

**Macroeconomics**

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**MAIN TRENDS OF IMPROVEMENT  
OF INVESTMENT ATTRACTIVENESS  
OF UKRAINE'S ECONOMY**

**Abstract**

The comprehensive analysis of investment climate in Ukraine in comparison with other countries is conducted; the potential for attracting of foreign direct investments in Ukraine is defined. On the basis of study, the basic factors of unfavorable investment environment are formulated and the ways to improve it are suggested.

**Key words:**

Foreign direct investment, investment potential, innovation, innovation development, Ukraine, countries of Central and Eastern Europe.

**JEL:** F21.

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**Problem definition.** Over the recent years in the practical and theoretical activity, the specialists and scientists pay great attention to the problems of construction of the effective system of foreign direct investments involvement. At the same time, Ukraine is among the countries with the unattractiveness investment climate, which is proved by the range of international evaluations and ratings. Therefore, there is a problem concerning deepening and acceleration of economic and regulatory reforms implementation in Ukraine.

**Problem examination.** The question concerning development of investment potential of Ukraine and activation of the foreign direct investment inflows into the national economy is of current interest. Among foreign scholars, this problem was examined by S. Hlinkina, H. Grey, M. Kopitsova, R. Mirdala, J. Regnitzer, V. Shabanov and others. Among native scientists, such scholars as S. M. Kadochnykov, V. V. Koziuk, V. V. Melnyk, O. M. Mozhovyi, A. M. Poruchnyk, N. O. Tatarenko, V. H. Fedorenko, A. S. Filipenko investigate the improvement of investment climate of Ukraine. But these researches are not completed inasmuch as Ukraine faces new internal and external challenges, which require the search of new decisions and instruments of foreign direct investments involvement.

**Topicality of investigation.** Foreign direct investment is an effectual resource of functioning and development of economy. Ukraine needs foreign capital. But to provoke the foreign investor's interest, it is necessary to provide all favorable conditions of foreign direct investment. In Ukraine, the business image should be changed. All efforts of the country should be channeled on the provision of favorable conditions of national and international business doing.

**Task definition.** This paper is aimed at conducting of analysis of Ukraine's investment environment, discovering the factors, which interrupt the process of involvement of foreign direct investments into Ukraine's economy. On the basis of the experience of other countries, in particular, countries of Central and Eastern Europe, the ways of investment crisis overcoming are proposed and the methods of increase of the volumes of foreign capital involvement are determined. In the process of investigation, the methods of comparison, grouping, benchmark, selection likewise graphical method is used.

**Material statement.** After the independence of Ukraine was proclaimed, the course of Ukraine's integration into EU was adopted. It provides the adhering to European principles of democracy, economic liberties and transparency of country for the economic investors. Involvement and encouragement of direct foreign investments was and still remains the important component of the program of economic reforms implementation in Ukraine, transformation of economy and adaptation of economy to the European standards. In order to create and

improve the national investment environment, the number of laws and normative acts, which define the regime of investment activity in Ukraine, were adopted. The Laws of Ukraine «On investment activity» (1991), «On regime of foreign investment» (1996), «On trans-border cooperation» (2004) and others are framework. They define the main principles of foreign direct investment involvement and regulation of activity of foreign investors in Ukraine.

Except basic laws and numeral amendments to them, about 20 Orders of the president of Ukraine and 35 Resolutions of the Cabinet of Ministers were approved and aimed at improvement and simplification of regulation of foreign investors' activity. But often the policy of the country in the given sector is inconsistent and contradictory and complicates the investment activity. The example is the Law of Ukraine «On formation and functioning of special (free) economic zones» (SEZ) (1992), which provide considerable benefits for enterprises with foreign capital. This Law was actually abolished in 1996. The noted Law became a boost for the active development of SEZ – during their activity the assignments to the budget increased two-fold, the total production – six-fold employment – three-fold. But often abuses caused the full repeal of benefits, reformation, or even liquidation of SEZ [2].

Foreign investors consider legal, political and economic unpredictability as the considerable disadvantage of investment environment of Ukraine. Ukraine belongs to the countries with extra investment risks [11]. In accordance with the indicator of unauthorized disclosure of corporate information and the level of right of property provision Ukraine ranks No 60 among the 70 biggest countries of the world [3]. The level of trust to the judicial system, corruption and protection of intellectual property rights and also is a source of concern for foreign investors [11].

In accordance with the results of the conducted research concerning market conditions, European center has evaluated the entrepreneurial risk in Ukraine in 75% and depicted a tendency to its deterioration. The main negative factors of investment environment of Ukraine are imperfection of legislation in the sphere of corporative governance, complexity of the system of registration, non-transparency of information about stock holders, frequent choices of forcible takeovers of enterprises etc. Overall, the majority of expert evaluations points out the low investment attractiveness of Ukraine for foreign investors [1].

The ponderable structural problem of foreign direct investment in Ukraine is the extensive nature of their direction. Thus, the share of foreign capital, which comes to enterprises, was reduced after 2003 for more than two-fold (machine manufacturing, light and food industry – three-fold, infrastructure – two-fold, metallurgic, oil, chemical industry – 1,5-fold). At the same time, their receipt into the real estate was reduplicated and into financial sector – was tripled [5]. In spite of such increase of financial and banking sectors, they entered an economic recession during the economic crisis. Until 2008, 40% of capital of Ukrainian banking institutions was in ownership of foreign investors.

The similar situation was in the countries of Central and Eastern Europe (CEE) – Hungary, Estonia, Lithuania, Latvia, and Bulgaria, where banks did not have the needed support from the foreign owners of assets. More obviously, the negative consequences of foreign direct investment involvement appeared in Hungary, where the share of foreign capital in individual industries of economy, including banking sector before the entry to EU was 70–100%. Foreign companies continue to channel investments into leasing, insurance companies, banking sectors, trade networks. But they were not economically effective for the country and Hungary among the countries of CEE overcame the consequences of the crisis very hard. Thus in 2004-2008, the increment of growth of foreign direct investment into Hungary was one of the highest in the region, and the rates of growth of GDP in that period amounted to only 1,3 %, 2,5 less than on an average in the countries of CEE [4].

Taking into consideration the given experience of the CEE countries, Ukraine has to take a balanced approach to the involvement of foreign capital, and to reinsure itself from the similar misbalances by the system of formation of priorities for the foreign investors. It is necessary to promote them to the investment into the sectors of real economy with the reorientation from extensive to intensive, infrastructural and innovation directions, which require capital investments.

To achieve the noted target, there are lots of preconditions in Ukraine: expedient geopolitical location, skilled manpower, rich natural resources, dissatisfied consumers' demand, undersaturated market of goods and services, competitive weakness of domestic producers. In accordance with some ratings, Ukraine belongs to the number of countries with great potential of foreign direct investments involvement. For example, in accordance with the globalization index, which is annually, formed on the basis of 14 of political, economic and social indicators of the Magazine Foreign Policy, among 72 the biggest countries, which produce 90% of the world GDP, Ukraine ranks 43 place [12]. In accordance with the index of potential of foreign direct investments involvement, which is defined by UNCTAD, Ukraine ranks 48 place among 141 countries [15].

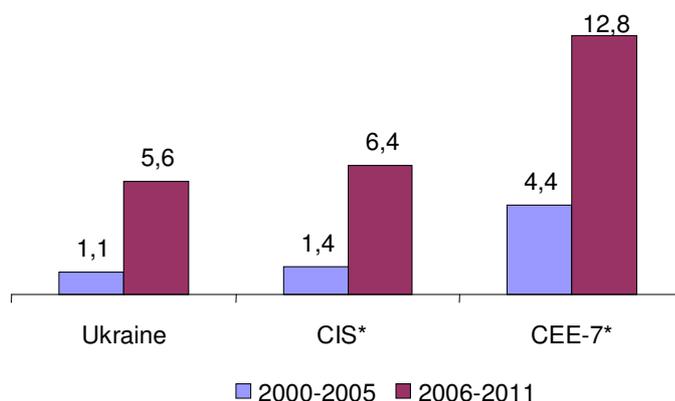
International Bank for Reconstruction and Development and International Finance Corporation calculated the possibilities of Ukraine concerning involvement of foreign direct investments, which amount to 100-120 billion of US dollars [7]. But in reality the given potential is used insufficiently (Figure 1).

For the period of the most dynamic development of Ukraine's economy (since 1999 till 2008) the volumes of foreign capital involvement increased tenfold. But it was insufficient for the beginning of the industry renewal – the share of the fifth technological mode in the production, which in developed countries occupy more than third, was reduced in Ukraine during that period from 3 to 2% [8]. The peculiarity of the foreign direct investment into Ukraine is the receipt of the prevail share of foreign capital to the already existed enterprises by means of pri-

vatization of the state-owned property. Only less than 10 % are channeled into the establishment of new enterprises (greenfield investment). This percent is considerably different from the average European [5]. The increase of the receipts of foreign direct investments to Ukraine is connected with the processes of privatization. Thus, in 2001 it was the privatization of big companies deal with production and distribution of electric power, in 2003 – chemical enterprises, in 2005 – re-privatization of metallurgic concern «Kryvorizhstal» with the record amount of foreign direct investments – 4,3 billions of US dollars. In 2006 the considerable volumes of foreign capital came in the form of mergers and acquisitions – M&A, in particular in banking sector (purchasing of Reiffeisen International by Austrian financial group, in August 2005, 93,5% of bank Aval shares totaling to 1,028 billions of US dollars; in March 2006, purchasing of 100% of shares of Index Bank by French financial group Credit Agricole etc). The highest annual volume of foreign direct investments involvement in Ukraine was reached in 2007– about 8 billions of US dollars [5].

Figure 1

**Average annual rates of foreign direct investment involvement in the countries of the world, billion US dollars**



Calculated according to the data [5, 15]: calculations of the author.

(\*) – mean value concerning each country of the region for the pointed out period.

Ukraine according to the volumes of foreign direct investments per capita yields to the countries from CIS, and according to the ratio of the volume of investments and GDP considerably yields to the world indicators and countries of CEE. Besides it, in the last 10 years in the structure of foreign direct investments involvement in the countries of origin, some disproportions took place. Thus, the main donor of foreign capital in Ukraine is Cyprus – 22 %, and its share since 2003 increased. But, in personal opinion of some experts, this is actually the capital of Ukrainian companies, which returns to Ukraine with the status of foreign direct investments and under protection of corresponding legislation, aimed at obtaining of benefits and preferences. The majority of investments from Cyprus come to Ukraine [15]. The similar schemes are used by Ukrainian business in Virgin Islands (3,3 %), Bahama Islands (0,9%), Panama, Belize (0,1 %) and others [9]. Experts from the company Ernst and Young have researched admitted that more than a half of foreign direct investments from the Netherlands and about one third of Austrian foreign direct investments are reinvested by the capital of Ukrainian companies [10].

In Ukraine the considerable deterioration of investment environment took place during the world crisis. Over the period of 2008–2011 the national credit rating of Ukraine was downgraded by 9 times by the rating agencies. First of all, the reason was connected with the significant decline of GDP for 15 % in 2009, the deficit and the government debt was increased to 16 %, the rates of internal and external investing were reduced, the reforms' implementation was ineffective [5]. As a consequence, in the rating of economic freedom Ukraine declined from 134 place in 2007 to 164 place in 2011. The similar decline was in the rating of Ease of Doing Business – from 118 position to 145 position [9].

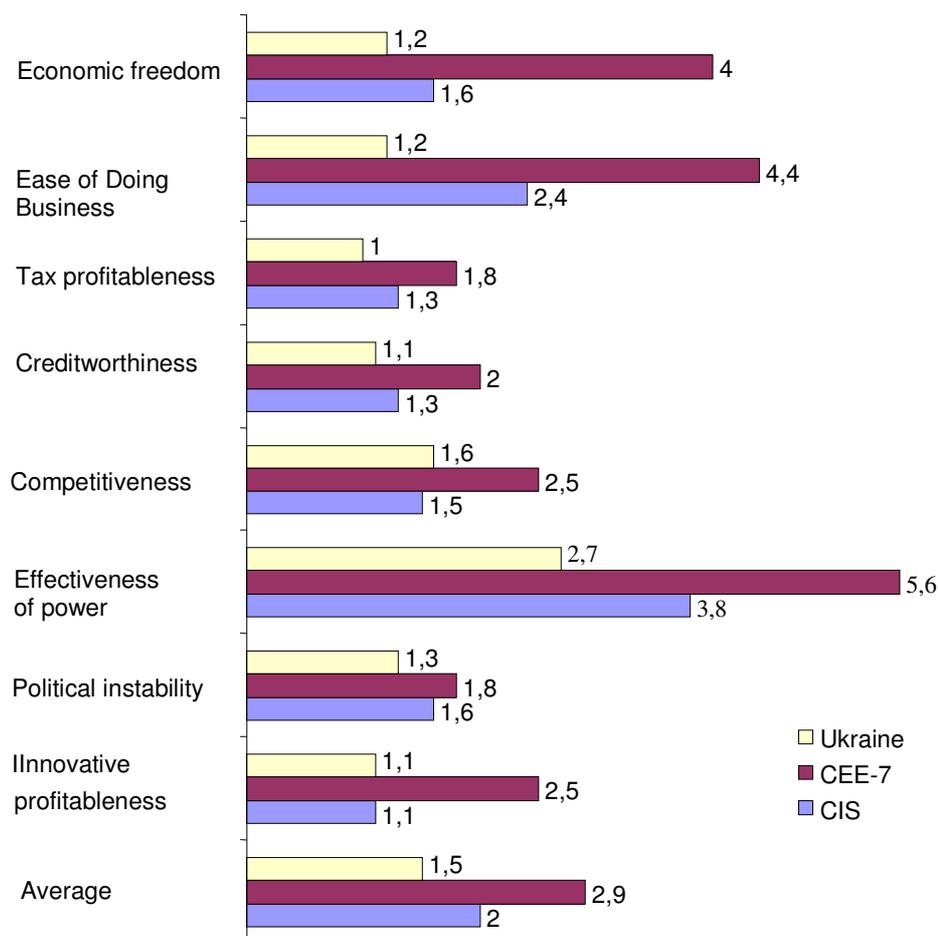
The key problem of the investment environment of Ukraine is organization of the state regulation of economic activity, taxation system, business administration. Moreover, over the last years the state of affairs only undergoes degradation.

The noted critical evaluation of the investment environment of Ukraine shows the significant gap between the investment attractiveness of Ukraine and countries of CEE. Moreover, the average indicator of investment climate profitability of the CIS countries is a quarter higher than the indicator of Ukraine (Figure 2). Therefore, it is obvious that Ukraine requires complex reformation of economy and consideration of economic development priorities. There are certain conditions and significant potential of development for these. Firstly, the given potential of non-realized possibilities is in the sphere of innovation development where in comparison with the countries – founders of EU or CEE countries there are great opportunities for development and involvement of foreign direct investments. The UNESCO data acknowledged of the above mentioned. Ukraine according to the nation's intellect ranks 23 place among the 192 member states of this organization [13]. According to the rating of innovation potential,

which is calculated by the experts of the World Economic Forum, Ukraine ranks 63 place among the 139 countries of the world, It stands higher than Russia, Spain, Portugal, Hungary, Baltic countries [140].

*Figure 2*

**Comparison of evaluations of investment environment attractiveness in 2011**



Calculated according to the data [8;10;15]: calculation of the author.

In the times of USSR the half of innovation production, inventions were Ukrainian. But financial provision of innovation sphere in USSR was at 3 % level of GDP, at the same time when Ukraine in the modern period makes available funds for financing only at the level of 0,84% of GDP (innovations in whole), 0,41 % of GDP – for research activity of engineering development. The number of enterprises, which introduce innovations year after year decreased and amounted to 12–13% [5].

Nevertheless, there are enough indicators in Ukraine, which induce to the budgetary and private financing of innovation sphere. Among them there is a high potential of GDP development, big raw material supplies bus, low level of own processing, outdated technologies of production etc. A key problem, which reduces the effectiveness of state programs, concerning innovations development, is the lack of distinct definition of priorities.

The Law of Ukraine «On priorities of innovation activity» (2003) defines 41 priority spheres, which causes the erosion of resources. Instead in Germany there are five such spheres, in Russia – 8. On the legislative basis, there is no distinct gradual approach. Over the period of last ten years in Ukraine 20 key directions of regional development, 20 strategies, 80 conceptions and 20 regional strategies, which permanently changed, were defined [7].

Law of Ukraine «On innovation activity» (2002), which introduce the efficient tax incentives for innovation enterprises both domestic and with foreign capital, stipulated the following: 1) 50% of profit tax, received by means of purchasing of innovation goods or services stays at the enterprise in order to use it exclusively for the financing of innovation activity; 2) 50% of value added tax, received from the received by means of purchasing of innovation goods or services stays at the enterprise in order to use it exclusively for the financing of innovation activity.

But the given benefits were abolished in 2005. After the abolishment of special regime the productiveness of technological parks, which were established during the period of this law operation, was reduced significantly. Export of technological parks products and the number of employed people decreased two-fold, tax payments to the budget eight-fold.

The noted policy contradicts the policy of the other countries, where the priority and privileged regimes for the technological parks and special zones and priority development of innovations were intensified. Lots of countries introduce government grants. Israel subsidizes 32 % of the innovation project value, in Singapore, 90 % of technological parks are financed by the state, Taiwan introduced seven-year term without profit tax, In China companies, which realize the innovation products pay only 10 % of profit tax. In Russia, domestic and foreign companies, which realize innovation projects in «Skolkovo», completely grant the remission of taxation [14].

In such a way, it is obvious that Ukraine requires distinct well-balanced program of development of investment-innovation activity. It is expedient to decrease the number of priority directions of innovation activity, but to increase the volumes of their financing, emphasizing on foreign investors. On our opinion, it is necessary to renew the legitimacy of the Law of Ukraine «On innovation activity» and preferential stipulated by this Law. On O. Havrysh opinion, Ukraine is able to reach the production of science-intensive products of 20 % of GDP in case of strategic planning of innovation sphere development, studying the experience of the successful innovation countries [9].

Lots of experts suggest that Ukraine requires serious liberalization and transformation of tax system. In accordance with the investigation of business environment by the experts from the World Bank in 2011, Ukraine according to the profitableness of the fiscal system is the lowest in the world rating. Tax system of Ukraine is one of the most complicated, ponderous systems, overloaded by the state administration. Even the essential improvement will not make it favorable or preferential for foreign enterprises. Therefore, on our opinion, the question is about the drastic change of the system of tax administration, considering the majority of rates.

Foreign investors suppose that the biggest disadvantage of investment environment of Ukraine is legal, juridical, economic unpredictability. They refer Ukraine to the list of countries with the increased investment risks and point out the ineffective work of mechanisms of market rights and freedoms provision for foreign investors, protection of their property rights and interests [11].

**Conclusions.** In order to promote the revenue of foreign investments, Ukraine requires deep reformation of economy in the part of improvement of investment climate. To achieve this objective, there are two parallel complexes of measures. The first deals with the provision of negative factors overcoming – corruption, bureaucratization, legal and judicial self-will, shadowness of economy, custom and tariff burden, The second complex should provide the positive changes intensification of protection of private and intellectual property, intensification of market reforms, provision of openness of economy, etc.

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The article was received November 21, 2011.