

**A STUDY ON FOREIGN DIRECT INVESTMENT IN UKRAINE:
REALITIES AND PERSPECTIVES**

By

Andriy P. Haydutskyy

THESIS

Submitted to

KDI School of Public Policy and Management

in partial fulfillment of the requirements

for the degree of

MASTER OF BUSINESS ADMINISTRATION

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ABSTRACT

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Foreign direct investment takes an important role in the development of modern economic relations. With its enormous potential to create jobs, raise productivity, enhance exports and transfer technology, foreign capital is a vital factor in the long-term economic development of the world's developing and developed countries.

Foreign direct investment plays a special role in economic development of countries with transition economies. Ukraine is determined to be one of this kind and it means that the country is open for foreign capital, international high-scale management, experience and support from international government and private organizations.

In this case it is important to determine the importance of foreign capitals for transition countries and how it could help such countries to overcome stagnation and become important players in the world.

Thus, this science paper is going to summarize the investment situation in Ukraine: current trends, investors' feeling about the country, investment competitiveness as well as to determine future perspectives for the country in the way of attracting more investment capital and that steps the government and private companies should do to improve investment climate in Ukraine.

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2004 (Year of publication)

Dedicated to my family

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INTRODUCTION

International investments occupy a very important place in the development of present day world economic relations. In different forms they create the corresponding markets of loans and entrepreneurial capitals, make other factor markets and markets of goods and services dynamic. That is a large scale diversified international investing activity that forms in the World economy basic long term and, as usual, nonreversible mechanism of highly integrated economic development.

At the level of separate national economies, international investing processes display themselves on the one hand as export (escape) of capital, but on the other hand as import of capital. In other words a phenomenon of taking and utilization of foreign investments. The formation of motivations and policies with regards to foreign investments depends on the degree of national economies development, the level of their integration into the World Economy.

The problem of attraction and utilization of foreign investments is very urgent for countries with a transitional economy. Efficiently utilized foreign investments occupy a special place among potential resources for market transformation of these countries' economies. In the light of new political and economic changes in Eastern Europe and the process of evolution from a communist to a capitalist system, the importance of such investments needs rethinking, because for most of these countries foreign capital is a major factor to assist in the stabilization and economic recovery. Besides that, in the countries which are in crisis (stagnation), foreign capital is practically the only factor promising stabilization and further revival of the economy without destructive social and political costs.

For successful transformation, the host government should create an appropriate investment climate, including the creation of a 'good image', the provision of attractive,

new opportunities for foreign investors, and the development of an appropriate legal base which is suitable for both foreign and domestic investors. If governments do not develop an appropriate investment climate Western firms may find it best to wait, rather than to invest in Eastern Europe.

Meanwhile from the theoretical point of view actuality of further research of international investment activity problems with the accent on macroeconomics aspects of regulation of the reception and use of the foreign investments is obvious. In the author's opinion, system research of the subjects of investment processes behavior in the real and constantly varied conditions of specific accepting country permits to produce teleological measures and gears of activation of foreign investment activity. The special scientific interest is focused on searching for a combination of the qualitative and quantitative economic analysis using the modern research methods.

Aims of the Project. The project intends to examine the set of economic mutual relations, arising during the foreign investment activity in accepting country in particular in Ukraine

The purpose of the present dissertation is a systematic analysis of measures, gears and regulations of development of effective foreign investment activity in the transformation period of Ukrainian economy, and on this basis making recommendations for the encouragement of foreign investments.

In the first chapter observations are made on the essence of the foreign investments on the basis of study, selections and oriented adaptation of appropriate terms. The system research and valuation of the foreign investments will be conducted, which will show, on the one hand, the laws and rules of the construction of taxonomy and availability of the international standards, on the other - real condition of normative-legal and information maintenance of investment processes in Ukraine;

Chapter 2 examines real acting elements in the system of investment processes in Ukraine. The purposes and problems of receiving country (characteristics of the element "the receiving country"); the foreign investors (countries, institutional character of the sources of investments) are described.

The chapter also describes the relations inside the system. The characteristics of flows of capital (form, dynamics and volumes of the foreign investments) are given; regulatory influence of the legal nature on the part of the receiving country is described; the role and place of the foreign investments in internal economic priorities of Ukraine was defined.

Chapter 3 includes the main emphasis of this project to show the directions and means of improvement, determining political, legal, institutional and social psychological characteristics of the environment for activation of foreign investment activity in Ukraine.

Reevaluation and at the qualitative level justification of the system of factors and criteria of the foreign investments selection with their orientation to internal economic priorities of development of the Ukrainian economy will be done.

The chapter concludes with the development of the methodical approaches and main instrument of the multifactor optimization of foreign investment activity, in view of accepting party features.

Chapter I. Investment Activity in the System of Modern International Economic Relations

§1.1. Theoretical Aspects of Foreign Direct Investment

The international investment activity takes the special place in the system of modern international economic relations. Foreign direct investment is regarded as one of the most important factors for the development process of developing countries. Initially, it is regarded important in providing additional capital to these countries where capital resources are scarce and labor plentiful. Such an inflow of foreign capital brings about an increase in labor productivity and helps increase real wages.

The modern condition of the world economy, on the one hand, reflects the latest tendencies of capital movement, and on the other hand, directions of the further development of the international economy's structure which depends in many respects on scales and rates of international investment activity. Until recently, it has been traditional that advanced countries exported, and developing countries imported the capital. Foreign direct investment (FDI) dominated the theory and practice of the developing countries. Now the directions and structure of investment processes have changed radically. The foreign investment of other advanced countries, as well as new industrial countries play an essential role in economies of such countries as USA, Germany, Japan, France and others. For a number of post totalitarian countries, foreign investment becomes the key factor of their economic development.

It actualizes theoretical and practical researches of international investment activity just through the prism of FDI and produced by their movement phenomena, interrelations and processes. In turn, the terminological definition of the described and analyzed phenomena is important.

Mutual relations in the system "the investing subject - country of basing - accepting country - object of the investments" (see fig. 1.1) have the key significance in international investment activity.

From the point of view of various participants of investment process concept of "investment" has various sense nuances.

From the point of view of *object of investment* (real enterprise), foreign capitals are the costs of manufacture and accumulation of production assets and increase of material stocks i.e. investment is initial and compulsory stage of any industrial cycle.

From the point of view of *accepting country* the investment takes central place in functioning and development of national economy. Thus it should be distinguished by:

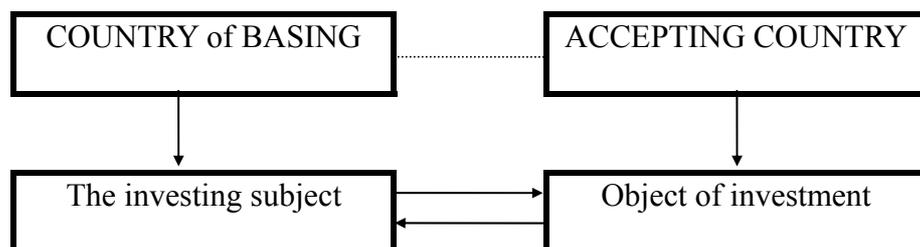
- national (internal) investment;
- foreign direct investment.

It is important to understand, that economic purposes of the country can be expressed through the investment purposes and directions of the investment policy, and the concretization of directions of solving economic problems, that the country phases, is reached at the level of the appropriate particular investment programs.

Investment has similar significance for *country of basing* also. There are two possible ways from the point of view of country of basing:

- internal investment;
- foreign direct investment.

Figure 1.1 Key elements in the system of international investment activity



In the context of the given work we consider only foreign direct investment. Thus it is possible:

a). Consideration of the *country of basing* as a principal, home environment for foreign investor. In this case particular state policy in relation to outflow of the capital is considered as the factor, has an influence on the decision of the *investing subject* (foreign investor).

b). The *country of basing* acts as the *investing subject*. Situations, when the capital, invested outside the country of basing will bring more profit (or other profits), than the capital invested inside the country, are possible. In this case, and in the context of the given work, the country of basing acts as the investing subject, in relation to which all the regularities of behavior considered below are topical.

Therefore it is possible to conclude that, foreign direct investment are long-term deposits of capital by the *investing subject*, who is the resident of *country of basing*, into the economic system of *accepting country* with the purpose of making profit.

Proceeding from the purposes and main tasks of the research, classification of elements of the system of foreign investment activity has principal significance.

We systematized possible types of classifications with allocation of two main elements of the system (investing subject and accepting country), and outline the connections between them (flows of capitals). It is expedient to allocate three large groups of classifications:

- I. According to the characteristics of the investing subjects;
- II. According to the characteristics of flows of the capitals;
- III. According to the characteristics of accepting country.

The set of these classifications creates rather adequate picture of international investment processes. The theoretical approach explaining by many famous economists as

MacDongell, Ohlin, Nurske and Caves shows us the classification types that are systemize the investment process (Table 1.1).

Table 1.1 Classification types systematizing the characteristics of the investment process

Foreign Direct Investment Classification		
I. Under the characteristics of investing subjects.	II. Under the characteristics of flows of capitals.	III. Under the characteristics of accepting country.
1). Classification by the institutional nature of the INVESTING SUBJECT, according to "sources": -private (private persons, legal entities); -state; -international organizations; -mixed.	4). By the geopolitical orientation of the capital flows: - developed countries - developing countries; - advanced countries - advanced countries; - others.	10)By modes of ACCEPTING COUNTRY: - restrictive mode; - national mode; - preferential mode; - compulsory mode.
2). Classification by target orientation of the INVESTING SUBJECT. a) Running up to the financial purposes: - getting business on credit, loan and others.	5). By degree of restitution: - retrievable (credits, loan, etc.); - risky (share in the property of the enterprise); - irretrievable (technical help of international organizations etc.).	11). By nature of the investment capitals use: - "eating away" investment; - "amortization" and "raw" investments; - "extensive" investment; - innovative investment.
b) Running up to the enterprise purposes: - getting the enterprise under control; - taking enterprise profits.	6). By dynamics in time: - short-term; - middle-term; - long-term.	12). In relation to the structure of foreign trade activities of ACCEPTING COUNTRY: - exported production; - import replacing production.
c) Running up to other purposes: - getting the sovereign subject (accepting country) under influence; - sanitizing of interstate economic relations and etc..	7). By degree of primacy: - primary; - reinvestments.	13) Classification by the forms of realization of the investment: - address technical assistance; - training programs for experts and information support of business; - credits and loans; - concessions; - foreign enterprises on the territory of accepting country; - joint ventures;
3). By the form of registration (declaration) of sources of investments, or other flows of capital: - obvious investment; - latent investment; - "black investment".	8). By size: - small-sized (qualifying minimum for each country); - average; - large; - largest.	14) Classifications by branch attributes.
	9). By kinds and forms of the investments: - financial investment; - real investment; - intellectual investment.	

It is obvious to say that FDI brings certain benefits to national economies. It can contribute to Gross Domestic Product, Gross Fixed Capital Formation and balance of payments. There have been empirical studies indicating a positive link between higher GDP and FDI inflows, as well as FDI can also contribute toward debt servicing repayments, stimulate export markets and produce foreign exchange revenue. Subsidiaries of Trans National Corporations (TNC), which bring the vast portion of FDI, are estimated to produce around a third of total global exports.

FDI inflows can be less affected by change in national exchange rates as compared to other private sources (portfolio investment or loans). This is partly because currency devaluation means a drop in the relative cost of production and assets (capital, goods and services) for foreign companies and thereby increases the relative attraction of a “host” country. FDI can stimulate product diversification through investment into new businesses, so reducing market reliance on a limited number of sectors/products.

FDI, where it generates and expands and expands businesses, can also help stimulate employment, raise wages and replace declining market sectors. However, the benefits may only be felt by small portion of the population, e.g. where employment and training is given to more educated, typically wealthy elites or there is an urban emphasis, wage differentials between income groups will be exacerbated. Cultural and social impacts may occur with investment directed at non-traditional goods as well.

§1.2. Regulation of Foreign Investment Activity

Foreign investment regulation of activity is carried out by using set of methods (legal, administrative, economic; social-psychological) at various levels (fig. 1.3).

Legal methods. The methods, which are determined by the whole system of the Law and the way of political organization of the Society. This group of methods includes

Figure 1.3 Methods and levels of foreign investment activity regulations.

Levels \ Methods	Legal	Administrative	Economic	Social-psychological
International				
National				
Regional				
Branch				
In-company				

systems of Civic and Processional Law, arbitration practice, etc. Practical activity of power structures aimed at keeping the rules of Law efficient, may be attributed to this group of methods also.

Administrative methods. The methods of ordering of the definition of legal subject, economic subject, questions of the property, procedures of the resolution of disputes in the judicial order and etc.. They are based on "the civic Law".

Economic methods. They are realized through the system of grants, credits, realization of money policy, fiscal system and etc.. They are based on "economic Law" and the laws on budget.

Social-psychological methods. They are oriented towards cultivating some kind of ideology, education of certain type of citizens' mentality and etc.. Large-scale, directed activity of social-psychological sort can be conducted only by the structurally formed institutions. The regulation of creation and activity of such organizations occurs on the basis of the acting Law.

The main methods of management, are legal methods, that are stipulated by:

- pretty high level of development of these methods, that allows to conduct the appropriate analysis;
- successful association of regularities of management of the above mentioned versions of methods (management).

- basic for all other methods of management.

The levels of regulating are also different in importance.

The international level of management unites various groups of agreements:

- agreements on joining to interstate organization (Organization must have institutionalized organs: or (and) of management, or (and) executive, or (and) of control, or (and) financial organs);

- interstate agreements (multilateral or bilateral).

The significance of an international level of management by investment processes in conditions of internationalization steadily grows.

One country's national policy can affect economic parameters of another countries, especially in view of growing significance of Trans National Corporations (TNC) as factor of the integration of processes of trade, transfer of technologies and movement of financial means. The national level of management is main and basic for all other lower-placed levels.

The analysis of various legal national systems has shown, that there are two different, from the point of view of legal technique, approaches to foreign investments regulation. In one case a legislator adopted single act in the field of regulating admission of foreign capital (for example, Canadian law on the foreign investments 1985). In another case - various legal acts, ordering different aspects of the enterprise activity regulate admission of foreign capital (for example, USA).

As a rule, such approaches are stipulated by the way of integration of the country into the World economy. Rather liberal attitude to regulation of foreign investment is characteristic for countries (USA, Japan) which export the capital (first approach). The second approach - aspiration to apply the single act is characteristic for countries which import the capital (see tab. 1.2).

At any approaches to a grouping of legal acts, the list of issues they regulate is rather stable.

1. Definition of foreign investor. Kinds of the foreign investment.
2. The forms of foreign investment. Participation in property.
3. Regulation of foreign investor's profit repatriation.
4. Requirements to results of foreign investor's activity.
5. System of investment privileges and restrictions.
6. System of warranties on foreign investor's rights maintenance.

Each of the allocated issues is regulated depending on the purposes of foreign investment attraction into accepting country. There is rather flexible system of variants of normative regulation.

Firstly we can define Types of investors and kinds of foreign investment.

Following categories of the subjects belongs to the group of foreign investors:

- foreign legal persons;
- foreign private persons;
- persons without citizenship;
- domestic citizens, living abroad;
- foreign states;
- international organizations.

Depending on the special conditions in accepting country, there can be rather specific categories of the subjects. For example, ethnic natives of accepting country, who are the residents of country of basing (from the legislation of South Korea).

All further privileges and restrictions depend on the way of defining of foreign investor. The kinds of foreign investment are defined by normative-legal systems rather uniformly - kinds of some values, deposited by foreign investor directly into objects of

enterprise or other activity with the purpose of making profit (income) or reaching other purposes (social effect, etc.).

Depending on the special conditions in the accepting country, some variants in defining the kinds of investment are possible: intellectual investment, bills of exchange, securities, good will (trademark). The last may be treated as value, only in case of existence of the appropriate normative base. Basically the regularity is as follows, the more a country requires investment, and the more concepts are included in the investment list.

As a rule, foreign investor is qualified by size (and kind) of deposited capitals. So, the average-World-sizes (see tab. 1.2) are: qualifying minimum - 50 - 100 thousand US dollars; qualifying share of property in a legal subject - from 20 %.

In the same time it is interesting to determine the possible Forms of foreign investment, especially its participation in property.

The main forms of foreign investment are following:

- share participation in the enterprises, created together with national, legal and private persons, or purchase of a share in already acting enterprises;
- by creation of the enterprises, completely belonging to foreign investors, creation of branches and other structural units of foreign legal persons or purchase in an absolute property of already acting enterprises;
- purchase of real or personal estate, including land, buildings, apartments, premises, equipment, vehicles and other objects of property by direct reception of the property, or in the form of shares, bonds, and other securities, as well as rights of lease, loan and leasing;

Table 1.2 Ways of the foreign investment regulation in various countries

The adjustable factor COUNTRY	The sanction on investment activity	The order of importation of the investing. capital	The right of the property on branches, size of a share, forms of investment.	Tax privileges and stimulation	Repatriation of profit	Infrastructure's privileges
1	2	3	4	5	6	7
Advanced countries						
USA	Not required	Not limited	National mode (plus branch restrictions)	National mode	Not limited	National mode
Italy	The sanction on kinds and forms	Not limited	Weak regulation	Territorial and branch		Credit privileges
France	The sanctions on all kinds and forms		20 % qualifying share; + branch restrictions	National mode; + territorial and branch	Not limited (individual restrictions)	National mode (+ territorial and branch)
Finland	Allowance system	Allowance system	20 % qualifying share; + branch restrictions	Are not essential	Control	National mode
Germany	Not required	Not limited	National mode (restriction on occasion)	Territorial and branch	Not limited	Territorial and branch

1	2	3	4	5	6	7
Asian countries						
Korea, South	The sanction for a share is greater than 50 %	Privileges on branches	Qualify. min 100 thousand (50 thousand. USD - for HT). In small and average - min a share of 50 %	On branches, territories, influence on the national trade balance	Is not limited, protection is guaranteed, reinvestment are permitted	Credit on branches, territories and technologies
Japan	The automatic sanction under the application	Not limited	Branch restrictions	Branch and territorial	Not limited	Territorial and branch
China	The administrative sanctions (individual approach)	Are adjusted (rates and the form are stimulated)	The individual decisions including concessions, 100 % the property	Advanced and essential system of privileges		Territorial and branch
Countries of transitive economy. Former USSR. Baltic countries.						
Latvia	Allowance system		Branch restrictions	Regressive-stimulating character; branch		
Estonia	Branch licensing	Is regulated, privilege	National mode + branch licensing	National mode, regression stimulus from size and branch	Privileges of export of production	
Lithuania	Allowance system					

Source: Luzik, P. (1999): *International Experience in Tax Reform and Lessons for Ukraine*. Centre for Economic Reform and Transformation, Herriot-Watt University,

Discussion Paper No. 99/04.

- independent purchase of rights on using the ground and concessions on using natural resources or purchase of the same rights with participation of national private or legal persons;

- purchase of state securities and securities issued by local bodies of self-management;

- realization of the economic activity in free economic zones.

The central point, uniting and regulating mutual relation between various forms of realization of foreign investments, is a question of participation in property. The following main methods of regulation of this question were generated in the world practice:

- preservation of the control over strategic branches of national economy; preservation of some branches or kinds of manufacture under the aegis of a state ownership;

- restriction of a share of foreign investor in the property;

- partial removal of restrictions for privileged investors;

- 100 % property of foreign investor.

It is also important to mention about The regulation of foreign investor's profit repatriation. It include such features as:

- requirement of compulsory creation and storage in banks of accepting country the certain size reserve;

- size of exported capitals is defined,, depending on the size of (imported) investment;

(In India the repatriation of capital is permitted under the condition of increase of its cost, that entails export taxation.)

- size of exported capitals is defined as a percent of profit after tax payments;

(For example, in Algeria not more than 18 %; in Guinea Bissau - not more than 20 % of a total sum of profit after tax payments.)

- size of exported capitals is defined as a combination of size of imported capital and received profits by the sanction on transfer abroad of the incomes in sizes which do not exceed certain percent of minimum volume of the investment;

(In Tunis the corporations of non-productive sphere are allowed to transfer the income not exceeding 8 % of investment volume, for others a certain size is defined in each particular case.)

- it is adjusted by the general rules of currency regulation and agreements on currency cooperation;

(For example, in Africa in the countries-members of "gold franc" the regulation is going on within the framework of the rule of a zone.)

- they are adjusted on the basis of special rules;

(Joint ventures in China can transfer the total sum of a net profit on a certain time established by the legislation. In South Korea the right on all transfers is guaranteed depending on the approval of the contents of investment project. In India the incomes of technical services, percent on credit and dividends are freely transferred. However the tax is imposed on all of them.)

- it is not adjusted: free order of movement of capitals.

The next point is The requirements to results of foreign investor's activity that are defined by the purposes of accepting country, and are differentiated by many parameters. The main of these parameters are:

- share of the local participant in the share capital;

- level of technology's transfer;

- scales of activity, and corresponding sizes of added cost;
- saving of means and time;
- orientation of the market (external or internal);
- ability to creation of new working places;
- opportunity of personnel's training;
- level of local resources use and factors of manufacture;
- priority of a place (territory, region) of the investments use.

Depending on the above mentioned target positions accepting countries differentiate their approaches to foreign investors. In the given context all this is about administrative permissive-prohibitive methods of effect. Clearly described target positions of accepting country permit foreign investors to predict the scripts of their business with greater percent of probability.

Further we would like to mention the System of investment privileges and restrictions.

- **Factor privileges:**

- subsidizing of enterprises;
- guaranteed and privileged loans;
- tax exemption (differentiated by size and time);
- partial repayment of taxes;
- accelerated amortization norms.

The main method of effect on foreign investor, used practically by all the countries, where the clear legal concept "foreign investor " exists. The measures might be of stimulating as well as of discriminative character. There are variety of methods, and their quantitative combination in different countries is great. The most characteristic dimensions of used factor privileges and the countries, using different kinds of privileges, are represented in the

table 1.2.

Following examples illustrate the variety of the approaches. In India all the enterprises (foreign and national) completely oriented on export or created in export-manufacturing zones, are free of taxes for 5 years. The enterprises, which realize 75 % of their production abroad and other 25 % at the precisely designated local markets, can receive tax privileges in the form of holidays. Different special privileged conditions are granted to the enterprises, 60 % production of which are oriented on export. For example, depending on the current size of imported goods (on the basis of conditions of deliveries FOB) they get the right on liberal import duty; exported goods are not taxed by excise; supply of raw material for manufacturing goods for export purpose is carried out on the basis of the control price; financing (crediting) of export manufacture is carried out on the basis of the reduced percent rate. An enterprise of this sort has right to receive the financial help from the special fund (Export credit guarantee corporation).

In Singapore the special investment tax privileges are received by the following categories of the enterprises: the pioneer enterprises are released from the profit tax at the rate of 40% for term 5 - 10 years; the enterprises, extending activity on 5 years are released of the profit tax at the rate of 40% exceeding its former level; the enterprises, income of which is less than 50 % of the new investments, are released of the tax.

According to the World Bank `s valuation, the influence of factor privileges for the decisions of foreign investment, which is going to be oriented on the home market of the accepting country, is not so great. Proceeding from economic expediency, for export oriented firms in determination their profitability the large significance has the cost of made product. In this connection, for decrease of exported goods cost factor privileges appear to be very important.

- **Commodity privileges:**

- Tariff export and tariff import barriers.

Are applied in practically in all national economics. Including, the commodity privileges and barriers are practiced for attraction of the foreign investments oriented on internal economy. The protection of the manufacturers against competition with the help of tariff and tariff import barriers is a rather strong stimulus. The experts of World Bank approve that the commodity privileges can render influence to the decisions of the foreign investors, the activity of which is directed on a home market.

• **Special means of the control above results of activity of the foreign investor:**

- free economic zones and zones of a special mode;

For example, in the various countries(South Korea, India, Germany, France, China) the foreign firms can receive special concessionaire terms, in case their investment are enclosed in underdeveloped regions or free economic zones of accepting country. The preferential right to the possession up to 100 % of the capital is also practiced, if the investor can ensure certain results. This is done to sell the certain part of the production on external or specified markets. To execute these investments is greater than the specified size in a given period of time.

- establishment by state top and floor level of the prices on certain goods and distribution of action of the state supervision on distribution and sales operation (Tanzania, Nigeria, Benin);

- use of the legislation, indirectly regulating activity of the foreign investor: the labour legislation, ecological legislation, laws on protection of the consumer's rights, patent legislation, legislation on industrial development.

For example, Gana, Tunis, Kenya actively use the legislation on protection of the consumer's rights for elimination of negative effect of foreign firms, such as failure of the sale, artificial and unreasonable rise in price, secret agree, various discrimination measures

in relation to the buyers.

- creation of the state enterprises, necessary for maintenance of the whole technological cycle of the firm - investor, including the ensuring of raw material and semifinished items, and in the case of necessity import, replacing raw material and semifinished items.

• **Other privileges:**

- RESEARCH AND DEVELOPMENT;
- training of personnel;
- infrastructure service (including information);
- insurance, warranty from political risks.

The given group of methods belongs to the characteristic of advanced countries: USA, Germany, France, Japan. We have a realization by state the concerning the program of preparation and increase of qualification of the staff, and special financial help programs for the small and venture enterprises, and granting financial (credit) means under the more low interests.

And in the end of our paragraph we would like to mention some points about the System of the warranties of observance of the foreign investor's rights. It traditionally consists of the three main elements:

- warranty of inclusion in national system of right.
- warranty of investment privileges observance and legislative stability in current investment cycles.
- warranty from the measures of confiscate character.

Warranty of inclusion in the national system of right.

Such kind of warranty, in essence, is the basis for an opportunity to use by the foreign investors the whole system of the national right. To use not only in the part of the rules of law, but also in the part of legal institutes: judicial, executive and retaliatory bodies in mutual relations with the national subjects of right.

Warranty of observance of investment privileges and stability of the legislation in current of a reasonable investment cycle.

The countries, granting a preferential mode to the foreign investor, as a rule are developed dynamically. The environment of these countries is characterise by the constant changes of elite groups, structure of legislative bodies and governments. It forces to stipulate the special mode of observance of the foreign investor's interests. For example, in Latvia in the package of the documents regulating enterprise activity is determined, that if the later acts will worsen conditions of the investments, to the foreign investments in current 10 years are applied those acts, which were in force at the moment of entering of the investments.

Warranty from measures of confiscate character.

Measures of confiscate character: nationalization, requisition, the confiscation, in relation to the foreign investments in the majority of the legislation of accepting countries are forbidden by the direct normative acts. But, as a rule, drafters leave for self an opportunity of revision decisions. For example, opportunity of use of the foreign investor's property in case of disasters, mass diseases, with the purposes of national safety is left.

Regional and branch levels of management on essence are recurrence of set forth above methods in smaller scales.

On in-company level of management, alongside with set forth above economic

regulations huge significance has psychological methods. As a whole, in-company regulation concerns to microeconomy, in this connection, in the given work is not considered.

By consecutive consideration of all levels of management, at certain abstraction from particulars, special formulations and linguistic stamps, it is possible on all levels to find out some common features - some system. So, for example, it is possible to find out parallelism in ways of regulation of investment processes at international and national levels that illustrate data tab. 1.3.

Thus, after describing the regulation of foreign investment activity, its methods and levels, kinds and forms of foreign investors as well as types of investor and possible privileges and restrictions for them we could easy understand the theory of investment subject. It will help us further, in the diploma, understand the practical concepts that investors use while making decisions to invest in this or that country.

Table 1.3 Comparison of various levels of management of the adjustable factors

International level: the adjustable factors	National level: the adjustable factors
1. Determination of the investments and investors 2. Condition of importation.	1. Determination of the foreign investor. Kinds of foreign investment. 2. Forms of I. Participation in the property.
3. Encouragement of investments. 4. The general norm of mode.	5. System of investment privileges and restrictions.
5. Transfer of payment. 6. The requirements to results of economic activity.	3. Regulation of the foreign investor's profit repatriation. 4. The requirements to results of the foreign investor's activity.
7. Deprivation of the investor of the property rights. 8. The dispute's settlement. 9. The norms of the corporation's behavior.	6. System of the warranties of the investor's rights observance.

§1.3. Current Trends in Attracting Foreign Direct Investment in the World Economy

World foreign direct investment has grown rapidly since the early 1980s. Indeed, foreign capital has become one of the most important means of integrating world economy and a major factor in the globalization of trade and economy. Global flows of FDI have grown phenomenally over the last ten years, rising by 5 times for the period 1990 – 2000.

But during the past couple of years a downturn in the international business environment and increased investor uncertainty has resulted in a significant drop in global foreign direct investment (FDI) flows. Global GDP growth averaged 2.8 per cent in 2002 – ahead of 2001 but below the long-term average of 3.5 percent. The world economy is forecast to expand by 2.9% in 2003, again below potential. Another sub-par performance for the global economy in 2003 combined with investor uncertainty point to continued weakness in cross-border investment flows. With the global economy expected to return to normal conditions in 2004, FDI flows should pick up accordingly.

The overall weakness in global FDI flows masks an important underlying trend – namely, the shift in FDI away from the United States to overseas markets, especially China and East Europe. The drop in FDI inflows to the US contributed to the decline in the US greenback seen over the past year.

Global FDI inflows fell by an estimated 27% in 2002 to \$US 534 billion, following a 51% decline in 2001 (Table 1.4.). The drop in FDI flows during 2001 and 2002 are the first decline since 1991, a time when much of the world was in recession or experiencing an economic slowdown. A reduction in merger and acquisitions (M&A) was the primary factor behind the drop in FDI flows over the past couple of years. To be sure, the past two years have been characterized by a collapse in technology investment, falling equity markets and a widespread economic slowdown covering industrialized countries and many

Table 1.4 Global Foreign Direct Investment Inflows in billions US dollars

	1995	1996	1997	1998	1999	2000	2001	2002(e)
World Total	331	386	478	694	1,088	1,492	735	534
<i>annual % change</i>	<i>28.8</i>	<i>16.6</i>	<i>23.8</i>	<i>45.2</i>	<i>56.8</i>	<i>37.1</i>	<i>-50.7</i>	<i>-27.3</i>
Developed Countries	203	220	268	484	838	1,227	503	340
<i>annual % change</i>	<i>40.0</i>	<i>8.4</i>	<i>21.8</i>	<i>80.6</i>	<i>73.1</i>	<i>46.4</i>	<i>-59.0</i>	<i>-32.4</i>
<i>share of total (%)</i>	<i>61.5</i>	<i>57.0</i>	<i>56.1</i>	<i>69.8</i>	<i>77.0</i>	<i>82.2</i>	<i>68.4</i>	<i>63.7</i>
Developing Countries	127	166	210	209	250	265	232	194
<i>annual % change</i>	<i>13.4</i>	<i>30.7</i>	<i>26.5</i>	<i>-0.5</i>	<i>19.6</i>	<i>6.0</i>	<i>-12.5</i>	<i>-16.4</i>
<i>share of total (%)</i>	<i>38.5</i>	<i>43.0</i>	<i>43.9</i>	<i>30.1</i>	<i>23.0</i>	<i>17.8</i>	<i>31.6</i>	<i>36.3</i>

Source: UNCTAD World Investment Report, 2002. Data for 2002 are preliminary.

emerging markets alike – all of which contributed to a decline in M&A activity. Despite the widespread downturn in FDI flows over the past 2½ years, there are some countries starting to show a turnaround in cross-border investment. Some of the higher growth markets in Asia and Eastern Europe are experiencing a relatively strong intake of FDI. In contrast, FDI inflows to the industrialized countries continue to suffer as M&A activity has yet to recover and concerns over corporate balance sheets linger.

These impediments to cross-border investment should begin to abate as the global economy is expected to gradually improve over the next 12 to 18 months, setting the stage for a recovery in FDI flows. A pickup in economic activity should see cross-border investment stabilize and perhaps even accelerate during 2004. A survey of investment promotion agencies (IPAs) from 106 countries conducted by the United Nations Conference on Trade and Development (UNCTAD) indicates that global FDI flows will remain sluggish over the short term but should gain momentum over the medium term.

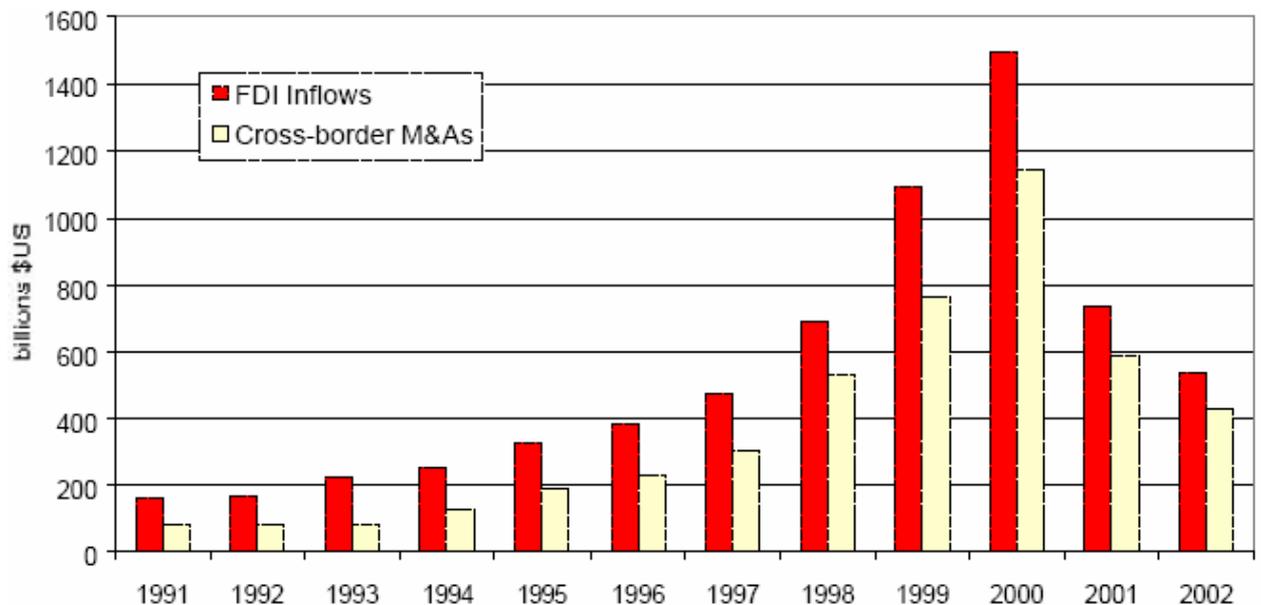
The decline in FDI in 2002 was uneven across regions and countries. It was also uneven sectorally: flows into manufacturing and services declined, while those into the primary sector rose. The equity and intra-company loan components of FDI declined more than reinvested earnings. FDI entering host economies through M&As went down more than that through greenfield projects. Recent trends about FDI in the world you can find in

Appendix A.

The UNCTAD survey was conducted during the first quarter of 2003 and showed that many countries have seen investment plans delayed and, in some cases, cancelled. In general, industrialized countries reported the greatest number of delays and cancellations while developing countries fared relatively better – a pattern expected to continue through the next 12 months. In fact, this pattern matches both global growth trends and the shift of labor-intensive manufacturing capacity from industrialized countries to developing markets.

Cross-border investment flows for most major industrialized markets are not expected to recover in 2003. FDI inflows to the developed world fell by an estimated 32% in 2002. Some industrialized countries are likely to experience further declines this year, reflecting the economic slowdown, geopolitical uncertainty and the downturn in M&A activity (Figure 1.4). Among the developed nations, most of the weakness in cross-border investment this year is again expected to be concentrated in the United States, United Kingdom and Japan. In recent years,

Figure 1.4 Global FDI and M&A. Lower M&A activity dragging down FDI flows



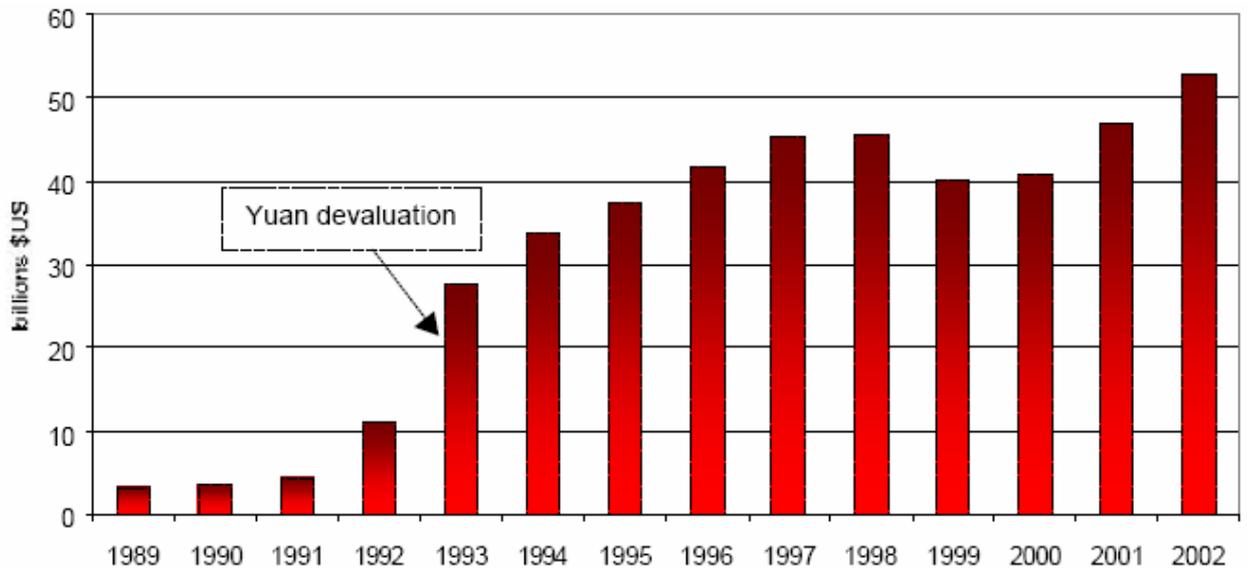
Source: *Export Development Canada: Foreign Direct Investment – June 2003. – 16p.*
cross-border M&A accounted for roughly 90% of FDI in the G-7 group of nations.

Although M&A activity continues, a return to the high levels seen in the late 1990s is not likely in the foreseeable future.

In contrast to other major industrialized countries, FDI flows into the Eurozone held up relatively well in 2002 as companies in this part of the world engage in more restructuring, a trend that is supporting crossborder M&As. Throughout much of the 1990s, companies in the Eurozone generally lagged the US and UK in terms of their restructuring efforts. As a result, firms in the Eurozone still have some catching up to do in order to close the gap with their counterparts in the United States and United Kingdom. However, economic weakness is expected to result in lower FDI inflows during 2003. Preliminary numbers for early 2003 show a downturn in FDI flows into the euro area.

Many emerging markets are also showing weakness in their early 2003 FDI intake – a symptom of sluggish economic growth, war in Iraq and investor uncertainty. However, several key markets are bucking this trend in early 2003, including China, Russia and Romania. FDI into China is on track to top last year's \$US 53 billion although it appears the SARS outbreak may temper short-term FDI inflows. Despite some short-term weakness in capital flows, the strength of China's underlying economic fundamentals will continue to support longer-term FDI inflows. You can find the investment trends to China on Figure 1.5. The same can also be said of other Asian countries hit by SARS, namely Hong Kong, Singapore and Taiwan. Many global companies are increasingly turning to China for the production of key parts and components in their global supply chain. Other companies see China as a cost-effective platform for servicing global export markets. The end result is an increase in foreign investment into the country. China's WTO membership has accelerated this process and FDI into China could rise to \$US 100 billion a year within the next decade.

Figure 1.5 China's annual FDI inflows in billions US dollars



Source: EDC Economics, Bloomberg

Most of the FDI flowing into the developing countries over the past couple of years has been for greenfield projects (i.e., construction or expansion of new factories and infrastructure). Recent years have seen South Korea and India institute reforms to attract more foreign investment but India's economy still remains relatively closed to FDI, attracting just \$US 3.4 billion during 2001. Cross-border investment flows to Taiwan, Hong Kong, Indonesia and Thailand declined significantly in 2002. FDI to these countries will probably remain sluggish this year but should begin to improve by the end of 2003 and into 2004.

FDI flows into Central and Eastern Europe were relatively stable in 2002 with overall inflows on par with 2001 levels. However, there is a mixed performance across different countries within the region. Foreign direct investment in the Czech Republic, Hungary and Russia was up strongly in 2002 while Poland and Romania reported declines. Restructuring and privatization have been a major driver of FDI into Central and Eastern Europe over the past few years. In addition, EU accession has attracted foreign investment as multinational companies see the region as a cost-effective location to serve West European markets. So far in 2003, FDI into Russia and Romania are showing solid gains.

Africa experienced a large drop in FDI inflows during 2002. Political concerns and investor uncertainty account for much of the souring in FDI flows to Africa. In addition, as reported by UNCTAD, a couple of large one-time transactions in Morocco and South Africa boosted overall inflows for 2001, making inflows during 2002 look that much weaker as a result.

Latin America experienced a noticeable decline in FDI inflows during 2002 and preliminary data suggest the weakness has continued into the early months of 2003. Much of the downturn in 2002 can be traced to Mexico and, to a lesser extent, Argentina and Chile. Foreign investment in Mexico was inflated in 2001 by Citicorp's \$US 12 billion acquisition of Banamex. Apart from this single large transaction, FDI in Mexico during 2002 was roughly in line with recent years. Brazilian FDI inflows in 2002 were also down from the prior year's inflows and the data for the first quarter of 2003 show the weakness has continued. As with other emerging markets, FDI inflows to Latin America as a whole are expected to gradually improve over the next 12 to 18 months. Even in Argentina, where the short-term outlook is fairly bleak, a many foreign companies are taking a long-term view. As reported by the Economist Intelligence Unit, a number of multinational corporations have recapitalized their Argentine subsidiaries by more than \$US 2 billion over the past 1½ years – evidence of their commitment to this market.

All in all, international experts predict that FDI flows will stabilize in 2003. Flows to the developing countries and developed countries are likely to remain at levels comparable to those in 2002, while those to Central and Eastern Europe are likely to continue to rise. In the longer run, beginning with 2004, global flows should rebound and return to an upward trend. The prospects for a future rise depend on factors at the macro-, micro- and institutional levels.

The fundamental economic forces driving FDI growth remain largely unchanged. Intense competition continues to force TNCs to invest in new markets and to seek access to low-cost resources and factors of production. Whether these forces lead to significantly higher FDI in the medium term depends on a recovery in world economic growth and a revival in stock markets, as well as the resurgence of cross-border M&As. Privatization may also be a factor. FDI policies continue to be more favourable, and new bilateral and regional arrangements could provide a better enabling framework for cross-border investment.

Findings of surveys of TNCs and investment promotion agencies (IPAs) carried out by UNCTAD and other organizations paint an optimistic picture for the medium term. IPAs in developing countries are far more sanguine than their developed world counterparts. Developing countries are also expected to be more active in outward FDI. IPAs expect greenfield investment to become more important as a mode of entry, especially in developing countries and CEE.

Chapter II. The Analytical Characteristic of Foreign Investment Process in Ukraine

§2.1. Modern Tendencies and Features of Using Foreign Capital in Ukraine

Ukraine – is country of Central-East Europe. It occupies the territory of Southern West part of East-European Plain, part of the Carpathians and the Crimea Mountains. The total territory area – 603,700 sq.m. Ukraine lies within moderate latitudes and has ports on the Black sea and the Azov sea. Geoposition between Eastern and Western peoples and cultures made a great impact on the history and now-a-day development of Ukraine.

Location	Central–Eastern Europe
Land size	Over 603 700 sq. km
Population	Approx. 50 millions
Languages	Ukrainian and Russian
GDP growth	9,1% (2001) 4,2% (2002) 7,2% (2003)
Currency	Hryvna (\$1 – 5,4 UAH)
Neighbors	Slovakia, Russia, Poland Belarus, Turkey, Moldova, Romania
Main industries	Metallurgy, Agriculture, Electroenergy, Aircraft & Shipbuilding, Food Processing



Ukrainian industrial potential includes machine production, ferrous and non–ferrous metallurgy, bus production, light and cargo vehicles production, tractors and other agrarian techniques production, production of diesel locomotives, lathes, equipment for Electric Power Plants, turbines, aviation engines and aircrafts, equipment for oil refinery and chemistry plants. Ukraine is a powerful energy producer.

From an economic point of view, the economy performed better than anticipated by most analysts. Although the pace of GDP growth slowed from the high level of 9,1% achieved in 2001 to about 4,2% for 2002, is still better than the rates achieved by most countries of the world, which are still facing economic slowdown (Table 2.1).

The economic activity of the country continues to be driven by the growth of domestic demand, particularly wholesale and retail trade (9.6% growth in comparing with previous year), the processing industry (8.2%) and agriculture (3.9%). Domestic demand was stimulated by increases in the population's income (28%) as well as by increases in credits provided by the banking sector (33%).

In fact, over the last two years, very important pieces of key economic legislation have been drafted, with the assistance of international agencies. This legislation includes the Law of Joint Stock Companies that would improve corporate governance and protect minority shareholders; the Civil Code and Commercial Code that would provide a more stable legal framework for businesses and protect property rights; the Tax Code would reduce tax rates and expand the tax base. The government has also been successful in raising international resources. In November, 2002 the government issued \$260 million of

Table 2.1 Macroeconomic situation in Ukraine

(Percent Change Over the Same Period Last Year)

	1994	1995	1996	1997	1998	1999	2000	2001	2002
Real GDP	-22,9	-12,2	-10,0	-3,0	-1,9	-0,2	5,9	9,1	4,1
Industrial Output	-27,3	-12,0	-5,1	-0,3	-1,0	4,0	13,2	14,2	7,0
Agricultural Output	-16,5	-3,6	-9,5	-1,9	-9,8	-6,9	9,8	10,2	1,9
Capital Investment	-22,5	-28,5	-22,0	-8,8	6,1	0,4	14,4	20,8	6,2**
Consolidated Budgetary balance (% to GDP)	-8,9	-6,6	-4,9	-6,6	-2,2	-1,5	0,6	-0,3	2,0*
Real Incomes of Population	-14,0	1,8	-17,1	6,3	-1,6	-8,0	9,9	9,0	21,2
Inflation (December to December, %)	401,0	181,7	39,7	10,1	20,0	19,2	25,8	6,1	-0,6

* - 11 months of 2002 versus 11 months of 2001

** - 9 months of 2002 versus 9 months of 2001

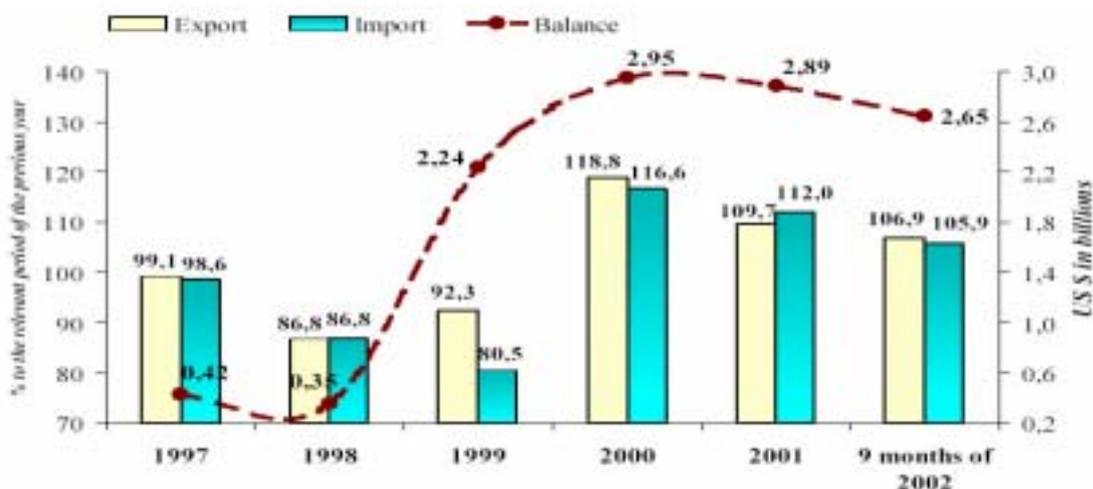
Eurobonds 2000 with yield of 10.8% and a final maturity in 2007. Placement was management by Credit Swiss First Boston and Dresdner Kleinwort Wasserstein.

The trade balance for goods and services was even very favorable. During January-September of the last year the trade balance in goods and services reached \$2.6 billion (12% over the balance achieved in the same period last year). Exports of goods and services reached 15.6\$ billion (6.9% increases over last year), whereas imports of goods and services reached \$13 billion (5,9% increase) (Figure 2.1).

Ukraine has continued to diversify its exports, increasing trade with Europe, Asia and Africa in order to compensate declines of export to CIS countries and the US. Russia remains Ukrainian main trading partner, but with only 17.9% of exports. Turkey is the second export market (7.5%) followed by Italy (4.9%), Germany (4.4%), China (3.9%) and United Kingdom (3.2%).

An essential condition for sustained economic growth in Ukraine is a substantial increase in foreign direct investment (FDI). Slow growth in investment became the most painful of the economic crisis in Ukraine. Through twelve years of independence, investment had steadily increased. However, the limited rate of national savings and

Figure 2.1 Dynamic of foreign trade in goods and services

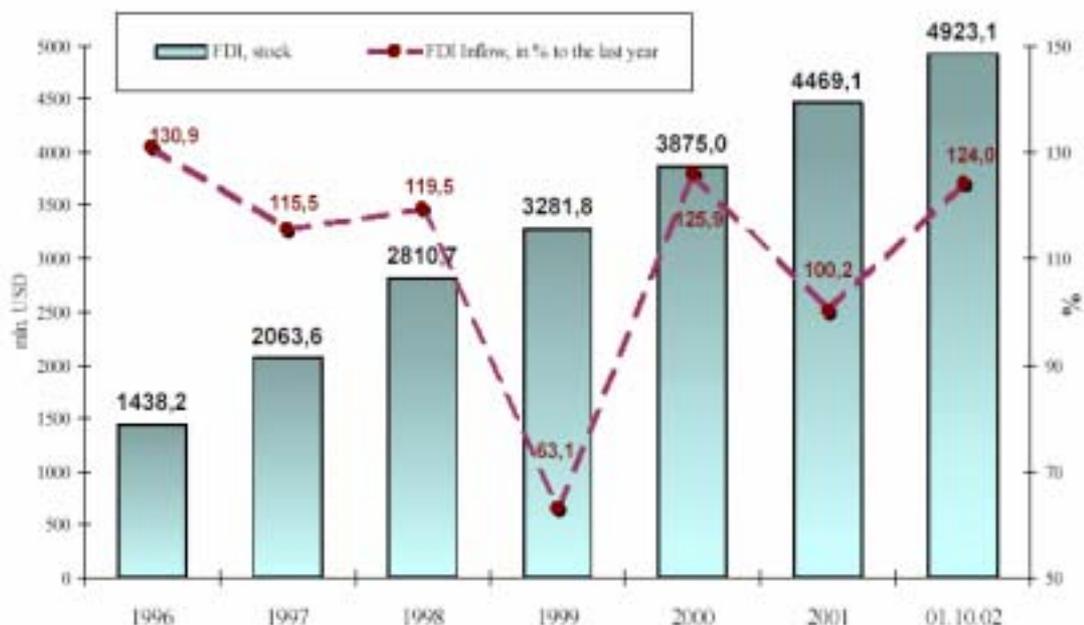


the inability of private investors to fully compensate the lack of capital investment have hindered the increase in investment. Ukraine needs a considerable investment inflow for economic growth. According to experts, Ukraine needs at least \$40 billion in FDI over this decade if it is to maintain a significant level of sustainable growth.

Since independence Ukraine has attracted over \$5 billions of foreign direct investment (Figure 2.2). In comparison with many developing countries this amount of investments is very small. The largest volume of FDI stock took place in 2002, when foreign investors contributed about \$1,050 millions. In 1999, investments dropped by almost 50%. This drastic decline in FDI occurred because of the 1998 economic crisis and an increase in political risk due to the presidential election in 1999.

Overall, over 100 countries have invested in the Ukrainian economy. The highest volume of FDI has come from the USA, Cyprus, Netherlands, Great Britain, Russia and Germany. These 6 countries contributed approximately 60% of the total FDI in Ukraine (Figure 2.3).

Figure 2.2 Foreign direct investments in Ukraine, \$ million

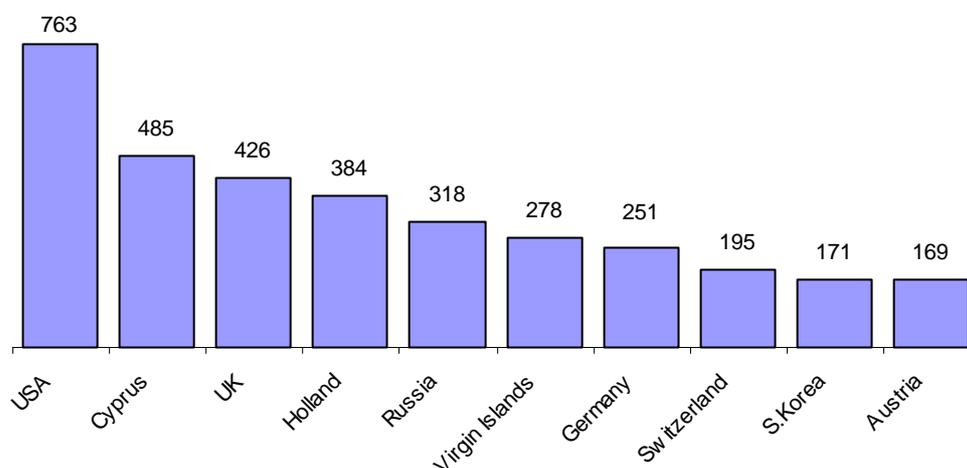


The USA remains the main foreign investor in country. As of end year 2002, the US share of FDI contributed \$763 million or 17% of total FDI. More than 15% of the investment went to internal wholesale and retail trade. However, in 2002 investors were mostly interested in the financial sector, food processing industry and hotel business. Some US multinational companies, such as Coca-Cola, P&G, McDonalds, Philip Morris and others, using proactive expansion and investing strategy, have propelled the USA to the top of the list of foreign investors in Ukraine.

FDI from Cyprus almost doubled over the last two years. As of the end of last year Cyprus had invested more than \$480 million in the Ukrainian economy. The high volume of FDI from Cyprus can be explained by dozens of Ukrainian offshore companies registered in Cyprus. Last year Cyprus businessmen almost doubled their investment into the transport and mining industry. Significant investment were made in the financial sector and real estate.

In the mid-90s, Russia was traditionally one of the largest investors in Ukraine. Currently, Russian investors are targeting nuclear fuel, coke, and oil-refining industries, which received 42% of the overall Russian FDI in Ukraine. Health care and social security, the financial sector and the transport industry have also attracted significant investment.

Figure 2.3 Major foreign investors in Ukraine, \$million

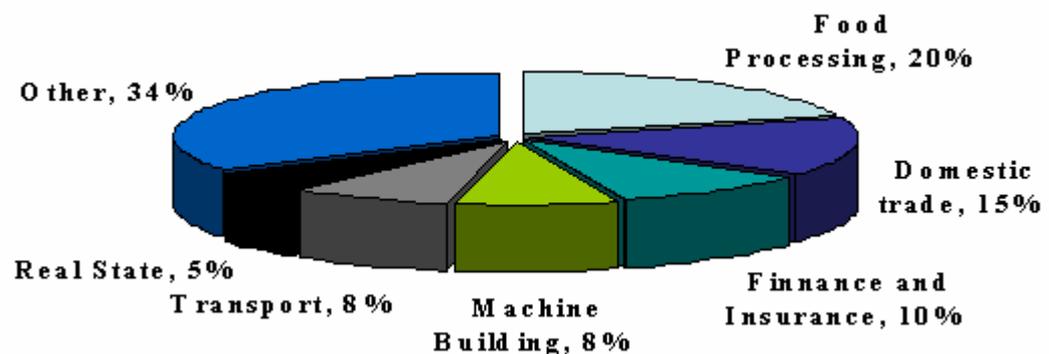


With regards to FDI from South Korea we would like to mention that main part of its investments (over \$160 million) was invested in car-building industry. At present, there is Daewoo-ZAZ joint venture company in the center of Ukraine.

Speaking about attracting of foreign capital in different industries we need to say that traditionally, the food processing industry and internal wholesale and retail trade have been the most attractive for foreign investors. These sectors usually give investors a quick return on investment and lower risk compared to other industries. FDI in food processing and internal wholesalers and retailers exceeded 32% of the total FDI. Nevertheless, machine building and metallurgy are also attractive for investors due to their export orientation and to the high liquidity of products. After the financial crisis of 1998, FDI started flowing into the banking sector. In the end of 2002, the banking sector, along with insurance companies, hold the third position in FDI volume (Figure 2.4).

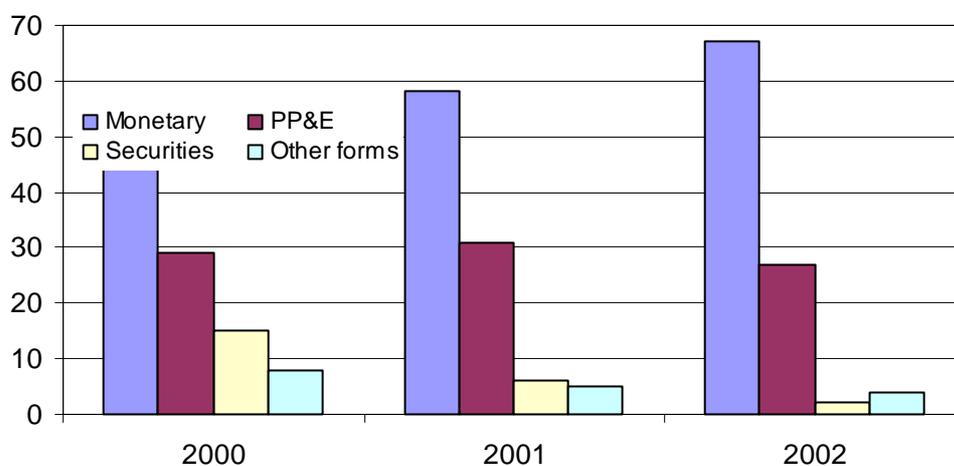
FDI constituted monetary investments, their share increased by 10.3% in 2001 and by 8.7% in 2002, reaching 66.5% of all foreign investments. The share of investment in the form of property, plant and equipment (PP&E) varies slightly, although this form of investment comprises 30% of FDI. Investment in securities steadily declined during the last three years from 15% in 2000 to 2% in 2002 (Figure 2.5).

Figure 2.4 Foreign direct investments by sectors



The forms of investment were changing over the years. While in 2000, 47.5% of all Special place in attraction the great amount of FDI in many countries also plays the Special Economic Zones. Special (free) Economic Zones (SEZs) have been increasingly applied as a vehicle for generating investment. The 1992 law on the framework and principles for SEZs was made redundant by a series of case-specific laws establishing separate tax holidays for individual zones. In 1999 the government decided not to establish any more new zones until a review of the entire process had been completed. In spring 2000 the government approved regulations governing the new Interport Kovel SEZ near the Polish border, which came into being on 1 January 2000. The new regulations detail the documentary and other requirements for investors who want to set up in the SEZ, and also set out the way in which it will be managed. The zone's administration will report to a council for its development, to include representatives of the economy and transport ministries and of the customs and tax services. Other SEZs in operation include Zakarpatska, Lviv (Truskavets and Yavoriv SEZs), Kyiv (Slavutich SEZ), Poltava (Kremenchuk SEZ), Odessa, Donetsk/Lugansk and the Crimean Autonomous Republic (Sivash SEZ).

Figure 2.5 The forms of investment in the Ukrainian economy, %



Typical incentives granted to enterprises located within a SEZ are likely to include exemption from customs duty (and sometimes VAT) on goods and services brought into Ukraine, lower corporate profit tax, a reduction of tax on non-resident profits from investment activity, the abolition or reduction of payments and fees into social security and pension funds, and exemption of all foreign currency revenues from sale of goods and services produced in the SEZ from mandatory currency sale to Ukrainian banks on the interbank currency exchange. For establishing a business within an SEZ investors are generally obliged to invest a designated sum (from US\$ 200,000 to US\$ 1 million), to build specific infrastructure elements, and to ensure employment of local labour (50 per cent of the jobs created). All investment-related business projects would typically have to be aimed at job creation, the introduction of new technologies and environmental protection. The life of an SEZ ranges from five to 60 years. The current amount of investment into SEZ we can easily find in Appendix B.

So, we can briefly summarize that Ukraine is becoming more open and interesting for investors from year to year. But the country with huge population, land, important natural resources and market-oriented economic policy needs three times more investment inflows to become a strong competitor on the world markets.

§2.2. Investment image of Ukraine

For evaluation of investment climate in Ukraine and its further development people use modern information technologies: questionnaire, studying problem questions, overview of investors' correspondence.

In 2002 Ukrainian Government and Administration of the President have spread questionnaires among foreign investors through diplomatic officials, American Chamber of

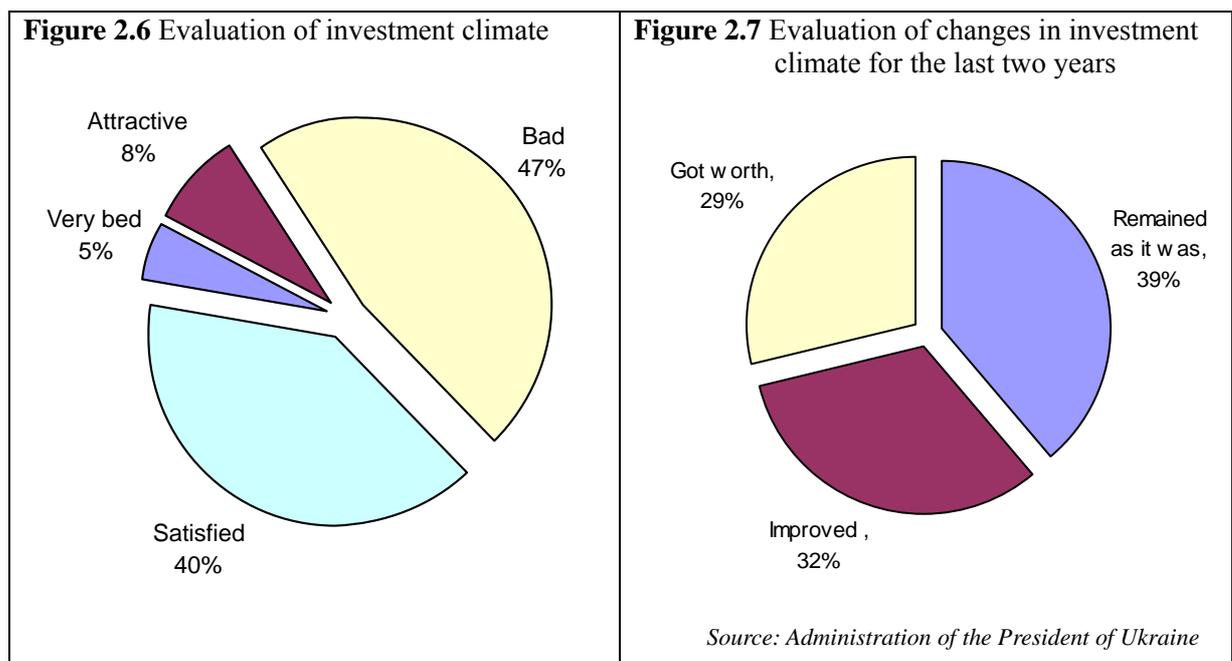
Commerce and World Bank.

In this questionnaire many famous companies as Coca-Cola, Henkel, Siemens, Alkatel, CSFB, Mitsui, Samsung, McDonalds and others participated. Together more than 100 investors answered to questions.

Results of questionnaire show that investment climate is quite good for investors' activity. 40% of investors satisfied with investment environment and 8% of them think that climate is attractive (Figure 2.6).

We need to mention that investors perceived positively the activity of President and Government in creating better investment climate. More than 30% of investors think that the environment improved (Figure 2.7).

Another fact of positive investment image of Ukraine shows that more than 60% of investors reinvest their net profit again to the Ukrainian branch and do not send money abroad. It means that foreign investors believe in the positive future of economic development in the country.



According to investors' valuation the most important components of Ukrainian investment environment are: high quality of ground, good natural climate, low labor costs, social and economic stability. Main part of investors also highly values possibilities to rents funds, development of real estate and economic stability. In the same time investors would like the government to improve tax system and return of value added tax (Appendix C). Questionnaire shows that many investors waste their time with government and local officials. Almost 1/5 spends from 25% to 50% of their work time to solve problem questions. In the same time more than 50% spend 5-25% of business time with officials.

Almost half of investors are satisfied with service of Ukrainian diplomatic organizations. Another half of them suggested to improve the quality of service.

Also we need to mention that main part of investors (75%) believe that on their decision "to invest or not to invest" influence their own experience or experience of business partners. Conclusions of International rating agencies (IRA), articles in newspapers, Internet or TV almost don't influence on their decisions (Figure 2.8).

As many foreign investors are transnational companies it is important to compare Ukraine with other countries. In this case Ukraine is more attractive than Romania, Bulgaria, Kazakhstan, Egypt or Thailand.

Figure 2.8 Influence on decision about investing in Ukraine, % of investors

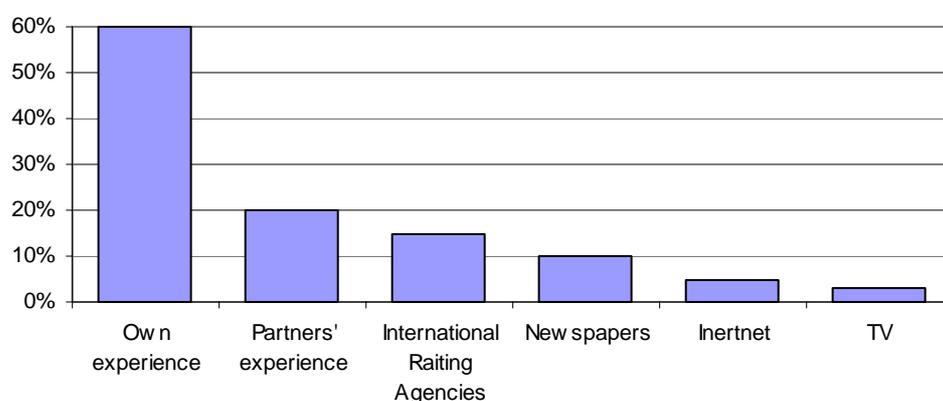
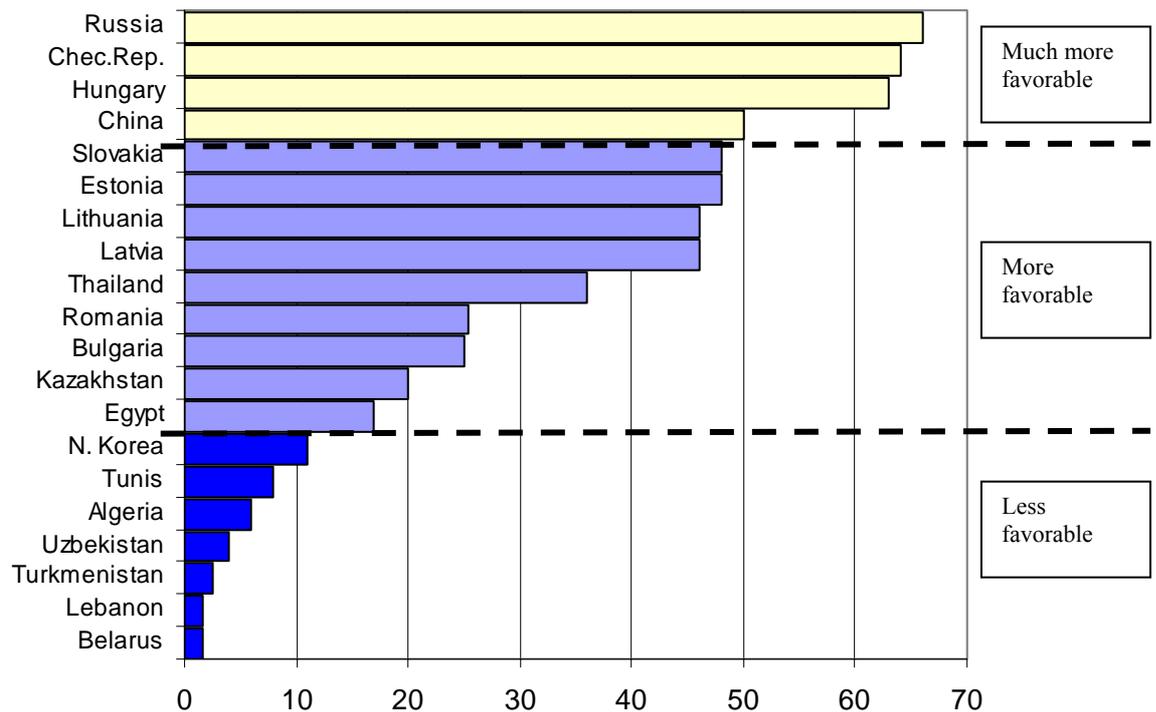


Figure 2.9 Evaluation of investment climate of some countries comparing with Ukraine, % of total number of answers

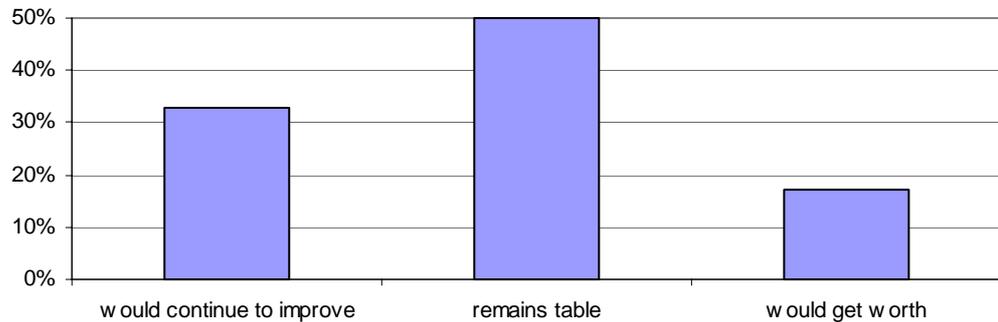


But in the same time more than 50% of investors believe that the environment is better in Russia, Check Rep., Hungary, China and Baltic Countries (Figure 2.9).

According to future positive forecast about development of Ukrainian economy and investment climate many investors are going to expand their business. Many investors sure that investment climate of Ukraine is improving. About 33% of all investors believe that investment climate continues to improve, while 50% are sure that it is stable to have business in this country (Figure 2.10).

In the same time over 1/3 of investors sure that investment climate would continue to improve in the future and 66% of investors believe that it would not be worth. According to positive forecast of investment climate in the country the main part of investors is going to increase the scale of business in Ukraine. So 75% of investors predict to increase amount of investment to Ukraine. Among them 60% are going to increase production manufacturing, and 25% - would not decrease it.

Figure 2.10 Investors' expressions about future changes of investment climate in Ukraine, % of total number of answers



In the same time more than a half of all correspondents wish to increase the number of workers, and 36% would not fire anyone.

So, we would like to say that the evaluation of Ukrainian investment climate is quite good. The most positive thing is that 72% of investors believe that their decision to invest in Ukraine was right.

§2.3. Regulation of the Foreign Investment Activity in Ukraine

The normative acts, regulating investment of the Ukrainian nonresidents' capitals can conditionally be divided into two groups: group of the legislative and normative acts directly devoted to the foreign investment, and group of the acts regulating behavior of the foreign investor in the general national order.

To the first group it is possible to attribute the following legal acts.

The laws of Ukraine: the Law of Ukraine "On Foreign Investment Regime" from 19.04.96; the Law of Ukraine "On Taxing an Enterprise Profit" from 22. 05.97 (if the investor is a legal entity); the Law of Ukraine "On Conditions of the Foreign Investment" from 24.12.93; the Law of Ukraine "On the System of Taxes" (ed. of February 18, 1997); the Law of Ukraine "On making alterations To Law of Ukraine On the System of Taxes and

Duties" from 19.02.97; the Law of Ukraine " On the Value-Added Tax" from 03.02.97; the Law of Ukraine "On the general basis of formation and functioning of special (free) economic zones " from 13.10.92.

Decrees and Resolutions of the Cabinet of Ministers of Ukraine: Decree of the Cabinet of Ministers of Ukraine "On the Excise Duty"; Decree of the Cabinet of Ministers of Ukraine "On Removal of the Restrictions Retaining the Development of Entrepreneurship" from 03.02.98; Decree of the Cabinet of Ministers of Ukraine " On Currency Management and Control System" from 19.02.93; Decree of the Cabinet of Ministers of Ukraine "On Profit Tax" from 26.12.92 (if the investor is a natural person); Resolution of the Cabinet of Ministers of Ukraine "On the concept of creation of special (free) economic zones in Ukraine" from 14.03.94.

Restrictions on Foreign Investment

Restriction on Types of Business

Under the 1996 Law on Foreign Investment, foreign investors may choose any type of business, invest in any project or engage in any activity that conforms to the purposes stipulated in the enterprise's charter that is not prohibited by law. Foreign investors are not required to obtain government permission to acquire or to establish a private company. Generally there are no maximum limits imposed on foreign ownership, with the few exceptions noted below.

Regulated Industries

Certain activities can still be carried out by state authorities, including activities related to circulation of narcotics, psycho-tropic substances, and analogues and precursors, production and sale of military weapons and ammunition, extraction of amber, protection

of certain especially important state property objects, as well as activities related to the development, testing, production and exploitation of carrier rockets, including their launch into space for any purpose. In addition the State has the exclusive right to carry out activities related to technical exploitation of primary networks (other than local networks) and satellite networks of telephone communication of public use. Activities related to the production of certain motor petrol mixes can only be carried out by the list of oil processing enterprises established by the government.

State Control

Legislation limits the participation of foreign entities in certain types of businesses as follows:

- Information agencies – no more than thirty percent (30%);
- Television and radio organizations – no more than thirty percent (30%).

Licensing

Like all companies in Ukraine, enterprises with foreign investment must obtain licenses for certain activities (at present some 60 types of activities are subject to licensing).

The list of licensed activities includes, but is not necessarily limited to, the following:

- Exploration of mineral deposits;
- Production and sale of medicines and chemical substances, veterinary medicines and preparations;
- Domestic and international transportation of passengers and cargo by air, river, sea, railway and automobile transport;
- Providing agent services and freighting sea trade fleet;
- Producing securities, banknotes and postal payment signs;

- Collection and processing of solid and liquid precious metals and precious stones containing production wastes and scrap thereof;
- Insurance activities; and
- International and intercity postal transportation, postal correspondence processing.

Land Ownership and Usage

Ownership of land in Ukraine has been a complicated matter. Previous law provided different rules for land ownership according to the intended use. Although no formal land market existed in Ukraine, land could be given to farmers, urban dwellers and other individuals by the State. Ukrainian enterprises were not able to own land on which their facilities were built. During November of 2001 new land legislation was adopted entitling foreign individuals and legal entities to own plots of nonagricultural land. This new provision should facilitate foreign investment into real estate and industrial sectors. Collective ownership of land is not envisioned under the new land code.

Protection of Foreign Investment

Ukraine has entered into investment-protection treaties for the protection of foreign investors against specific restrictions as well as for the indemnification of losses resulting from expropriation or similar actions. Such treaties have been entered into with Argentina, Armenia, Austria, Azerbaijan, Belgian-Luxembourg Economic Union, Belarus, Bulgaria, Canada, Chile, Croatia, Republic of Cuba, Czech Republic, Estonia, France, Georgia, Germany, Grease Republic, Hungary, Indonesia, Iran, Israel, Italy, Kazakhstan, Republic of Korea, Macedonia, Moldova, Latvia, Lebanon, Lithuania, Netherlands, Russia, Slovakia, Slovenia, Spain, Sweden, Switzerland, Turkey, Turkmenistan, USA and Vietnam. In practice, however, this protection has been difficult to enforce.

Ukraine also ratified the Convention on the Procedure for the Settlement of Investment Disputes between governments and foreign entities and/or individuals.

Investment Incentives

Generally speaking the same incentives are available to both Ukrainian and foreign investors. Ukrainian officials believe that a specific incentive to foreign investors is that the import of property contributed to the charter capital of Ukrainian entities is exempt from import duty. In addition, the import of equipment as contribution to the charter capital is also exempt from VAT upon customs clearance. However, these practices are followed by many of the other countries that Ukraine competes with for FDI. Certain industry-specific and regional incentives are also available to investors in Ukraine.

Production of Automobiles

Special tax incentives are provided for businesses involved in the production of automobiles and spare-parts. Qualifying entities are those with an investment (including foreign investment), exclusively monetary, of US \$150 million or more.

Regional Incentives

There are a number of special economic zones and so-called territories with prioritized developments created by the legislation. The law grants a simplified registration procedure and a favorable tax and customs regime to enterprises operating in these zones.

Sources of Finance for Foreign Investors

Outside of financing from investors, commercial banks remain the principal source of finance for foreign investors. Credits are used primarily to facilitate trade.

Short-Term Financing

The principal sources of short-term credit are commercial banks. The number of foreign banks licensed to operate in both local and foreign currency has increased but remains small relative to Ukrainian financial institutions.

Medium-Long-Term Financing

The legislative framework required for long-term capital, and for financing techniques, instruments and institutions remains undeveloped in Ukraine. To cope with infiltration, commercial banks are now implementing a floating interest rate for medium-term loans. Financial leasing remains a new technique in Ukraine and is used primarily for imports of high-technology equipment designed for managerial and organizational functions (for example, computers). Exporters may apply to Ukrexportimport, as bank that offers limited short to medium-term export financing.

Stock and Bond Offerings

Foreign investors and companies may participate in the bond and equity markets, but restrictions apply.

Project and Trade Financing

The European Bank of Reconstruction and Development (“ERBD”) currently has several available sources of financing for qualified foreign investors. The World Bank and its private sector lending arm, the International Finance Corporation, also offer a source of financing for specific projects.

Importing and Exporting

Customs Duties

Under Ukrainian regulations, the import of goods is subject to customs duties unless specifically exempted by legislation. In general, export is not subject to customs duties. Restrictions are imposed on certain imports and exports, especially on items in strategic areas.

Non-Tariff Regulations

Licensing and quota regimes are established each year by the Cabinet of Ministers of Ukraine. The following list of goods are currently subject to licensing: substances damaging the ozone layer, certain types of rolled metal, medicines, personal hygiene products, veterinary substances and certain other items.

Customs Duties

Ukrainian customs duty rates for particular goods depend on the country from which the goods are imported and the country in which the goods are manufactured. Customs duty rates are established in either a fixed amount or as a percentage of customs value of goods. Import of goods from certain CIS countries is exempt from the customs duty under free trade agreements. Ukraine levies customs duties at preferential rates in cases of import from countries, which participate with Ukraine in any sort of customs unions or created special customs zones. Privileged rates are applied in cases when goods originate from countries obtaining most favorable status. Import from other countries is subject to tax at standard rate.

Other Import Taxes

Import of goods into Ukraine, in addition to the above customs duty, is subject to VAT, excise duty and customs processing fees.

Temporary Customs Clearance

Ukrainian customs' legislation provides for temporary clearance in certain situations including the import of goods for specified limited periods of time to be exhibited, leased (a year), repaired, etc. For goods granted temporary clearance, the requirement to pay customs duty is deferred assuming compliance.

Registration of Intellectual Property

Ukraine has established legislation for the protection of intellectual property rights ("IPR"). Since 1993 Ukraine has enacted legislation relating to patents on inventions, models, industrial designs, plant varieties, seeds, and cattle breeding, as well as laws on trademarks, copyrights and related systems. Special amendments have been made to the Criminal and Administrative Codes of Ukraine to provide criminal and administrative sanctions for the disclosure of trade secrets and unfair competition.

The weak point in Ukrainian intellectual property law is the issue of remedies and their enforceability. As a matter of practice, ordinarily only civil remedies (injunctive relief, compensation for damages including punitive damages, specific performance, etc.) may be sought by the injured party in the courts. Ukrainian legislation does not provide for any criminal sanctions, except for violations of trade secrets.

Administrative liability in the form of fines, confiscation of products, equipment and raw materials may be sought in the event that an infringement of intellectual property rights is accompanied by unfair competition on the part of the party infringing.

Despite the laws, potential investors in Ukraine should be aware that intellectual

property rights in Ukraine are not accorded the same level of protection that one has come to expect in more developed economies. To date the legislation has not been effective for either Western buyers of Ukrainian technologies or exporters of intellectual property into Ukraine. Accordingly, abuses of intellectual property rights in the market place are common.

In general we can state that Ukrainian investment legislation quite similar to many others of different countries. Some investors find even the national legislation more favourable and attractive than in other developed and developing countries. We compare the investment climate of Ukraine in paragraph 2.4 where the survey takes place.

§2.4. The establishment of priorities of foreign investment into economy of Ukraine

It is well known that attraction of foreign capital to any country has both positive and negative aspects.

Problems of the foreign investment in Ukraine naturally are based on problems of national economic processes, but also on problems of participation of Ukraine in the global economic system. The transitive condition of the Ukrainian economy forms specific conditions of the receiving and using of the foreign investments, and the regulation of these processes assumes the necessity of the complex analysis and account of the internal and external factors of economic development with target orientation on appropriate trends.

Processes of the foreign investment can not be adequately described only at the "Geo-economic" level, at the level of the interstate economic relations. The analysis of processes and tendencies in particular economy is necessary, which is the environment and tool of realization of the foreign investor's intentions. Therefore the consecutive level

analysis of Ukrainian economy on the macroeconomics level was conducted. Discovered problems and priorities, with a high degree of definition determine the long-term tendencies of economic processes, set the role and place of the foreign investments in further fate of national economy.

The problem of foreign investment in Ukraine for today is connected not only with their volume but with structure and efficiency of their use. So it is very important to design the state programme of using the foreign investments. This programme should be organic part of national economy evolution and it should provide the need in state safety of our country and the system of foreign investment economic encouraging. So with economic incentives which will intensify the investors' interest to invest money to key branches of Ukrainian economy there should be limits or full prohibition of investing foreign capital into key branches for country and production safety.

Peculiarities of up-to-date development are forming the new economic model of progress, civilisation, destruction of inter-branches connections, association of production spheres into unified integration structure, creation of big production and technology associations, acceleration of countries development' speed due to innovative, informative and reconstructional factors. For example, for the last years to increase two times the gross domestic product of USA it took 47 years; in Japan - 33 years; Indonesia - 17 years; South Korea - 10 years. Annual global market of computers increases for 17,5% annually.

For today Ukraine in general exhausted opportunities of reforming on the basis of fiscal and monetary instruments. There should be new economic model on the basis of reproduction of investment environment and stimulating of innovations. At the up-to-date stage the greater part play not reaching the commercial effects by individual subjects of economy but strategy effects (national, geoeconomic), which are more reliable indicators of industrial and economic development and efficiency of investments.

Today in Ukraine there are no huge perspectives of development. That is why even general approaches to establishing of foreign investment priorities have great importance. Choosing them it should be taken into account following specific aspects:

- object strategic approach in politics of industrial and economic development;
- global regularities of development and geoeconomic priorities;
- domestic industrial potential deindustrialization;
- structure and investment crisis;
- mass nonprofitability of enterprises;
- loss of global civilised and technologic positions;
- unbalanced finance and credit systems;
- considerable external debt;
- barterization and seamy side economy;
- sharp reducing of state investment activity.

The data provided below, about ranging of economic branches by economic factors can be used for analysing the investment priorities (table 2.2).

Thus, the most priority branches according to prognosis factors are trade, building, industry. We have also deeper calculations of priority in investment of some industrial complex branches by factors of profitable level, perspective development level, level of investment risk.

On the basis of these generalisation factors all branches were separated into four groups by level of investment attractiveness (table 2.3).

The necessity of a deeper approach during basing of every investment project with use of wider spectrum of factors is obvious. Also some conventional but with real numbers classification of Ukrainian regions for investment attractiveness groups is worth attention.

Table 2.2 Ranging of economic branches of Ukraine by the prognosis profitability ratios

Macrobranches of economy	Rank of branch according to priorities	
	According to the ratio between profit from realisation and assets volume.	According to the ratio between balance profit and assets volume.
1. Industry	2	2
2. Transport	8	7
3. Communication	9	9
4. Building	1	1
5. Trade and public catering	5	5
6. Supply and sell	3	6
7. Procurement of agricultural production	12	12
8. Utility (municipal) economy	11	11
9. Consumer service	7	8
10. Information and computing service	6	4
11. Science activity and science service	10	10
12. Other kinds of activity	4	3

Data provided by Ernst&Young Ukraine Ltd

Executed analysis showed that regions of Ukraine are characterised by very wide variation range of economic and resource potential (table 2.3). Furthermore nature factors, geographical position, urbanisation level, historical connections, transport system development, educational level and entrepreneur activity influence the investment attractiveness of regions.

The estimation region's investment attractiveness is very important for the foreign investment attraction. Taking into account the published data, the new system of regions attractiveness of Ukraine has been developed. To range regions the following factors were used: profitability of investments use, level of industrial and agricultural production, market condition, nature and resource potential. It should be noted that measures for creation more favourable climate will lead to changing of already defined priorities.

Table 2.3 Classification of Ukrainian regions into investment attractiveness groups

Group	Branch	Characteristics
First, high level	<ul style="list-style-type: none"> • ferrous and non-ferrous metallurgy • natural leather production • perfumery and cosmetics production • alcohol production 	The most branches of this group have high and stable internal sell market. Individual branches have considerable export potential.
Second, rather high level	<ul style="list-style-type: none"> • oil-working • oil-extraction • machinery building and metal working • cement • vine production 	The indexes of investment efficiency use for these branches are 20-25% higher than in average in industry.
Third, Medium level	<ul style="list-style-type: none"> • chemical • oil-chemical • reinforced concrete production • cotton production • fruit and vegetable tinned goods production • butter and cheese production 	The brunches of this group have average factors of investment use efficiency.
Fourth, low level	<ul style="list-style-type: none"> • coal • electric power engineering • peat industry • sugar industry 	They may be attractive in conditions of finance reconstruction.

Some regions have favourable conditions for free economic zones location and development. At the present time Ukraine has only 10 projects of free economic zones creation and is carried out carry out the local economic experiment at the territory of Krasnoperecopsk region and Armianskaya zone “Sivash”.

Global experience shows that the way out of a crisis is possible only in the case of increasing of national production level, particularly industrial complex with approaching to global level. In our opinion the only possibility for Ukraine too slow down the economic crisis is to employ new technologies and on this basis reach new national technological level. In this connection in order to attract foreign capital the necessity of forestalling technological development should be accounted for first; second it should be designed and

introduced programs of forming the national investment and technological leaders, big enterprises, high-technology production, “points of growing”, which investment has priority meaning for creation the national model of industrial and economic development.

The above mentioned problems and the results stipulated by them taking into account interaction of inside and external economic factors, Ukraine is guided by the following system of priorities of structural reorganization of national economy:

1. Increase of social orientation of economy and on this basis solving the complex of social economic problems, which have the structural nature, namely:

- balancing of the consumer market of goods and services with the population's incomes;

- increase of motivation to labour at the expense of maintenance of rational, and in due course European norms of consumption and level of life;

- suppression of inflation.

Technological reequipment of production in all branches and at all levels of economy. The tasks in this direction of structural reorganization consist in solving such vital problems for the economy of Ukraine as:

- maintenance of competitiveness of the own industry in the world market;

- increase of export potential of Ukraine and reduction of import, first of all, at the expense of finished products of final consumption;

- formation of the active trade balance and strengthening of monetary independence of Ukraine.

3. The reduction of resources consumption, first of all, at the expense of power consumption of manufacture with orientation to more complete and effective use of own energy-raw materials resources, which Ukraine has. This direction of structural reorganization has the following tasks:

- reduction of dependence of economic development of Ukraine from import of energy-raw materials resources;

- greatest possible inclusion of own natural resources potential in the economy's turn-over;

- entry of Ukrainian economy to the level of advanced countries in consumption of primary raw material and power resources per unit of final product;

- gradual overcoming of crisis condition, which the ecology of Ukraine phases and maintenance of balanced ecological development.

4. Increase of the level of internal equation of the economy of Ukraine at the expense of reorientation of production means manufacture, first of all, at the expense of branches of mechanical engineering, metallurgical and chemical industries change the production to more complete satisfaction of needs of own inter - branch cooperation with the purpose of:

- reduction of dependence of Ukrainian economy, in particular of processing branches of MIC, light, automobile, medical and other industries from foreign deliveries of means of production;

- improvement of the trade balance through optimization of own inter - branch relations and reduction of economically unprofitable external economic cooperation;

- acceleration of development of industrial and non-productive infrastructures on the basis of internal investment resources.

5. Acceleration of development of manufactures, which are able to improve export potential of Ukraine. The problems, which are thus solved include:

- increase of the economic role of Ukraine in international division of labour;

- preservation, and in due course expansion of the external markets of sales of own production;

- accumulation of currency resources for necessary technological re-equipment of manufacture and payment of critical import.

Stages in realization of priorities of structural reorganization and establishing of new economic system as a whole are obvious. At the first stage (the nearest 2 - 3 years), the stage of stabilization the inflationary processes are to be overcome, the decrease of manufacture is to be stopped and conditions for the exit of economy from crisis are to be created. In this period the accents are made on:

- increase of capacities in manufacture of the consumer goods and raw material to them, but also increase of services to the population;

- construction and reconstruction, modernization of objects of fuel and energy complex, productions directed on increase and saving of power resources, and improvement of adequate provision of economy's needs in fuel and energy resources;

- objects of the agriculture's infrastructure, promoting more effective processing of agricultural raw material, avoidance of wastes at preservation, transportation, realization of production;

- capacities and objects increasing of manufacture of export production, but also increasing competitiveness of own production in the world market and substituting imported products;

- investment object as carried out during re-cooperation of the enterprises of mechanical engineering, metallurgical and chemical industry with the purpose of reduction of external economic dependence and increase of internal equation of Ukrainian economy.

At the second stage (5 - 10 years) activation of economic development with revival of positive traditional and formation of the new tendencies and, first of all, in investment and technological environments is possible.

In long-term prospect (third stage) conditions for establishing and self-development

of effective national economy, internally balanced and deeply integrated in the structure of the world economy can be achieved.

In external economic priorities the modern external economic policy should provide the structural change in export-import activity, formation of modern export oriented sector of economy at rationalization of import. The consecutive reorientation of the commodity structure of foreign trade should include:

- replacement of export of fuel, energy and raw material by export energy- and material intensive finished products;
- transition from deliveries of black metals to deliveries of roll, first of all qualitative and profile;
 - re-specializing and technical re-equipment of the mechanical engineering with export oriented development of machine-tool construction, airplane and rocket building; use of opportunities of conversion of the defensive industry;
 - intensifying of export in technological sphere (powder metallurgy, superfirm and high-quality materials); transition to export of the licenses and know-how; engineering;
 - development of the international transit transportation with transport-forwarding security;
 - formation of the infrastructure and economic conditions of dynamic development of international tourism;
 - transition from import of finished production assets and materials to purchase of machines and equipment for their own manufacturing (on criteria of economic expediency in view of the time factors);
 - importation of materials and furnishing products for expansion of the manufacturing of export production.

Positive experience of introducing the new programs of innovative process

introduction has Great Britain as well as South Korea.

The expediency of strategy priority approach is conditioned by the opportunity of forming more balanced economic politics, multi-level system of aim and resource priorities; increasing of value of alternative vector of distributing the innovative flows for technologic renewing; leading to functional reconstruction of the system “science production”. But further deepening of the integration processes and international competition conditions the necessity of introduction of flexible protection mechanism of national producer protection, orientation of technical, technological, industrial and social politics for global standards; providing the low and economic guarantees of foreign investments protection; unification of national economic law and international one; perfection of international economic relation forms; forming effective system of capital accepting.

It should be based on overstate investment conception. It means the stipulation of the major state role in market infrastructure (roads, markets, warehouses, insurance companies, resource funds) development, providing the support for the strategic enterprises development, and investment attraction into high technology production.

In that way the key conditions of passing of investment processes in economy of Ukraine are formed in the system of priorities of its social economic development, stipulated by action of inside and external economic factors. That is the conformity to these priorities that makes foreign investment activity economically and socially significant for transforming economy of Ukraine.

Chapter III. Mechanisms of activation of foreign investment activity in Ukraine

§3.1. Creation of favorable investment climate

The market economy is the natural environment for effective development of investment activity. Such environment in Ukraine is only being formed and market reorientation of economy proceeds in complex intertwining of political and social processes.

The structure of environment of receiving country at the macro level includes the following elements: politics, law, economy, social-cultural and infrastructure characteristics.

For the special analysis of environmental components of the development of foreign investment activity, especially in the new post Soviet states, it is expedient alongside with the above mentioned parameters to allocate institutional component (fig. 3.1).

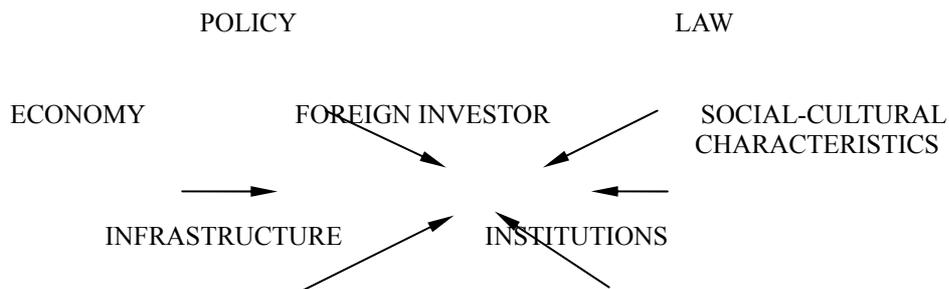


Figure 3.1 The environment structure of the receiving country

It is necessary to look through the above mentioned most essential structural components of Ukraine's investment environment.

Necessary properties of political component of the environment for the development of investment activity are:

- political stability;
- positive attitude to foreign direct investment.

Inter-political picture of Ukrainian society is dynamic enough and is characteristic for the countries at the stage of rough and comprehensive development. The main characteristic of the modern political system of the country is the random uniting of the old and new institutional political elements: elements of Soviets (especially of local self-governing Soviets), elements of parliamentary republic and elements of presidential governing. It caused the non effectiveness of all branches of power. In these conditions each of the branches of power (legislative, judicial prosecutor's branch, executive) becomes a nucleus of consolidation of certain political forces and tries in its own structure to duplicate the function of other branches.

The forecasting of the political situation in receiving country is made by both the investing subjects and the special consulting-expert institutes which are to serve the investors. This valuation occurs practically in all used techniques taking into account two main parameters: global disintegration of the society under the property qualification and centers of power in elite part of society. The ratio between these two factors determines political stability of the society, direction of its development as well as it determines long-term trends of legal and economic component. Facto-graphic analysis of disintegration of the society and dynamics of the centers of power look as follows.

Property disintegration of the society in Ukraine goes fast and is dramatic enough. At present about 40 % of the population of Ukraine have the income below calculated living minimum, i.e. live at the expense of former (basically property) savings. At the other pole 10 % of the citizens of Ukraine even according to the international standard are the well-to-do people.

Organizationally in the political sense the Ukrainian society is amorphous enough.

Up to the present time there are about 40 more or less significant parties and public party type organizations registered. But even the above mentioned most numerous organizations officially have tens of thousands people as their members the figure which is extremely insignificant. The low role of political parties and associations was confirmed by the 1998 elections in the Supreme Rada (the Supreme Council) of Ukraine.

The ruling national elite same as in all states - former republics of the USSR was formed on the basis of the party - economics nomenclature. Thus, rather conditionally, it is possible to allocate two groups with the extremely changing structures. First one is the former communist leaders - "partocratic" grouping. The second center of power is the grouping of managers, of the former "red" directors of the huge strategic plants, the new national bourgeoisie. Rather conditionally it is possible to define the third grouping - national-democratic forces. The trade-union movement cannot be considered as the serious factor of the policy.

The growth of the authority of the President's "team" should be also noted. The data of sociological researches, which was made in late 1990s, testify about high authority of the representatives of the industrialists and businessmen and about the support by the majority of voters of the policy carried out by the President of Ukraine.

Besides, "the group of the industrialists and businessmen" is rather seriously transformed and that will be covered below.

All this testifies about steady and stable trend of growth of influence of industrial-enterprise elite of Ukraine.

Legal environment represents the set of normative-legal acts and state-institutional mechanisms of maintenance of these acts. To stimulate the foreign direct investment activity it is necessary to ensure, besides the positive economic contents, the developed

legal regulators, their reliability and availability, as well as predicts of changes.

The analysis of the normative base of FDI into Ukraine is made in the previous chapter in detail. Evaluating the legal environment as the component of general investment environment can add to this analysis the consideration of the long-term tendencies and general dynamics of development of the internal normative base.

The legislative normative acts of the transitive period (1991-2000) were evaluated as positive by foreign investors and experts. First of all the fact that they were adopted resulted in qualitative changes, in transition from almost complete economic isolation to normal international economic relations. Secondly, these acts basically guaranteed the foreign investors economic independence and non-interference into their actions on the part of state authorities. Thirdly, many normative-legal acts constantly changed towards liberalization. This ensured the scope and rather high dynamism of FDI into the economy of Ukraine in these years (in particular when creating joint ventures).

However, it is obvious that the adopted legislative acts were incomplete; some of the acts and norms did not correlate between each other. A number of the normative acts were inaccessible to western businessmen because operative information means are underdeveloped and because some of it is "closed"; in particular inconsistency in taxation matters and other. Difficulties connected with this (alongside with other difficulties - economic and social) sharply reduced the efficiency of enterprise activity.

It is important to pay attention to general liberalization of the economic legislation, improvement of normative regulation of the national mode of business. In such way reasonable reduction of taxes occurs: the value added tax is reduced from 28 to 20% (according to the Law of Ukraine "On the Value Added Tax" from December 23, 1994) and in 2005 it would decrease to 17%; the tax on income is replaced by the profit tax at the rate of 30% from the profit (the Law of Ukraine "On Taxation of Profit of the Enterprises" that

came to force from January 1, 1995). In the latter acts semantics and definiteness is much improved: circumstances of formation of income and profit were precisely determined; the terms concerning taxation and etc were determined too.

Thus the tendency of improvement of normative supply and increase of stimulating effects on both foreign and the national investors is obvious.

The population of Ukraine is about 50 millions. Negative growth of the number of population of about 150 thousand people a year is observed. About a quarter of the able to work population has higher and secondary special education. With high enough qualification of the Ukrainian labour its cost is minimum: the official minimum wage is about 50 US dollars per month.

The area of Ukraine is about 600 thousand square kilometers. Among natural resources the most essential is black soil. There are industrial stocks of wood (basically folios type trees). The recreation resources are significant; there is high potential for the development of international tourism. Mineral resources are widely represented: gold, diamonds, gas, crude oil, uranium and iron ores, coal, decorative and construction stones, sulfur, etc. The majority of deposits are either exhausted (oil in Pre-Carpathian area) or their development provides raw material at the higher than world price for similar resources. As a whole the cumulative valuation of natural resources of Ukraine, its volumes of stocks of each of the kinds of raw materials and their cost was not done. At present time it is clear that Ukraine strategically depends from energy resources (gas and oil) and as a fact can not be considered as the perspective exporter of raw materials.

Technological potential of Ukraine is rather high. Technologies like metal physics and similar, black and ferrous metallurgy, machine building and instrument building, rocket and aircraft building, shipbuilding, automobile industry, information technologies, engine building industries are traditional for Ukraine. For the year 2002 the country was #7 in the

world in export of steel products.

The accumulated national wealth can be evaluated only very approximately. Initial figures for these valuations are some precedents of financial life of Ukraine. The other source that gives an idea about the order of accumulated national riches is the information on the campaign of privatization. The cost of the property of the enterprises that are have be privatized is evaluated at the cost of approximately 60 billion USD. Taking into account the fact that this property makes about 15% of real capital assets (the number of strategically important enterprises and branches not subject to privatization as well as objects of infrastructure is great) but also the used techniques of valuation which can lower the real cost in 3-20 times gives you the idea about real figures.

The average propensity of the population to saving money is rather high and as forecaster it will last for a long time. If 3 - 10 percent of the money earned by people and directed on the long-term savings (invested through financial institutes) are considered to be the average norm, then such a figure for Ukraine is much greater. This situation is typical for the countries with transitive economy and could be explained by many reasons.

Constant liberalization of customs policy is thus observed: the quoting and licensing of the export of the majority of goods was canceled. Any restrictions on the access of the legal subjects to participation in international trade were practically removed. Customs service is developed. At the same time the tendency to make the import policy stricter remains steady. Now practically for the majority of imported goods the customs tax is 100 - 150%, besides there is an excise due for the constantly extended list of goods. The problems of international trade are as follows: the nonrational structure of integration (quite a big number of imported goods are made in Ukraine in conditions of partial loading of manufacture); and the specific weight of "barter" trade is rather large.

The restrictions on international traffic of capitals were removed both in the normative and organizational-technical respect. In the normative respect "the notorious" fixed exchange rate was canceled. Now the rate is determined by the results of the trade at the Ukrainian Interbank Currency Exchange. In the organizational-technical respect more and more banks of Ukraine open the correspondent accounts in the countries with steady economy, they get connected to the SWIFT system, and develop personnel cooperation.

On the whole the President and his team have taken a rather rigid course on restraining the inflation; by pursuing the policy "of expensive money" through obtaining foreign credits. It would be more correct to say that the reverse to "inflationary", "the credit expectation", allowed the National Bank of Ukraine to spend more actively stabilization funds of hard currency. In the period of 4 years from 1994 - 1998 the inflation fell from 50 - 60% a month to approximately 15%. And this tendency seems to be steady enough.

The credits granted to Ukraine are given at rather large interest rate (from 8% up to 12%). The bank currency deposits really paid by steady Ukrainian banks make up about 25% annual interest rate. It is obvious that despite legislative restrictions "the cost" of the extra capital is much higher, and makes up from 40% annual interest rate.

The development of other financial institutions (investment and trust funds, insurance companies) is not sufficient. Not only secondary but also primary market of securities is in the process of development. The questions of the circulation of securities of the foreign emitents are not legislatively settled. In these conditions as well as in those of reduced profitability of manufacturing, the depression of the home market and unsuccessful structure of the industry the depreciation of fixed assets and the capital investments for the analyzed period of time are not practically done.

In Ukraine still many state enterprises have great influence on market trends. But real interference into the economy on the part of the state is less significant than it would

be possible to expect. Thus the state because of many reasons loses the opportunity to influence directly the enterprises. The direct operative interference is replaced by civilized methods: by the methods of effecting through the monetary and fiscal policy. Concerning the above, the significant liberalization of the legislation could be noticed: rather low rate of the tax on the profit (30 percent) is established and at the same time essential investment privileges are granted.

Within the framework of the used qualitative method of valuation it is possible to ascertain that the infrastructure of Ukraine is adequately and harmoniously developed. There is a good system of the material communications: the system of highways, the railway network (including electric ways), the system of the airports, including international airports, the system of sea and river transport with port and navigation infrastructure, the network of pipelines.

In addition to the traditional aspects of considering infrastructure, it is necessary to note the information infrastructure level development. In this respect Ukraine has a large system of mass media: the periodic press, the system of the radio and television broadcasting. The system of telecommunications and information-computer technologies is being developed organically. With such existing technological and the most important personnel potential Ukraine easily enters in to the world system of telecommunications.

Special information (infrastructure) systems exist and are being developed. So the Center of Computer Information Systems exists at the Supreme Soviet of Ukraine. On the basis of the "Agencies of International Cooperation and Investments" the system of coordination of international cooperation of Ukraine is created.

It is obvious, that the solution of many economic problems would not been made without adequate institutional registration. In this respect Ukraine overcomes its separation from international economic institutes and structures. Since 1992 Ukraine has become the

member of International Monetary Fund and International Bank for Reconstruction and Development, European Bank for Reconstruction and Development. The qualitative shifts in policy of Ukraine concerning international institutional groups are important. Ukraine has solid potential of cooperation in SIC, Black Sea Economic Cooperation (BSEC), Carpathian Euroregion. The Agreement about Partnership and cooperation between European communities and Ukraine; the Global initiative of European Commission for Ukraine (is adopted by an European Commission on April 27, 1994); the Protocol of intentions between European Community and countries of CIS (program TACIS) and others are in force.

Also appropriate internal institutes regulating or ensuring foreign trade activities are formed and act: Ministry of foreign Economic Relations, State Export-Import Bank, the State Customs Committee, Currency-Economic Department of the Ministry of Finances, divisions and services of other departments, Department of International Cooperation and Investments of the Cabinet of Ministers of Ukraine. All this testifies to prompt changes in all components of investment environment of Ukraine.

§3.2 Factors and criterion of the interest coordination of foreign investment activity subjects.

The conducted consideration of the segregation of the object research dynamics, obviously should be finished with some practical results. Moreover, the theory within the framework of which work is executed should give the user the adequate forecast of the development of events, orient him practically, optimize his behavior.

The interpretation of segregation within the framework of the traditional qualitative approaches is not adequate for realization of such optimization. It objectively shows the following.

Ukraine belongs to countries with transitive economy. It requires structural

reorganization of the national industry; improvement of the balance of international trade, integration in the world economical system. To solve the first, and especially, the second problem it is rational to involve the foreign direct investment and capitals. Ukraine, within the framework of the classical approach, undertakes a complete spectrum of measures for the attraction of foreign investors. Therefore the following processes have taken place.

1) The absolute volumes of the involved FDI of various kinds and forms are not great. Depending on various techniques of valuation they make 10% from volumes which Ukrainian economy is able to take. Relative volumes (concerning the countries - the former republics of the USSR), are also low and make about 33% at standardizing pursuant to the scales of national economics of compared countries. This is provided that in the rating of investment attractiveness, developed by various consulting-analytical, Ukrainian economy takes the higher place.

2) It is impossible to define any expressed interrelation between measures taken by Ukraine in order to attract foreign capital and dynamics of FDI.

At the same time, it is known from the world practice, that the behavior of the foreign investors is not always based on the adequate theoretical and information basis. The crises of nonpayment, in particular taking the countries of Latin America, and disability of many governments to adequately react to the phenomenon of TNC, and increasing of volumes of "Mafia world economy", and many less scale facts testify to that.

The number of the baseless theoretical forecasts of smaller scale includes the facts of incorrect valuation of Ukraine's rating, as of accepting country. In particular, in the forecasts for 1992, Ukraine took the first place on investment attraction among former republics of the Soviet Union; at the rating of post soviet countries - 138 place in the world list. In the similar forecasts Ukraine came down to the seventh place; at the world rating - 147 place. Hence, there are two moments of weakness of the theoretical approaches,

discrepancy of the real facts to the theoretical preconditions: absence of correlation of "measures on attraction - dynamics of receipts of the foreign direct investment"; instability and inability of qualitative techniques in determination of the rating of country's economy as the objects of investment. The quantity of similar discrepancies of the facts of real international economic relations and traditional methodological approaches grows and ignorance becomes more difficult and more expensive.

Methodically the improvement of the practice provision of the international economic relations is seen rather unequivocally. Improvement takes place in the reduction of abstraction, generality of the used approaches, restriction of the receptions of direct extrapolation without the account of qualitative change of the characteristics of object of study, increase of quantity of considered parameters of activity. Thus the compromise between qualitative and quantitative methods should be. Moreover, in opinion of the author, the prospect consists not so much in the introduction of traditional parameters scaling (operation by "quantitatively measurable sizes"), but in expansion of qualitatively considered parameters. I.e. the prospect of today is not in numerical modeling of traditional theoretical models, and in increase of complexity of these models, which should be considered at the system level by expert and pithy methods.

In this case the author develops the subjective-cybernetic approach to consideration of international flows of the capital. Following assumption is the statement that both participants of investment processes are the active subjects. As the subjects they have purposes and can form active behavior after achieving them. Therefore, the strategy of activity is chosen from the spectrum of possible alternatives with the help of some criteria, for example, criteria of optimum. Optimum of activity is higher, if more complete purpose is reached, and smaller efforts (resources) are spent to achieve it (purpose).

Then, each of the active subjects of international investment processes has it own:

- purposes, which it wants to fulfill;
- possible ways of activity on achieving these purposes;
- criterion of efficiency choosing the best way of achieving these purposes.

Furthermore it is necessary to specify these characteristics, for both - foreign investor and accepting country.

The integrated purpose for the foreign investor is to maximize the rate of return on the invested capital. To achieve this purpose investor needs to solve a number of problems and choose the best alternatives of investment.

The analyses of the researches of many scientists show, that the consideration of alternatives can be understood as the solution of the sequence of problems, directed on forecasting of rate of return of the investment cycle. (The sequence of problems is represented in a kind of "problems tree". Thus each step of choice reduces definition - reduces quantity of alternatives of choice, so, that some quite certain plan of activity remains).

The investor should calculate (predict) the rate of return on each of possible alternatives of investment activity:

- Alternative 1
 - investing the capitals in the economy of the country of basing;
 - investing the capitals in international economic activity;
- Alternative 2
 - international economic activity as a kind of import to accepting country;
 - international economic activity as a kind of investments into the accepting country's \ economy, choice of the country of investments;
- Alternative 3
 - investment into various branches in the chosen country, determination of volumes,

kind and form of the investments;

- Alternative 4

- selling manufacturing production at international markets;

- selling manufacturing production at home markets of accepting country;

- Alternative 5

- repatriation of profit; kinds, forms and volumes of the export of capital;

- reinvestment of profit into the economy of accepting country, prospect of the new investment cycle.

The choice occurs on the basis of comparison of each of investment activity's alternatives profitability. The profitability is calculated by rather complex and diverse techniques, which include plenty of microeconomics parameters. To operate with regularities on macroeconomics level we shall present the scheme of calculation in a generalized form (fig. 3.2).

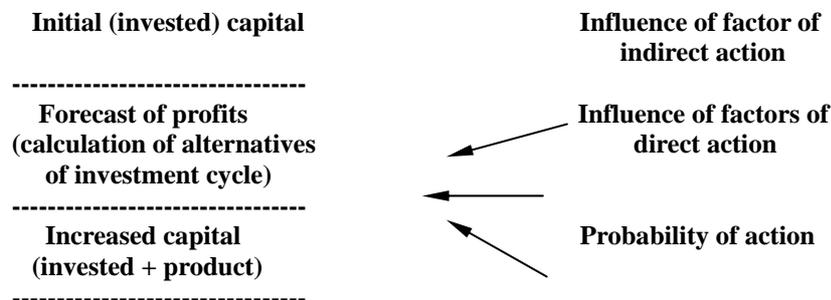


Figure 3.2 Generalized scheme of calculation of profit rate on investment capital.

In practice, as a rule, there is not enough information for real quantitative calculations. The borders of its reliability fluctuate in so significant limits, that the results of calculations on various alternatives of investment activity become indiscernible. In these conditions the role of qualitative, expert methods, valuation of the tendencies sharply grows. Thus in essence it is important to ensure "interface" of quantitative formal and qualitative expert methods. In particular, it is necessary to organize the procedure of

forecasting in the terms, convenient for experts (Fig. 3.3). The description of investment processes in classification systems and the definition of management methods of investment activity and environmental factors are already given in the work. The scheme defines investment risks. These risks are rather important components of taking the decisions, and are rather diverse in nature. It is possible to determine the main ones, occurring in practice, they are as follows: *financial risk*; *inflationary risk*; *market risk*; *bankruptcy risk*; *liquidity risk*; *political risk*.

Optimal investment from foreign investor`s point of view is the achievement of the biggest efficiency of the purposes of investment at the least risk. Considering their behavior from the point of view of profitability parameters during long enough periods, it is possible to mark out some strategy (or purposes determining these strategies).

1. Tax escape in countries of basing.
2. Activation of the markets in accepting country for own production, which is imported by this country (target credits and credits in the connected commodity form).
3. Making profit from the production imported in accepting country, masked as foreign investment; escape of customs barriers.
4. Exportation of the profit as production exported from accepting country, made at the enterprises - objects of FDI.

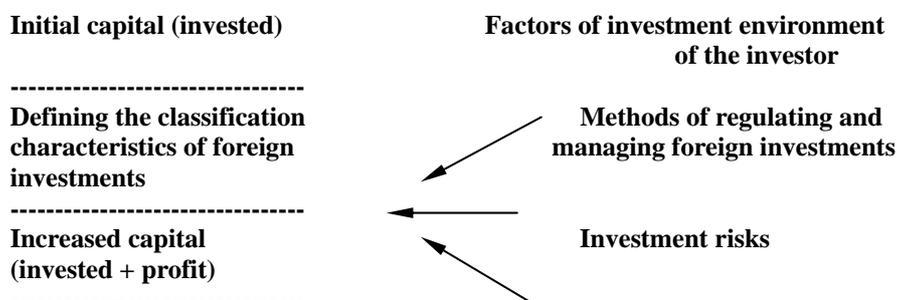


Figure 3.3 The scheme of expert reasons on forecasting profitability of the investment cycle.

5. Exportation of the profit as money resources; repatriation of the capital.

6. Purchase of stock values in the country of basing; reinvestment in the frames of diversification of own property and geographical base (for TNC). Avoid the restrictions for foreign resident on purchase of property right on the territory of accepting country (holding, subsidiary companies, portfolio /re-/ investments).

In the result of conducted systematization we shall distinguish the following parameters of efficiency of the foreign investor activity.

- a) Target efficiency - the degree of achievement of the goals set, degree of realization of strategy of profit making.
- b) Economic efficiency (profitability) - the rate of profit on invested capital.
- c) Risk - the probability of achievement of the goals set and realizations of the investment programs.

The description of accepting country behavior as the subject of international economic relations (IER) is a much more difficult process. The IER are subordinated, in the long-term respect, to the balance regularity: " export = import " .

Having included the flows of capitals we have some expansion of balance equation:

$$\begin{array}{l} \text{CAPITAL} \\ + \text{EXPORT} = \\ \text{INFLOW} \end{array} \qquad \begin{array}{l} \text{CAPITAL} \\ + \text{IMPORT} \\ \text{OUTFLOW} \end{array}$$

In short-term prospect the purpose of accepting country, as of the subject of IER, and participant of international investment processes, in particular, is MAXIMIZING the "INFLOW of the CAPITAL" and "EXPORT". Outflow of the capital and import will be thus in every possible way minimized. In the long-term prospect, by virtue of balance regularities, the flows are directed to stay at balance, but external turn-over of goods and capitals grows. It grows on the basis of a phenomenon of added value, created during manufacture; it grows through increase of capacity and scales of economy of accepting

country, grows through the increase of GNP.

Regularities of the balance of IER, particular characteristics of the efficiency of economy of accepting country impose borders on volumes of the capital to be involved. (fig. 3.4).

Diagram 1 - shows the dynamics of profit increase depending on the increase of volumes of developed investment capital. It depends on scales of economy of accepting country, efficiency of technologies, cost of resources; as well as markets of sales of finished products. The functional dependence is not linear, has the size of saturation, volumes of investment, the excess of which does not lead to further growth of profits.

Figure 3.4 Dependence of the of accepting country's future profit on volumes of foreign investment loans

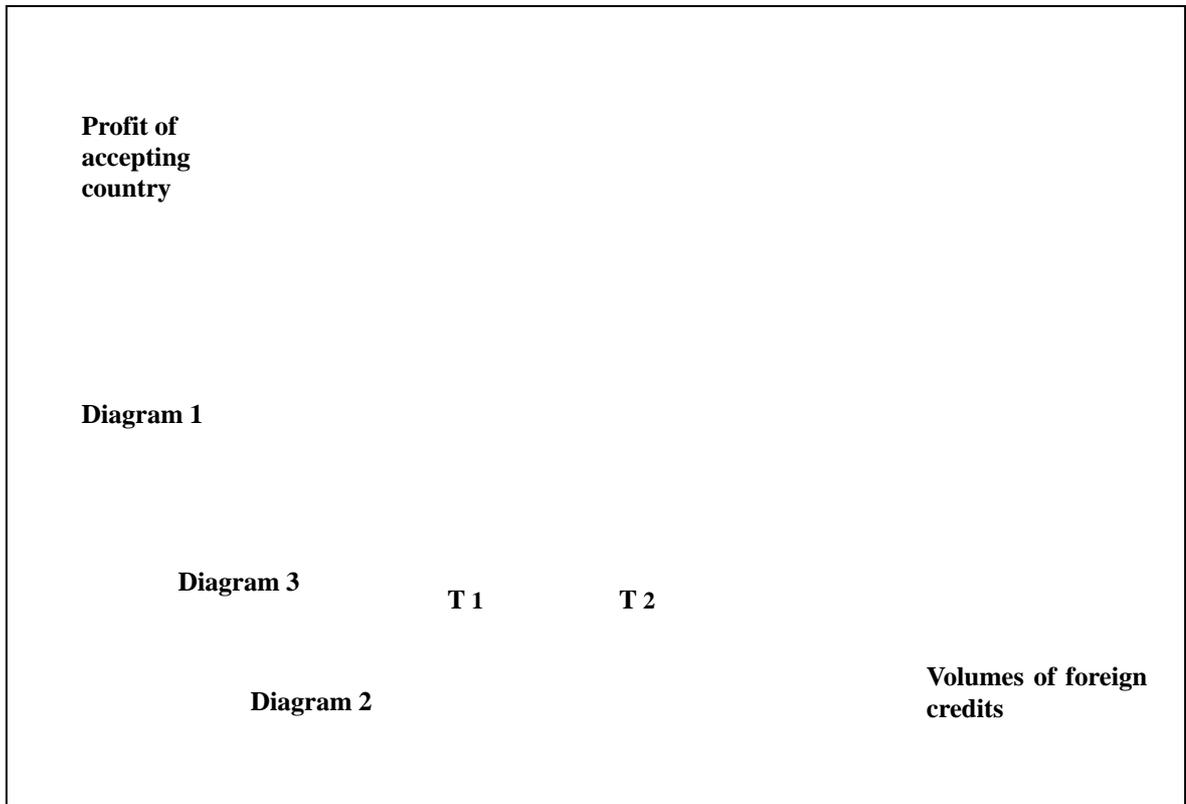


Diagram 2 - shows the dynamics of increase of deductions to the creditors (investors) with increase in volumes of extra investment means. From the point of view of accepting country - losses (negative investments). From the foreign investor point of view (mirror diagram) - profit on volumes of the invested capital. The angle of inclination of the diagram 2 is defined by the credit rate (rate of return on the invested capital).

Diagram 3 is a resulting diagram of accepting country's profit. Theoretically it has an expressed point of the maximum - maximum of the profit (T1) at the given size of the credit rate (angle of inclination of the diagram 2) and certain volume of the invested capitals.

Then as the integrated purpose of accepting country it is possible to consider ACHIEVEMENT of MAXIMUM "PROFIT" (GROWTH of ECONOMY) FROM the INVESTMENT CAPITALS, instead of receiving maximum volumes of investment resources.

There is a great number of computing problems, methodological complexities and complexities of information maintenance. It is necessary to take into account both external, and internal sources of investment resources, in order to define their "equilibrium price " (interest rate) on the average for the whole economy. Besides it is extremely important to take into account not only non-linearity in behavior of the described system, but also dynamics of its behavior. The main thing is that as a result of delaying the return of invested (loan) capitals, the use of investment volumes differs the return of the capitals and profits, recredit under security of growing value. In the result of synergism of various manufactures and markets in national economy (multiplication's effect) the inflow of the capital displaces the diagram 1 (and the whole system to the right - upwards). On fig. 3.4 it is represented by the diagram 1. Therefore the real point of maximum profit lies more to

the right (T2). (But it is necessary to take into account, that dynamics can be also negative: the decrease of volumes of manufacture, "eating away of the credits" etc. It is also difficult to take into account inertia of recession.)

All these difficulties of numerical modeling, force to put the problem of existence of borders of volumes of attracted investments rather QUALITATIVELY, than quantitatively.

The alternate ways of activity of achievement by accepting country of its purpose, are various complexes of measures (various strategies) of attracting the foreign investors. Practically usually the following strategies are used:

1) Ensuring of higher rate of return on the invested capital, than in alternate accepting countries.

2) Introduction of import restrictions in order to protect national manufacture of import replacing production (commodity privileges).

3) Ensuring of higher rate of return in separate, key branches of national economy (factor privileges).

4) Export stimulation.

5) Restrictions to repatriate the foreign investor profit.

6) Reinvestment stimulation.

The particular complexes of measures and ways of investment environment management are described in detail in the present work. The risk for accepting country is rather specific, and consists in difficulties for export and (or) reduction of inflow of the capitals. It is possible to determine the following most characteristic versions of risks, such as:

- POLITICAL PRESSURE;
- ECONOMIC ISOLATION;

- RECEIVING of NOT FULL PROFIT;
- OUTFLOW of the CAPITAL;

Optimal chosen strategy of foreign investors' attraction can be evaluated from the point of view of several criteria.

- a) Target efficiency - the degree of achieving the purposes: formation of positive foreign trade balance, increase of absolute volumes of international trade; increase of dynamics of GNP growth.
- b) Economic efficiency - achievement of maximum rate of return on certain volume of loan and investment means, within the framework of opportunities of economy of accepting country.
- c) Risk - risk of damage for the economy of accepting country.

Within the framework of the system approach, it is not enough to describe isolated laws of behavior of each of the subjects. It is necessary to come nearer to the real description of INTERACTION of two active subjects: the foreign investor /FI/ and accepting country /AC/. For this purpose it is convenient to use the approaches, developed in frameworks of " the theory of the conflicts ". The mutual relations of the subjects can be considered to be the conflicts of the type of games". Both parties act within the framework of the same rules, and consequently the conflicts are never finished and can not be finished by destruction of the whole structure of the relations.

In the light of the given theory the mutual relation of FI and AC can be determined as the false conflict. Really, integrated purposes of each of the interacting parties: increase of rate of return at the invested capital - for the foreign investor; and achievements of maximum growth of national economy - for accepting country, - are not strictly mutually exclusive. Restrictions introduced by us on volumes of the FDI at the given interest rate, exclude in the long-term prospect of negative direction (in relation to the AC) of

international flows of the capital, danger of prevalence of "outflow" over "inflow" of the capitals.

The investor in his decisions is also limited by opportunities of the domestic and international markets of the capital, which promise him one or other rate of return. To him, as capitalist, the structure of industrial profit is indifferent: which share is left to itself by accepting country, and which is paid to the foreign investor. Investor is interested in absolute volumes of return rate. The given law is rather well known and developed.

Within the framework of the theory of the conflicts it is possible to go little bit further, having compared various strategies of behavior after the aims of each of the parties are achieved. (see tab. 3.1)

The table 3.1 develops the approach which specifies that inside each of the countries - participants of the international market of the investment capitals there are groups of persons both profiting and loosing from the liberalization of the market, there is the structure of profits and losses.

Moreover, within the framework of the used approach it is possible to evaluate optimum of INTERACTION process of two active subjects of international investment processes. For this purpose we used ideas about stability of the conflicts decisions. It is proved, that in conditions of continued disputed interaction, when each round of interaction is followed by the next, it is extremely unprofitable to make bet on a single gain. If each of the parties pursues the cooperation, the result will be optimum possible gain of each. It is whence possible to define optimum of the subjects interaction.

The international investment processes are optimal for both active subjects (foreign investor and accepting country), if they steadily remove the conflicts of their interests.

Table 3.1 Conflicts of international investment processes subjects behavior's strategies

Strategies of accepting country Strategy of the foreign investor	Manufacture of import replacing production	Restrictions of outflow of the capital	Expansion of export	Stimulation of reinvestment	Expansion of tax base
Avoiding taxes in the country of basing	+	+	+	+	- Conflict 1
Purchase of the property in accepting country	+	+	+	+	+
Profit through export from accepting country	- Conflict 2	+	+	+	+
Overcoming of customs barriers by AC	+	- Conflict 2	+	+	+
Repatriation of the capital	- Conflict 3	- Conflict 3	+	- Conflict 3	- Conflict 3
Activation of the markets of sales	- Conflict 4	- Conflict 4	+	- Conflict 4	- Conflict 4

Where "+" - coincidence of interests of the parties, adhering to the given strategy;

"-" - discrepancy of interests of the parties, adhering to the given strategy.

Table 3.1 shows possible strategies and gives representation about areas of conflict, for which, it is necessary to find the steady compromise. We see, that the conflicts of strategies are of the following types:

- 1) Conflict "of tax incomes".
- 2) Conflict of the "height of customs barrier".
- 3) Conflict of "repatriation of the capital".
- 4) Conflict of "preservation of the structure of accepting country's industry".

We shall describe these conflicts qualitatively, with the indication of area and methods of their quantitative solution.

1) Conflict "of tax incomes".

With the increase of fiscal and other economic privileges, FI's gain grows and that

of AC decreases: tax incomes decrease (nonlinear). Thus for FI the following risks grow: economic (financial, inflationary, liquidity) and political-social. The risk of bankruptcy and market risk change nonlinear. The main risks of AC on the contrary - decrease.

The formalized approaches to the quantitative solutions are based on the use of "Laffers curve" (ratio of the tax rates in percentage to volumes of tax incomes). Thus dynamics of economy growth depending on the volumes of the investments should be taken into account: the diagram 1' on fig. 3.4.

2) Conflict of "the height of customs barrier".

As the guiding line in the rather bulky consideration of the conflicts a given type is the consideration of industrial structure. The basis of correct structural policy is based on the international manufacture specialization of various kinds of production, depending on relative advantages under the factors of manufacture of the given goods.

Depending on the cost of the factors of manufacture on import replacing (or any considered) goods, the accepting country should:

- do not have relative advantages;
- have equal or large relative advantages.

When considering both cases we shall assume, that the rate of return on invested capital is defined by the condition of the investment capitals international market and, hence, is fixed. For AC it means, that "outflow of the capital" is constant.

In the first of considered cases AC suffers losses, because of abstracting capitals from more profitable "export perspective" goods (not optimum position on curve of "industrial opportunities"). Profit of FI, is not lower than the fixed norm of percent and does not change. The risks of the foreign investor both political-social and economic ones grow. The risks of the AC do not change at all.

In the second of considered cases both the accepting country and foreign investor

win(at the expense of increase from a cycle to a cycle of the capitals volumes). The risks of the foreign investor and risks of accepting country are reduced.

The formalized approaches to the quantitative solutions of the given type of problems are based on the analysis of "supplies and demand" on various kinds of goods in the international markets. Thus the parameters of the supply (volumes - price) are based on techniques of calculating the products prices on the basis of the inter - branch balances.

3) Conflict of "repatriation of the capital".

In the case of FI's gain the increase of the capitals volumes returned into the country of basing, simultaneously, reduction of the AC's gain occurs. Reinvestments are decreased. Thus the FI risks grow, and the AC risks (except for risk " of excessive outflow ") - decrease.

The formalized approaches to the quantitative solutions of the given type problems are based on law of "supply and demand" on the investment capitals. "Supply" is defined by the condition of the international market. "Demand" for the investment capitals should be described by the diagram 3, fig. 3.4.

4). Conflict of "preservation of (nonrational) structure of accepting country's industry".

In the case of (temporary) FI's gain - the increase of profit from "compulsory" import in accepting country (credits and investments in the connected and commodity forms) will occur and the losses of accepting country will increase, in particular, forthcoming outflows of the capital will increase. But most adverse consequence of such cooperation for AC is "preservation" of unprofitable structure both inside national industry and in the external economic relations. Thus the risk of the investor as a whole grows, with the exception of little smoothed (in a short-term period) risk of political-social incidents. The risk of AC as a whole decreases at exception (in prospect) of the risk of excessive

outflow of the capital.

The formalized approaches to the quantitative solutions of the given type of problems are based on laws of two types. On the one hand the foreign trade (international) balances are taken into account as well as the cost of the investment capitals in the international market. On the other hand the analysis of the structure of industry and the costs of the manufacture factors, relative advantages of accepting country, cost and volumes of final product, prospect of the commodity structure "export - import" are taking into account too.

Thus, all considered types of the conflicts have one law. At the increase of one party's gain, the loss of the second grows. But, thus, with the growth of disproportion in distribution of gain, instability of situation simultaneously grows. As for the winning party the risk is growing and for the loser – the risk is reduced.

All the above-mentioned allows to formulate the number of nontrivial results. From the point of view of the theory of games we managed to confirm the profitability of normal work of international investment capitals movement system for each subject. Besides the gears of cybernetic self-regulation are found, liberalized condition of capitals international flows was also described. This condition is the most probable, steady and optimum in the long-term plan for both parties. Its calculated (volumetric and qualitative) significance can be used at the criterion valuation of international investment processes.

§3.3. Multi-factor optimization of foreign investment activity

Considered above problems show, that such rather complex social economic system as the international investment flows of the capitals should be considered and analyzed through the methodological apparatus of adequate complexity to discover. Moreover, the modeling of complex systems from the very beginning allows the spectrum of different

approaches and models, which in essence are equally correct, but are various, because they describe object of research from the various points of view.

Traditionally optimization of foreign investment processes is conducted only from the point of view of optimum for accepting country. In essence systematic attributes of the characteristics of the capitals flows and the direction of their use could be optimized: size, kinds and forms of the investment, direction of use. I.e. attempts of optimization of each separate financial transaction as an individual object (by analogy to engineering objects) were made.

Dealing with the process, instead of individual engineering object, it is necessary and possible to analyse the process's components optimization: multi-factor optimization of the process of goal defining, multi-factor optimization of process of achievement of the goal, multi-factor optimization of object - result of activity. We must expect, that the correctly conducted optimization of the preliminary processes increases the optimum of final result: optimum of the goal defining increases the efficiency of investment activity; optimum of investment activity increases the quality of the objects of investments.

Formalization of the subjects behavior within the international investment processes is convenient through the concept of strategy; strategies for foreign resident and strategies for accepting country.

The social economic system is more complex, and requires even more refined, functional - oriented approaches to optimization. These approaches assume to distinguish:

- optimization of parameters of investment processes;
- optimization of procedures of management by investment processes on the part of the accepting party.

It is necessary to make optimization on each of directions according to the certain procedures rules: valuation of the optimized parameter, and on the basis of valuation, give

recommendation for its optimization. We shall evaluate investment processes and designate their optimum in the frameworks "of ordering of classifications types", which was described in the first chapter, in correlation with the real factography of those, indicated in the second chapter.

According to characteristics of flows of the capitals we have the following picture. The overall volume of foreign direct investment as of 1 January 2003 was about \$5.1 billions. The largest investors are: the USA, Cyprus, the Netherlands, Germany, the United Kingdom and Russian Federation. The largest volume of foreign investment came to the food processing industry, internal trade, and financial-credit sphere. Taking into account that by the end of 1997 Ukraine had received some \$ 3.5 billion from international financial institutions and official sponsors, it is possible to describe the situation as critical for the Ukrainian economy, especially when the country received the credits to cover its budget deficit. It is impossible to ignore the fact of granting by Russian Federation the commodity credit on energy resources.

In the geopolitical sense FDI go basically from advanced countries. The investments are predominate returnable, in the commodity and financial form; average and large in size; middle- and long-term in time. The investment subjects are represented, basically, by state and international organizations. These investors predominantly pursue non-enterprise, and non-financial purposes: sanation of interstate economic relations, political stability of large geopolitical regions and in the world as a whole, establishment of influence on the accepting country.

These capitals were compulsorily used in the accepting country as "eaten away", as they were received in the kind of the commodity credit or were used for payment of "critical import".

The problems of optimization, obviously following from the above given analysis,

can be classified similarly. The absolute VOLUMES of the attracted capital, in comparison with possible ones are insignificantly small. Therefore, before approaching to the volumes, of about US \$20 billion a year, at the average rate of interest in 8 - 12% a year, the investment can be attracted without limitations. Simultaneously, taking into account the unreliability of the centralized accounts, it is necessary to improve the gears of market self regulation of the capitals market.

It seems quite possible to attract relatively small-sized capital. But there is a problem of servicing of such lines and transformation of these attracted liabilities requires significant development of financial institutes.

The DIRECTIONS, the branch and structural orientation of the employment of investments in their "free" part, are used as a whole, pursuant to the certain priorities. It is necessary to change the KIND structure of investments, going from the commodity and financial investments into intellectual and real investments, investments in the technologies and know-how.

Reducing scales of the investors from state and international organizations, it is necessary to give more attention to TNC. On volumes of the TNC's turn-over do not frequently concede to state and international financial institutes, but their attraction promises a number of advantages and profits. It automatically excludes gears of "monetary eating away" of the credits - excessive charges of the convertible currency on maintenance of the national currency's rate, damaging more important (and directed on the same stabilization) structural reorganization of the economy. Besides only TNC are able to ensure adequate entry of the Ukrainian enterprises in world economical system, and (taking into account pitiful condition of the home market of Ukraine for import) this entry will be export oriented.

Expansion, down to removal of any restrictions on purchase of the property rights in

Ukraine, simultaneously stimulates reinvestment and limits outflow of the capitals. Besides solving the main questions - definition of the land owning, the determination of strategic branch restrictions and etc., there are many other urgent problems, the solution of which stimulates the purchase of the property by the foreigners in Ukraine. They include development of the stock market and market of securities, and appropriate infrastructures, ensuring their work. Then the risks of the foreign investor, at the reasonable schemes of co-ownership decrease. With the appearance of "firm nucleuses" - subjects of the law possessing about 35% of the enterprise's assets and actively participating in their work, there are the persons, bearing not only administrative, or criminal liability (which are in an existing legal system rather illusive), but also personal economic responsibility (and risk) for the attracted capitals.

For realization of these directions it is necessary to have rather justified procedures and gears of foreign investment's management. The real practice of management is described in chapter II, approaches to their consideration and valuation - in chapter III.

Pursuant to these approaches we distinguish:

- methods of direct regulation and management of foreign investments;
- methods of regulation through environment of foreign direct investment, indirect management.

Prompt development of social economic processes in Ukraine, the close interrelation of many factors, makes it necessary to determine not only their actual condition, but also the tendency of their dynamics.

The complex of measures of the direct regulation and management of FDI (legal, administrative, economic and social-political) could be evaluated as approaching to optimum. This complex of liberalism and stimulating beginnings is approaching world practice. (In economic measures there are no direct grants and direct soft loans in

stimulated branches and regions. Opportunities of free economic zones are not enough used either.) Risk of the given complex of factors for the investor, is practically equal to zero.

It should be also taken into account, that with starting of the normal gears of market self-regulation the automatic optimization of managing effects on investment processes will come. Therefore problems of restraining the inflow of the capitals in Ukraine, are rooted in the condition of investment environment.

Among the factors of environment (policy, law, economy, welfare features, infrastructure, institutions) the leading place is taken by policy. Dealing with internal political processes, the politological forecasts unequivocally testify to inevitability of occurrence in Ukraine of strong oligarchic grouping of the representatives of the industrial capital. Its (grouping's) policy, certainly, will be pointed on encouraging of the foreign direct investment.

The legal situation at the "macrolevel" is safe enough. It is possible to expect improvement in the part of struggle with robbery and improvement of the activity of arbitration practice. In the field of economy when vaulting and forecasting three rather powerful, but latent, or not working until recently processes are to be taken into account.

First, the established control for macroeconomics practice in Ukraine from the international financial organizations. The coordinator of such effects is IMF. As these organizations credit critical import of Ukraine, they have an opportunity of economic monitoring. It significantly neutralizes the opportunity of the opponents of economic reforms.

Secondly, it is necessary to take into account, that about 40% of turn over in Ukrainian economy are in shadow sphere. In their essence these are quite "normal" that some branches of the economy (neither narcobusiness, not prostitution etc.), forced

"underground" by nonrational customs, fiscal and monetary policies. Already this fact much deforms and blackens the real picture of the condition of business in the economy of Ukraine. "Legitimization" of its turn over in accordance with liberalization of economic conditions will look as unexpectedly fast recovery of the economy.

And, thirdly, it is necessary to take into account, that "large" privatization in Ukraine is going on. Despite the "voucher's" way of its realization, the real inflow of the capitals through investment funds should be expected. It should considerably revive not only market of securities, but also the market of finances.

Determining for political, and through them all other components, are deep processes of the social - psychological order. The rates of formation of the "average class", of representation and organization of the class of owners will influence the directions of flows of the capital between Ukraine and the rest of the world. In this aspect Ukraine has significant advantage as agrarian country capable to generate the average class on the basis of farmers. Thus, on the basis of conducted researches, it is possible to predict the following development of international investment processes in Ukraine.

The subjects of two types will act as the main foreign investors. There are first of all international and state organizations. The volumes of investments from them are largely subject to the risk of political pressure. The foreign direct investment will be granted not in optimum for Ukraine form of the financial and commodity credits and at the interest about twice exceeding the average in the world. The second group of the real investors - former (and present) residents of Ukraine, returning the capital as the foreign investments. The investments will be granted in the kind of direct risky business investments.

The main factor restraining foreign investors is high (by foreign valuations) political risk, causing instability of investment environment as a whole. But in the status quo scenario the experts predict the inflow of FDI as it represented in Fig. 3.5.

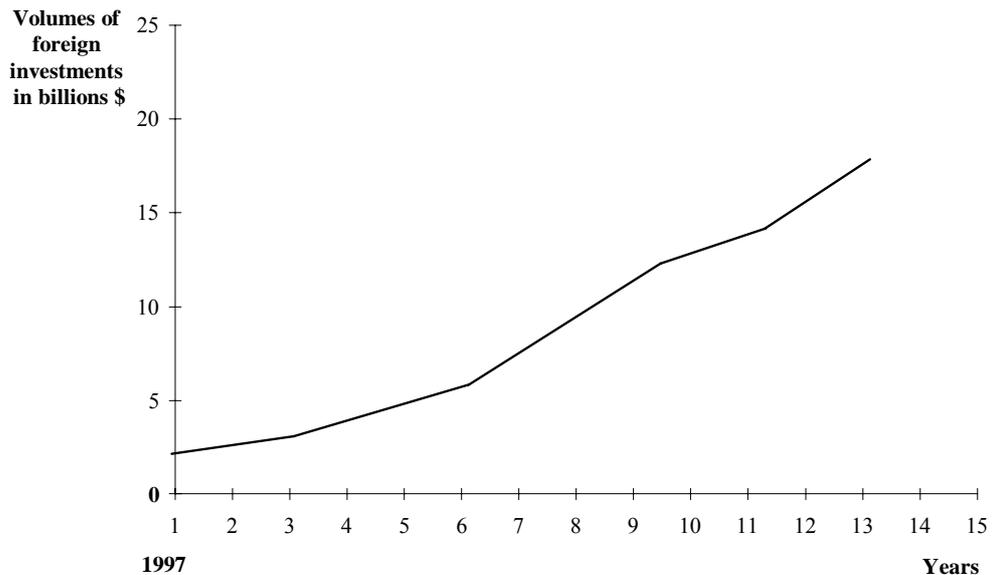


Figure 3.5 The prognisised dinamics of foreign investments growth into Ukraine.

The direct methods of management and regulation of foreign investments are used rather competently by Ukraine, actively and in the greatest possible way in the practice volume. Their further "improvement" does not promise the significant growth of investment's rates. The major roles will "play" the characteristics of environment, the general situation in the economy, its orientation: socialist or capitalist options.

It is possible to hope, that due to the self-regulation gears, inherent to the market economy, considered methods and the ways of direct regulation of the foreign direct investment can not in essence deviate beyond the optimum frameworks. And in light of this law it is necessary rather carefully to refer to any "global program" (or theory) of improvement of the reception of FDI, which offers concentration of the authority in hands of the officers of the state-bureaucratic apparatus.

The practical optimization is possible on the basis of liberalization, decentralization of management of foreign investment. Investment should pass through the proprietor, bearing the personal economic responsibility for the decisions taken. The management on the part of state should be indirect, through creation of certain tendencies and conditions in

the factors of environment.

On this basis it is possible to recommend the following key practical measures.

1) Realization of the international propaganda campaign on formation of the image of Ukraine, as the country with the low political risk and favorable investment climate. Information effect, done through all information channels should show, that the real risks for the investor in Ukraine are not so high as they are believed to be. In particular, the low political risk is stipulated by the mentality and psychology features of the population of Ukraine.

2) To differentiate financial and administrative authority in investment processes. All infrastructure and institutional formations can be in the hands of the state. But the financial institutes, real financial flows should belong to the owners, bearing economic risks for their actions. In this respect the scheme of formation and structure of the capitals of "Ukrainian Bank for Reconstruction and Development" and of "the National Company of Insurance of the Investments" will be the key one.

3) To concentrate efforts on attraction of TNC as foreign investors.

It should ensure access to the world technologies and markets and would give the opportunity for the national TNCs to cooperate with the rest of the world.

Conclusion

The number of the objective factors of the development of modern world economy ensures the special place for international investment activity in international economic relations. At the present time there is a tendency for rapid growth of foreign direct investment in Eastern Europe. This is regarded positively by both investors and recipient countries. Therefore in modern conditions theoretical and applied problems connected with research of international investment activity becoming vital due to the prism of foreign investment capital and processes produced by them in accepting country.

Foreign direct investment should be understood as long-term investment of capital by the investing subject, which is the resident of the country of basing, in the economic system of accepting country with the purpose of receiving profit.

The analysis of the economic literature shows that it is important to systematize FDI into 3 main groups, which could be further divided into subunits:

- I. According to the characteristics of the investing subjects.
- II. According to the characteristics of the capitals flows.
- III. According to the characteristics of accepting country.

The national level of regulation is essential: - it defines the nature of foreign investor, determines kinds of the foreign direct investment; it adjusts the repatriation of the foreign investor's profit; it determines the requirements to the results of the activity of foreign investor; it forms the system of investment privileges and restrictions; it forms the system of the warranties of the foreign investor's rights.

The research shows that the market reforms and structural transformation which are going on in Ukraine require considerable foreign direct investment. The need for

investment is constantly increasing because of the need to renew production capacities. The absolute size of the involved foreign direct investment is still very small and should be improved.

The analysis of the survey shows us that investment climate in Ukraine is quite favorable and the government together with national state and private institutions could attract much more foreign capitals.

Firstly, we can declare that Ukraine has many sectors of economy that are attractive for investors: telecommunication, domestic trade, tobacco industry, food industry, machinery construction and metallurgy. Many investors from the USA, Germany, Netherland and Russian Federation work in these and other sectors of the economy. The biggest part of their capitals was invested in the development of food industry, internal trade, machine-building and metal works, chemical industry.

Secondly, it is important to recognize the growing interest in sectors relating to mineral resources exploration, building, food processing and agriculture, which have considerable export potential. Foreign investments acquire practical, economic and social importance and are realized pursuant to inside and external economic priorities of the economy of the country.

Thirdly, as it has been shown in the research, there is a great importance in estimation of investment attractiveness of Ukrainian regions, in order to design the system of priorities of a structural reorganisation of the economy.

Such priorities for Ukraine are as follows:

- increase of social orientation of economy and solving on this basis of the complex of social economic problems of the structural nature;
- increase of the level of internal equation of economy, more complete satisfaction of own inter - branch cooperation needs;

- reduction of resources and power consumption of manufacture with orientation to more complete and effective use of own energetic - raw material resources;
- technological re-equipment of manufacture with the purpose of improvement of competitiveness of production;
- accelerated development of manufactures, which are able to improve export potential.

The above mentioned system, is a basis for the system of foreign investment attraction, acceptance and location.

The analysis of legal regulation practice regarding foreign investment activity in Ukraine indicates precisely the directed dynamics from rigid and undeveloped direct management, through differentiated regulation activity realized by state executive bodies, to the advanced and complex system of differentiated infrastructure. Thus the strengthening of policy occurs concerning foreign capitals as a part of increase of definiteness of the legislation and reduction of the field of permissions presumption.

The research is especially justified in the situation when there are some problems relating to the analysis of Ukraine economy. The used system - cybernetic approach to the analysis of investment processes was correct.

There is an absence of expressed correlation between processes regarding direct regulation by the foreign investments and real dynamics of those for the analyzed period. It testifies about special topicality of favorable business environment creation within accepting country. These components are rather important, however voluminous at description.

We could also declare that the unique situation had developed in Ukraine, at which material infrastructure is designed for volumes of manufacture more than in six times exceeding the used ones; the proposal on the part of potential manufacture is huge. It guarantees that at realization of correct structural and macroeconomics policy the rate of

return on the invested capital will be extremely high. The correctness of realization of internal structural and macroeconomics policy is guaranteed by over-national, rather stable and powerful factors: by the condition of the payment balance of the country and monitoring of international financial organizations. The social - cultural status of the population of Ukraine guarantees positive changes of public processes ensures as a whole favorable attitude to the foreign investor and own capital.

In the research we also identified a number of major areas of conflict between investment activity subjects which Ukraine needs address and find the steady compromise. The conflicts, as the case of strategy's different directions of the subjects are the following:

- 1). Tax receipts.
- 2). Heights of customs barrier.
- 3). Repatriation of the capital.
- 4). Preservation of the structure of industry of accepting country.

Research shows that the most important problems of optimisation of investment subjects in Ukraine were:

- invested capital in comparison with what might be possible is insignificantly small;
- invested capital is a short-term medium-sized investments.

For successful development of foreign investment in the direction of liberalization it is possible to recommend the following measures:

- realization of international campaign to form the image of Ukraine, as the country with low political risk and favorable investment climate;
- change the of investments structure, going from the commodity and financial investments to intellectual, real investments, investments in the kind of technologies and know-how;
- reducing scales of the investors from state and international organizations, it is necessary to give more attention to trance national corporations. The only TNC are able to ensure

adequate entry of the Ukrainian enterprises in the world economical system, and (taking into account pitiful condition of the home market of Ukraine for import) this entry will be export oriented;

- during the process of privatization grant the foreign investors, which are acting in roles the general investor, national and probably preferential mode;

- to differentiate the financial and executive authority in investment processes;

Expansion, towards the removal of any restrictions on purchase of the property rights in Ukraine, simultaneously stimulates reinvestment and limits outflow of the capitals.

There is no doubt that Ukraine has considerable potential to attract much more foreign direct investment. Already inward investment has been made, but the government needs to address some important issues in order to encourage more investment.

Successful development of the Ukrainian economy, as the participant of the international economic relations, will have a huge impact on the development and growth of the country and the Eastern Europe.

APPENDIXES

Appendix A. Foreign direct investment inflows by regions, 1991-2002 (millions of dollars)

Region	1991-1996 (annual average)	1997	1998	1999	2000	2001	2002
World	254 326	481 911	686 028	1 079 083	1 392 957	823 825	651 188
Western Europe	91 030	139 274	263 025	496 205	709 877	400 813	384 391
European Union	87 584	127 888	249 934	475 542	683 893	389 432	374 380
Central and Eastern Europe	8 183	19 033	22 479	25 145	26 373	25 015	28 709
North America	53 406	114 925	197 243	308 118	380 764	172 787	50 625
Africa	4 606	10 667	8 928	12 231	8 489	18 769	10 998
Latin America and the Caribbean	27 069	73 275	82 040	108 255	95 358	83 725	56 019
Latin America	14 982	48 228	52 424	70 346	57 248	39 693	25 836
Asia	59 411	109 092	99 983	108 529	142 091	106 778	94 989
West Asia	2 228	5 918	6 893	754	1 523	5 211	2 341
Central Asia	1 035	3 107	2 997	2 462	1 871	3 963	4 035
South-East Asia	56 147	100 067	90 093	105 313	138 698	97 604	88 613
The Pacific	416	190	333	280	118	159	140

Appendix B. Foreign direct investment and national investment into Special Economic Zones and Territories of prior development, thousands US dollars.

Zone/Territory	Due date 01.01.2000		Due date 01.01.2001		Due date 01.01.2002	
	FDI	national	FDI	national	FDI	national
	<i>Special economic zones</i>					
Azov	-	-	-	-	1 196	-
Donetsk	-	-	111	604	314	2 226
Slavutich	350	213	1 889	405	4 607	663
Kurortopolis- Truskavets	-	-	568	1 163	2 521	2 779
Yavoriv	4 197	264	12 040	8 729	15 479	15 737
Zakarpattya	-	-	1 843	35	2398	537
Porto-Franko	-	-	-	-	-	2514
Reni	-	-	-	-	-	360
Mikolayiv	-	-	-	-	784	-
	<i>Territories of prior development</i>					
Donetsk region	47 118	86 309	115 480	154 192	217 253	187 377
Zakarpatsk region	6 159	2 632	7 821	20 583	9 454	28 939
Volinj region	-	-	175	99	279	373
Lugansk region	-	-	1 363	1 148	1 741	1 923
Kharkiv city	-	-	1 684	2 966	8 628	6 905
Autonomy Republic Crimea	-	-	272	8 213	5 666	25 188
Zhitomir region	-	-	1 858	154	3 262	164
Chernigiv region	-	-	37	-	2 533	-
Sumi region	-	-	-	-	-	-
All	57 825	89 418	145 139	198 290	276 114	275 685

Appendix C. Investors' valuation of the main components of investment climate in Ukraine, number of respondents' answers

Components of investment climate	Mark					Average bal
	Very good	Good	Satisfied	Poor	Very poor	
<i>Stability</i>						
Political	0	10	65	32	8	1,7
Economic	0	17	62	33	5	1,8
Social	1	24	60	28	2	1,9
<i>General characteristic of the country</i>						
Internal markets	7	38	42	19	2	2,2
Infrastructure	0	9	49	43	9	1,5
Communications	0	10	55	38	9	1,6
Ground production	43	38	9	2	1	3,3
Climate	20	65	16	2	0	3,0
<i>Market infrastructure</i>						
Financial sector	0	6	61	34	8	1,6
Level of credit rates	0	8	31	53	18	1,3
Stock market	0	1	18	51	26	0,9
Real estate	0	10	65	21	0	1,9
<i>Fiscal system</i>						
Taxes	0	3	20	45	43	0,8
Pension funds	0	13	60	29	5	1,7
Local taxes	1	3	61	25	5	1,7
<i>Labor relations</i>						
Labor costs	27	53	30	1	2	2,9
Labor quality	19	53	33	8	0	2,7
Labor relations	1	37	58	7	2	2,2
<i>Ground and rent relations</i>						
Field rent	0	14	34	42	2	1,6
Field market	0	2	26	46	14	1,2
<i>Private business climate</i>						
Certification	0	0	17	57	35	0,8
License	0	0	17	53	31	0,9
Burocratization	1	0	29	44	34	1,0
Deregulation of business activity	0	1	35	51	13	1,2
Intellectual property	0	6	27	35	27	1,1
<i>Investing conditions</i>						
Registration of investment	0	12	58	29	7	1,7
Realization of investment projects	0	1	42	40	12	1,3

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