

Reform proposals for improvement of the investment climate

After overcoming the economic crisis of 2014/15, Ukraine is back on course for growth. However, to give their citizens a real perspective, higher growth rates are needed and more investment is a key prerequisite.

Even though the investment and business climate has significantly improved in recent years, further efforts are required. In cooperation with the German-Ukrainian Chamber of Industry and Commerce (AHK Ukraine), the German Advisory Group has prepared a study with reform proposals for improving the investment climate. The study comprises a total of 28 specific reform proposals from companies, which were drawn up in 6 different working groups. The focus here is on reforms with a direct impact on the business climate and investments, the reduction of administrative barriers and bureaucracy, and the creation of a level playing field.

Starting point

After the severe economic crisis of 2014/15, Ukraine has been back in growth mode since 2016, which is, among other things, a successful outcome of macroeconomic stabilisation measures. However, the real gross domestic product (GDP) has by no means returned to its pre-crisis level of 2013. If the economy were to grow by 3% in real terms each year, roughly in line with the current pace of growth, the 2013 level would not be reached again until 2022.

Development of real GDP

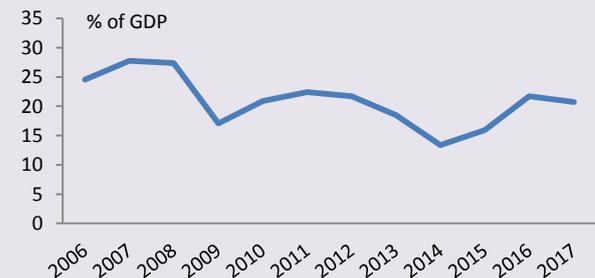


Source: IMF WEO October 2018, own calculations

This implies an urgent need to increase the medium-term growth rate. If this does not succeed, the process of migration of Ukrainian workers, which has been intensifying for some time now, will continue to accelerate. A key factor for higher growth lies in stimulating private investment. Although the current investment ratio of 20.7% of GDP (2017) is significantly higher than in the crisis year 2014 (13.4%), it is still far

from past levels. In 2006, i.e. before the global financial crisis, the investment ratio was 24.5% of GDP. According to the international rating agency Fitch, countries with similar credit ratings have comparable investment ratios.

Investment share in GDP



Source: IMF WEO October 2018

How can the investment rate be increased? An important role in this context is played by the investment and business climate, which summarises the business environment. According to the international comparative study "Doing Business" of the World Bank, the framework conditions in Ukraine have already improved significantly in recent years as a result of a number of reforms: in 2012 the country occupied 152nd place, this year it improved to 76th place.

Background of the study

Despite visible successes in improving the regulatory environment for companies, they continue to report certain limitations and barriers which, in turn, weigh on their investment intentions. This assessment is in line with the still rather hesitant attitude of foreign investors towards Ukraine. So far, there has been no reversal in the trend of foreign direct investment (FDI) inflows, which, however, play a central role in productivity, wage developments and economic growth.

In order to identify certain obstacles and develop concrete proposals for solutions, the German Advisory Group in cooperation with the German-Ukrainian Chamber of Industry and Commerce (AHK Ukraine) prepared a study with reform proposals of German companies operating in Ukraine. The chamber, which was officially opened in 2016, comprises almost 130 member companies from a wide range of business sectors.

In order to capture this unique bottom-up perspective of companies, the Advisory Group has worked closely with 6 different working groups. On the basis of standardised questionnaires, the various obstacles were identified, structured and prioritised, and the associated negative economic effects analysed. On this basis, policy proposals were then drawn up which were addressed to state institutions (e.g. Cabinet of Ministers, Parliament).

Selected reform proposals

The procedure described above has resulted in a total of 28 reform proposals, 9 of which are cross-sectoral (i.e. in the areas of "law" or "taxes and accounting"). The remaining proposals focus on individual areas and sectors, such as finance or logistics and transport.

Prioritisation is essential for the targeted implementation of the reform proposals in question, which naturally differ in scope and impact. For this reason, the study includes a "Top 10" list of reforms that decision-makers should first address, as they promise relatively quick wins. These 10 reforms can be divided into three areas.

Measures with direct impact on business climate and investments

Two measures predominate here. On the one hand, access to electricity supply remains very problematic and a serious obstacle, especially for manufacturing companies. Accelerating the connection to the energy grid could lead to a significant increase in investment in the real sector. On the other hand, a possible shortage of transport licences through Poland turns out to be a serious obstacle for exporters to the EU. More transparency is needed here and, if necessary, an increase by negotiation is recommended.

Reduction of administrative barriers and bureaucracy

Various measures should be taken in this area, such as the use of EU invoice prices for imports and the abolition of certain transport documents. This also includes the abolition of certain penalty payments in taxation, the limitation of account restrictions in criminal investigations and improved enforcement of court decisions (e.g. in tax matters) against the state.

Equal conditions of competition

This is about creating a level playing field. Corresponding proposals concern the banking sector, where the state share has risen significantly as a result of the crisis, but also agriculture (e.g. pesticides). It is equally important to take decisive action against companies that exploit bogus self-employment to their advantage. In such a way, compliant companies would be strengthened.

Outlook

The study with reform proposals for improving the investment climate can be seen as an important complement to the agenda of other international institutions. While the latter are often focused on important strategic issues (e.g. the establishment and impact of an anti-corruption court, land reform), our study provides an equally important micro-perspective. The main focus here is on German companies operating in Ukraine, which is of course decisive for the sectoral orientation of the recommendations. At the same time, however, all other companies operating in Ukraine would also benefit from the proposed reforms.

What is crucial, however, is the implementation of our proposals, in particular the legal implementation. Support in the specific development of improved framework conditions can be assured here on our part.

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PS/03/2018 offers a detailed coverage of the topic [„Unlocking investment through reforms: Proposals from German business in Ukraine“](#).

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