Investment climate in Ukraine: aspects of investment activity at a regional level

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Abstract. The main objective of this study is to examine trends and prospects of investment activity in Ukraine. This paper investigates the term “investment” and considers the role and importance of investment in social and economic development of the state. Based on the data provided by the State Statistics Service of Ukraine, the current state of foreign investment promotion to Ukraine has been analyzed. The growth rate of the investment climate in Ukraine has been distinguished. It has been defined that it is impossible to reach sustainable economic growth and overcome the consequences of the financial crisis without the injection of investment into both individual sectors of the national economy and the economy of entire regions. The article examines the dynamics of investment attraction into the regions’ economy and defines sources of such investment. As a result of the research, investment activity of regions has been outlined. Investment efficiency of regions has been assessed. Based on the findings, suggestions to improve the investment climate in Ukraine and increase regions activity have been offered. Model for investment attractiveness assessment, which takes into account availability and sufficiency of own financial resources, that define the level of region’s financial health, has been suggested.

1 Introduction

Modern mechanisms for the development of economic systems influenced by the market transformations dictate the need for reforming of existing approaches to the provision of financial resources of the state. Unstable economic and political situation in Ukraine, exacerbated by the negative consequences of the global financial crisis, necessitates closer attention of the country’s leadership to the processes of economic growth stabilization. Since Ukraine has chosen the way of European integration, an urgent need has arisen for the adapting of innovative development model that would ensure the economic growth of the country, increase its potential and economic security, and allow resolving existing problems of social protection of the population.

Ukrainian and foreign scientists and practitioners, as well as the pace of European countries development, prove that investment, as a component of the innovative model of

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economic development, makes it possible to improve and ensure sustainable economic growth. Accordingly, investment is a significant factor of development, both at the state and regional levels.

Under the conditions of today, the process of effective management system development, investment activities regulation, as well as the activation of an investment mechanism aimed at developing strategic and priority sectors of the economy are of key importance.

At this stage, investment activity in Ukraine, despite some positive trends, faces certain problems. Thus, the investment activity of Ukrainian and foreign investors is significantly constrained due to the unfavorable investment climate, imperfection of the legal framework; inadequate generation of investment projects and programs; as well as weak development of investment instruments and investment market.

It is also worth noting that there exist certain regional imbalances in the concentration of investment resources and the outflow of foreign direct investment.

Taking into account all these factors, we understand that nowadays there is a huge demand to improve existing mechanisms for attracting investments, and support them at the state level.

Various aspects of the state investment policy implementation are constantly in the focus of attention of scientists and practitioners of different countries. Adequate investment mechanism predetermines both the inflow of capital into the country and the pace of economic development. In order to determine the place and role of investments in the economy of Ukraine and its regions, we consider it essential to investigate the definition of the term “investment”.

A detailed study of investment and its impact on the pace of economic development of the country was elaborated in the middle of the twentieth century. Representatives of neo-classical and neo-Keynesian schools argued that the rate of economic growth is directly influenced by the processes of capital accumulation. R. Harrod proved that investment generates savings [1]. The same hypothesis was held by R. Lucas and R. Solow [2, 3]. According to the researchers, investment increases due to a favorable taxation regime or market volume growth, resulting in increased aggregate demand, employment and output levels [4]. Despite the similar approaches to determining the role of investment in the economy, the very idea of investment is approached and defined differently in different spheres of the economy.

Economic theory defines investments as expenditures on acquisition, maintenance, expansion, renovation and upgrading of fixed capital. From the point of view of financial science, investments are all types of assets that are invested in economic activity with the goal of generating profit [5]. The macroeconomic approach considers investments to be a component of the gross domestic product (GDP), which provides capital gains and is not consumed at the present time. Microeconomics defines investment as a process of creating new capital [6].

The term “investment” is very broad and comes from Latin investio “to clothe in, dress, cover” or investire “endow”, which means “committing money, values, means [7, p. 320] or long-term investment of capital into an enterprise, or a business” [8, p. 260].

Having carried out the research, we believe it is worthwhile to note that both Ukrainian and foreign scientists hold the view that investment is a process of committing capital with the expectation of its further increasing.

Practical implementation of investments is provided by investment activities, which is a combination of income generating activities of citizens, legal entities and the state that aim at embodiment of their economic interests [9, p. 22].

Investment activity, in its essence, consists of searching for investment resources, selection of the most productive investment objects, development of investment programme, analysis of the investment project, building of investment portfolio, and realization of investments. Accordingly, investment activities influence economic growth rate of both the country on the whole and its regions, although it requires significant state regulation.

2 Findings

Over the past 20 years, Ukraine has created favorable conditions for investment activities promotion. Thus, a certain legal framework [4, 10-12], which defines the main mechanisms for investment policy implementation in the country, has been established. But, despite the positive trends at the level of government regulation, the state of investment activities remains at extremely low level, which is significantly aggravated by a permanent reduction of investment resources [5]. Among the main reasons for the decline in investors' activity are limited domestic savings and the failure to recover capital investments.

The level of direct investment is considered to be an indicator of investment activity of any state. According to the State Statistics Service of Ukraine in 2017 the country's economy received 1.6 billion US dollars of direct investments from 76 countries. This indicator seems to be the lowest over the past seven years. Thus, in 2011 the level of investment was $ 6.0 billion. The received funds were directed mainly to the already developed sectors of economy, namely, to institutions and organizations that carry out financial and insurance activities – 26.1%, as well as to industrial enterprises – 27.3% [13]. Ukraine's major investors included Cyprus – 25.6%, the Netherlands – 16.1% and Russia – 11.7%, Great Britain – 5.5%, Germany – 4.6%, Virgin Islands (Brit.) – 4.1 %, and Switzerland – 3.9%.

Among the positive trends in 2017 the growth of the share of capital investments from public funds, especially from local budgets (Table 1) was observed. Thus, there are changes in the structure of capital investments in terms of financing sources in favor of increasing of the share of enterprises' own funds (up to 69.9% of the total volume of capital investments compared to 69% in 2016) and budgetary funds (up to 12 7% compared to 10,1% in 2016).

Table 1. Investments in the economy of Ukraine by sources of finance.

Source	2014	2015	2016	2017
Total, billion, UAH, including:	219,4	273,1	359,2	412,8
State budget funds	2,7	6,9	9,3	14,3
Local budgets funds	5,9	14,3	26,8	38,2
Enterprises' own funds	154,6	184,4	248,8	288,6
Bank credits and other loans	21,7	20,7	27,1	21,8
Foreign investors funds	5,6	8,2	9,8	5,7
Funds of population for housing construction	22,1	32,0	29,9	32,3
Other sources of financing	6,7	6,7	7,5	11,9

* Source: Composed by the author based on the data of State Statistics Service of Ukraine [13].

Along with direct investments, capital investments are of utmost importance for the economy of the country. The volume of capital investments increased by 22.1% in 2017 compared to 2016. Among industries that still have high investment potential are: manufacturing industry – 33.1%, construction – 12.3%, agriculture, forestry and fisheries – 14.0%.

In order to create simplified favorable conditions for foreign investors in Ukraine and prevent corruption in Ukraine, the law No. 1390-VIII "On amendments to certain legislative acts of Ukraine concerning the abolition of mandatory state registration of foreign investments"(May 31, 2016) and the Law of Ukraine "On amendments to certain

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legislative acts of Ukraine concerning elimination of barriers to attraction of foreign investment"(May 23, 2017) were adopted and came in force, that made it possible to settle the basic aspects of the implementation of investment policy.

Nevertheless, no less important is the issue of how to increase investment opportunities and potential of regions of Ukraine. Analysis of the current practices of investments promotion for regions development shows that it is impossible to solve high-priority tasks of local authorities by means of market self-regulation.

Deepening of regional disparities requires authorities close attention to the issue of providing regions with investment resources, as well as studying the factors that shape the investment climate and increase the investment activity of the regions.

It should be noted that at this stage there is no single approach to the definition of the term "investment activity" in present studies. Some authors compare it with the concept of "investment potential" and "investment resources".

Summarizing we can state that the investment activity of regions is the interaction of internal and external factors of the region's development, where internal factors are investment opportunities while the external factors are investment processes and investment climate.

The social and economic state of the regions of Ukraine is characterized by crisis phenomena, the emergence and development of which is caused by not only external challenges and unfavorable macroeconomic trends, but to a large extent by the negative consequences of industrial enterprises restructuring and political crisis. The increase in the volume of domestic and foreign investment is an important prerequisite for the gradual recovery of economic growth which can be reached by creating favorable investment environment in Ukraine that will provide the appropriate regulatory and legal guarantees to foreign and domestic investors.

Taking into account the insufficiency of budgetary funds at region level especially the issue of attracting investment funds remains quite urgent as well as assessment of investment attractiveness of the regions. It is the investment attractiveness of the region that makes it possible to attract resources and provide financing for the programs of social and economic development of the region.

Nowadays there exist a significant number of approaches and methods both descriptive and rating ones which make it possible to figure out the region's level of attractiveness for investors. It is worthwhile to note that investment attractiveness is a kind of integral indicator that allows evaluating the effectiveness of invested funds on the basis of the financial and property state of the region. Also, investment potential reflects the development prospects of the region on the basis of fixed investments [14].

In turn, the assessments of the investment attractiveness of the regions, using international methods developed by such institutions as Institutional Investor [15], Euromoney [16], Business Environment Risk Index (BERI), Transparency International, and Moody's Investor Service [17] are carried out at the macro level, although they can also be applied at the meso-level. Their main tool is surveying market participants as to the barriers to and conditions of economic activities in the given region. Such assessments use the following indicators: political and legal environment; economic environment; resources and infrastructure, socio-cultural environment and ecology [15-18].

The rating assessment of the attractiveness of the regions is taken into account when making decisions regarding investing (Table 2) [19].

In turn, such scientists as I. Zablodskaya and O. Shapovalova [20, p. 69-71] suggest matrix method to assess the investment attractiveness of the region. Based on such two criteria as industrial activities and regional industry specialisation, a matrix of sectoral specialisation of regions can be built.

Table 2. International rating assessments of regions.

<table>
<tr><th>Institution</th><th>Rating title</th><th>Scope</th><th>Number of indicators</th></tr>
<tr><td>The Mori Memorial Foundation</td><td>Global Power City Index</td><td>Global</td><td>69</td></tr>
<tr><td>MasterCard</td><td>Worldwide Centers of Commerce Index</td><td>Commerce</td><td>74</td></tr>
<tr><td>City of London</td><td>Global Financial Centers Index 7</td><td>Finances</td><td>64</td></tr>
<tr><td>PricewaterhouseCoopers</td><td>Business-readiness Indicators for the 21st Century</td><td>Business</td><td>51</td></tr>
<tr><td>Economist Intelligence Unit</td><td>Livability Ranking</td><td>Livability</td><td>30</td></tr>
<tr><td>Mercer LLC</td><td>Quality of Life Survey</td><td>Quality of Life</td><td>39</td></tr>
<tr><td>UBS</td><td>Price and Income Survey</td><td>Quality of Life</td><td>122
goods and services</td></tr>
<tr><td>Chinese Academy of Social Sciences</td><td>Global Urban Competitiveness Report</td><td>Business</td><td>9</td></tr>
<tr><td>The Financial Times «FDI Magazine»</td><td>FDI Cities & Regions of the Future</td><td>Investment</td><td>96</td></tr>
<tr><td>Forbes</td><td>–</td><td>Investment</td><td>17</td></tr>
<tr><td>Institutional Investor</td><td rowspan="5">–</td><td rowspan="5">investment attractiveness</td><td>creditworthiness</td></tr>
<tr><td>Euromoney</td><td>market (40%), credit (20%), political and economic (40%) indicators</td></tr>
<tr><td>Business Environment Risk Index (BERI)</td><td>9</td></tr>
<tr><td>Moody’s Investor Service</td><td>16</td></tr>
<tr><td>World Bank</td><td>7 groups of indicators</td></tr>
</table>

To assess the investment attractiveness of the regions, it is advisable to determine the indicators by which selected partial indices can be calculated based on selected groups. Among such indicators we should highlight the following: indicators for assessing the economic development of the region (volume of products sold (industry and agriculture), UAH, per capita; volume of services sold in the region, UAH, per capita; retail turnover, UAH, per capita; number of small business enterprises per 10,000 people in the region, units; depreciation of fixed assets, %); indicators for assessing the external economic openness of the region (exports (imports) of goods and services in the region, USD, per capita; export-import coverage ratio %; ratio of total exports to Gross Regional Product, %; ratio of import volumes to private consumption expenditures of the population of the region, %); indicators for assessing the innovative and investment activities of the region (the share of innovative products sold in the total volume of industrial products sold,%; the share of innovative enterprises in the total number of industrial enterprises, %; foreign direct investment in the region’s economy, USD, per capita; investment in fixed assets, UAH, per capita; investment in fixed assets and housing construction, UAH, per capita; cost of introduced fixed assets, UAH, per capita), indicators for assessing level of the region’s infrastructure development [14, 21]. In turn, the Rating Agency “Euro-Rating” calculates the aggregate rating of the attractiveness of regions on the basis of both investment activity (capital investment, foreign investment and construction) and the socio-economic effect of investment (salaries, housing, employment and services provided). Using methodology elaborated by the agency [22], as well as data gained from the State Statistics Service of Ukraine, we can estimate the degree of attractiveness of the investment opportunities of the regions (Table 3). It should be noted that the main component of the methodology is rating assessment according to the 200-point rating scale [22], where:

– Maximum (over 200 points) (ineA) shows that the investment policy is effective. High investment activity provides advance increment rate of the basic indicators of the social and economic sphere [22];

– High (from 181 to 200 points) (ineB) shows that the investment policy is effective. The region is characterized by significant investor activity, which provides the growth of most of basic indicators in the social and economic sphere;

– Above average (from 161 to 180 points) (ineC) – the investment policy is somewhat above the average level. Investment activity is not high enough, but it allows to ensure the growth of a number of socio-economic indicators;

– Average (from 141 to 160 points) (ineD) shows that the investment policy is neutral. The activity of investors, as a rule, is moderate. Most indicators of the socio-economic development are at an average level;

– Below the average (from 121 to 140 points) (ineE) shows that investment policy requires improvements. The pace and volume of investment is generally lower than the national average. Most of the indicators of socio-economic development are lower than the average;

– Low (from 101 to 120 points) (ineF) shows inefficient investment policy. Investors are reluctant to direct funds to the city or region economy. Most of the indicators of socio-economic development are lower than the average;

– Minimum (less than 101 points) (ineG) shows that the investment policy is absolutely inefficient. Investors are reluctant to direct funds to the city or region economy. Almost all indicators of the socio-economic development are below the national average.

Table 3. Ratings of investment efficiency of the regions of Ukraine during 2015-2017 (annual average).

Region	2017 г.		2016 г.		2015 г.	
	Rating	Points	Rating	Points	Rating	Points
Cherkasy	ineD	141	ineB	185	ineE	144
Chernigiv	ineD	150	ineB	184	ineF	111
Chernivtsy	ineF	117	ineG	95	ineD	141
Dnipropetrovsk	ineA	201	ineB	200	ineC	176
Ivano-Frankivsk	ineD	157	ineC	177	ineB	194
Kharkiv	ineA	204	ineA	202	ineB	196
Kherson	ineC	175	ineF	107	ineC	170
Khmelnytsk	ineE	131	ineC	172	ineD	152
Kirovograd	ineD	145	ineC	166	ineE	128
Kyiv	ineB	193	ineA	216	ineA	207
Lviv	ineC	178	ineA	210	ineA	222
Mykolaiv	ineE	126	ineC	166	ineB	185
Odesa	ineB	187	ineA	210	ineC	176
Poltava	ineA	225	ineB	182	ineC	170
Rivno	ineD	147	ineG	94	ineD	145
Sumy	ineE	125	ineE	138	ineF	111
Ternopil	ineE	135	ineF	107	ineE	130
Transcarpathian	ineD	144	ineE	128	ineD	146
Vinnytsa	ineB	183	ineC	180	ineC	168
Volyn	ineC	175	ineD	148	ineB	190
Zaporizhzhya	ineC	165	ineD	154	ineD	150
Zhytomyr	ineE	138	ineE	121	ineE	130

*Author’s calculations.

Following the results of 2017 Poltava region took the first position in the investment efficiency rating assessment having received 225 points. For the whole year, this region never dropped out of the group of leaders and its rating did not fall below 200 points. Dnipropetrovsk and Kharkiv regions also received ineA rating level (201 and 204 points respectively).

The number of regions that have high investment efficiency (ineB) remained unchanged; among them are Odesa, Kyiv and Vinnytsa regions. Odesa region has lost one position, compared with the previous period.

In general, the results of 2017 were slightly worse than in the previous period. Nevertheless, the number of regions with the rating assessment below the average remained unchanged. However, it should be noted that in comparison with 2016, in 2017 there is no region at ineG level, which has a positive impact on the overall investment image of the country (Figure 1).

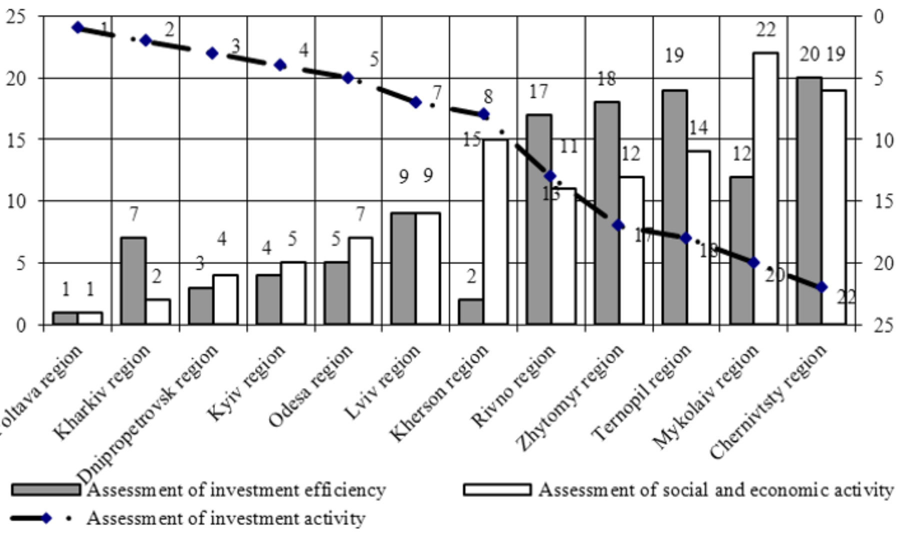

Fig. 1. Rating of investment efficiency of certain regions of Ukraine in 2017.

It should be noted that in order to obtain high rating assessment the region should not only succeed in investment attraction but should also use such investment efficiently, which is only possible when the socio-economic indicators, that characterize the level of well-being of the population of the region, improve.

3 Conclusions

Modern practice of regional development management has faced a number of problems, namely: lack of own financial resources; distribution of transfers while drafting the local budget is based not on the actual requirements, but on the present fiscal capacity of the region; securing of the local budget balance is provided not by tax methods, but by regulation through transfers buildup.

The solution of these problems, in our opinion, lies in improving the financial support for the investment development of the region. And namely, in the creation of its own revenue base sufficient for the shaping of financial capacity and maintenance of investment activity and efficiency of the region.

To this end, we have developed a model for the interconnection of the financial capacity of the region with its investment activity and efficiency. In the suggested model, the assessment of investment attractiveness is based on the availability and adequacy of the own financial resources, which characterize the level of the region's financial health. In order to assess the investment activity of the region, it is expedient to use formal rates for estimating the growth of financial capacity by sources of generation. Such rates include total budget revenue increment rate; tax revenue increment rate; non-tax revenue increment rate; sale proceeds increment rate; market services proceeds increment rate; grant-in-aid amount increment rate; subvention and subsidy amount increment rate. The above-noted rates contribute to determining the level of the region's financial health, which is a direct indicator of stability and investment attractiveness.

Under limited financial resources and minor investment potential of the regions at the present stage, in order to attract additional funds, it is advisable to develop a set of recommendations on creating an effective financial boost system for all participants in financing investments in the regional development, that are to be organized into two groups: benefits and incentives.

Benefits for the participants of investment financing, depending on their nature, can be presented in the form of:

– Tax benefits – investment tax credit, special tax treatment of certain activities, accelerated method of depreciation, tax rate decrease, deferral or instalment plan for tax payments, granting tax rate of 0% for certain activities, if the participants comply with the developed and established obligations;

– Budgetary fiscal incentives – grants-in-aid from the local budget for legal entities and sole proprietors, subventions and subsidies for local budgets from different levels of budgets; infrastructure order placing, equity investments in acting or greenfield enterprises; guarantees.

The mechanism for selecting the best investment project that participated in the competitive selection process can become an incentive, and as a result, grants from the budget and a preferential taxation mechanism are guaranteed.

Boosting of these processes should also include strengthening the intellectual property protection, budgetary support for innovation activity and the ongoing updating of investment projects databases. It is necessary to inform population and investors about investment opportunities in the region, including regular updating of the investment passports of settlements. At the same time it is necessary to advertise the proven track record of investment projects and make overtures to investors for successful practices.

So, the effective model of investment attractiveness for the region is the combination of effective forms of influence on the process of resources shaping and distribution in the region in order to provide its sustainable development and guarantees for the population.

Thus, the conducted studies allowed to prove empirically the existence of interrelation between GDP volumes and the level of innovative development of the region, as well as to determine the top factors of regional development in different situations, depending on the degree of their innovative development. Unfortunately, numerous quantitative indices often do not fully reflect the investment effect in economic growth.

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