European approaches for investment regulation in Ukraine

Oleksandr Layko

1. Institute of market problems and economical & ecological researches of NAS of Ukraine, UKRAINE, Odessa, Franuczkiy boulevard 29, E-mail: alexlayko@gmail.com

Abstract – the prospects of implementation of European approaches to the regulation of the investment process in Ukraine are considered. According to the modern tendencies of preferential transfer of capital investment process to the revenue-generating and self-recouping activities the main emphasis is made on supporting of reproductive processes in strategically significant commodity markets. The European approaches to decentralization of the investment process and the granting of state guarantees to investors are considered as the main factors for funding activation and support of financial capital reproduction that is to be provided by government as a cause of readiness to the European integration. Implementation of regional management approaches in the investment environment is offered by the help of governmental leverages of tax and regulatory policies.

Key words – European approaches for investments management, management of regional investments, local governance of investment activities, stimulation of capital reproduction in significant commodity markets.

I. Introduction

On the eve of national European Initiatives realization the question of adaptability of national economic processes and structures to those precepts and principles that formed in Western Europe rises as challenge. The investment aspect of this issue is one of the most important, since modern features of investments are such that they are inextricably linked with processes of the value added development, and with return on reinvestment. At the same time, the investment process itself - is one of the main economic levers that objectively change the structure of economic complex, and therefore the investment trends need to be managed by creating of incentives for creating of strategically effective national economic system.

II. Results

For many years, Ukraine formed centralized, industry - oriented system of economic regulation with simultaneous control of individual markets concerning questions of quantitative development and investments in these markets. There is also a selection of some specialized control structures which’s aim is to manage the investment process by means of activities focused mostly on improving of the business climate. But in our multifaceted country the regional and structural distinguishes are to be taken into account otherwise the neglecting of some features leads to huge disparities in economic development in many areas. Now we have several times divergents in progress terms of attracted investments in developed regions (24% in Kiev , 11% in the Donetsk region , about 7% in Dnipropetrovsk , Odesa and Kharkiv regions) and the weak development of peripheral regions (0.9% in Kherson, Chernihiv, Chernivetska areas) [1]. In case of centrally-departmental regulation approach it is almost impossible to overcome the disparity of economic development and achieve balance in many indicators. The investing is considered as main tool for high-quality updates in country’s economic growth, but the existence of investors is not so important as the ability to arrive the business’ needs to fulfill the contributions necessary for efficient development not to err, but to prove effectiveness of our management.

The main drawbacks of a national investment process consider irrational governance structure and lack of effective institutional support. Moreover, institutional barriers, unfortunately, is a major deterrent to the arrival of external and to the activation of internal strategic investors. Issues of collaboration with foreign investors include, above all, the solution of the problems that most concern institutional investors. So, with the support of the "Local Investment and National Competitiveness" (LINC) U.S. Agency for International Development (USAID) Ukraine State Agency conducted a survey of investors operating in Ukraine [2 p.14]. The survey involved 130 companies doing business in 16 regions of Ukraine. The survey proposed to companies to identify the main issues arising from them during their activities in Ukraine. According to the study of the responses to the questions the ranking of the most common problems of foreign investors in Ukraine was prepared (table I).

<table>
<thead>
<tr>
<th>The essence of the problem</th>
<th>Significance, %</th>
</tr>
</thead>
<tbody>
<tr>
<td>Relations with tax authorities</td>
<td>22,8</td>
</tr>
<tr>
<td>The issue of inspections and inadequate regulatory framework</td>
<td>14,5</td>
</tr>
<tr>
<td>Problems in land issues</td>
<td>11,8%</td>
</tr>
<tr>
<td>Relations with customs authorities</td>
<td>11,03%</td>
</tr>
<tr>
<td>The procedure for licensing and approval procedures</td>
<td>10,27%</td>
</tr>
<tr>
<td>Other problems, including raiding</td>
<td>5,7%</td>
</tr>
</tbody>
</table>

As we can see, almost all the main issues arising from foreign investors related to the institutional environment of the national investment system. Conditions of institutional environment that ensures the functioning of the investment process is characterized by a number of conflicts that arise between active regulations and the real needs of investors. Such contradictions can be called classic because they occur between productive forces and production relations and indicate the need to improve the regulatory environment. In particular, the investment process in Ukraine is actually passed on sustainability principles and should support reproductive cycles on strategic commodity markets, because more than 60 % of the total capital investments are made in Ukraine by the internal economic agents and nearly 95% of the total investment resources are involved from internal finances. At the same time, the main focus of regulatory policy is aimed on mobilization and attraction of new investment resources from external sources.
Economic growth and the creation of new value added occur the most in real economic sector, but actually in Ukraine and other CIS countries the main forces were directed on creation of foundations for the development of infrastructure sector, financial markets and stock exchanges based on the integration to the global financial and investment community. Increasing investments in domestic strategically important production require permanent indirect incentives, as it is done in the developed countries of Europe and the world, but in Ukraine the approved documents and institutional organizations provide point-oriented subsidiary policy that deals with certain categories of enterprises. Development of strategic economic activities possible in terms of priority-set regulations for prospective activities, but in Ukraine during the tax reform the burden of main taxes (such as income tax and value added tax) was reduced for all large and middle enterprises without support and contributions of their strategic development. Total tax allowance doesn’t give the necessary effect of economic growth because the institutional field is not ready and not clear enough for strategic development. Total tax allowance doesn’t give the necessary effect of economic growth because the institutional field is not ready and not clear enough for significant economic activities development. Investment requirements and innovation development obligations are to support all the allowances. This is the only way, in our opinion, of progressive economic development in conditions of external financial capital lack.

The current trend of the dominant of domestic investments is characteristic not only for Ukraine but also for many countries of the CIS. The trend takes place throughout the history of our country's independence [1,3]. Current patterns of global investment process also change last time, with the reason of global crisis, and due to the attempt of the most of Asian countries to develop the owners’ investments process on the basis of rapid return on equity. In our opinion, and according to some leading economists [4,5,6], for national economic system the most efficient and productive investment pattern is to focus on supporting on the implementation of practice of reinvestment activation in the system of commodity markets. Such statements are logical, based on the task of constructing of self-sustainable system of production in Ukraine, matching to the main objectives of the program of economic reforms for 2010-2014 years [5], and, based on world trends regarding the resourcing of investment process (Table II).

### TABLE II

| RESOURCE STRUCTURE OF INVESTMENTS IN THE GLOBAL ECONOMY, % [2] |
|-----------------|-----------------|-----------------|-----------------|
| **Years**      | **Initial investments** | **Reinvestments** | **Other sources** |
| Average 2005-2007 | 65              | 20              | 15              |
| 2007            | 69              | 15              |                 |
| 2008            | 76              | 7               | 16              |
| 2009            | 72              | 14              | 17              |
| 2010            | 58              | 19              | 14              |
| 2011            | 39              | 46              | 23              |

The attraction of foreign investments is important for Ukraine, but strategic investors from abroad are not eager to invest resources in an environment where even domestic investors cannot efficiently expand operation activities and invest capitals in the areas and types of activities, where the return on costs made would be extremely high. However, the establishing of an appropriate institutional environment not only promotes the national capital in meaningful economic activities renewal but also attracts foreign stockholders to domestic enterprises.

It should be noted that the extremely low presence of foreign capital in the economy of Ukraine can be considered as disadvantage, on the one hand, (Table III), but on the other hand, the largest foreign investors in recent years were from the EU countries. Although capital that fell through the European offshore, probably had national origin and nature of such investments had only the matter of momentary decision-making of investors concerning the movement of funds for their storage and for possible return.

### TABLE III

| FOREIGN DIRECT INVESTMENTS IN UKRAINE [8] |
|-----------------|-----------------|-----------------|-----------------|
| **Years**      | **FDI** | **2006** | **2007** | **2009** | **2011** | **2012** |
| **Cumulative, $mln** | 5604 | 9891 | 4816 | 7207 | 7833 |
| **Change, $mln** | -2204 | 4287 | -6097 | 712 | 626 |
| **Change, %** | -28% | +77% | -56% | +11% | +8.7% |
| **Cumulative, $mln** | -133 | 673 | 162 | 192 | 1206 |
| **Change, $mln** | 408 | 806 | -848 | -544 | 1014 |
| **Change, %** | -148% | +606% | -84% | -74% | +528% |
| **Cumulative, $mln** | 5737 | 9218 | 4654 | 7015 | 6627 |
| **Change, $mln** | -1796 | 3481 | -5249 | 1256 | 388 |
| **Change, %** | -24% | +61% | -53% | +22% | -5.5% |

For comparison, in Ukraine the annual capital investments are about 260-300 bln.hrivnas, of which the share of foreign investors have no more than 2,5-7 bln.hrivnas, that ranges from 1 to 3% of the total investment [1].

Most useful for Ukraine, in our opinion, is the experience of Europe of the establishing of institutional basis for regulation of investment through the reproductive processes, with the support of regional initiatives. Promotion of investment opportunities in the European territories is important but not the most important factor in the investment process. The main role in European sphere of capital return-on via the markets of goods and services is allotted to the support with help of establishment of effective regulatory rules due to which capital will be directed in significant and complex efficient types of business activities. The government completely able to create favorable conditions for return-
on invested capital in strategically important markets and thereby to reconstruct the economic system of the country. Major advances in enhancing investment of EU countries, in our thought, are achieved due to increased openness of the economy to national and foreign investors by the help of guarantees and state support as well as through regionalization and specification of regulatory instruments established by the government for stakeholders.

The current reform activities of Ukraine in the sphere of investments has predominant influence on the resulting indicators, but do not improve the internal environment in the markets – which are the core of added value creates, which is the source of play invested capital. Such ion. Ukrainian government’s actions meet critics, but on the other hand, the today’s policy improves national performance in international investment ratings. Thus, in the ranking of Doing Business [2] Ukraine has improved its position by 15 units and has moved from 152nd to 137th place, thus we entered to the top three countries that have demonstrated a significant improvement in business conditions over the last year.

The greatest improvement of Ukraine’s position in the ranking of Doing Business (66 positions) held under “starting a business” nomination. In this chapter of ranking Ukraine moved from 116th position to 50th position. But actually it’s still hard in our country to run business, in view of circumstances with controlling state authorities, and it’s hard to stop or interrupt business.

According to the report of the World Economic Forum's global competitiveness in 2012 - 2013 years, among 144 countries, it’s the second year when Ukraine improves its position in the Global Competitiveness Index. Thus, according to this index Ukraine has risen to 9 positions, thereby moved from 82 th to 73rd place.

Leading positions in the ranking of global competitiveness occupy Switzerland, Singapore and Finland, which are the top three. Russia and Kazakhstan are ahead of Ukraine, taking under 67 and 51st place in the overall ranking of global competitiveness.

Improving of Ukraine's position in the ranking was due to the country's strong position on individual index components, such as highly educated population, a large market capacity, which is a good basis for further growth.

The European Union authorities constantly monitor the global and domestic trends and make the main focus of the investment policy committed to a greater extent in the sphere of commodity markets, i.e. the real sector of the economy. The stimulation and support of European producers position on domestic and foreign markets is a main part of the extended investment policy and a part of common European policy that includes special methods for new capital incurring and for renewal of financial resources in business cycles.

The total investment strategy is outlined by The European Commission in its Communication "Towards a comprehensive European international investment policy" [9] in 2010 but also, according to the financial crisis consequences, the main features of investment process regulation were reviewed and supplemented. These prospects are described in the Europe 2020 Strategy and include modern contributions to the objectives of smart, sustainable and inclusive growth [9].

The EU’s investment policy is focused on not only on the business climate improving and on the presentation of European territory and the possibilities for new investors but it’s rather accent on providing for internal investors the better market access with legal certainty and a stable, predictable, fair and properly regulated environment in which must be easier to maintain entrepreneurship and to gain the better returns-on-capital.

The two aspects distinguished from the total EU’s investment policy:
- The improvement of market access;
- Supporting legal certainty and transparency.

The Ukrainian trade policy features must also meet modern EU’s trends and requirements in this sphere. But it’s so not because of governmental incentives directed to the integration, but because of national interests, which are to be better realized in order of domestic markets trade protection.

The EU’s way of the task realization of better market access includes mechanisms of negotiations for gaining agreements of more clear investment rules and of effective external merchandise decisions. In these context new preferential trade agreements for EU’s economic agents in negotiations with third countries will also include investment positions. The investment protection on new markets is planed and as different special action, and as part of total trading policy on the markets of third countries. It’s clearly understood that the capital renewal is possible by the means reproduction processes on commodity markets and therefore the efficient position for European enterprises is to be supported. The special actuality of such means is obvious in conditions of modern global financial crisis.

Now the European Commission negotiates on including the investment protection, as part of the Free Trade Agreement talks with Canada, India, Singapore and Japan. Also such agreements are to be gained in negotiations with key partners such as United States, and Russia.

According to the key points of European policy on investments in Ukraine should also be formed strategic objectives and directions of regulation for investment process. It is necessary for the speedy and efficient accession to the European community in economic terms and for the viability of the national investment in the light of globalization challenges. Therefore, the investment regulation should not be only point-aimed and subsidiary it must be permanent and involve leverages of indirect regulation.

The main directions of the transformation of the national investment system in the light of European integration, according to author’s opinion, should include:
- Decentralization and regionalization of administrative mechanisms, empowerment and development of higher responsibility in the regions;
- Separation and support of specialization benefits of effective collaboration;
It is important to realize the principles of the tax authorities in meaningful economic activities. It’s established by the national legislation that the priority in Ukraine for investments is considered in agricultural sector, machines-building, transport, housing and communal services [6].

Support measures to attract investments may be appropriate for all these economic activities, but it’s worth to focus on agricultural production because in this area, in our opinion, the specific possibilities for decentralized of investment management already exist and certain efforts in this area have already taken place. In Ukraine in the sphere of agricultural production in some cases the agricultural fixed tax is to be used, and being based on this ground the administrative mechanism which could allow the implementation of the fiscal competing areas principle may be realized.

The course of agricultural production support is already taken by the government and is aimed on enhancing of investments with help of the draft Law “About the stimulation of investments in rural areas” [7], which, however, provides a subsidy mechanisms to support investment in agricultural activities.

This bill provides measures of discrete subsidized support for some farmers that are not effective and should be spending that are structurally unable to improve agricultural production, especially in the absence of a clear mechanism for providing government subsidies specifying the mutual obligations of recipients. Powerful regulators of capital renewal in this aspect are taxes, but the official version of the bill is expected to leave the standard list of benefits for farmers contained in the Tax and Customs Codes. Therefore, we offer the use of a differentiated scale of fixed agricultural tax and the giving of powers for specific biddings establishment for the local authorities. Also need to be considered measures of improvement of tax support for the agricultural sector, with help of such measures:

- The possibility of fixed agricultural tax use from the registration moment by new enterprise, but not after the results of 4 quarters work, as it’s required in present Tax Code;
- The establishment of investment commitments with preferential tax regime, namely the possibility of fixed agricultural tax, the registration must be accompanied by compensation method all state tax benefits in the event of default investment conditions.

Complete implementation of tax competition and investment attraction paradigms on the regional level is possible with help of administrative consolidation of supervisory powers, and we are aware that the preferences of the single tax and the fixed agricultural tax are not as significant as the major taxes on enterprises, such as income tax and value added tax. However, the first steps should be taken exactly in the regulation of investment in agricultural sector, as one of the largest parts in Ukrainian economic complex. Outside the major metropolitan areas the agriculture is the dominant type of economic development and the production process modernization on the basis of innovations should also lead to better infrastructure development in national countryside areas.
The most important is to provide the support of reproductive processes in the strategic markets of goods and services through guarantees from the state in order to regulate constant rate of entrepreneurial activity. One of the main tools of this policy, we believe, is the introduction of personal liability of officers and the establishment of regional funds and the giving of other guarantees and financial assistance.

The implementation of personal and official responsibility of the local (regional) authorities is necessary in order to regulate the process of implementation of investment projects. Personal responsibility for procedural conditions invariance concerning the support of investment projects in the region should be extended to those persons (officials of regional administrations) who charge the projects since the signing of the agreement between the implementing agency and the regional state administration. Such responsibility of the officer has to be valid during the whole term of his staying as authority or during the term of project realization. After a possible change in the leadership of the regional state administration the conditions of the project regulation and support are to stay unchangeable until the project would be completely implemented. This procedure, in our opinion, should increase the stability for investors.

Terms of Ukraine’s accession to the European Community provides for the Ukrainian side a financial assistance in sum of about 186 million euros after the agreement on association signing and about 800 million euros - from World Monetary Fund. Also in Ukraine annually heavily funds of subsidy programs that do not bring the desired long-term effect are spent. We consider that it would be approprable to direct these funds to the formation of a special fund of the state (regional) investment projects support. The general mechanism of action of this support is to provide temporary financial assistance to present guarantees for loans in exchange for rights to corporate management, formed as a result of such projects.

In modern conditions of budgets and other financial recourses deficit it’s especially important to spend money highly efficiently and to prevent abuse. Subsidiary approach of financial state assistance for business is reliable instrument in some special cases but not generally at all. The subsidiaries are usually spent without possible return on such investments. But government should effectively disburse the budget amounts, and that is why the proposed instrument of state guarantees exchange for further corporative rights of entity where the investment project is realized is needed. The corporative rights give possibilities to the regional authorities of local development budget forming with help of such amounts. The budget of development could be spent for different regional improvements: from infrastructure elements renewal to social incentives realization and support of economically-, socially-, or ecologically- important local projects.

Above all it’s necessary to measure the effectiveness of proposals given for the regional investments activation. Also it’s necessary to research investments from the perspective of commodity markets development. That is why there is a need of scientific justification for regional segments of commodity markets research and regulation.

We talk about regional segments of markets of goods and services because the regional markets hardly exist themselves. And as a rule markets have more wide borders than regional level they are rather global institutes than regional. But almost every market has its own points of concentration, where changes and activities are the most significant.

There are different researches of regional investments and of the regional aspects of commodity markets development. Official statistics also gives us the information necessary for decision-making concerning regional economic, social and other aspects. But managers and scientists need to know the degree of effectiveness of proposals made for regional segments of commodity markets in format of the reproductive processes state. Our proposal consists of method return-on capital efficiency evaluation in regional segments of commodity markets.

First of all we should explain the possibility and relevance of market’s regional segments research. Such explanation is possible due to the method of the degree of closeness calculation. The coefficient of the regional market openness is proposed and used in Ukraine by the Antimonopoly committee [12].

According to the method of the Antimonopoly Committee of Ukraine [9] it’s proposed to determine the territorial boundaries of the market in terms of the degree of market opening (DMO):

$$ DMO = \frac{Import\ in\ the\ regional\ market}{Sales\ in\ the\ regional\ market} \times 100\% \ (1) $$

It is assumed that the scope of the market is identified correctly if the indicator does not exceed 30%. Also it’s assumed that the exceeded measure of this index value of 30% is also approprable in case of the certain methodological refinements presence.

For the purpose of evaluation of limits of certain goods market in the region we offer a slightly different approach. In view of the presence in the regional market as goods produced in the region, and goods imported from other regions and from abroad, offering access to a reverse index - the degree of closeness of the market (DMC) and define it as follows:

$$ DMC_{i-good} = \frac{PR_{i-good} - Ex_{i-good}}{Sales_{i-good}} \times 100\% \ (2) $$

where: $PR_{i-good}$ - Produced in region of i-good; $Ex_{i-good}$ - Exported from region of i-good

Normative values of goods (services) market closeness we propose to leave on the level as specified in guidelines of the Antimonopoly Committee of Ukraine "On Approval of Methods of monopoly (dominant) position of undertakings on the market" [13], i.e. at 70%.

According to calculations provided in our researches [13] we consider the theoretical possibility of regional sectors of commodity markets study. The most of national markets in our country’s regions are close enough for
such research. It once more proves the importance of reproduction processes importance for investment process.

The main criteria for evaluating the effectiveness of capital reproduction, from an economic point of view, we consider the multiplicativity and intensity. Social, environmental, budgetary, financial and other types of efficiency are important but deserve a separate study.

According to the pricing structure, the contain of created added value offers to measure a number of factors that characterize the intensity of invested capital renewal in the development of markets for goods, works and services. This approach we feel justified in view of the fact that over 60 % of capital investment in Ukraine and each region are made due to expenses of own funds of enterprises, and this is, in fact, the reinvestment of capital, multiplied in the economic process.

The general rule for constructing a system of coefficients and of calculation of their values considers the presence of correlation:

- Element of added value to the amount of capital investment if we want to determine the intensity of the renewal of added value element;
- The amount of capital investment to value added element if the element is determined by the coefficient of updating multiplication of value added.

The proposed method is to be tested in order of real figures use. But this is the challenge of another research issue.

Conclusion

The European leverages for investment process management take into account modern tendencies of global and internal markets change. The crisis consequences made economic agents to act more thrifty and more prudent. The main source for investments in business development made is represented mainly by the income reinvestments. Such tendencies are to be taken into account by Ukrainian authorities on the eve of European Union association. The national investment into account by Ukrainian authorities on the eve of income reinvestments. Such tendencies are to be taken into account by Ukrainian authorities on the eve of income reinvestments.

The proposed method is to be tested in order of real figures use. But this is the challenge of another research issue.

References


“ECONOMICS & MANAGEMENT 2013” (EM-2013), 21–23 NOVEMBER 2013, LVIV, UKRAINE 33