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INTERNATIONAL INVESTMENT POSITION OF UKRAINE: POSSIBILITIES FOR IMPROVEMENT IN THE CONTEXT OF TAX POLICY CHANGES<https://orcid.org/0000-0002-8147-1837>

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O. Klymenko, S. Mala, H. Matviienko. International investment position of Ukraine: possibilities for improvement in the context of tax policy changes.

This article is devoted to the analysis of Ukraine's International Investment Position (IIP) for the purpose of identifying ways to improve it. The authors investigated the IIP of the main countries of the world. They identified the countries of the European Union with the highest net IIP deficit relative to GDP. This article analyzes the dynamics and structure of Ukraine's assets and liabilities to determine how they came to be. This article also identifies the main risks, advantages, and disadvantages of foreign direct investment flows in Ukraine.

The article will suggest that improved fiscal policy, including tax legislation, will enhance Ukraine's IIP. A sound tax policy promotes foreign investments into the country's economy, can structurally improve the investment position, and prevents uncontrolled capital outflow. It is necessary to adopt a package of anti-Base Erosion and Profit Shifting (BEPS) laws against tax evasion and against disclosure of other property information to implement the capital transfer tax. The article identifies the main advantages of this model of taxation.

Клименко О. М., Мала С. І., Матвієнко Г. А. Міжнародна інвестиційна позиція України: можливості покращення у контексті змін податкової політики.

Стаття присвячена аналізу міжнародної інвестиційної позиції України (МІП) з метою визначення шляхів її покращення. Авторами досліджено МІП основних країн світу та визначено країни Європейського Союзу з найвищим дефіцитом МІП у порівнянні з ВВП. У статті проаналізовано динаміку та структуру активів та зобов'язань України, а також визначені основні ризики, переваги та недоліки потоків прямих іноземних інвестицій в Україні.

У статті висловлено припущення, що поліпшення фіскальної політики, включаючи податкове законодавство, сприятиме покращенню МІП в Україні. Надійна податкова політика сприяє залученню іноземних інвестицій в економіку країни та може структурно поліпшити інвестиційну позицію та запобігти неконтрольованому відтоку капіталу. Необхідно прийняти пакет законів анти-BEPS для боротьби з ухиленням від оподаткування і розкриття інформації про власність та ввести податок на виведений капітал. У статті визначені основні переваги цієї моделі оподаткування.

Клименко О. Н., Мала С. И., Матвиенко Г. А. Международная инвестиционная позиция Украины: возможности улучшения в контексте изменений налоговой политики.

Статья посвящена анализу международной инвестиционной позиции Украины (МИП) с целью определения путей ее улучшения. Авторами исследовано МИП основных стран мира и определены страны Европейского Союза с высоким дефицитом МИП по сравнению с ВВП. В статье проанализирована динамика и структура активов и обязательств Украины, а также определены основные риски, преимущества и недостатки потоков прямых иностранных инвестиций в Украину.

В статье высказано предположение, что улучшение фискальной политики, включая налоговое законодательство, будет способствовать улучшению МПП в Украине. Надежная налоговая политика способствует привлечению иностранных инвестиций в экономику страны и может структурно улучшить инвестиционную позицию и предотвратить неконтролируемый отток капитала. Необходимо принять пакет законов анти-BEPS для борьбы с уклонением от налогообложения и раскрытия информации о собственности и ввести налог на выведенный капитал. В статье определены основные преимущества этой модели налогообложения.

Formulation of the problem. The economic development of the state depends on many factors, and, in particular, on the course of international investment processes. Foreign investments are an effective factor of the country's economy development. The efficiency of foreign investment depends considerably on the investment climate of the investment importing country. Internationally, various indicators and ratings are applied to determine the country's investment attractiveness, including the data of the "international investment position of the country" (IIP). Therefore, the issue of improvement in the international investment position of Ukraine is relevant. To improve the international investment position of Ukraine, it is expedient to improve fiscal policy, including tax legislation. A sound tax policy of the state promotes investments into the country's economy, can structurally improve the investment position, promote foreign investment and prevent uncontrolled capital outflows. Many countries have recognized this fact and reformed their tax codes according to new global needs and changes in the international financial environment [1].

Analysis of recent research and publications. Among the researchers, whose works are devoted to the problem of IIP assessment and investment development in Ukraine, it is possible to distinguish the following authors: M. Denysenko, M. Krupka, I.V. Alekseev, V. Maiorova. However, the possibilities for improvement in the international investment position of Ukraine considering tax policy changes remain under investigated. Issues relating to the features of Ukrainian tax system functioning are considered by such Ukrainian scientists as T.I. Yefimenko, Yu.B. Ivanov, A.I. Krysovaty, O.M. Desiatniuk, K.I. Shvabiy, and others. In recent years, the tax system of Ukraine has undergone significant changes, its "modernization" has taken place and a number of innovations have been introduced. These steps have increased the scientists' attention to the study of investment attractiveness of Ukrainian economy due to the introduction of innovations in the tax area.

The purpose of the paper is to determine the factors of the development and assessment of the international investment position of Ukraine and substantiate proposals for its improvement taking into consideration the changes in tax policy.

Results of the research. Bringing foreign investments into the nation's economy depends on a number of factors, including internal political stability; the nature and pace of market reforms; economic legislation stability; guarantees of inviolability of private property and foreign investments; favourable foreign economic conditions [2, p. 452].

In modern globalized world capital is extremely mobile. Enterprises may invest in any project in different countries around the world to find the highest level of profitability. It means that enterprises will look for projects and countries with lower investment rates in order to maximize profit after tax payment. If the tax rate in the country is too high, it will contribute to investment "outflow" to other countries, which will slow down economic growth. Additionally, high marginal tax rates may lead to tax evasion. In the ranking of investment attractiveness among the nation of economies of the world ((BDO) International Business Compass (IBC)) in 2018, Ukraine ranked 131 among 174 countries [3]. The country lost its position by 42 points compared to 2015 (89 in 2015).

In the conditions of free capital flows and development of global financial environment, the assessment of the country investment position is of great importance. The investment position determines the future strategic development of the country and its financial security. The net international investment position is determined by the difference between foreign assets and liabilities of the country [4]. Depending on the net investment position, countries are divided

into net debtors and net lenders. The analysis of net lenders and debtors makes it possible to identify future geopolitical leading countries, as well as those countries which may face debt repayment crisis. The largest net debtors in the world are the USA, Spain, Australia, and Brazil [5]. There is a tendency to net liabilities increase in such countries as: the USA, France, Ireland and Turkey. Spain, Brazil and Eurozone countries have reduced their net debt obligations (table 1). Among the largest net lenders in the world there are Japan, Germany, China, and Switzerland. Such countries as Germany and China, the Netherlands and Canada are gaining a positive balance of NIIP [6].

Table 1

Net IIP, Top 5 Economies with deficit and surplus, billions of US dollars [5]

Country	2013	2014	2015	2016	2017
Net IIP (Deficit) Top 5 Economies					
United States	-5368,6	-6945,4	-7461,6	-8181,6	-7725,0
Spain	-1334,5	-1234,2	-1053,1	-1006,2	-1172,6
Euro Area	-1983,5	-1488,1	1313,6	-806,5	-823,6
Australia	-752,2	-695,2	-674,2	-699,8	-757,1
Brazil	-723,9	-705,9	-347,7	-585,5	-659,3
Net IIP (Surplus) Top 5 Economies					
Japan	3093,3	3012,4	2815,0	2879,2	2909,1
Germany	1344,2	1449,3	1539,2	1689,2	2124,4
China, P.R.:Mainland	1996,0	1602,7	1672,8	1950,4	1814,1
China, P.R.: Hong Kong	758,0	870,2	1003,1	1153,8	1421,2
Norway	640,5	709,0	696,8	734,8	886,0

Negative net investment position is observed in Ukraine during the entire period of independence, which is a negative trend [7]. The largest liabilities (debts) and assets were in 2012-2013, after 2013 there is a tendency to decrease the debts and assets (Fig. 1).

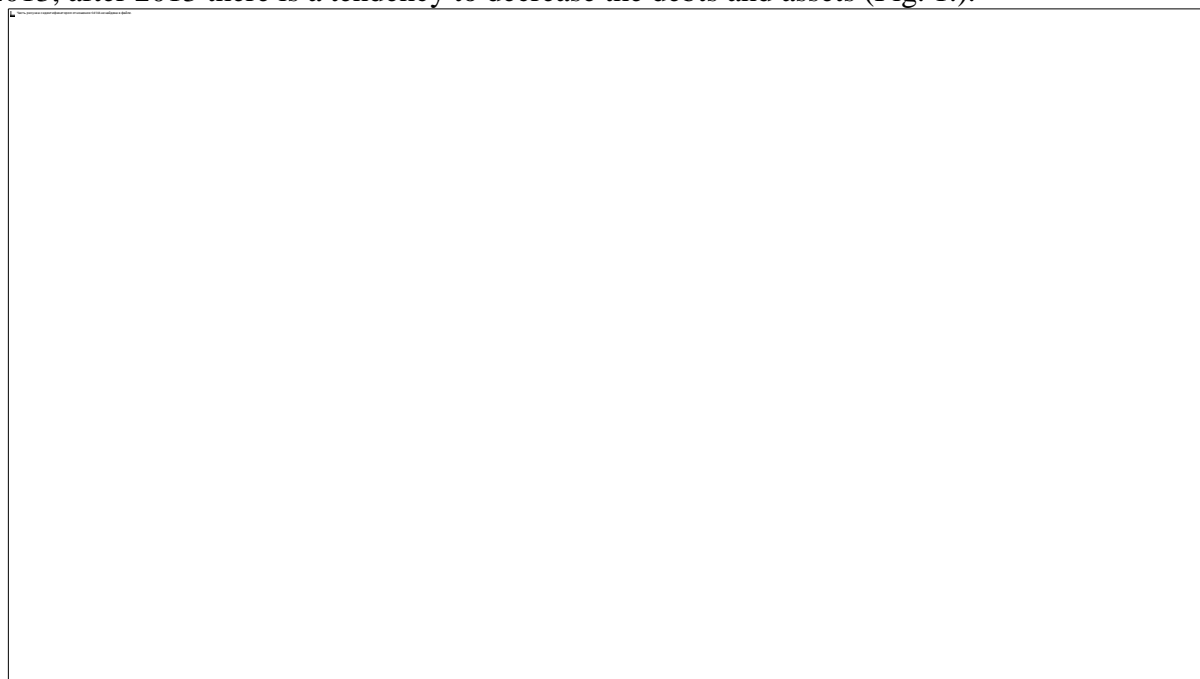


Fig. 1. The main indicators of Ukraine's international investment position in 2010-2017 (millions of US dollars) [7]

Comparing the indexes of the international investment position with GDP, one may obtain the information about the possible impact of IIP on the economy. The country's largest commitments to GDP were in 2015, up to 173%. Beginning from 2015, assets and commitments

as a percentage of GDP tend to decrease. It should be noted that over the last 18 years Ukraine has slightly improved its net international investment position (Fig.2).



Fig. 2. The main indicators of Ukraine's international investment position in 2010-2017,% of GDP [7]

The analysis of IIP is essential for understanding the factors of sustainability and vulnerability of the economy, and the level of liquidity of the country. The main indexes of the IIP can be used to determine the rates of profitability, to assess the economic structure and identify interdependencies between the internal and external sources of funding. Compared to the majority of the EU countries, Ukraine has a normal investment position. Thus, in recent years most European countries have had a negative net investment position as a percentage of GDP. It leads to a debt crunch in the EU, which may cause significant financial and political problems there in future.

Particularly significant negative indexes show such countries as Ireland, Greece, Spain, Poland, and Portugal. Their NIIP deteriorates in the course of time and affects further economic development [8] (Fig.3).

The total foreign assets and liabilities value may indicate the degree of involvement of the country in the international flows of capital. For more profound assessment of Ukraine's position as an international lender and debtor, analysis of the dynamics of assets and liabilities structure is vital, which largely determines the solvency of Ukraine.

The share of foreign direct investment (FDI) in the structure of IIP assets of Ukraine is increasing, which can be considered as a positive trend (in 2017 they amounted to 6.31%). Direct foreign investment may positively impact on the receiving country through the transfer of capital, technologies, and managerial resources, which in turn can stimulate its economic growth. Direct investments into Ukraine are 6 times more than investments from Ukraine. Almost 94% of direct investments from Ukraine were directed to Cyprus mainly into professional, scientific and technical activities.

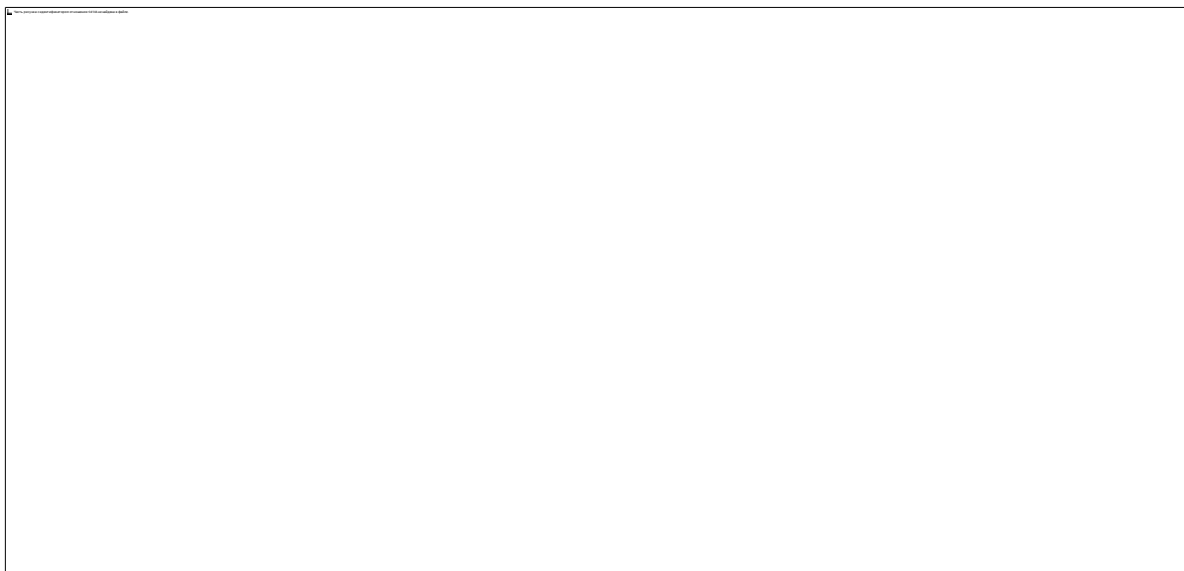


Fig. 3. Net investment position in% of GDP in some European countries [6]

A significant share of direct investments from Ukraine comes from Donetsk region. Direct foreign investment creates preconditions for transnationalization of Ukrainian companies, integration of the Ukrainian economy into the world economic space. Portfolio investments are not widespread in Ukraine at all; they take up only 0.08% of assets (Fig.4).

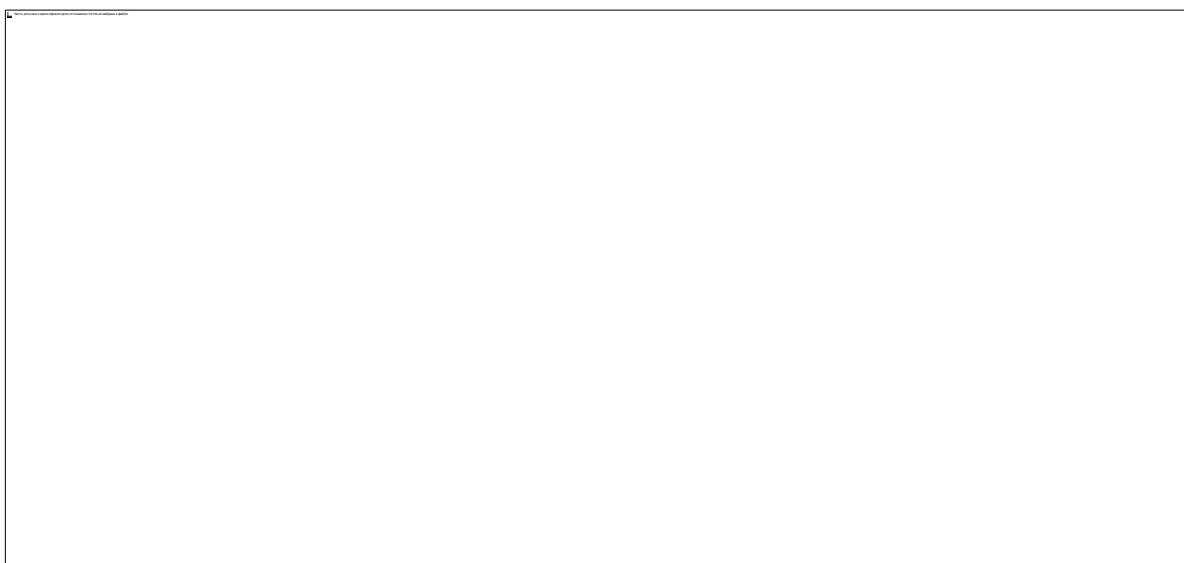


Fig.4. Structure of assets of IIP of Ukraine (%) [7]

The largest share in the structure of assets is taken up by other investments (79.07%), a significant share of which (82%) is represented by cash currency in extra-banking sector (its amount increased by 13.5 times over the past 18 years), which indicates high dollarization rate, as well as shadow economy growth, and a significant share of cash in the total money supply. All these factors reduce the efficiency of NBU's efforts to stabilize the national currency rate and increase the inflationary risks.

Regarding reserve assets, their dynamics is constantly changing, with the lowest rate of 6.24% in 2014, and the largest one - almost in half - in 2005 (45.4%). Due to the chronic deficit of the current account balance, there is a need to increase reserve assets. The structure of reserve assets was significantly affected. Thus, in 2000 the biggest share in their structure took up cash currency and deposits (75%), and in 2017 it was reduced to only 4%. In 2017, the largest share in reserve assets is taken up by long-term securities - 79%. In 2016-2017, the share of reserve

assets of special drawing rights was increasing as a result of active cooperation between Ukraine and the IMF in recent years.

In the structure of liabilities the share of other investments is gradually decreasing, portfolio investments are increasing, while direct investments into Ukraine have significant fluctuations in dynamics (Fig.5).

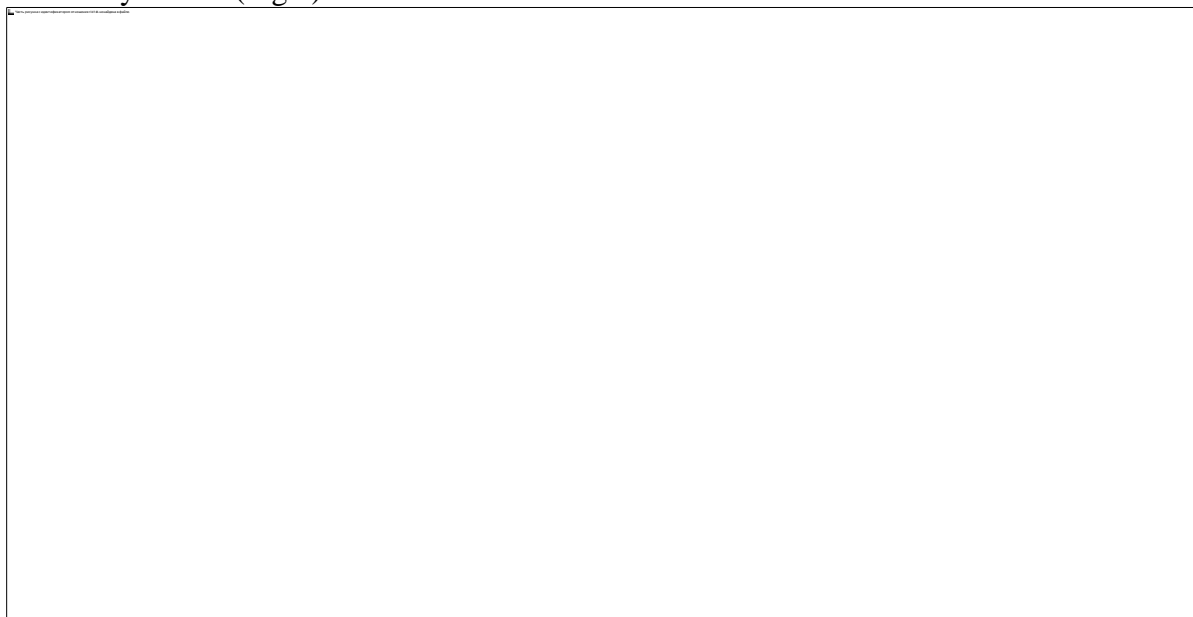


Fig. 5. Dynamic (millions of US dollars) and structure (%) of liabilities in the IIP of Ukraine [7]

According to the analysis of FDI source countries, most FDI come into Ukraine via large financial centers. According to many experts, it means that a significant part of FDI may, in fact, be the so-called “circular FDI”, which originally belonged to domestic shareholders, and then come into Ukraine via financial centers such as Cyprus.

However, it should be emphasized that not all FDI coming from financial centers is circular one. Investors from other countries also use large financial centers because of loyal regulation and low taxes. According to the studies of German Advisory Group, foreign direct investment is beneficial for the recipient country. In Ukraine FDI companies in which a foreign investor holds no less than 10% of the authorized capital make up only 4.6% of all Ukrainian companies. However, this comparatively small number of enterprises accounts for over 20% of the labour pool of Ukraine, 24% of the total capital of Ukraine and almost 35% of the gross value added - the index of production. Thus, FDI companies are not only considerably larger than enterprises with solely domestic investments; they are also much more efficient. Therefore, the economic benefits of FDI in Ukraine are significant. They are the following: more rational application of investments, transfer of new technologies; managerial and marketing experience from abroad; entry of the national companies into international markets; new job formation and an increase of state and local budgets revenues. But international investment has its own economic disadvantages, such as interest and dividends payment in currency, which may increase capital outflows from the country; limited decision making in the companies with foreign capital; focusing on import of products and technologies transfers etc [9].

Foreign investment helps to increase the sources of financing for expanded reproduction. If the country manages foreign investment effectively, then it will eventually be able to significantly improve the competitiveness of its economy and ensure sustainable development. An increase in foreign investment helps the country to cope with the crisis, and integrate into the world economic space. Foreign investment improves the balance of payments, strengthens the national currency exchange rate, but, on the other hand, there are some potential threats, especially if investment is directed to low-tech sectors (it may cause environmental pollution, reduce financial independence of the country, increase future transfers of capital abroad, etc.).

Ukraine is a developing country and therefore needs foreign investment. Ukraine's development depends considerably on international investment processes. International investments play an essential role in foreign economic priorities of the country. Direct investments into Ukraine decreased by 27% compared to 2014. In 2017 the largest investors of Ukraine were Cyprus - 25.6%, the Netherlands - 16%, the Russian Federation - 11.7% and Germany - 4.6%. The main areas for direct investments are industry (27.3%), including processing (20.63%), wholesale and retail trade - 13.13%, financial and insurance activities - 26%.

There are significant disparities in the regional structure of FDI in Ukraine. Thus, Kyiv and Dnipropetrovsk region receive 70% of investments (60% and 9.7% respectively). Long-term debt securities of the general government sector account for a significant share (68% in 2017) in portfolio investment, indicating a significant increase in public sector debt.

Loans, trade credits and advances are increasing in the structure of other investments, while currency and deposit liabilities are gradually decreasing. It should be noted that since 2006 other investment in liabilities has had a tendency to rapid growth. In the structure and dynamics of loans the loans from other sectors and sectors of general government are dominated. Thus, the structure of IIP of Ukraine is not optimal, and threatens with debt crisis to occur in future.

To improve IIP, it is necessary to incorporate certain changes to the tax legislation of Ukraine. After reduction of the UST rate, introduction of more than one hundred amendments to the Tax Code, and creation of a mechanism for automatic VAT refund, recently among the economic scientists and practitioners an interest has been arisen by the government initiative, which is related to the possible introduction of the so-called capital transfer tax. In Ukraine this model of taxation has been under discussion since the end of 2015. For the first time it was proposed in the liberal bill № 3357. The idea of tax on transferred capital was too innovative for Ukraine, so it wasn't adopted by the Parliament. Although the National Council of Reforms has approved the introduction of capital transfer tax since 2018, still the adoption of the bill is indefinitely postponed. Today, the bill on capital transfer tax lives its own life, and its authors actively co-operate with the Verkhovna Rada of Ukraine Committee on Tax and Customs Policy.

Basically, the idea of this tax is not a new one; this model of taxation has been valid in Estonia since 2000. The main positive factors which contributed to the improvement of the investment climate in Estonia were the following: the country ranks the first among 138 countries in the overall International Tax Competitiveness Index (2018) rating [1]; the level of investment growth in 2000-2004 amounted to 39%, which exceeded the level of neighboring Latvia and Lithuania; domestic companies began to invest into the renovation of fixed and financial assets.

Despite the fact that Estonia has adopted a fundamentally different mode of tax income than in other EU countries, this model corresponds to the OECD principles of Base Erosion and Profit Shifting (BEPS) and the EU Directives.

Therefore, in our legislative environment after the adoption of the draft law on the capital transfer tax, it is necessary to adopt a package of anti-BEPS laws against tax evasion and disclosure of other jurisdiction property information. Without such a package of documents there is a risk that companies will use liberal legislation to evade tax via offshore or transfer capital to the accounts of related parties.

Conclusions. The characterization of IIP naturally complements the stratum of information reflecting the financial situation and position of the country in the world monetary system. IIP shows, on the one hand, the owner and the amount of foreign assets (claims in foreign currency), and on the other – the debtor and the amount of external debt (foreign currency liabilities to non-residents). From IIP analysis it can be noted that the structure of assets is unacceptable, a greater share of assets is represented by other investments, there is no portfolio and direct investments, and loans are growing rapidly in liabilities. In recent years portfolio debt securities have increased due to an increase in public sector liabilities. As in assets and liabilities, such results were caused almost exclusively by long-term debt securities. Under analytical

interpretation of the changes in the investment position it should be taken into account that the stocks of international assets and liabilities at the end of the period are adjusted considering the exchange rate fluctuations, which are very significant in Ukraine, as well as the revaluation component.

Such trends are a negative factor that can lead to a solvency crisis and worsen the financial position of the country. In order to improve the investment position of Ukraine, it is sensible to make changes in the tax policy toolkit, namely in terms of introducing capital transfer tax and fiscal stimulation of attracting investments into the country.

The main advantages of this model of taxation are: 1) creation of incentives for entrepreneurial and investment activity (as experience of Estonia confirms, inflows of foreign investments increase considerably); 2) there is no need to reduce the financial result of an enterprise; therefore, financial reports of enterprises may become more transparent and attractive for investors and banks; 3) it is easy to check tax liabilities, since it is difficult to conceal transactions relating to objects of taxation. Taxpayers will have sufficient control over the implementation of such transactions. Consequently, the controversial issues in determining the cost of goods and services will disappear. This issue is currently the reason for discussions and often manipulations by taxpayers as well as corrupt practices from the side of fiscal services.

Thus, investment position is influenced by the economic environment, as it can be expected that macroeconomic and regulatory factors will affect the relative profitability of external and internal investments. Other factors to improve IIP include the implementation of trade agreements aimed at removing obstacles to cross-border capital and labor flows. Implementation of all measures will allow to fundamentally change IIP of Ukraine, increase revenues and accumulate the assets of the country.

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Keywords: international investment position of countries; foreign direct investment; assets; portfolio investments; tax policy; the exit capital tax.

Ключові слова: міжнародна інвестиційна позиція країн; прямі іноземні інвестиції; активи; портфельні інвестиції; податкова політика; податок на виведений капітал.

Ключевые слова: международная инвестиционная позиция страны; прямые иностранные инвестиции; активи; портфельные инвестиции; налоговая политика; налог на выведенный капитал.

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