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Problems of attracting investment to Ukraine

Summary. The article analyzes the investment climate in Ukraine. The structure and dynamics of investment income in the national economy are investigated. The main problems and factors of attracting foreign investments, that are restricting the investment activity of domestic enterprises, are analyzed. It's explored the place of Ukraine in the international ranks towards doing business and the overall state of the investment climate. The influence of macroeconomic factors on the investment activity of foreign investors is substantiated. It's offered the directions of increasing the investment attractiveness of the Ukrainian economy in the current conditions of development.

Key words: investment, investment climate, investment attractiveness, index of investment attractiveness

Introduction

Investment activity occurs under conditions of uncertainty caused by factors of both internal and external nature. As a result, there are dangers, threats, and risks that affect the outcome of the investment. In order to elaborate an effective investment strategy of economic development of Ukraine it is necessary to analyze the dangers, threats and risks that arise in the course of investment activity, and the influence of the destabilizing factors on it.

Problems of investment activity of enterprises in the conditions of economic instability and attraction of investment capital in the economy of Ukraine were investigated by native and foreign scientists, in particular V. Berens, L. Borsch, A. Galchinsky, L. Hitman, Y. Honko, I. Blank, A. Dibrova, I. Dorosh, M. Kisil, M. Kodenskaya, I. Lipsitz, O. Mertens, A. Neshita, A. Peresada, G. Podlisetsky, P. Rogozhin, V. Savchuk, O. Starikov, T. Khachaturov, V. Hobta, V. Shevchuk, A. Peresada, A. Filipenko, O. Rogach, P. Gaidutsky, T. Kovalchuk, V. Kravchenko, L.J. Hitman, M.D. John and others. However, despite the multidimensionality of scientific research, investment activity of Ukrainian enterprises in conditions of economic instability needs further investigation. The purpose of the study is an assessment of investment activity in Ukraine and ways to improve the investment climate.

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The importance of investment for the development of the Ukrainian economy

In current context, Ukraine is faced with the objective need to intensify the investment process. Structural and qualitative design of production and creation of market infrastructure occur almost entirely through investment.

Investment is a major driver of economic growth, which provides an increase in some of the country's annual real product. However, during the transition period to the market, investment activity was the most degraded in Ukraine. Nowadays, the situation in this sphere is quite complicated due to the decrease in business activity of most economic entities, the final deterioration of the investment climate and the ability of budgets at all its levels.

The investment process is becoming the most important part of the world economic relations, affecting the interests of a growing number of countries, both those that accept the investment and those that are their sources. The interdependence of developing countries, regions and population in the face of globalization becomes not only a clear fact but it also requires a new level of awareness of the place of the nation-state in international relations and of the tasks of governance at the national and global level. Broadly speaking international investment processes it is a system of rights and obligations of participants of different countries regarding investment resources issues.

The revival of the Ukrainian economy and ensuring its sustainable development is impossible without the activation of investment policy, aimed at attracting internal and external resources. To raise the national economy, intensive investment of capital in cost-effective and environmentally friendly production technologies is needed in order to produce new quality products that are competitive in the global market for goods. In this regard, the management of the investment process is becoming the most important task for Ukraine. The problem of regulation of the investment process itself is complicated and requires taking into account many factors, among which political factors gain a particular relevance. At the same time we cannot ignore the patterns of development of the world economy, state participation in foreign economic and financial processes is objectively necessary because the economy is only part of the complex of international relations.

The larger the volume and the higher the investment efficiency, the faster the reproduction process is, the more positive the market transformations are. On the other hand, underinvestment leads to a loss of competitiveness of the national economy, decline in fixed capital, fall in production and increase in production cost, which in its turn causes aggravation of the problem of investment resources, therefore, it leads to reducing of the investment activity. Against this background, the investment process needs constant in-depth research, first of all, on the justification of the investment strategy, the choice of effective forms and directions of investment, as well as the search for new ways to enhance investment activity in the development of a competitive economy. It should be taken into account that the course, nature, intensity and effectiveness of investment management largely depends on the investment climate of the country¹.

¹ A.V. Nikitina: Investment activity in Ukraine: current state and prospects for development, Bulletin of Zaporizhzhya National University 2010, no 6, p. 161–165.

Investment determinants in Ukraine

Let's consider the positive and negative factors of the investment climate. To the positive factors of the investment climate include favorable geographical location of the country, availability of available resources, developed economic potential. Among these factors, the country's entry into the leading integration associations of states, the significant size of its territory, a sufficient population, a stable political environment, the absence of conflicts, permanent governmental changes, early elections, a harmonized legal environment, stability and impartiality of legislation, protection of investors' property rights, availability of a developed system of state support and guarantees, efficiency of the judicial system. This is socio-economic stability, a modern internal market, no double taxation, stable and transparent tax system, moderate tax pressure, strong banking system, convertible money, affordable loans, low inflation, lack of restrictions on the input and output of capital, duty-free regime, or regime of low duties.

The most painful issue in Ukraine is the issue of the permit system, quality of state control system, hopelessly outdated technical regulation, and the presence of restrictions on the input / output of capital, profit, dividends, currency as well as the lack of real state support and guarantees of investors. An unfavorable investment climate in Ukraine is caused by instability, threats and risks of a hybrid war, inflation, imperfect legislation, a variable tax system, high duties, the cost of resources, risks of loss or impairment of capital, bureaucracy, corruption, shadow relations with the government, low level of effective demand of people and high poverty. In Ukraine, there is no mechanism for the protection of property rights, which is the basis for widespread raiding. The country has not introduced stock instruments favorable for investment, as a result of which there are practically no opportunities for reliable and efficient allocation of funds of pension funds, other institutional and direct investors. Only government securities can perform the function of such an instrument. In the state, there is an ineffective, corrupt, virtually inoperative judicial system in which no issue can be resolved without money.

At this point, the investment climate in Ukraine remains unattractive to foreign investors due to the escalation of the military conflict, political problems of constant changes in tax and budget legislation. In 2018 foreign direct investment in Ukraine amounted to 1121 million dollars, which is 49% less than the corresponding previous period (Fig. 1).

The most problematic remains the real sector of the economy, which is not yet able to provide a quick pay-off period on investment and for that reasons it remains without the necessary funding and modernization. Consequently, attracting domestic investment can be a powerful alternative to foreign investment, which among other things leads to a decrease in the shadow economy, because the reduction in cash is directly related to the scale of the shadow economy. In addition, an amnesty of shadow capital is possible only through attracting them with the help of investment.

Analyzing the data of Table 2 we can see that certain changes have occurred in the structure of foreign direct investment in Ukraine by its type of economic activity. The industries remain the highest priority for foreign investors, the share of investments in which at the beginning of 2019 increased by 2.2 p.p. compared to 2016, and amounted

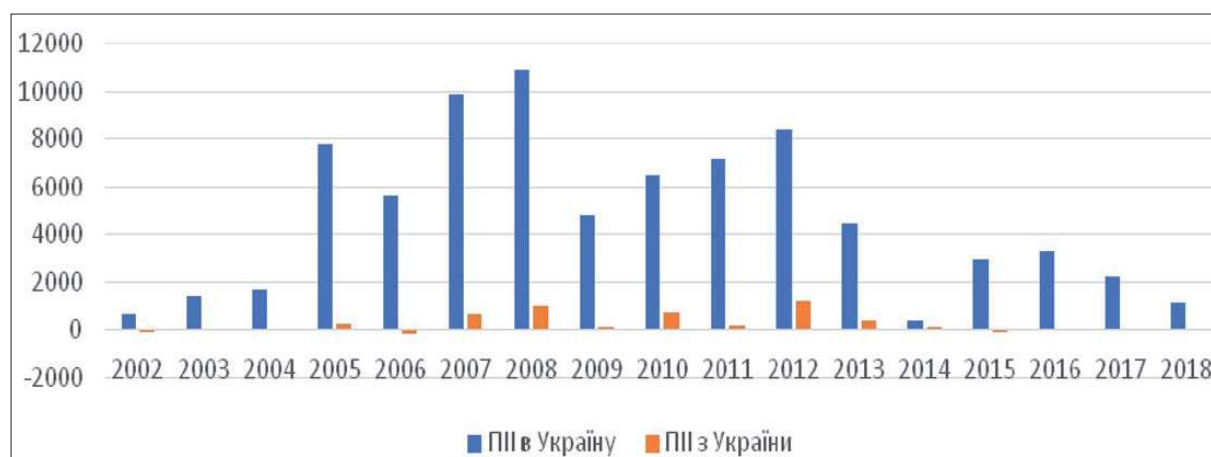


Figure 1. Foreign Direct Investment in Ukraine in 2002–2018

Source: National Bank Estimates Volume of Domestic Funds Received to Ukraine as Foreign Direct Investment in 2010–2017, https://bank.gov.ua/control/uk/publish/article?art_id=73849831&cat_id=55838 (access: 03.03.2020).

to 33.0%, which is definitely a positive fact. Considerable funds from foreign investors are invested in wholesale and retail trade, in real estate transactions and in information and telecommunications spheres, and the share of investments in these activities for three years also increased and amounted to 16.7%, 12.4% and 6.5% of total foreign investment as of January 1, 2019, respectively. The structure of foreign direct investment in Ukraine by type of economic activity at the beginning of 2016 and 2019 is presented in Table 2.

Table 1. Structure of foreign direct investment in Ukraine by type of economic activity

Types of economic activity	Structure of foreign investments as of January 1st [%]	
	2016	2019
Industry	30.8	33.0
Agriculture, forestry and fisheries	1.6	1.7
Construction	3.2	2.9
Financial and insurance activities	13.5	10.9
Information and Telecommunications	6.5	6.5
Wholesale and retail trade	15.9	16.7
Real estate transactions	11.7	12.4
Professional, scientific and technical activities	7.0	6.3
	6.3	
	7.0	
Other economic activities	9.8	9.6
Total	100.0	100.0

Source: S. Kharchuk: State of investment activity of enterprises of Ukraine in conditions of economic instability, *Ekonomika ta derzhava* 2020, vol. 1, pp. 66-72. DOI: 10.32702/2306-6806.2020.1.66

It should be noted that over the analyzed period, the share of investments in financial and insurance activities decreased significantly, which had been consistently high in previous years. Over the last three years, it has declined from 13.5% in 2016 to 10.9% at the beginning of 2019. Meanwhile, there are negative changes in the structure of foreign investment by type of economic activity, which can be attributed to the reduction of the amount and share of investment in professional, scientific and technical activities from 7.0 to 6.3%, and in construction – from 3.2 to 2.9%, as well as in the field of forestry and fisheries, where Ukraine implements important investment projects, only 1.7% of foreign investment was invested.

The experience of European countries testifies of the positive effect of amnesty due to the attraction of exported capital to the national economy by investing in government securities. Thus in the 2000s, this practice was widely used in Belgium, Luxembourg, Ireland and Italy for both businesses and households, resulting in a return of 2 billion to 60 billion euro. The emphasis was on the disposability of such shares, their combination with tax amnesty, as well as the strengthening of inspections and sanctions after the end of the shares.

Separately should be highlighted such an important indicator of investment attractiveness as the standard of living of the population. In Ukraine, it is significantly lower than developed countries, as a result of which the consumer purchasing power of the population is reduced. For example, Ukrainians spend an average of 3200 euro a year, while in Europe this figure reaches over 12,000 euro, which is almost four times higher². In addition, according to the State Statistics Committee of Ukraine, more than half of all revenue is spent on food and non-alcoholic beverages.

This situation is unfavorable for both the short-term effects of investors and the long-term effects of the state. Foreign investors will not invest in a country where the economic situation is characterized by prolonged instability, and the low purchasing power of the population in many cases nullifies any attempts to develop a business, especially in the consumer sector. At the same time, getting long-term effects on the national economy both low volumes of foreign investment and the urgent need to guide the proceeds to support for the existing economic system and guaranteed minimum social benefits will interfere.

Attention should also be paid to the sectoral structure of attracting foreign investment. For the state as a whole, it is important that funds go to innovative industrial production, which today is the basis for the effective development of any economy in the world. The most important for the investor is the fast and stable profit, which is more probable in the already developed types of economic activity. In Ukraine, on average, one third of foreign investment goes to industry, however, low-tech industries and industries (metallurgy, general chemistry, food industry) are mainly funded. Another third of foreign investment is in financial activities, which is essential for all kinds of business activities, but cannot be considered the real foundation of a country's well-being in the long run.

² A.Yu. Ramsky: Household investment potential: a monograph, Kyiv National University of Technologies and Design, Kiev 2014, p. 352.

Activities undertaken to improve the investment climate in Ukraine

European experience in ensuring the activating of investment processes shows that most effective to attract foreign investment by using a wider range of measures in the own economy, in particular, a stable focus on creating an attractive investment climate in the country and 30 allocations for the investor of the image of the country with the best opportunities to receive effective investment. Formation of strategic foundations for a favorable investment climate in the context of Ukraine's cooperation with the EU is possible only through comprehensive, decisive, swift, transparent and consistent state-level reforms, which, as evidenced by the experience of European countries, will create a competitive environment and provide the Ukrainian economy with incentives for modernization and development.

For the further improve of the investment climate of Ukraine, that is relevant today, are the issues of improving the legal and institutional framework to increase the capacity of mechanisms to ensure a favorable investment climate and to form the basis for maintaining and improving the competitiveness of Ukrainian enterprises in the conditions of economic instability.

Some positive steps have already been taken in this direction:

1. A legal framework for investing and developing public-private partnerships has been created in Ukraine today. The legislation of Ukraine defines guarantees for investors, economic and organizational principles of public-private partnership in Ukraine.
2. The national regime of investment activity is applied to foreign investors in the territory of Ukraine, that is, given equal terms of activity with domestic investors. Foreign investment in Ukraine is not subject to nationalization.
3. To enhance the protection of foreign investment by the Law of Ukraine of March 16, 2000 no 1547 ratified the Washington Convention of 1965, on the Settlement of Investment Disputes between States and Foreign Persons³.
4. Intergovernmental agreements on the promotion and mutual protection of investments with more than 70 countries of the world have been signed and ratified by the Verkhovna Rada of Ukraine.
5. In order to simplify the procedure for attracting foreign investments and preventing signs of corruption during their state registration on May 31, 2016, Law of Ukraine 1390 was adopted "On amendments to some legislative acts of Ukraine regarding the abolition of the obligation to state registration of foreign investments"⁴.
6. The Law of Ukraine on Amendments to Some Legislative Acts of Ukraine on Removing Barriers to Attracting Foreign Investments" dated May 23, 2017 was adopted. This law regulates the basic aspects of issuing work permits for foreigners and tem-

³ Verkhovna Rada of Ukraine: Convention on the Settlement of Investment Disputes between States and Foreign Persons. The Convention was ratified by the Law of Ukraine of March 16, 2000, no 1547III (154714), https://zakon.rada.gov.ua/laws/show/995_060 (access: 02.11.2019).

⁴ On Amendments to Some Legislative Acts of Ukraine to abolish the obligation of state registration of foreign investments: the Law of Ukraine of May 31, 2016 no 1390VIII, <https://zakon.rada.gov.ua/laws/show/139019> (access: 02.11.2019).

porary residence permits, which will facilitate the involvement of foreign managers and foreign skilled workers, what is necessary at the first stages of the development of a subsidiary in Ukraine⁵.

7. An Agreement on Promotion and Protection of Investments between Ukraine and the OPEC Foundation for International Development was signed (June 27, 2018). The agreement provides for the most favorable investment management regime and is projected to contribute to an increase in foreign investment in key sectors of Ukraine's economy⁶.

Regular, naturally recurring crises are an indispensable phase in the cyclical development of any system. The depth and consequences of a crisis are determined by the level of socio-economic development of a country or group of countries. With the end of the global crisis – 2010–2011 – a new long wave has started, which will reach its maximum in 2020–2040. Countries with the ability to adapt quickly to new, tough competition will find themselves in the leader group. Growth in fixed capital accumulation during 2015–2020 will be one of the components of entering the economic system into a new long wave of economic development. Developed countries are focusing their efforts on strengthening and developing the information technology mode of production, getting rid of the accumulation of capital through its massive depreciation.

Ukraine's accession to the OECD Declaration on International Investment and Multi-national Enterprises and membership of the OECD Investment Committee will provide such significant benefits to the country as: indicating Ukraine's introduction of international standards for investment activities; help in attracting foreign direct investment by removing sector restrictions, in which foreign investment is prohibited, and ensuring, provision of a national regime for transnational corporations (hereinafter referred to as TNC) in accordance with the system of development of international standards in regulating relations of TNCs with countries that accept their investments; will help to improve the competitive environment and influence the introduction and diffusion of innovations; will promote the implementation of the principles and standards of corporate social responsibility in line with the OECD Guidelines for Responsible Business.

Conclusion

Thus, the effectiveness of the investment policy of the state is a determining factor in shaping investor confidence and positive investment expectations about the ability of invested capital to generate stable returns with minimal risks, not directly related to the effectiveness of their activities. Further research towards identifying new actionable measures, as well as the specification of the proposed favorable investment

⁵ On Amendments to Certain Legislative Acts of Ukraine on Elimination of Barriers to Attracting Foreign Investments: Law of Ukraine of May 23, 2017, no 2058-VIII, <https://zakon.rada.gov.ua/laws/show/205819> (access: 13.11.2019).

⁶ On ratification of the Agreement on the promotion and protection of investments between Ukraine and the OPEC: Agreement of December 5, 2017 no 2220VIII, https://zakon.rada.gov.ua/laws/show/893_00117 (access: 15.01.2020).

environment for investors is very necessary, as improvements in the investment climate and a balanced investment policy determine success in structural restructuring of the Ukrainian economy, in solving urgent social, environmental, infrastructural and other problems, the result of which should be the improvement of the quality of life of citizens, which will eventually create an image of the financially independent, economically self-sufficient and innovatively oriented state, adapted to modern geopolitical challenges and the requirements of the European and world markets.

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