

Attraction of foreign investment to Ukraine: problems and solutions

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ABSTRACT

The study focuses on the problems involved in attracting foreign investment to Ukraine and some suggestions to their solution, based on the country's economic potential. The role of foreign investments is investigated in the system of financial provision of the Ukrainian economy. The purpose of the research is the determination of the solutions to the problem of attracting foreign investment to Ukraine, forming further strategy of investment allocation between the priority sectors. Research object is foreign investments in the economy of Ukraine. If the government adopts economic, legislative and administrative reforms, that have been proposed in the paper, the investment climate of our country will improve, which will increase the image of our country in the global market and will lead to the inflow of foreign capital into Ukraine. It is advisable to maintain investment projects aimed at developing the private sector, organizing exhibitions on investment projects.

Introduction

This topic is especially pertinent today because it is impossible to strengthen Ukraine's economy without investment boom, including foreign investment, without finding reliable and stable sources of capital and, ultimately, without establishing a favorable investment climate.

Problems of attracting foreign investment, creating a favorable environment for its development, mechanisms to stimulate investment activity is reflected in the works of foreign and Ukrainian scientists such as R. Alibera, B.Gubskiy, D.Dunning, J.Keynes, V. Kozik, V.Novitsky, O. Rogach, F. Ruhman, I.Fisher. Strategic priorities for investment development in terms of adaptation to the globalization of the economy were highlighted in the works by O. Bilorus, A.Gal'chyns'kiy, V. Geyets, D. Lukyanenko, Y. Saveliev, A. Filippenko.

E. Avdokushyna, J.Bell, A.Hawryluk, J.Galbraith, K.Clark, A.Miller, S. Pisarenko, M. Porter, A. Rumyantsev, V. Tsygankov, M Chumachenko devoted their writing theoretical, methodological and organizational aspects of the formation and functioning of services market.

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Availability of Competitive Sectors

Agrarian sector. Agrarian sector is one of the most prospective sectors in Ukraine, generating more than 20% of country's GDP. Ukraine is in the top five of the largest grain exporters and is №1 sunflower oil exporter.

Complex machine building. Ukraine is a traditional leader in production of machinery, cars, and airplanes, and is also one of the six space equipment manufacturing countries in the world.

Energy. Ukraine produces about 20 billion m³ of the natural gas per year, and has about 1 000 billion m³ of discovered natural gas reserves. Ukraine has a huge potential for producing energy from renewable sources and implementing energy-saving technologies. Ukraine's "green" energy tariffs are more attractive than in many other countries.

IT sector. Ukraine is the 5-th biggest market of the IT outsource services, which is growing at a fastest pace.

Tourism. Ukraine has huge unrealized tourism potential due to the variety of tourist attractions: ski resorts in the Carpathian Mountains, Crimea, Black Sea beaches, medieval cities and castles, ethnic, music and movie festivals and many others, which attract 20 million tourists annually.

In broad terms, investment is the foundation of a modern economy: it brings together the interests and resources of private individuals, legal entities and the state to generate real socio-economic development. Global experience shows that transition economies are not capable of developing their economies properly without attracting and effectively using investment, including foreign investment. By accumulating business, public and mixed capital and providing access to modern technologies and management, investments not only help form national investment markets, but also bring new life to markets for goods and services. In addition, investments generally support efforts at macroeconomic stabilization and make it possible to ease social pressures during the transformation period.

The investment potential of any country - frequently, the term "investment appeal" is used - is characterized by a combination of macroeconomic indicators, such as: economic growth, the ratio between consumption and savings, lending rates, profit rates, inflation levels and dynamics, consumer demand, the presence and proportion of production factors, infrastructure development, and so on.

Ukraine could potentially become one of the leading countries in terms of direct and portfolio foreign investment. This is supported by Ukraine's large domestic market, comparatively skilled yet inexpensive labor, major scientific and technological potential, abundant natural resources, and its available, if underdeveloped, infrastructure.

Certain reform-based transformations and positive practical improvements can be seen in Ukraine's economy currently. These positive results include the growth of GDP in recent years, rising average wages and pensions, a well-provided consumer market, diversified exports, a relatively stable national currency, and steadily growing annual investment.

Indeed, effective investment activity by any and all business entities will foster the growth of the country's economy because, no matter what, it generates material resources for the society and makes it possible for the overall well-being of the population to improve.

Today, the quality of investment policy affects many things: industrial output, the condition and technical level of fixed assets at Ukrainian enterprises, the options for restructuring the economy, and the solutions to social and environmental problems.

Investment is the basis for developing individual businesses, specific sectors and the economy as a whole. The modern economic environment demands an active policy for attracting foreign direct investment. In Ukraine, investment activity is regulated by legislation

that is in the process of being updated and improved, in order to draw greater inflows of FDI and to improve their effectiveness.

Material and methods

For the purpose of this study, the works of domestic and foreign scientists and community organizations on investment management and effectiveness were used as a theoretical and methodological base, as well as Ukrainian investment legislation and regulations. This paper is based on materials used by the State Agency for Investment and Innovation, materials of state statistics and tutorials, as well as materials that reflect the investing and financing activities of the research object.

Results and discussions

The risk of investing in any country is essentially the level of uncertainty in forecasting return on investment (ROI) and it includes political, economic and social components.

It is possible to invest foreign capital in Ukraine by:

- setting up companies with the share-based participation of foreign capital - joint ventures;
- setting up companies that fully belong to foreign investors and their branches;
- purchasing rights to use land and other natural resources, as well as other property rights;
- buying ownership of enterprises, property clusters, buildings, structures, shares in companies, stocks, bonds, and other securities;
- providing loans, credits, property and rights to property, and so on.

The state regulates investment activity in order to support its economic, scientific, technological, and social policies. This regulation is determined by socio-economic indicators, national and regional economic development programs, and the State and local Budgets, which allocate public funding for investment activity.

At the same time, favorable conditions need to be established for investors who put their money into those areas Ukrainian society needs the most. First of all, this is the social sphere, upgrading production, creating new jobs for citizens who need social security, implementing innovation and hi-tech projects, applying discoveries and inventions, developing the agro-industrial complex, implementing programs to eliminate the after-effects of the Chernobyl disaster, manufacturing building materials, and investing in education, culture, environmental protection, and healthcare.

Foreign investors can bring in scientific and technological know-how and cutting-edge management practice. In addition, attracting foreign capital to actual production is much more useful than borrowing to purchase the same goods, which only increases the country's debt burden.

At the moment, the flow of foreign capital is already vitally important to achieve medium-term goals, such finding a way out of the current crisis and reviving economic growth. At the same time, Ukraine's national interests do not always coincide with interests of foreign investors. This makes it important to attract foreign capital in such a way that investors can satisfy their own needs while simultaneously helping the country reach its social goals.

How to stimulate investment to Ukraine

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The Government's immediate objective must be to stimulate investment and to spur significant growth in investment volumes. Increasing investment flows was and continues to be a priority for executive bodies.

To spur investment, including foreign investment, a number of measures need to be taken at the national level:

- reduce the level of state regulation of commercial activity and ensure the stability of relevant legislation;
- eliminate ambiguities in legislation and regulations and finish judicial reform;
- improve regulations regarding the exercise of property rights;
- complete administrative reform, make the policy-making process both public and transparent, and, hence, eliminate red tape and corruption;
- institute effective corporate governance;
- foster the development of capital markets, first of all the banking sector and the stock and insurance markets;
- reduce tax pressure;
- ensure a stable political environment;
- increase efforts to establish a positive image for Ukraine.

The role of the government in stimulating investment

The key policy objective regarding investment is to establish equal conditions for doing business and investing in Ukraine's economy for business entities of various forms of ownership, to ensure that investment happens in a transparent and civilized manner, and to improve the distribution of investment sources. Government policy should concentrate on:

- accelerating economic growth on its own renewable investment base and a suitably market basis;
- instituting open consultations between executive bodies and business, and disseminating information about the real economic situation, domestic and foreign markets, market prices, and regulations;
- significantly reducing the share of the shadow economy;
- establishing equal conditions for the activities of business regardless of their form of ownership or the origin of their capital;
- forming a working competitive environment;
- strengthening the stock market, developing vehicles for joint investment, insurance and pension funds, establishing a market for corporate securities and integrating it into international capital markets;
- providing additional economic incentives to attract investment to priority sectors;
- setting up an effective system for protecting intellectual property;
- establishing conditions for the development of high technologies and the infrastructure for innovation;
- developing and utilizing the country's investment potential;
- establishing cooperation with key non-government and community organizations and institutions that are prepared to participate in formulating and implementing investment and innovation policy in Ukraine.

These elements of the new "investment and innovation system" aim at improving the business and innovation climate in the country and should be instituted by the State Investment and Innovation Agency as soon as possible. They reflect the ideas of domestic and international businesses and community organizations as presented during roundtables, sessions of the World Economic Forum in Kyiv, and numerous investment forums held in

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Ukraine, and propositions that were presented during debates on the working drafts of Green and White Papers on problems with attracting foreign investment to Ukraine.

Key solutions to investment problems

Forming a legal base

One of the most important factors for improving Ukraine's investment climate is to establish a legal environment suitable to a market economy. This requires the state to take two key steps:

- conclude interstate agreements providing incentives, protecting investments and avoiding double taxation, exchange information about regulations and legislation governing investment activity, and establish stable legislation and other conditions;
- expand cooperation with the International Monetary Fund, the World Bank and the EBRD regarding financial assistance to Ukraine and carry out the necessary measures to complete accession to the World Trade Organization.

To gradually adjust national legislation to EU legislation and WTO requirements, regulations and legislation need to be adopted governing:

- further tax reforms;
- a legal base to facilitate a working stock market;
- the protection of individual contributions to life and health insurance programs, and to non-state pensions.

Establishing transparent executive decision-making

The institution of transparent government procedures for making decisions related to investment projects financed by State and local Budgets and those investment projects that have vital significance for the general population must include:

- making decisions to hold public debate on draft regulations regarding developing business activity, setting up community councils and business councils under executive bodies, consulting with businesses, community organizations, academics, and other specialists to evaluate the effectiveness of existing regulations;
- participating in international events to promote Ukraine's investment potential, showcasing priority investment projects through the international media and the internet, holding exhibitions and similar events more frequently.

Improving the privatization investment climate

Privatization policy should aim at:

- replacing the fiscal model of privatization with an investment and innovation model and privatizing large companies and monopolies based on individual plans by selling controlling stakes to industrial investors;
- re-equipping enterprises technically and technologically using part of the proceeds from privatization.

Providing incentives for long-term lending

Improving the investment climate in Ukraine depends considerably on resolving problems with the way the banking system operates: increasing the concentration of banking capital, expanding long-term lending to the real sector of the economy, and attracting personal deposits.

The main factors that restrain long-term commercial lending to businesses are high lending risks, the insolvency of most borrowers, lack of real guarantees that they will repay their loans and liquid collateral, and an ineffective tax system. To stimulate investment activity through long-term lending, the state needs to take steps to:

- institute a mechanism for effectively protecting lenders and a transparent procedure for selling off collateral;

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- ensure that banking capital is concentrated more by increasing capitalization and solvency among banks and instituting procedures for reorganizing and eliminating the unstable ones;

- provide incentives for banks to attract more personal deposits;
- set up a specialized financial institution to provide long- and medium-term financing and loans for priority investment projects;
- institute mortgage lending;
- provide incentives for foreign capital flows to the banking sector.

Developing the stock market

The main objectives in developing the domestic stock market include:

- implementing a tax policy that will foster the stock market;
- establishing conditions for increasing stock market capitalization and liquidity;
- expanding cooperation with the OECD, the International Organization of Securities Commissions and other international organizations in order to institute international disclosure standards;

- simplifying the procedure for settling for securities contracted with non-residents;
- improving the system of accounting, settling and reporting for stock market participants;
- making the activity of joint investment vehicles transparent;
- concentrating trade on organized markets whose operations meet international standards;
- raising the effectiveness of the National Depository System in protecting the rights of holders of securities and in regulating settlements for operations involving securities by setting up a central depository based on the National Depository of Ukraine;
- developing a mechanism for insuring stock market participants.

Renewing territories with special investment regimes

The purpose of introducing a special investment regime in territories with unfavorable socio-economic and environmental conditions is to attract investment into priority industries in order to preserve existing jobs and create new ones, to introduce new technologies, to develop foreign trade, to increase the output of high quality goods and services, and to set up modern industrial, transportation and market infrastructure.

Another important investment policy goal is fostering industrial parks for hi-tech production. To renew investment processes in territories with special investment regimes, the government needs to take two key steps:

- develop and implement strategic and short-term development programs for each zone and territory where a special investment regime will be introduced;
- provide incentives for investing in priority sectors, facilitate the introduction of cutting-edge technologies and the manufacture of products that are competitive on external market by optimizing priority commercial activities.

Attracting investment to science, technology and innovation

To provide incentives for attracting domestic and foreign investors to science, technology and innovation, the government should ensure:

- a system of discounted refinancing for commercial banks, if they provide loans at discounted interest rates to implement investment projects related to developing and installing hi-tech equipment and other innovative products;
- an expansion of the practice of providing commercial loans secured by commercial property at discounted interest rates;
- the establishment of share-based investment funds to implement large-scale investment projects;
- lending to innovation enterprises through leasing, factoring and other operations;

- the necessary infrastructure to develop innovation processes and a full innovation cycle, from concept to manufacturing and selling hi-tech products and technologies;
- the organization of a single center in Ukraine where the efforts of the Government, science and business can be consolidated to develop high technologies.

Conclusions

The investment potential of Ukraine is characterized by high heterogeneity, because the investment policy should be conducted based on the capabilities and needs of each region. Thus, the western region can be effective with the use of local natural resources (sulfur, potassium salt, oil, gas), developing a network of health resort and tourist complexes. The Eastern region needs reconstruction and technical equipment of mines, metallurgical and engineering industries on the basis of waste, low-waste and clean technologies. The South is the most profitable as to the reconstruction and technical reports, development of production equipment for the food and canning industry, expansion of health resort and tourist complexes. The Northern region should use the newest technology and implement measures to their ecological, economic and social regeneration.

The introduction of joint investment vehicles should provide suitable conditions for investing. By improving the system of corporate governance, a transparent system for protecting the rights of all investors will develop.

Investment resources should grow with the effective use of public investment and increased long-term lending volumes for the real economy, at the same time as the possibilities of foreign investment are used in more traditional ways.

Government support for high technologies and the development of an innovation infrastructure in the country should help attract investment into innovations and bring the Treasury revenues from the use of this know-how.

By implementing the strategy for long-term economic development, Ukraine should see State Budget and local budgets investments on industrial and social projects grow, while the specific volumes are determined at the appropriate level of government.

Foreign investors are awaiting for the possibility to start exploring Ukraine's rich resources, and creating a favourable climate for that would give a rise to Ukraine's future prosperity.

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