

and to foresee in prospect the co-ordination of structural changes in the determining macrosystem indexes.

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INTERNATIONAL FINANCIAL POSITION OF UKRAINE

According to the economic theory, to regulate external payments and compensate payment's balance deficit, the governments very frequently use different external financing sources. The breakdown of these sources is reflected in the Chart 1. As one can see, the sources might be divided in officials (state) and privates. Some of them result in debts (they are designed as the rectangles in the Chart 1), others don't form the debts (they, correspondingly, are presented as the ellipses in the same Chart).

Definitely, each of these sources has its own advantages as well as disadvantages. For instance, official assistance in forms of grants or/and written-off debts have predominantly political character and, correspondingly, may change its forms following political changes in the society. Official assistance's mechanism is very flexible. Particularly, several preferential credits, interest rates, discounts, financial moratoriums, etc, might be used.

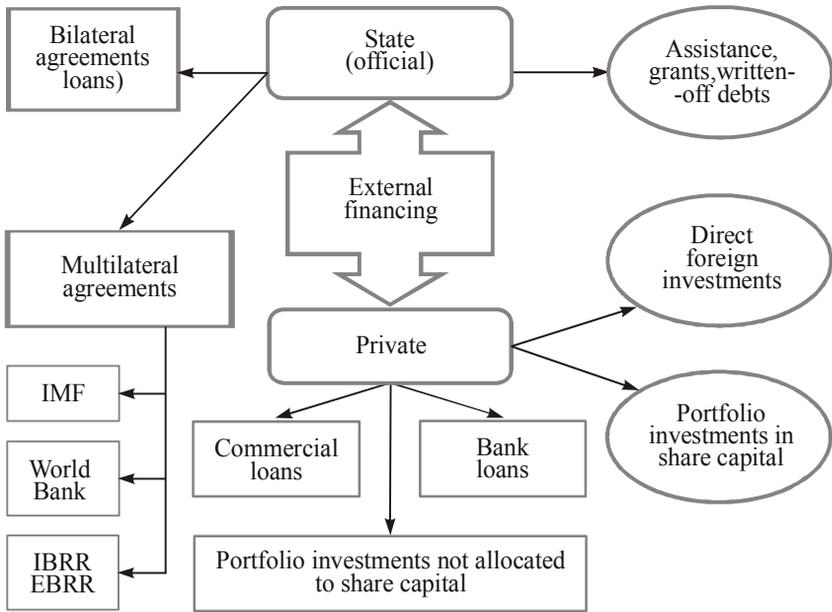


Chart 1. Structure of external financing sources

Bilateral agreements this is, according to its economic sense, state (official) investments into potential markets. Country-donor considers these investments as mechanism, which may help to control the main stream of the beneficiary country's economic development. For instance, according to the great majority of bilateral agreements, country-beneficiary has to spend a significant part of the loan's amount (up to the 70 per cent of its cost) purchasing goods and services that have been produced in the country-donor. As a result, a great majority of the bilateral loans may be considered as an instrument that country-donor uses developing its economic policy and several co-operation programs with the country-beneficiary.

Official (state) loans make a significant part of the bilateral agreements. Majority of them have a preferential character and according to their parameters, they are very close to the international assistance. This is long-term loans (up to 25 years), with postponement of payment (7—8 years), preferential interest rate (3—4 per cent per year). Even more, a significant part of these loans are given to the country-recipient through the international finance organizations such as World Bank, International Monetary Organization, European Bank of

the Reconstruction and Development, etc. As a result, conditions of these loans reflect corporate interests of the creditors.

Private sourcing such as commercial and bank loans as well as financial sources that are coming from several funds and stock-market where debtors are selling their state and private assets. It is necessary to identify consider direct and portfolio private investments. Direct investments (may be primaries or reinvestments) are supposed to get business profit. Portfolio assets this is investment of the capital into stock-market papers in order to get dividends. As a result, outlay direct investments are considered as international investment activity while external portfolio investment is an activity in the stock market.

From beneficiary country's point of view, outlay (foreign) direct investments are recognized as more preferential, advantageous and profitable because they envisage long-term economic interests of the country-recipient and, what is extremely important, they don't affect payment's balance statement.

It's necessary to note that following overall globalization process, during the last ten-fifteen years international investments' growth rate is much higher than dynamics of the international trade. As a result, a part of the direct investments in the total amount of state and private capital by the end of the last century reached 33 per cent. There are so many reasons that may explain this tendency. In particular, recipient countries are considered by the donor countries as potential market of their own goods and services as well as sources of cheaper markets of the labor force, raw materials and energy. All these factors may guarantee higher level of production profitability in beneficiary countries than in donor countries.

However, one may ask very important questions, namely:

— «Is export and import of the capital mutually beneficial to beneficiary— and donor's countries?»

— «Does outlay financing, in particular, direct foreign investments affect positively GDP and production profitability level in the beneficiary country?»

In this regard we should say that neoclassic theory does not answer positively to such vital questions because, according to a great majority of scientific researches that profess the neoclassic theory, investment fees, which capital importer got in the beneficiary country are very frequently repatriated to the donor countries.

However, is observed a success story of the direct foreign investments' (DFI) use in the Central and Eastern countries, where DFI became the main source of the economic growth and covering of the payment balance deficit (see Table 1).

Table 1

**FOREIGN INVESTMENTS AS A SOURCE FOR COVERING THE PAYMENT
BALANCE, 2000**

Country	Relation of current operations account to GDP	Correlation between DFI increment and payment balance deficit
Bulgaria	-5,4	140
Czechia	-4,6	189
Hungary	-4,2	81
Poland	-6,2	82
Romania	-3,0	72
Slovakia	-3,7	286

Source: The Ukrainian Economy Development Tendencies — June 2001. — Pages 73—74.

As we can see, there is a strong positive relation between direct foreign investments increase and payment balance deficit. For instance, in Bulgaria, Czechia and Slovakia the direct foreign investments' increase overlaps absolutely the payment balance deficit, while in Hungary, Poland and Romania it makes about 80 per cent of this deficit. We also have to mention that DFI affect positively innovation process as well because donor countries simultaneously with the imported capital bring to the beneficiary countries contemporaneous technology, business and management style and know-how. As we know, these elements of the overall innovation process might be identify as factors of the economy modernization and quick economic growth.

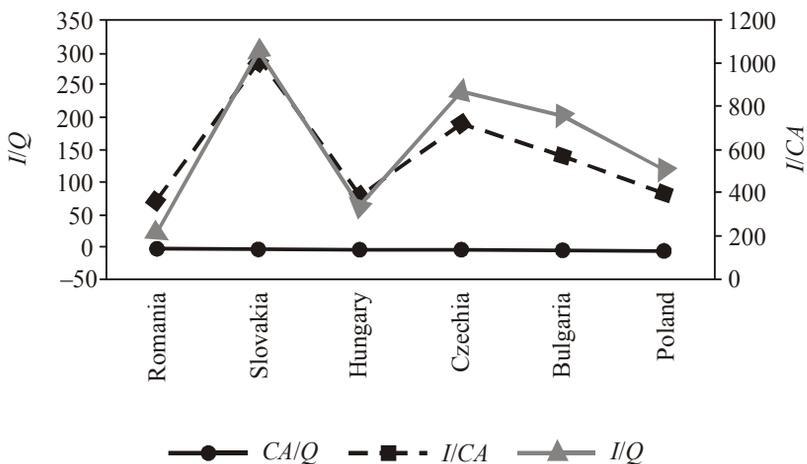
This relation might be presented formally by the following equation:

$$\frac{I}{Q} = \frac{CA}{Q} \times \frac{I}{CA} \text{ або } \frac{CA}{Q} = \frac{I}{Q} : \frac{I}{CA},$$

Where: CA — payment balance;
I — direct foreign investments increase;
Q — GDP

Looking at the Graph 1, we can make the following very important methodological conclusion, namely: direct foreign investments in Eastern European countries are considered as a factor of the payment balance deficit's covering.

Ukraine became the object of the international investment in the beginning of the 90th. That time the conditions for the foreign investors were extremely positive. Internal market was absolutely empty while a lack of funds necessary to organize an internal production also was registered.



Graph 1. Relation Between the Increase of Direct Foreign Investments and Payment Balance in Eastern European Countries

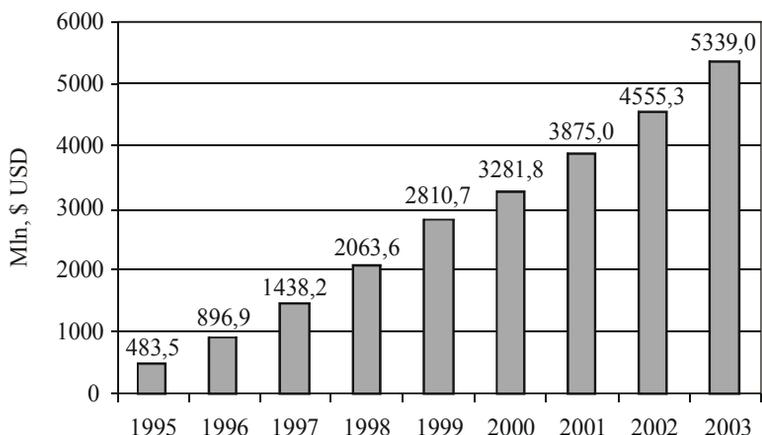
In this specific situation, the Ukrainian political elite have made a decision to create an exceptionally preferential investment climate. As a result, the Ukrainian Law «About Foreign Investments» has been approved by the Verhovna Rada (the Ukrainian Parliament) in 1992. According to this Law, enterprises created by the foreign companies due to direct foreign investments did not pay profit fee to the state budget during a long time.

However, the hopes to create a modern productive potential were not realized. It's difficult to believe, but during three years (1992—1995) Ukraine got only 485,3 million \$US of direct foreign investments, while according to the estimations, the yearly requirement was about 4 billion \$ US.

The Law mentioned above has been canceled; however, this did not result DFI's dynamics reduction. Even more, the significant yearly increase of the direct foreign investments was registered since 1995 and the biggest increase of 1.4 billion \$ US was registered in 2003 (see the Graph 2).

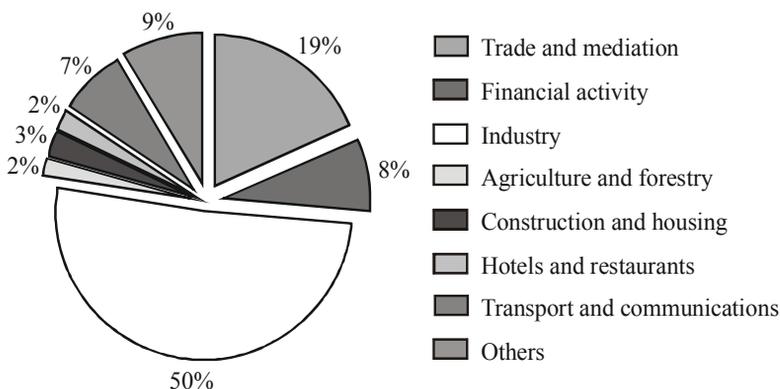
The biggest foreign investors are the United States, Netherlands, Germany, Great Britain and Russia. However, during the last 5—7 years among the main foreign investors appeared and began to make more and more significant part financial sources from such off-shore zones like Cyprus, Virgin and Islands-of-Men, etc. where the Ukrainian «shadow» money are coming from. These financial sources are protected now by the status of foreign investors' money and may become now more effective foreign investments because their owners on one hand know Ukrainian reality very well, on the other hand, they belong to new, well-trained generation of Ukrainian managers, and, as

a result, they are able to manage «new-born» companies more effectively than their foreign colleagues or/and Ukrainian managers that belong to «old guard of red directors» managerial group.



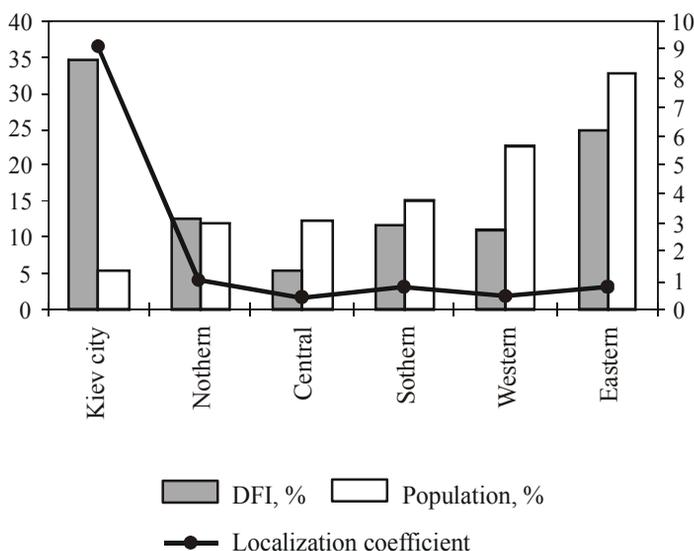
Graph 2. Dynamics of Direct Foreign Investments in Ukraine (as of the beginning of the year)

Taking into account that a certain part of foreign investments belongs to new Ukrainian owners and managers, we have to expect in the near future serious changes in the DFI breakdown by types of activity. In the beginning of 2003 total DFI amount was 5.34 billion \$ US. About 2,7 billion (about 50 per cent) has been invested in the industry; 18,5 per cent in the trade; 7,2 per cent in transport and communications; more than 8 per cent in financial activity (see Graph 3).



Graph 3. Breakdown of Direct Foreign Investments by Types of Economic Activity, as of 01.01.2003

Special methodological and practical interest represents an analysis of Ukrainian regions' breakdown by the population numbers and foreign investments amounts simultaneously (See Graph 4, where the left scale represents distribution's percentage while the right one, — localization coefficients of foreign investments). As can be seen, a great majority of foreign investments is concentrated in Kiev city ($L=9.1$), a certain part belong to the Northern region, where the Kiev oblast (district) also is located. The lowest localization coefficients are observed in the Western and Central regions of Ukraine (correspondingly, 0.49 and 0.43).



Graph 4. Breakdown of the Ukrainian Regions by Population and Direct Foreign Investments Amounts, as of 01.01.2003

In the beginning of 2004 the total amount of direct foreign investments reaches 7.7 billion \$US. As a result, this year DFI per capita was 155 \$ US that 2.3 times more than in the beginning of 1998. However, this figure is significantly lower than in other Eastern European countries with economies in transition. For instance, DFI amount per capita in Hungary was 1882 \$ US as of 01.01.2004 or 12.1 times more than in Ukraine.

We also have to mention that direct foreign investment did not become yet a significant factor of the economic development in Ukraine. Looking through the Table 2 data, one may make a conclusion that

each per cent of DFI's increase, results only 0.26 per cent of the GDP increment. Simultaneously, a very important conclusion about DFI dynamics unstableness also might be made.

Table 2

CHARACTERISTICS OF THE INVESTMENT PROCESS IN UKRAINE

Year	Rate of increase, in % as compared with the previous year			DFI increase in per cent to GDP	DFI Flexibility ratio
	Gross do- mestic prod- uct	Investments in fixed as- sets	DFI increment		
2000	5,9	14,4	18,1	1,9	0,32
2001	9,2	20,8	17,6	1,8	0,52
2002	5,2	8,9	20,1	2,2	0,26
2003	9,3	27,7	21,7	2,5	0,43

Source: Report of the President of Ukraine to the Verhovna Rada (the Parliament of Ukraine). — Kiev — 2004. — Pages 188—189, 302, 375.

The state policy in regard to the foreign investment process traditionally is considered in the context of the correspondent investment climate. We performed analysis of the investment climate in Ukraine using the methodology of the multiple regression. Analysis's results show that potential of Ukraine in attraction of foreign investments remains unused and low investment climate of the certain regions (first of all, Northern and Southern) as well as of the country as whole does not help further attraction of the foreign investment. Simultaneously the efficiency of attracted investments should be recognized as low.

Summarizing all mentioned above and making a final conclusion, we should say that logic of the investment process dictates a necessity to organize further scientific research that should be dedicated to the identification of the ways of effective investment strategy development focused on ensuring optimal proportion between interests of the foreign investors and national interests, on diversification of sources of the investment resources and improvement of the investment climate in the Ukrainian regions as well as in the country as a whole.