firms were more likely to recognize the impact than the others. Yet within land-intensive sectors, prospective investors were at least as likely to recognize the significance of land ownership in their investment decision making as those who already committed their money to Ukraine.

Out of 31 firms surveyed, the majority (16) indicated that easy land privatisation would boost their activity in Ukraine. Some of the firms that did not indicate any impact of land privatisation on their investment plans nevertheless indicated that they would welcome land privatisation, as it would enhance the general business/investment climate, creating an indirect benefit for them (see Figure 2).

Out of the abovementioned 16 respondents, firms in land-intensive sectors were more likely to follow the improvement of land privatisation by more investment and/or expansion of their business activity in Ukraine. However, most MNEs in this group indicated indifference to this issue and to its impact on their future investments. The reason for that is likely to be the dominance of the market-seeking motive over all the rest of their investment motives. As before, smaller (entrepreneurial) firms appeared more

Figure 2. If Land Were Easily Privatised in Ukraine, Would It Affect Your Investment Decision?



sensitive to the land privatisation process across the sectors of the Ukrainian economy. ■

This research was originated and sponsored by the USAID-funded Ukraine Enterprise Land Sales (Ukrels) Project. Ukrels commissioned Velox Company, a US-based consulting firm specialising in investment research and advisory, marketing, and management consulting in Ukraine, to undertake the study and prepare the report.

This issue of ICPS's Policy Studies journal also contains the report from a survey titled "Defining the Interests and Potential of Foreign Direct Investors in Ukraine", which was presented in ICPS newsletter #70.

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