

## MODERN TRENDS IN INDUSTRIAL INVESTMENTS IN KYIV

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***Summary:** the role of industry in economic development of Kyiv city through analysis of structure and dynamic in industrial investments in the city is studying in the paper. Structural changes in industrial development, industrial investments in Kyiv's economy, dynamic of FDI, and investment climate of Kyiv were analyzed in the paper. Conclusions and recommendations of how increase attractiveness of industry for investors that were given.*

***Keywords:** industrial investments, fixed assets, FDI, investment climate*

### 1. INTRODUCTION

Through many years before Ukrainian independence Kyiv as capital of Soviet republic was a main industrial center of the region. But since that situation drastically changed and now the manufacturing industries are not so important for the Kyiv economic development. Today services are the basis of city economic development and their share in Kyiv value-added is about 90%. Now from different political platforms we can hear that there is no need for developed industry in Kyiv and Kyiv as a capital should be just entertainment center and harbor for international headquarters [1]. At the same time the share of manufacturing in value-added of Vienna in 2006 was 16-17% [2]. It does not prevent Vienna from being one of the best cities in the world for living, while the main driver of its economic growth is tourism.

The issues of attracting investment to develop cities are also on EU's agenda. There is an initiative called JESSICA, which aim is to support sustainable urban development and regeneration through financial engineering mechanisms. Despite the fact that industrial production is not priority of the initiative it creates and improve background for technological advance in industry through **creation of new commercial floor space** for SMEs, IT and/or R&D sectors, medical, biotech and other specialized facilities, **energy efficiency improvements, urban infrastructure** – including transport, water/waste water, energy etc [3].

So **the aim of this paper** is studying the role of industry in economic development of Kyiv city through analysis of structure and dynamic in industrial investments in the city.

## 2. METHODOLOGY

The main problem of statistics data on investment activity as well as other economic issues in Ukraine is lack of comparable data set due to changes and improvements in statistics. Such changes break time series and do not allow building long dynamic rows of data. In particularly:

- FDI statistic was implemented only in 1995 in Ukraine,
- Classification of economic activities comparable with NACE was introduced on the beginning of 2000<sup>th</sup>;
- Changes in methodology of investment records (since 2011 investments recognized on the base of company's legal address instead of actual address of production facilities)
- Since 2012 data gathering on fixed assets investments has been stopped and statistical office focus efforts on capital investment only.

These measures narrowed possibilities for complex and detailed analysis in industrial statistics.

Despite these issues the paper based on official statistical data on industrial performance including industrial investments as well as on FDI. The paper is focused on structural changes in industrial development of Kyiv as a capital of Ukraine, industrial investments in Kyiv's economy, industrial FDI, and investment climate of Kyiv.

## 3. RESULTS

### *Structural changes in industrial development*

Today the economic development of Kyiv is less relies on manufacturing industries, while the main drivers are services. In 2011 the share of industry in value-added of the city decreased to less than 10%. It is 3 p.p. less then in 2001. It should be noted that the reason why industries have decreased contribution to value-added is not only the capital status of Kyiv city. Overall economic situation in Ukraine led to destroying of manufacturing plans, but these processes were accelerated in Kyiv as capital city with higher price of land. So manufacturing production decreased in relative and in absolute volumes and nowadays there are only few industrial plants on the economic map of the city, while in 80-s manufacturing was like a visiting card of Kyiv. The main industries in 80-s were machinery and metal processing (45% of total industrial production and 61% of industrial employment respectively), light industry, including textile, apparel and shoes production (accordingly 17 and 15%), food and drinks production (15% and 4%) and chemical production (9% and 6%). Also there were developed such industries as construction of materials production, wood processing, publishing etc. Considering in more detail machinery the main industries were machine tools production, chemical machinery, transport and road construction machinery.

In 80s Kyiv was famous by its instrumentation, including measuring tools, electronic components, cinema and photo equipment, computers, TVs, manufacturing of trade, public catering and food industry equipment. There were a lot of enterprises of food industry, wood processing and publishing. The future development of Kyiv's industry had been related to highly qualified labor intensive industries, such as precise machinery, machine tools, radio electronics and so on. The complex program "The general scheme of Kyiv industry's development till 1990" suggested improvement of industrial production structure and support for accelerating of industries which identified the city's specialization and its role in USSR economy, deepening cooperation and enhancement of cooperative relations, significant improvement of technology level and increasing of effectiveness of resource using. The program also stressed that Kyiv industry should be based on manufacturing of advances machines and equipment, automation and mechanization tools, production of consumer goods.

The program implementation was led to increasing the share of machinery in total industry production to more than 50% in 1990. But since then the situation had been drastically changed. Nowadays the share of machinery in the city's industry fell to 12%, while in 2007 it was 16%. The main reason was the growth of tariff on electricity, gas and water for peoples which stimulated increasing of fast growth in electricity, gas and water distribution. The modern industrial complex of Kyiv counts about 126 thousand of employees, or 11% of total employment in Kyiv's economy. Notably, two thirds of them work on large enterprises.

### ***Industrial investments in Kyiv's economy***

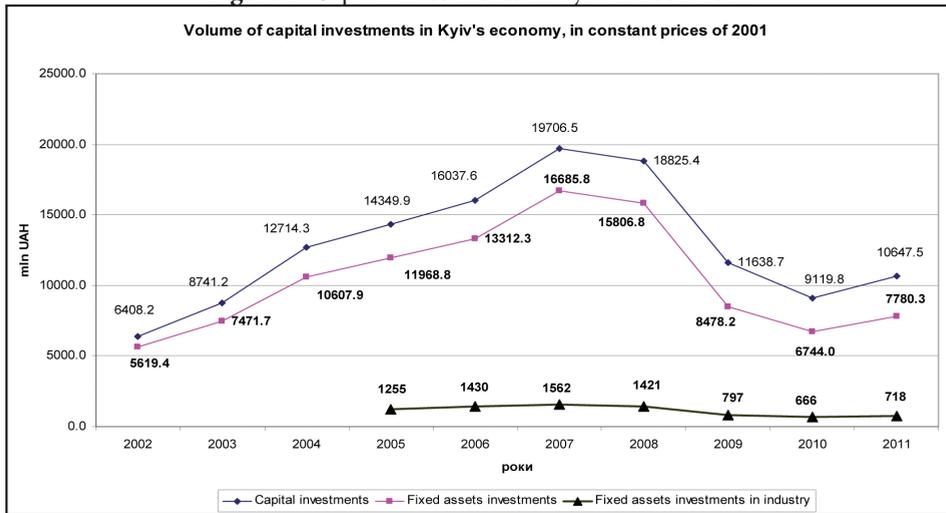
It is enough obvious that industrial performance and future development of industry to the great extend depends on the investments go to the setor. The consequences of global economic crisis led to minimizing of investments in Ukraine in general and to narrowing of sources for financing of industry. The volume of investments from own enterprises' funds decreased while the financial terms for credits and loans worsened. The state and municipal budgets had no money for investment into industrial projects. So the ration of investment in fixed assets to GDP, which is main indicator for country investment security, decreased and is still decreasing.

To evaluate how investment potential of industry is utilized we analyzed the dynamic of **fixed assets investment**, which is the main component of capital investments as well as dynamic of **foreign direct investment** (FDI) as an important source of new technologies.

### ***Fixed assets investment***

The Kyiv city is a leader in attracting of capital investments among rest of Ukrainian regions. Its share is 18% of total capital investments in the country, but the largest part of these investments went to service sectors, like trade, real estate, hotels and restaurants and so on.

The transport and communication attracted more then 22% of total capital investments in Kyiv's economy in 2011. The share of real estate, engineering and other services for entrepreneurs accounted 21%, while the share of investments in industrial enterprises was 19%. Compared with 2010 the largest growth of capital investments was in agriculture, hunting and forestry (12,5 times), education (2,5 times), trade and repairs (on 61%), hotels and restaurants and public administration (both more than 50%).

**Figure 1.** Capital investments in Kyiv in 2002-2011

Source: own calculations based on data from Main department of statistics in the city of Kyiv [4].

It should be noted that only 73% of capital investments went to fixed assets while this indicator all over Ukraine was 80%. Moreover this indicator has negative trend. The share of fixed assets investment in capital investments in Kyiv's economy was almost 88% in 2002, and then it was 85% in 2007.

The total amount of fixed assets investment in Kyiv was UAH 3.9 bln (or approx EUR 370 mln ) in 2011. More than 80% of it was invested in manufacturing. The dynamic of fixed assets investment in Kyiv's industrial enterprises in constant prices has the same look as general city trend. There is sharp declining in 2008-2010 due to crisis and weak recovery in 2011. But the pre-crisis level is not reached yet.

Notably that the share of industrial enterprises in total fixed assets investment was 36% in Ukraine while in Kyiv this indicator was only 10% in 2011. It means that Kyiv industry and manufacturing is not attractive spheres for investments. The leaders were real estate, trade and repairing services (accordingly 31% and 13%)

Analyzing investment in Kyiv by industries we see that the large amount of investments went to food industry (36%), chemical and petrochemical production (17%) and electricity, gas and water distribution (16%). The share of machinery was only 8%, including manufacturing of electric, electronic and optic equipment (3%).

Another interesting indicator is ration of fixed assets investment and volume of fixed assets (residual value). The essence of this indicator is reflecting the rate of renovation of fixed assets and equipment: higher level means faster renovation/modernization processes (or more new manufacturing capacities). The ratio for Kyiv's economy was only 9% in 2010, while 5 years before it was 16%.

The sources of fixed assets investment characterize the general level of investment climate. The share of credits increased up to 20% during 2002-2011. The growth started only since 2005. At the same time foreign investments decreased from 5,3% to 1,2%. It is negative situation, because foreign investment can bring new technologies (production,

managerial etc), especially when such investments comes from real investors but not from offshore firms.

**Table 1.** The structure of sources of fixed assets investments in Kyiv in 2002-2011

Sources	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011
State budget	2,5	3,4	4,7	2,6	3,1	2,4	3,7	3,9	11,7	11,3
Municipal budgets	7,8	8,6	9,0	10,5	10,3	7,6	8,4	3,3	4,2	2,5
Own enterprises' funds	46,1	37,9	51,3	41,7	44,3	47,5	47,5	58,4	49,1	49,5
Bank credits and loans	6,5	9,4	8,8	18,9	20,4	19,2	19,8	16,7	14,7	21,0
Foreign investors	5,3	6,0	3,2	5,5	2,4	2,1	1,5	2,9	1,2	1,2
Population funds for apartment construction	...	...	...	...	12,9	11,6	9,3	6,8	8,4	6,0
Population funds for private house construction	0,4	0,5	0,4	0,2	0,5	0,4	0,6	0,9	3,1	2,7
Other funds	31,4	34,2	22,6	20,6	6,1	9,2	9,2	7,1	7,6	5,8
Total	100	100	100	100	100	100	100	100	100	100

Source: own calculations based on data from Main department of statistics in the city of Kyiv [4].

Since 2005 the share of state budget grew from 2.6 to 11% while the share of municipal budget declined from 10% to 2%. It means that there were only changes in fund distribution between central and local budgets, but in fact there were no changes: budgets finance capital investment residually.

The main trend in the structure of fixed assets investment sources is increasing the share of own enterprises' fund and significant declining of foreign investors share. Both trends are negative, because they mean that foreign investors are not interested in Kyiv industry.

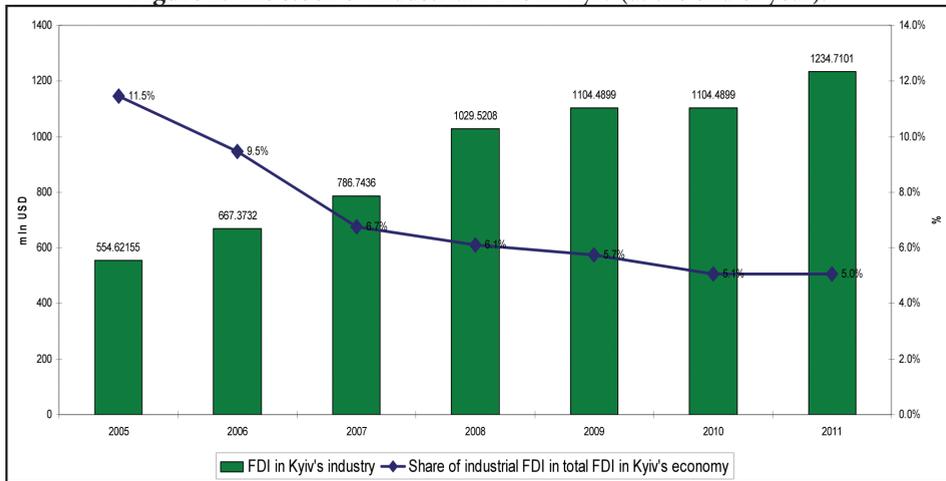
### Foreign direct investment

The amount of FDI in Kyiv counted almost USD 3,5 bln. In 2011 of which 85% came from EU countries. The share of CIS was USD 261 mln (7.5%). The growth of foreign equity in Kyiv economy given exchange rate differences was USD 2.6 bln. During 2011. The total stock of FDI invested in Kyiv was about USD 25 bln on 01 July 2012 that is 2% more than on 01 January 2012. The share of investment utilized in industrial complex was 4.4% or USD 1.1 bln, which is 11% less than on the beginning of 2012.

As we can see from the figure the share of industry has been declining constantly during last decade thus chances for technology renovation of the city industry is also declining. So, the share of FDI in the industry of Kyiv fell from 15% to 4% during 2006-2012. There were significant changes in the structure of FDI by industries: last years only food industry demonstrates positive trend. Exactly this industry gain large interest from investors. It can

be explained by market volume, good transport capacity, which expand border for food delivery, high rate of investment return etc.

**Figure 2.** The stock of industrial FDIs in Kyiv (at the end of year).



Source: own calculations based on data from Main department of statistics in the city of Kyiv [4].

### Investment climate

According to the results of the European Business Association 17<sup>th</sup> wave of investment attractiveness index of Ukraine - an independent survey of the top manager of companies-members of the EBA, which was attended by 103 respondents in the third quarter of 2012, investors ranked the country's business climate and business conditions at 2.14 points (the best score is 5). It was the lowest level since 2008 [5].

The EBA noted that business confidence in Ukraine's economy declined even compared to the previous quarter of this year - by 0.5 points. Thus the main problems that affect the negative assessments of the respondents remained unchanged are fiscal pressures, corruption, and unstable political situation before the elections in 2012. However, some improvements have taken place in the customs regulation: there was a simplification of customs procedures and, therefore, terms of trade.

The EBA Investment Attractiveness Index is an indicator, which is based on the perception of economic realities by more than 100 leading Ukrainian and international companies, which operates in Ukraine. Index indicators show a lack of (or even a slight worsening) of the business climate.

Today the main problems that have negative influence of Ukrainian investment climate are:

1. Unclear and frequent changes in Ukrainian legislation
2. Unreasonable tax burden
3. Imperfect system and difficulty in protecting their rights in court
4. Corruption, administrative and judicial apparatus, the bureaucracy
5. Lack of support investors by local authorities
6. Unequal conditions of business and conflicts of interest

7. Imperfection and transparency of public procurement;

8. Sporadic cases of corporate raids.

In contrast to the national trend experts indicated some improving of the Kyiv's investment climate [6]. According to experts, the business activity of Kyiv in comparison with other cities and towns is much higher. Thus, the total volume of foreign investments in Kyiv equals 50% of the total invested in the Ukrainian economy; also there are more than 60% of the financial assets of Ukraine. According to the State Tax Administration in Kyiv data, the main reason of investment activity increasing was large-scale event (EURO-2012), which took place in June 2012. But most investments were invested in the service sector.

#### 4. CONCLUSIONS AND RECOMMENDATIONS

The crucial change in economic development of Kyiv related to shift towards service sector. Its share in value added of the city increased to more than 90% during last 20 years. In the same the structure of industry changed significantly too. Machinery which produced more than half on industrial goods in 70<sup>th</sup>-80<sup>th</sup>, lost its role and now contributes only 12% of total industrial production. Current growth in industrial production was maintained by production and distribution of electricity, gas and water, while machinery as core of industry is withering. And investment processes are not oriented on the industrial development in general, so future of Kyiv's manufacturing is uncertain.

Taking into consideration negative tendencies in structure of Kyiv economy today city government should pay more attention into industrial development, establishing new high-tech plants and renovation old ones.

Kyiv need new mechanism for attracting investments to the industry. The main components of such mechanism should be:

1. Development of action plan for attracting investment with clearly defined aims, goals, ways and tools.
2. Selection of list of investment projects according to priorities of industrial development That could be interesting first of all for foreign investors.
3. Informing investors about investment potential, projects and successful stories (PR events, web-sites, fairs, exhibitions, printed materials etc).
4. Improvement of investment climate, including creation of municipal fund for new production facilities and civil servants culture.

The problem issues of investment in the industrial complex of Kyiv city can be resolved only by implementation of a set of measures, which should be taken by all participants of investment process (the authorities and companies).

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