

Z. Romanchuk,
Lviv Ivan Franko National University, Ukraine

UKRAINE'S INVESTMENT CLIMATE ANALYSIS AND WAYS OF ITS IMPROVEMENT

Abstract. The article raises the question of investment attractiveness' problems of the country's, which is one of the main factors of economic development. The concept of country's investment climate is feature; the situation of Ukrainian investment climate and its peculiarities at the present stage of development are investigated in the article. The place of Ukraine in international investment and its international rating are analyzed. The key factors that influence state's investment attractiveness for foreign investors are determined, the basic positive steps of the national government are viewed, main courses for investment climate improvement and inflow of foreign capital into the country are proposed.

Keywords: foreign direct investment, investment climate, investment attractiveness, foreign investors, investment activity.

Problem setting. In 2006 the European Union officially recognized Ukraine as a market economy. This encouraged deeper involvement of the national economy in international trade and strengthened investment and innovation streams inside and outside the country. But the modern world economy is primarily characterised by great attention to the business efficiency in the globalised financial markets, liberalisation of capital movements. In other words, potential investors are interested in favourable investment climate in the country that provides proper legal guarantees to foreign and local investors, favourable conditions for business and market economy development.

Favourable investment climate allows to solve the social problems, provides high employment, renewal of plant, modernisation, implementation of new technologies etc. Therefore, there is a necessity to analyse the current state of the investment climate in Ukraine, identifying the problems and finding solutions to enhance the investment processes.

Analysis of recent researches and publications. The issues of investment climate development and assessment are researched by a number of foreign and national authors, such as I. Blank, O. Havryliuk, A. Haidutskyi, V. Geyets, S. Zakharin, A. Maliutin, N. Marchenko, V. Melnyk V. Oparin, A. Peresada, S. Reverchuk, A. Rohach, V. Savchuk, A. Sokolovska and others.

The purpose of the article. The article aims at the analysis of the foreign investment inflow dynamics in Ukraine; the assessment of the current state of investment development in the country; identifying the ways of favourable investment climate formation to attract the foreign investors to Ukraine.

Statement of the main research material. The investment climate is one of the determining factors of investment attractiveness of the country. According to many researchers, the investment climate is to be seen as a combination of economic, legal, social, cultural, regulatory, political and other factors, which characterise the country and which make the country attractive to investors.

Investment climate assessment is a part of risk assessment in the current poorly structured economy. Investment risks affect not only investors, but recipients as well. Firstly, substandard risks lead to reduction of the investment resources inflow into the economy of recipient. Secondly, they entail additional losses and expenses for recipient to attract the investment. In its turn, investment climate creates conditions for investment activities and, thus, becomes of paramount importance and directly affects the successful attraction of foreign direct investment.

The most common way to determine the investment climate is to compare the parameters of investment potential and investment risk. Among the other studies, investment climate assessment is based on the comparison of investment risk and yield. In this approach the payback period index is used, as well as the index of present value, investment rate of return and political and economic risks.

Domestic and foreign scientific literature highlight various approaches to the methodology of assessing the investment climate, which differ depending on the purpose of the study, the number of indicators analysed and their characteristics, at the choice of the very indicators. These are the main of them:

- Index of Economic Freedom;
- «Euromoney» magazine investment climate assessment method;
- assessment method of Lozano Institute;
- BERI (Business Environmental Risk Index);
- Economist Intelligence Unit;
- Political Risk Services;
- Standard & Poor's Rating Group;
- Pricewaterhouse Coopers and others.

In the foreign countries the investment climate assessment is usually carried out in relation to the macroeconomic sphere. Special consulting firms, banks, experts, magazines and newspapers carry out the analysis of different number of countries (15 to 178), depending on the interests of the customers. The number of parameters taken into account may be ranging from 9 in the “Euromoney” magazine to 381 in the work of the Swiss Institute for Management Development. London financial magazine «Euromoney» calculates the so-called integral reliability index with one hundred points grade. Nine factors are taken into account: economic efficiency, political risk, debt, debt service, credit standing, the availability of bank credit, the availability of short-term financing, the availability of long-term capital, the probability of force majeure.

International experts seek the best way to determine the parameters of the investment climate and investment attractiveness by using empirical data grouping and rating each country based on their findings. The use of various aggregates that characterise the institutional environment and economic policy of the country, its resource, industrial, intellectual and infrastructural potential assessment, led to the establishment of world rankings of investment attractiveness of different regions and countries.¹

The methods of country's investment climate assessment can be divided into:

- 1) credit and stock ratings (index);
- 2) economic indexes.

Financial investors use credit ratings to assess the reliability of investments in debentures of companies or governments, the fund uses them to assess the reliability for investments in companies' profit participation rights. This allows investors to create high-quality investment portfolio and quickly manipulate the assets in case of rating changes.

In terms of foreign direct investment economic indices are of utmost importance. They differ from credit ratings, as the objects of research and consumers are different. Unlike credit ratings, economic indices are usually made only for particular countries. They characterise certain aspects of the national economy, such as the level of competitiveness, economic freedom and corruption. These indices are usually used by strategic investors to implement their investment strategy abroad, in particular in the field of foreign direct investment.

The most common global methodologies for country's investment climate assessment are widely known indexes: Dow Jones and Russell Indexes (USA), CAC-40 and CAC General (France), Financial Times Industrial Ordinary Share Index (Great Britain), Nikkei and JPN (Japan), TSE (Canada), Hang Seng Index (Hong Kong).

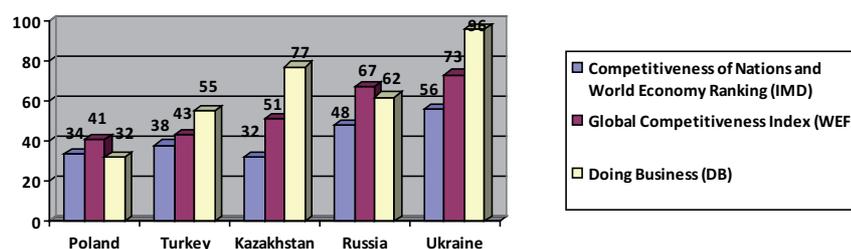
The world's leading economic magazines such as “The Economist” (England), “Fortune” (USA), “Euromoney”, as well as the most authoritative expert agencies: “Moody's”, “Standard & Poor”, IBCA – provide investment climate aggregates and risks assessment; their results are systematised in the national rankings of investment attractiveness of regions and countries, which are regularly published by these institutions.

Unlike the stock and credit indices, the economic indices and ratings of investment climate are defined both by a variety of analytical and rating agencies, and international organizations – the UN, the World Bank, the European Bank for Reconstruction and Development and others. The main factors that serve the basis for assessment in determining economic index include the following:

- the status and tendencies of economic development;
- political stability in the country;
- socio-demographical situation;
- monetary policy and inflation;
- legislative support of entrepreneurship;
- infrastructure development;
- corruption and violations of law;
- the level of state regulation of the economy etc.

¹ Медведкова, Н.С. (2012). Бюджетно-податкові важелі залучення прямих іноземних інвестицій в економіку України. *Інвестиції: практика та досвід*, 4, 18-21.

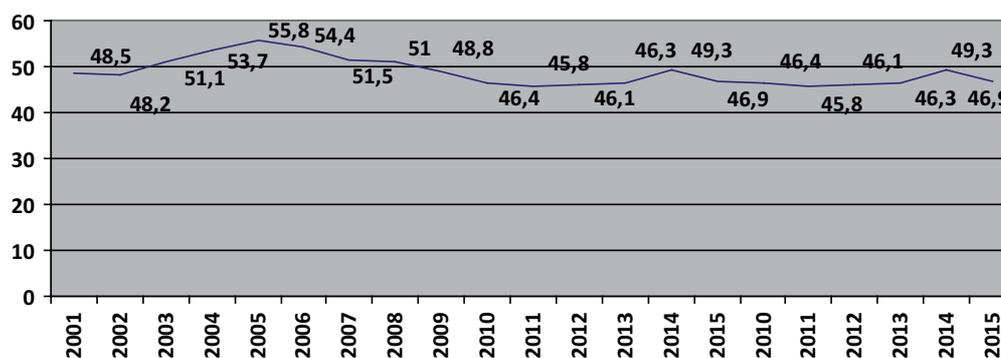
Investment activity in Ukraine can hardly be considered active. In Picture 1 Ukraine's position among the other states is featured, based on the competitiveness index, global competitiveness index and business index.



Pic. 1. Ukraine's position among the other countries according to Competitiveness of Nations and World Economy Ranking (IMD), Global Competitiveness Index (WEF), Doing Business ranking (Doing Business)

According to the international rankings of favourable business environment, Ukraine is far from the top. However, according to the Doing Business ranking 2015 prepared by the World Bank and the International Finance Corporation, Ukraine is among the first hundred among 185 countries, 16 points higher as compared to the previous year.

In Picture 2 dynamics of Ukraine's Index of Economic Freedom, which is annually calculated by the Wall Street Journal and Heritage Foundation is featured.



Pic. 2. The changes of Ukraine's Index of Economic (Heritage Foundation) during 2001 – 2015

As we may see from Picture 2, Index of Economic Freedom reached its top in 2005, and up to 2011 it tended to decrease. However, during the last two years Ukraine's rating after the jump to the value of 49.3 in 2014 fell by 2.4 positions.

The authors of the ratings note that Ukraine's future economic growth will require the serious problems to be solved, the most important of which being the restructuring of its institutional structure, which suffers from bureaucracy, lack of transparency and favouritism. This causes the need to protect the property rights and minimise the investment risks and promoting investment in the country. The business conditions in Ukraine, such as business launching process, employment, property registering, raising of credit, investors' interests protection, business, monetary, investment, financial freedom from the government, from corruption, protection of property rights do not meet international business standards, creating obstacles in attracting both foreign and domestic investment in the country's economy.

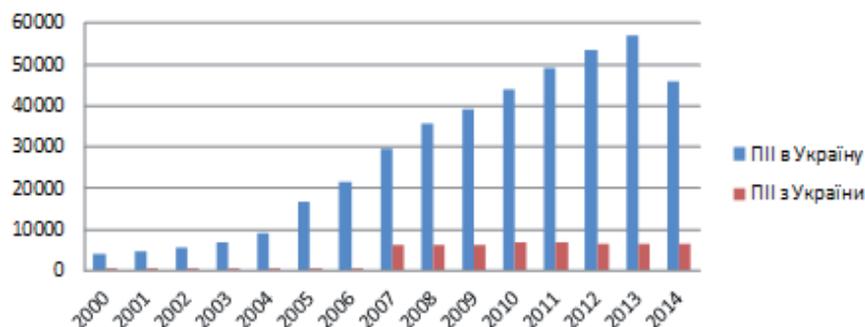
In the first quarter of 2014, investors were positive about the changes in the country, in the second quarter investment index rates began to decrease. Thus, according to the European Business Association, the business confidence in the country was 2.72 points out of 5 possible. In the second quarter of 2013 the rating was 2.15 points, and in the fourth – 1.81. Continuous instability in the country discouraged the investors, in the fourth quarter the ratings went down because of the revolution. The following actions caused by expectations of positive changes increased the level of confidence, but some of the government's actions again led to the decrease in ratings².

² Кірко́ва, Н.П. (2014). Оцінка динаміки інвестиційного клімату в Україні. *Інвестиції: практика та досвід*, 16, 46-50.

According to the EBA, among the negative trends that are observed today in Ukraine's economy investors note the following:

- corruption;
- imperfect legal environment;
- lack of transparency of the judicial system;
- problems with obtaining credit and loans;
- the complexity of tax administration;
- inspection of state supervision and other.

Increasing importance of the inflow of foreign capital for sustainable economic development of Ukraine highlights the importance of creating attractive investment climate and developing the opportunities for our country to attract foreign financial resources. It is therefore advisable to analyse and detect the patterns in the flow of foreign investments (Pic. 3).



Pic. 3. Foreign Direct Investment (stock capital), mln. USD

According to the State Statistics Committee of Ukraine, the amount of foreign direct investment (stock capital) contributed to Ukraine's economy in December 31, 2014 amounted to 45,916 mln. USD, which is 18.5% less than in the previous year. The decrease in ratings was primarily caused by the destabilising political events, but the upgrade process started in the second quarter of 2014, mostly because the businessmen hoped for positive changes.

The largest investor countries remain Cyprus (29.9% of all investments in the Ukrainian economy), Germany (12.5%), the Netherlands (11.1%), Russia (5.9%), Austria (5.5%), the UK (4.7%), Virgin Islands (4.4%), France (3.5%), Switzerland (3.0%), Italy (2.2%) and the USA (1.9%), which own more than 84% of total direct investment in Ukraine.

However, among the negative tendencies in Ukraine's investment sphere some positive steps may be noted, namely:

- in Ukraine national treatment of investment activities applies to foreign investors, i.e. they have the same conditions as domestic investors, foreign investments in Ukraine cannot be nationalised;
- in case of termination of investment activities foreign investors are guaranteed redemption of their investment in kind or in investment currency without paying customs duties and income from investments in cash or in kind;
- for foreign investors to facilitate the interaction with the executive and local authorities, pre-trial settlement of investment disputes, support the investment projects in the "single window" mode the State Agency for Investment and National Projects of Ukraine was launched. It is the main body in the system of central executive authorities, which ensures the implementation of state policy in the sphere of investment and national projects – strategically important projects, ensuring technological modernisation and development of basic sectors of the real economy of Ukraine;
- the administrative barriers for foreign capital entry is removed, regarding the mandatory registration of foreign investments;
- some improvements in the legal field are launched as the Council of domestic and foreign investors was established to promote the involvement and the effective use of domestic and foreign investments.

In essence, the main ways to improve the investment climate in Ukraine and promote the inflow of foreign capital into the country may be the following:

- improve the regulatory and legal framework of entrepreneurial and investment activities;
- reduce the investors' tax burden;

- create effective mechanisms of investment activity;
- restructure the economy, attract investments to the sectors that are particularly in need of investment;
- motivate business entities for long-term investments, and society for investment in the economy, rather than in consumption;
- encourage reinvestment;
- provide guarantees to investors;
- reform the Ukraine's tax system.

Attractive investment environment should be promoted by Ukrainian state. Indeed, although Ukraine's investment climate is not very favourable, such factors as favourable geographical and geopolitical position of Ukraine at the crossroads of European transport routes - Asia North - South, proximity to the world markets, the European Union, Middle East, favourable climatic conditions, rich resource potential, qualified staff, low cost and surplus of labour make Ukraine attractive to foreign investment.

Conclusions.

Thus, summarising the above, we can conclude that investment activity in Ukraine requires formation of positive investment climate. There are several factors that hinder investment activity of the country, including:

- legislation instability;
- unreliability of the banking system;
- imperfection of the tax system;
- excessive tax burden;
- imperfect system of legal and economic protection of investors.

It is possible to achieve a high investment climate attractiveness and overcome other existing problems only in case of timely and prudent investment policy of the state, which should be based on international experience and promote the priority areas of investment activity in Ukraine.

References

1. Kirkova, N.P. (2014). Ocinka dinamiki investicijnogo klimatu v Ukraini. *Investicii: praktika ta dosvid*, 16, 46-50.
2. Medvedkova, N.S. (2012). Bjudzhetno-podatkovy vazheli zaluchennja prjamikh inozemnikh investiciji v ekonomiku Ukraini. *Investicii: praktika ta dosvid*, 4, 18-21.
3. Bodie, Z., Kane, A., Marcus, Alan J. (2004). *Essentials of investments*. 5th ed. p. cm. (McGraw-Hill / Irwin series in finance, insurance, and real estate)
4. *Oficijnij sajt Derzhavnoi sluzhbi statistiki Ukraini*. <<http://www.ukrstat.gov.ua>>.