

Economics Conjuncture and Regulatory Climate in Ukraine: Business Attitudes and Expectations



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2019 in Ukraine is the year of two elections: presidential (in March) and of deputies to the Verkhovna Rada of Ukraine (in October). This is exactly why analyzing the economic expectations of Ukrainian business is especially important – not only from an economic, but also from a political point of view.

International studies demonstrate that the more procedures a business needs to go through and the longer these procedures take, the more likely it is that the level of corruption in the country is high¹. Ukraine is perceived to be a country with excessive regulation and a high level of corruption. According to the USAID-funded *Annual Business Climate Assessment (ABCA)* conducted by the Institute for Economic Research and Policy Consulting (IER), in 2015, from 5% to 21% of business expenses comply with regulatory procedures were bribes².

Creating a business-friendly environment through the introduction of deregulation measures (in particular, eliminating excessive administrative burdens on business and reducing excessive state control by simplifying procedures) is one of the key areas of the state's economic policy in accordance with the presidential 2020 Strategy³. Significant efforts to simplify the conditions for doing business have been made in the period of 2014-2018. The main achievements of de-

¹ World Bank (2009) *Investment Climate Research Study*. Available [online]: <http://blogs.worldbank.org/psd/restrictive-regulation-is-positively-correlated-to-corruption>

² Kuziakiv O., V. Bespalko, and I. Fedets (2016) *Annual Business Climate Assessment 2015*. Available [online]: http://www.ier.com.ua/files//publications/USAID%20LEV/LEV_ABCA_report_Cost_of_doing_business.pdf [in Ukrainian]

³ President of Ukraine Decree "About the Strategy of Sustainable Development Ukraine 2020" 5/15, 12.01.2015. Available [online]: <https://zakon.rada.gov.ua/laws/show/5/2015>

“ UKRAINE IS PERCEIVED TO BE A COUNTRY WITH EXCESSIVE REGULATION AND A HIGH LEVEL OF CORRUPTION

regulation in 2014-2017 were the reduction of the number of regulations and regulatory requirements, dropping the numbers, and increasing the availability of administrative services for both the general public and businesses.

In 2018, more attention was paid to the practical implementation of the previously adopted measures that dealt with the changes in approaches to state supervision and control. Inspections have traditionally been a problem for the Ukrainian business, because they required time and resources. According to the *Monitoring the Progress of Reforms in 2016*⁴, reducing the number and duration of inspections will save Ukrainian businesses UAH 0.5 billion a year, without taking into account fines and bribes.

It should be noted that in a complicated regulatory environment and with business aspirations to optimize tax burden, it was easy for the inspectors and businesses to come to an agreement. This "corrupt" tax

⁴ National Council for Reforms (2016) *Monitoring of Reforms Progress*. http://reforms.in.ua/sites/default/files/upload/full_ukr_20_02_2017.pdf [in Ukrainian]



2018 WAS NOT EASY ON THE UKRAINIAN ECONOMY. THE LATEST UKRSTAT REPORTS SHOW THAT THE GROWTH OF ECONOMIC ACTIVITY HAS BEEN VERY SLOW

created a significant burden on business and distorted competition. From 2015 to 2018, a moratorium on inspections of small and medium businesses was in place. At the end of 2016, the legislative basis for the reform of state supervision was laid down. The changes to the regulations that took place in 2017-2018 were intended to prepare the business for work in a “no moratorium” environment –the key result was the introduction of a public database of complex inspections that allows businesses to track information about planned state inspections at the enterprise⁵. At the end of 2018, the reform of the state fiscal service and customs – both of which are equally important for business –has begun.

But what was the actual impact of the changes on businesses? Here, Business Tendency Survey (BTS) is a helpful tool.

BTS is the source of information about the state and future progress of selected economic indicators based on the enterprise managers’ opinions and expectations and can serve as a tool of monitoring. Throughout the years, IER has been using the BTS for tracing enterprises manager’s perceptions on different topics. Based on more than twenty years of experience in conducting business tendency surveys, several instruments allowing for monitoring the business perceptions, expectations, and attitudes toward the main economic issues as well as measuring the quality of regulatory and business climate including corruption related issues were developed. Obtaining “first-hand” information about the implementation of regulatory procedures, from entrepreneurs, is an important component of a complex analysis of regulatory climate that contributes to monitoring and evaluation of respective policies. It is business’ perceptions towards business climate (with the focus on regulatory climate and business conditions) that are based on various points of view of relevant managers and their actual experiences.

TRENDS IN BUSINESS ACTIVITY: UNSUSTAINABLE GROWTH IN ANTICIPATION OF ELECTIONS

2018 was not easy on the Ukrainian economy. The latest Ukrstat reports show that the growth of economic activity has been very slow. Thus, industrial production in January-October 2018 compared to the same period in 2017 increased by only 1.8%. This result is still better than it was a year before in the same period (the increase over the ten months of 2017 compared to the previous year was only 0.4%) but worse than what was expected and predicted in early 2018. The situation was mainly a result of worse than expected growth in the manu-

⁵ <https://inspections.gov.ua/>

facturing industry due to a whole range of problems – including the logistic difficulties encountered by the blockade of ports in the Azov basin⁶.

In turn, the trends of economic activity based on the results of the BTS conducted among managers of enterprises indicate the instability of growth. Moreover, in addition to economic and geopolitical factors, the historical results of IER survey data show⁷ that Ukrainian business is traditionally cautious in its plans during the years of possible political changes – such as, for example, the year of the presidential election [See Figure 6]. However, there are many trends indicating that despite external non-economic factors, businesses are optimistic about the future.

VOLUME OF PRODUCTION: SLOWDOWN AFTER ACCELERATION

The analysis of trends based on the seasonally adjusted *Index of Changes in Volumes of Production*⁸ and the *Index of Expected Changes in Volumes of Production* indicate a slowdown in growth in the second half of 2018. It should be noted that during the last four years, the direction of change has altered several times, the tendency itself – to increase or decrease rates – did not last long. The IER data shows an increase

⁶ A policy paper with a detailed analysis of the impact of the situation in the Azov basin on economic performance is currently being prepared by IER.

⁷ According to the findings of the IER survey, in a pre-election period, the probability that business expectations towards improving business climate is lower than at any other time. See Kuziakiv O. (2006) "Impact of Pre-Election Situation on Business Expectations: A Survey Study of Ukrainian Managers", 28th CIRET Conference proceedings. Available [online]: http://www.ier.com.ua/files/publications/Articles/Kuziakiv_Oksana/_c28_KUZIAKIV_3.pdf

⁸ For methodology of *Index of Changes in Volumes of Production* see: *Quarterly Enterprises Surveys* (2018) Quarterly Business Climate Assessment, Vol. 4(66). Available [online] http://www.ier.com.ua/files//Regular_products/BTS/Industry/QES_ukr_03_2018.pdf



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in production growth from the winter of 2015 through the spring of 2016, followed by almost a year of deceleration, which from July 2017 to April 2018 again returned to accelerate the growth of economic activity in enterprises. Moreover, the results of the two recent waves of the survey in 2018 (in July and October), when translated into a seasonally adjusted trend, again show a slowdown [See Figure 1]. However, it is too early to talk about the stability of the trend. In absolute terms (share of respondents), the situation appears to be somewhat different and looks better. The comparison of the share of respondents who indicted increased and decreased production in October 2018 versus

October 2017 shows significant improvement. Thus, in October 2018, whereas the share of respondents who indicated that the volume of production increased by 31.6%, 12.8% of respondents indicated that production volumes decreased in comparison with the previous quarter. The corresponding figures for October 2017 amounted to 29.9% and 20.5%. If the balance (that is, the difference between positive and negative estimates) is compared, then the indicator for October 2018 (+18.8) is better than for October 2017 (+9.4%). In other words, the economic situation is better than a year ago; alas, a slowdown trend, which is a signal that something is going wrong, may still be observed.

The trend-based analysis of expectations also suggests slowing down the growth rate, with the difference that expectations have only one turning point. The trend towards growth has been observed since the end of 2014 and peaked in February 2018, followed by a seasonally adjusted trend, showing a slowdown in growth [See Figure 1]. However, the analysis of absolute indicators (share of respondents) in the case of expectations, in contrast to the assessment of past changes, also indicates a slowdown in growth. In comparison, – in October 2017, 34.9% of respondents expected to increase production in the next quarter and 15.1% of respondents planned to reduce the production, and in October 2018, these shares constituted 27.8% and 12.2%, respectively. The balance (the difference between the shares of “optimists” and “pessimists”) for October 2018 was + 15.6%, which is less than the figure for October 2017 + 19.8%.

Therefore, the trends in business activity based on short-term expectations are unstable – a tendency towards growth is very fragile and weak.

Next, to better understand the future economic condition in Ukraine, we shall look at the tendency that emerged on the basis of assessments of the financial and economic situation in the enterprise at the time of conducting surveys and forecasts on changes in the economic activity of the enterprise in the six-month perspective and the prospect of two years.

FINANCIAL AND ECONOMIC SITUATION AT THE ENTERPRISE: GETTING BETTER

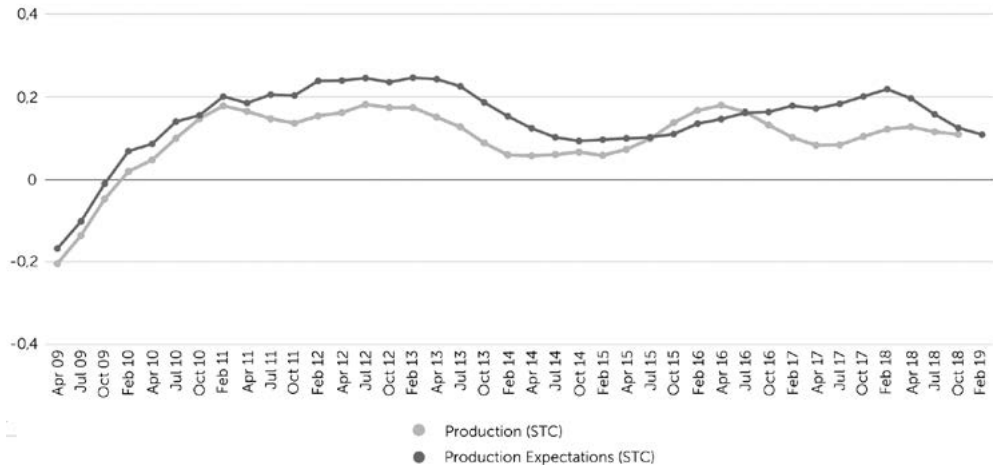
One of the positive trends of 2018 was improving the assessment of the financial and economic situation in the enterprise. In 2018, managers of enterprises were more satisfied with the results of their company than in the previous five years. The analyses of both raw data (shares of respondents) and seasonally adjusted indexes imply such an improvement.

As compared to July 2018, in October 2018, the share of respondents who positively assessed the economic and financial situation of the company increased to 20.6% from



IN 2018, MANAGERS OF ENTERPRISES WERE MORE SATISFIED WITH THE RESULTS OF THEIR COMPANY THAN IN THE PREVIOUS FIVE YEARS

Figure 1: Trends in business activity: Estimates of past and expected changes in production [seasonally adjusted trend; horizon of expectations of 3 months]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

13.7%, while the share of those who negatively evaluated the financial and economic situation of the company, decreased from 24.74% in July to 14.6% in October 2018. If the balance (the difference between positive and negative estimates) is compared, an increase from -11% in July to + 5.9% for October 2018 may be observed. It should be noted that this indicator has attained a positive value for the first time in the last five years, which is unconditionally positive in 2018.

Similarly, the analysis of the seasonally adjusted *Index of Assessment of the Current Financial and Economic Situation at the Enterprise* also indicates positive changes in business activity in the industry sector⁹. Since February 2015, there has been a tendency to improve the assessment of the financial and economic situation of enterprises. Although, strictly speaking, this is a reduction in the rate of deterioration of

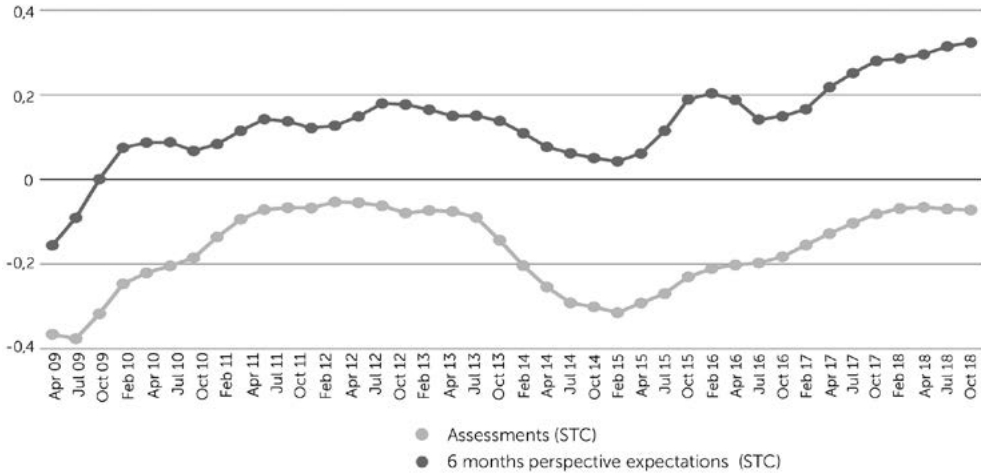
such an assessment, the trend is unconditionally positive [See Figure 2].

EXPECTED CHANGES IN BUSINESS ACTIVITY OF ENTERPRISES IN THE LONG TERM SIX MONTHS

Unlike the trend of business activity built on three-month expectations that shows a slowdown after February 2018 [See Figure 1], the trend of business activity based on half-year expectations has shown to be improving since July 2016 [See Figure 2]. However, when comparing the non-seasonally adjusted data (the shares of “optimists” and “pessimists”), it may be observed that their expectations in the six-month perspective, as well as in the three-month perspective, become more cautious. Thus, the share of “optimists” declined from 40.6% to 31.1%, while the share of “pessimists” increased from 3.7% to 7.4% in October 2018 compared to July 2018. As a result, the value of the balance shown in the *Index of Expected Changes in the Economic Situation* decreased from 0.39 to 0.24. At the same time,

⁹ IER (1998-2019) *Business Opinion: Industry*.

Figure 2: Trends in business activity: Assessments and expected changes of an economic situation at the enterprise [seasonally adjusted trend; horizon of expectations of 6 months]



Source: IER (1998–2019) *Business Opinion: Industry* [own calculations]

the share of those who expect neither an increase in business activity nor a decrease, spiked from 55.7% in July 2018 to 61.5% in October 2018. Thus, the tendency to increase business activity based on six-month expectations is also volatile and may change in time; seasonally adjusted data show an increase in optimism, while raw data show that although the share of “optimists” is pre-

dominantly larger than “pessimists”, the difference between them is shrinking.

BUSINESS ACTIVITY IN TWO YEARS: PLANS DEPEND ON THE SIZE OF THE ENTERPRISE

As far as long-term expectations are concerned, optimistic forecasts dominate the pessimistic ones, although the difference between them sharply decreased in October 2018. For the first time since the launch of the *Business Tendency Survey*, we asked about business activity prospects in two years: in October 2017, and later in February, July, and October of 2018.

In October 2017, 37.3% of respondents planned an expansion of business activity in the perspective of two years, and only 6.8% predicted a decrease in their business activity. The balance sheet ratio was +30.5%. Next, throughout 2018, the value of this indicator had decreased and reached the lowest value of +5.6% in October 2018. This increase was mainly due to a significant



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THE RESULTS OF 2018 SHOW SOME IMPROVEMENT IN THE BUSINESS CLIMATE BASED ON ENTERPRISES ASSESSMENTS

increase in the share of those who predicted a decrease in their business activity in the next two years. Thus, 31.6% of all respondents planned to expand their business activity within two years, while 26% expected to reduce their business activity.

Long-term business expectations depend on the size of an enterprise. Expectations of large enterprises differ significantly from the expectations of small and medium enterprises [See Figure 3]. Among the large companies, only 3.8% reported that they planned to reduce activity for the next two years, whereas 60.4% of managers of large enterprises reported their plans to further expand their activities. On the other hand, almost a third of small and medium-sized enterprises expected to reduce their business activity in the next two years. This means that large companies feel more comfortable in the current business conditions. In contrast, SMEs are more likely to perceive business environment and economic conditions as not favorable, and as a consequence will not plan to expand their activities.

Summarizing the above analysis, we note that although the values of both absolute

and seasonally adjusted indicators remain added, this tendency is evidence of the dominance of positive assessments and forecasts over negative ones. In this light, the dynamics of the trends themselves indicates an instability of growth as long-term plans depend chiefly on the size of enterprises.

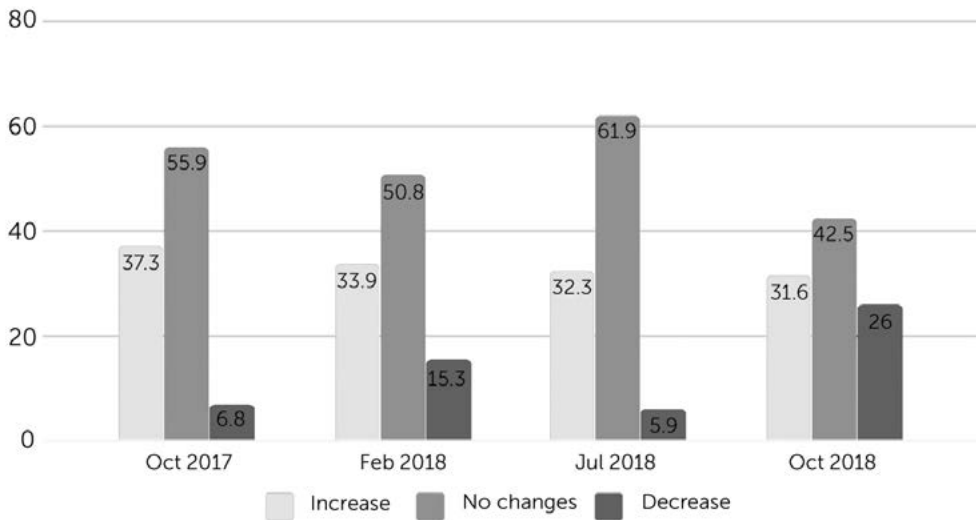
BUSINESS CLIMATE DETAILS: ASSESSMENT OF PREDICTABILITY AND CLARITY OF LEGISLATION HAS IMPROVED

Every May, IER investigates regulatory burdens across the three variables¹⁰: 1) the percentage of enterprises that indicate the interference of the state in operating activities; 2) the percentage of enterprises that consider economic legislation unclear and unpredictable; and 3) the percentage of managers' time spent on interaction with government officials. The variables have equal weights. The higher the value of the indicator, the worse for enterprises in regards to the business climate, which is measured by this indicator. In order to provide an overall assessment of the regulatory burdens in Ukraine we calculated the Annual Indicator of Regulatory Burdens (AIRB) as arithmetic means of these three variables.

The results of 2018 show some improvement in the business climate based on enterprises assessments. The value of AIRB has decreased from 34.4% in 2017, to 30.5% in 2018 [See Figure 4]. In 2018, the reduction of the values of indicator is characteristic for enterprises of all sizes. For small, medium, and large enterprises the indicator has decreased – compared with 2017, by 3.9, 4.2, and 3.7 percentage points, respectively.

¹⁰ In this survey, we avoid looking at the changes in registration procedures and quantity of regular/irregular controls by regulatory bodies, since progress in this area is well recorded by other analysts. See, for example, IER (2017) *Annual Business Climate Assessment 2016/2017*.

Figure 3: Dynamics of long-term expectations of enterprises [% of respondents]



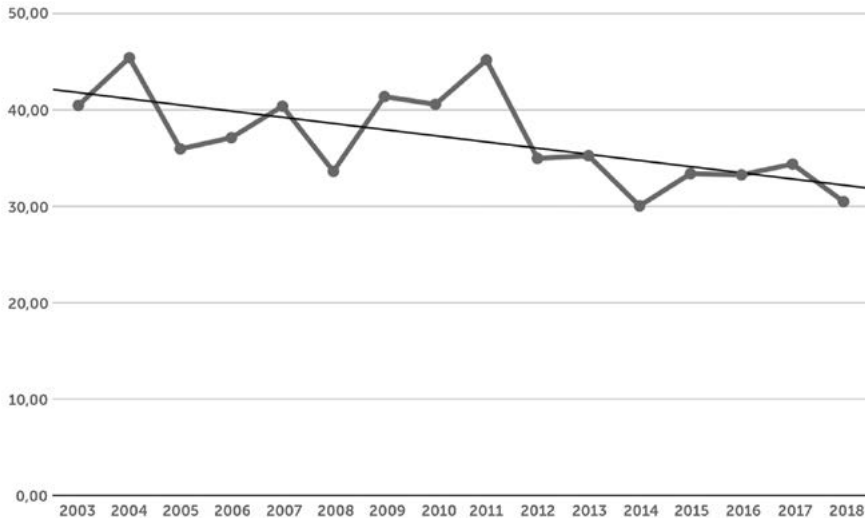
Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

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 THE LARGER
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 AND APPLICATION
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A decrease in AIRB (which signifies an improvement of business climate) has occurred due to a significant drop in one of the variables, namely unpredictability and non-clarity of regulatory acts. The share of respondents who considered legislation to be contradictory and unpredictable decreased from 51.3% in 2017, to 31% in 2018. The share of respondents who considered the legislation to be contradictory and unpredictable among small enterprises decreased the most, while the smallest decrease was measured for large enterprises. Such a change is very important for the quality of the business climate, which means that it became easier for companies to plan their activities. It is particularly important that SE recorded the decrease of uncertainty. However, let us not forget that the data was obtained during the moratorium on inspections for small business, which had acted as a kind of “shield” for businesses, and which has since been abolished in 2019¹¹.

¹¹ There is a moratorium on the conduct of inspections

Figure 4: The Annual Indicator of Regulatory Burdens (AIRB) [score 0=no burdens; 100=maximum of burdens]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

Therefore, in order to make far-reaching conclusions, it is necessary to examine the new data for 2019 and analyze their regulatory impact.

Moreover, the other two indicators of this index not only did not improve, but they even deteriorated. The level of state intervention in entrepreneurial activity is considered by respondents to be high. In 2016, this indicator reached a record high of 46%, then dropped to 38.5% in 2017, and in 2018, it rose again to 45%, thus almost returning to the 2016 level.

Time tax also increased in 2018, as managers spent 15.6% of their working time on interacting with government officials. The value of this indicator after an initial de-

crease in the years 2011-2015 (from 19.9% in 2011 to 11.4% in 2015), kept increasing for three years in a row – in 2016, the value was 12.5%, in 2017 it was 13.4%, and in 2018, it increased to 15.6% [See Figure 5]. The fluctuation of the indicator for the enterprises was more or less the same – it observed a decrease between 2011-2015 and then slightly increased during the period of 2016-2018. The lowest rate of growth was recorded for small companies; moreover, in 2017 and 2018, the values of “time tax” for this group were almost the same – 13.5 and 13.6 respectively.

The larger the size of the enterprise, the more time managers spend on interacting with government officials on the interpretation and application of laws.

of business by the controlling authorities (except for the State Fiscal Service of Ukraine and the State Financial Inspection of Ukraine) in 2015 and 2016. It was prolonged for 2017 and 2018, but the list of state bodies outside of moratorium has been expanded.

According to the surveyed managers, the increase of “time tax” may be explained by several reasons. The first would be the situation in Ukraine back in 2014, a tragic year



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in the history of modern-day Ukraine. The invasion of Russian troops, the annexation of Crimea, and the occupation of part of Ukraine led to revising the Ukrainian agenda in order to protect the sovereignty and territorial integrity of the country. In this period, state institutions were practically destroyed by President Viktor Yanukovich's kleptocratic regime. The state relocated its resources in response to external threats (including the war with Russia), while its domestic policy remained rather liberal – partly because of the lack of power from law enforcement. While the moratorium on inspections, discussed above, was launched in 2015, the de facto inspections were not conducted in 2014 due to the lack of control authorities had to do this. This may explain the decline of “time tax” in 2014 (12.5%) when compared to 2013 (13.4%) [See Figure 5]. The second reason for such a fluctuation of “time tax”

might have been explained by the implementation of a moratorium on inspections. In 2017 and 2018, the moratorium was prolonged, but the list of bodies that were not subject to it¹² was so significant that, according to many experts¹³, it virtually nullified its existence.

Thus, on the basis of the annual data, we can talk about certain changes for the best of only one (albeit very important) of the three indicators IER tracks.

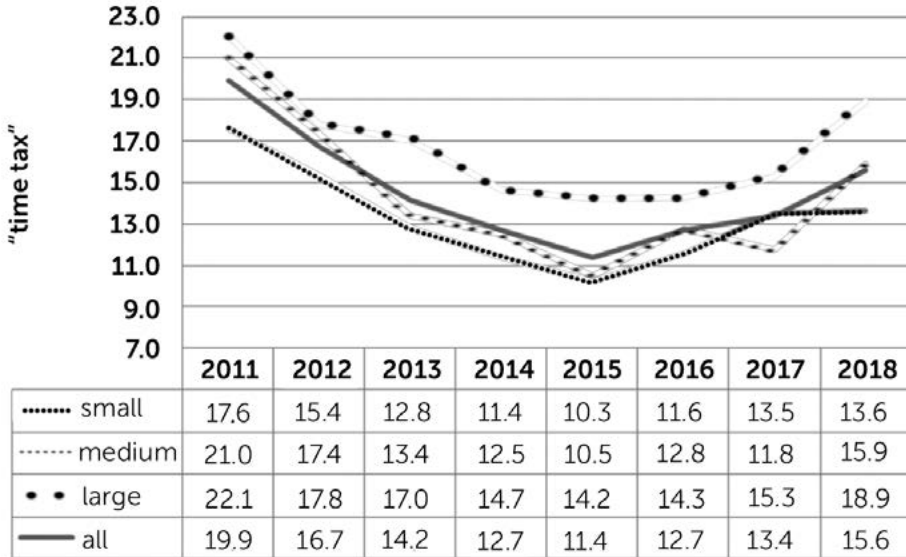
**BUSINESS CLIMATE: IMPROVING
CURRENT ASSESSMENT AGAINST
THE BACKGROUND OF LESS
OPTIMISTIC EXPECTATIONS**

In the background of mixed annual trends on regulatory burdens, an important trend for the year 2018 was the improvement of quarterly business climate assessments, against the backdrop of instability of economic growth and cautious expectations for the future. In 2018, for the first time in many years, IER recorded a gradual improvement in the assessments of the current state of the business climate. If we compare the *Index of the current state of the business*

¹² According to the Law on temporary measures of implementation of state oversight and control (No 1728, 03.11.2016), the list of the state bodies that had the right to conduct inspections despite of moratorium included fourteen bodies. These were: 1) the state regulatory body for energy and utilities; 2) National Commission on Securities and Stock Market; 3) State Procurement Service; 4) State Tax Administration; 5) State Audit Office of Ukraine and its territorial bodies; 6) State export control service; 7) State Inspectorate for Nuclear Regulation of Ukraine and its territorial bodies; 8) State Labor Organization and its territorial bodies; 9) State Aviation Service; 10) the State Architectural Inspection; 11) Ministry of ecology and natural resources; 12) National Council of Ukraine on Television and Radio Broadcasting; 13) National Bank; and 14) Antimonopoly Committee of Ukraine.

¹³ See, for example, the interviews with Ksenia Liapina, Head of State Regulatory Service in Ukraine: <http://www.drs.gov.ua/press-room/moratorij-na-perevirky-u-2017-rotsi-praktykum-dlya-pidpryemtsiv/> or http://uz.ligazakon.ua/ua/magazine_article/EA009942

Figure 5: "Time tax": Average time that enterprises' managers spend on communication with representatives of state authorities [arithmetic mean]



Source: IER (1998-2019) *Business Opinion: Industry*

*environment*¹⁴ in October 2018 with the corresponding period of 2017, we see that the indicator significantly improved – it increased by 15 percentage points (from -0.17 to -0.02), while it still remains in the negative. This increase was due to the almost double reduction of the share of business managers who consider the environment unfavorable (from 31% in October 2017 to 16.2% in October 2018). Meanwhile, the rise of the share of managers that assess business climate as favorable also doubled (from 8% in October 2017 to 15.5% a year later).

In turn, expectations of changes in the business climate show a different trend. The beginning of 2018 in Ukraine was character-

ized by growing optimism about improving the business environment. In April 2018, the *index of expected changes in the business*

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¹⁴ Index of change of *Index of Expected Change* shows the balance between positive and negative answers of respondents; its values may vary between -1 (all answers are negative) and +1 (all answers are positive).

environment increased by 13 points compared with February 2018 and is now at the level of 0.22. The rise of values of *Index of Expected Changes in the Business Environment* occurred at the expense of an increase in the share of those who expected positive changes (from 19.7% to 25.8%), while at the same time reducing the share of those who anticipated a deterioration of the business environment (12% to 7.2%, respectively). Simultaneously, 52.6% of company executives reported that they did not expect changes in the business environment during the next half-year. In July 2018, *the index of expected changes in the business environment* remained virtually unchanged at 0.21. However, in October 2018, its value fell by 0.16 percentage points. This decrease in the said index was due to a simultaneous reduction of the share of “optimists” from 29.5% in July to 27.6% in October, and an increase in the share of “pessimists” from 8.6% to 11.8%, respectively.

Thus, against the backdrop of improving the assessments of the current state of the business environment, Ukrainian business is somewhat more pessimistic about its possible changes in the first half of 2019, which is probably due to the forthcoming elections.

UNCERTAINTY CAUSED BY ELECTIONS

What are the factors affecting business valuation and expectations? Various factors affecting the estimates and expectations may be taken into account in this regard. For starters, political instability and uncertainty about the future caused by elections are one of them. On the eve of the election, business becomes more cautious and conservative in its projections and actions.

The analysis of historical data [See Figure 7] of the IER *Business Tendency Survey* suggests that business conducted before the elections, during the so-called “wait-and-



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see position”, typically leads to assessments and plans for the future to become moderate. This moderation is caused by fears due to the uncertainty of what the future may bring after the elections. In numerical data, this “wait-and-see position” is reflected by an increase in the proportion of those who do not plan to either expand or reduce their activities, and expect neither deterioration nor improvement of the business environment.

This behavior distinguishes all business pre-election periods, and relevant literature¹⁵ suggests that this is not unique to Ukraine.

¹⁵ See, for example, Berger, H. and U. Woitek (1997) “Searching for Political Business Cycles in Germany”, [in]: *Public Choice*, Vol. 91, pp. 179-197; or Canes-

According to international experience¹⁶, the analysis of the results of research of business economic cycles shows that in the period before the elections, business expectations become more cautious with the post-factum measurements of the economic behavior of the business indicate it becomes more moderate. This is due to the growth of what economists call uncertainty. Even though this behavior is characteristic of all economies, in those with better regulation, more efficient institutions, and a more predictable economic policy, the impact of possible changes due to elections on the business environment is smaller. In Ukraine, where in-

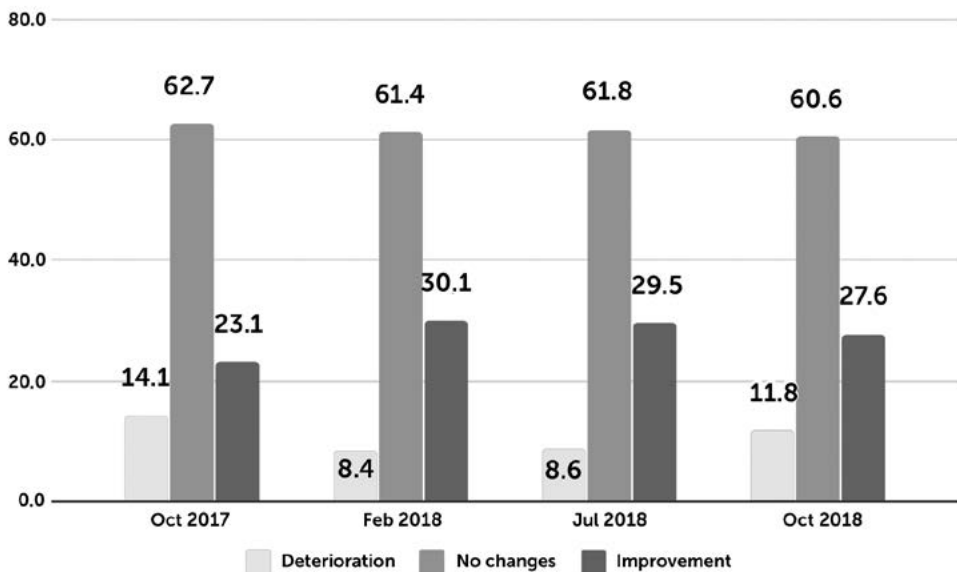


THE RUSSIAN MILITARY AGGRESSION IN UKRAINE SIGNIFICANTLY CONTRIBUTED TO THE REINFORCEMENT OF THE UNCERTAINTY FOR UKRAINIAN BUSINESS

Wrone, B. and J. Park (2014) "Elections, Uncertainty and Irreversible Investment", [in]: *British Journal of Political Science*, Vol. 44(1), pp. 83-106.

¹⁶ Buthe, T. (2000) "The Business Confidence Effects of Political Uncertainty: Some Simple Calculations on Pre- and Post-Election Periods in Germany, 1976-1998", a paper prepared for the 25th CIRET conference in Paris.

Figure 6: Expected changes in the business climate [% of respondents]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]



STRENGTHENING
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OF STATE
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AND SECURITY
OF PROPERTY
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THE ROLE
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UNCERTAINTY
FOR BUSINESS
IN THE FUTURE

stitutions and rules are not so strong, where economic policy during the last decade was inconsistent, and where having personal relations with the authorities is still considered as an important factor in conducting business successfully¹⁷, the very fact of possible personal changes “at the top” contribute to the increase of uncertainty.

In the IER study, the uncertainty is measured by two simple indicators: 1) the share of respondents who could not predict the changes in the financial and economic situation in the enterprise in the half-year perspective, and 2) the share of respondents who do not know in what direction the business environment will change in six months.

According to the results of the IER *Business Tendency Survey*, throughout the Ukrainian economic history, uncertainty increases before and remains high for at least a quarter after a presidential election. A significant increase in uncertainty was also observed during the 2008–2009 economic crisis. Another instance of a growth in uncertainty was recorded at the end of 2010 and was caused by the economic policy of the Mykola Azarov government during which the so-called “tax Maidan” occurred as a reaction to the possible increase of tax pressure for small and medium businesses. Additionally, the events in the fall of 2013, and subsequent developments caused by the Russian military aggression in Ukraine significantly contributed to the reinforcement of the uncertainty for Ukrainian business [See Figure 7]. Only since mid-2016, the business environment has become more predictable – the survey identified a gradual reduction in the proportion of those who cannot decide on the business climate in six months.

¹⁷ According to the IER survey, 46.0% of managers of enterprises consider informal relations with government officials as important or very important in ensuring success in business.



THE RATING OF EXPECTED REFORMS IN 2018 CHANGED SIGNIFICANTLY AS COMPARED WITH PREVIOUS YEARS

This tendency lasted until July 2018. According to the results of the surveys conducted in July and October 2018, the share of respondents who could not determine either the economic situation in the enterprise, or the changes in the business climate in half a year, was increasing. Still, both rates are much lower than observed during the period of 2010-2017. In particular, the share of managers of enterprises that could not predict the next six months on the financial and economic situation in a company in October 2018 amounted to 15.3%, in July 2018 to 15.9%, an increase from 12.7% in April 2018. In comparison, in October 2015, 32.7% of respondents could not make a six-month forecast.

On the basis of the analysis of the previous cases of business uncertainty, it may safely be assumed that the roots of the current uncertainty also stem from the forthcoming elections and the likely changes that these could bring. Strengthening the capacity of state institutions to ensure the rule of law

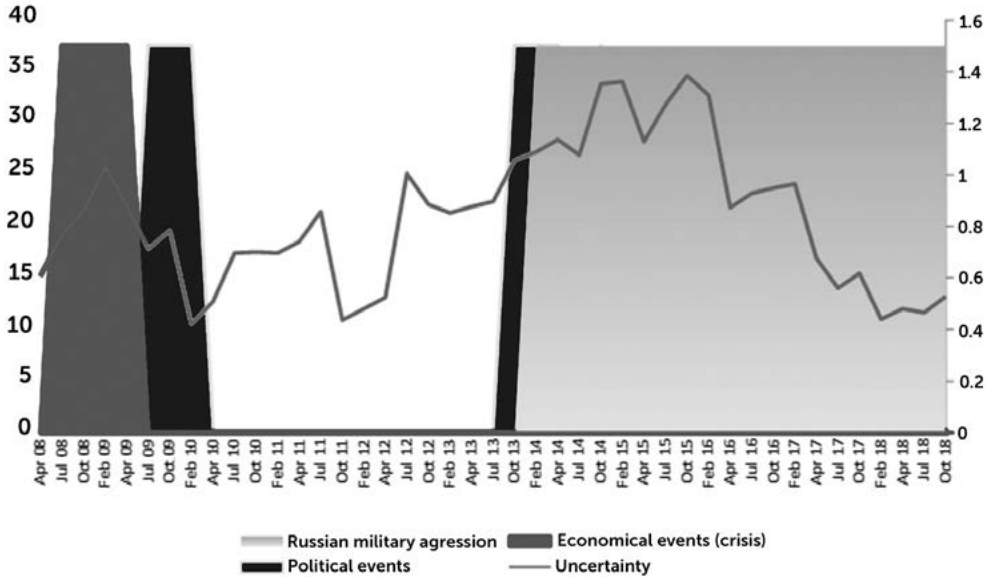
and security of property rights against the backdrop of neglecting the role of informal relations in the economy are the main preconditions for reducing the pre-election uncertainty for business in the future.

IMPEDIMENTS TO THE GROWTH OF PRODUCTION

What impediments did Ukrainian businesses face in 2018 and do the changing attitudes and performance barriers constitute important issues for understanding economic trends in 2018? Following the IER surveys conducted in October 2018, "low demand" took first place on the list of obstacles to the growth of production. This hurdle is ranked among the top ten impediments to production growth in the past ten years, sometimes swapping places with such problems like "a lack of liquidity". It should be noted that the share of managers of enterprises for which low demand is an obstacle increased in October 2018 to 57.6% from 53.9% in July 2018.

The second place in the rating was occupied by "liquidity problems". This problem has been listed as one of the top impediments throughout a long period of observation. At the same time, the share of respondents who pointed out the problem of liquidity as a barrier to growth in their enterprise decreased from 60.5% in July 2018 to 49.0% in October 2018. Such a change means that by the end of that year enterprises somewhat improved their financial conditions. The third obstacle is the "high competitive pressure". Its importance for respondents in October 2018 remained almost unchanged when compared to July 2018 and amounted to 42.7%. From an economic point of view, the fact that enterprises have experienced a relatively high level of competition in the markets, which is rather good news because competition pushes business development.

Figure 7: Uncertainty level in Ukrainian business [the proportion of respondents unable to make predictions on the business climate change in six months]



Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

Furthermore, “unfavorable regulatory climate”¹⁸ took the fourth place in the rating, with 36.1% of respondents identifying it as a major issue that may have a detrimental effect on the business environment. The value of this indicator has risen by 10.5 percentage points between July and October 2018, mainly due to an increase in the share of respondents who said that corruption is an impediment to growth – a number which was fluctuating [See Table 1]. There are two possible explanations of such a change: either something happens in the business environment frequently (quarterly) or it might

be a reaction of the business to media reports on corruption.

The fifth and sixth places in the rating for obstacles were occupied by “the shortage of skilled workers” (33.3%), and “a lack of raw materials” (31.3%) respectively. The problem with the shortage of skilled workers was one of the most divisive issues in 2018. Based on the IER survey results, it is not possible to check whether this indicates “brain drain” or is a result of a poor system of vocational education. Either way, it signals that the labor force issue will be of key importance for economic development in the near future in Ukraine. The reported greater significance of the “lack of raw materials” indicator likely stemmed from logistical difficulties faced by numerous enterprises due to a blockade of the Ukrainian Azov Sea by Russia.

¹⁸ Unfavorable regulatory climate is a combined indicator that includes three simple indicators: 1) the share of respondents who consider high regulatory pressure an impediment to business growths; 2) the share of respondents who consider corruption an impediment to business growths, and; 3) the share of respondents who consider frequent changes in legislation an impediment to business growth.

The least significant impediment for enterprises in October 2018 were “power supply problems” (7.3%) and “affordability of loans” (5.9%), which means that businesses have no problem securing a loan. Meanwhile, 29.1% of respondents stated that high interest rates are the impediment to growth [See Figure 7]. The power supply problem is usually at the bottom of the list of impediments; nevertheless, in 2018, this indicator observed an increase, which was a direct result of hybrid Russian aggression in Ukraine.

EXPECTED REFORMS IN 2018: CHANGE OF PRIORITIES

The rating of expected reforms in 2018 changed significantly as compared with previous years [See Figure 8]. The measures that characterize the creation of favorable and equal conditions for all business entities have shifted to the bottom of the ranking, while measures aimed at supporting specific sectors or activities have risen to the top. In 2018, the top ten of the expected reforms included measures aimed at creating favorable conditions for doing business and – for the first time since the launch of the survey – measures aimed at state support. This expectation is a signal that businesses require not only favorable business conditions, but also some specific policies of support (possibly, in the form of protectionism). At the same time, it is worth remembering that state support or specific economic conditions for some specific group in Ukrainian economic history are very often associated with “wasted” private interest and negatively impact economic or sector development (for example, a “free economic zone” policy at the beginning of 2000 or a special tax regime for automobile companies, among others).

The first place in the rating was occupied by the need to further reduce the single social tax (identified by 43.1% of respondents), followed by the need for stability of



THE VERY POSSIBILITY OF ANY PERSONAL CHANGES “AT THE TOP” CONTRIBUTES TO ECONOMIC UNCERTAINTY

the legislative field (39.1% of respondents) – in particular, the expectation of a three-year moratorium on changes to legislative acts regulating economic activity. The third place was occupied by the need for simplification of tax and accounting (30.3% of respondents). From the 4th to the 6th places there were measures of support that respondents expect from the state, given either to an enterprise from a specific sector or for specific activities (innovative enterprises, energy saving measures, etc.). The 7th place was held by the need for a full-scale e-government (26.6% of respondents). Ensuring full VAT refund was 8th place, the transformation of the state tax administration from control into service agency ranked 9th, while the creation of an effective mechanism for implementing legislation occupied 10th place.

When comparing the changes in the rating of expected reforms between 2017 and 2018, several conclusions may be drawn. First of all, the share of enterprises expecting the introduction of e-governance has almost halved. The development of e-governance has been championed in the analyzed years and the data show that enterprises felt the first results. The second change regards

Table 1: The impediments to the growth of production [% of respondents]

	October 2018	February 2018	April 2018	July 2018	October 2018	October- July 2018
1. Low demand	62.8	64.9	59.8	53.9	57.6	3.8
2. Liquidity problems	50.0	53.4	51.5	60.5	49.0	-11.5
3. High competitive pressure	44.0	38.9	46.7	42.2	42.7	0.5
4. Unfavorable regulatory climate (includes):	36.9	32.1	42.3	25.6	36.1	10.5
<i>a) high regulatory pressure</i>	20.5	12.5	18.9	15.1	20.5	5.4
<i>b) corruption</i>	11.1	9.1	16.5	5.4	14.2	8.8
<i>c) frequency of changes in economic legislation</i>	17.8	17.2	14.8	7.8	10.8	3.0
5. Insufficiently skilled workers	12.4	15.2	19.2	23.6	33.3	9.7
6. Insufficient raw materials	21.1	23.6	25.8	25.6	31.3	5.7
7. Excessive taxation	28.5	32.8	33.7	33.3	29.5	-3.8
8. High interest rates	20.8	23.6	19.9	24.4	29.5	5.1
9. Unfavorable political situation	36.2	29.7	32.3	27.5	27.8	0.3
10. Outdated technologies	13.8	10.8	10.3	13.2	11.8	-1.4
11. Lack of production capacity	9.1	10.5	5.8	19.0	10.4	-8.6
12. Power supply problems	4.4	5.7	10.3	9.7	7.3	-2.4
13. Availability of loans	5.7	8.4	11.3	5.8	5.9	0.1

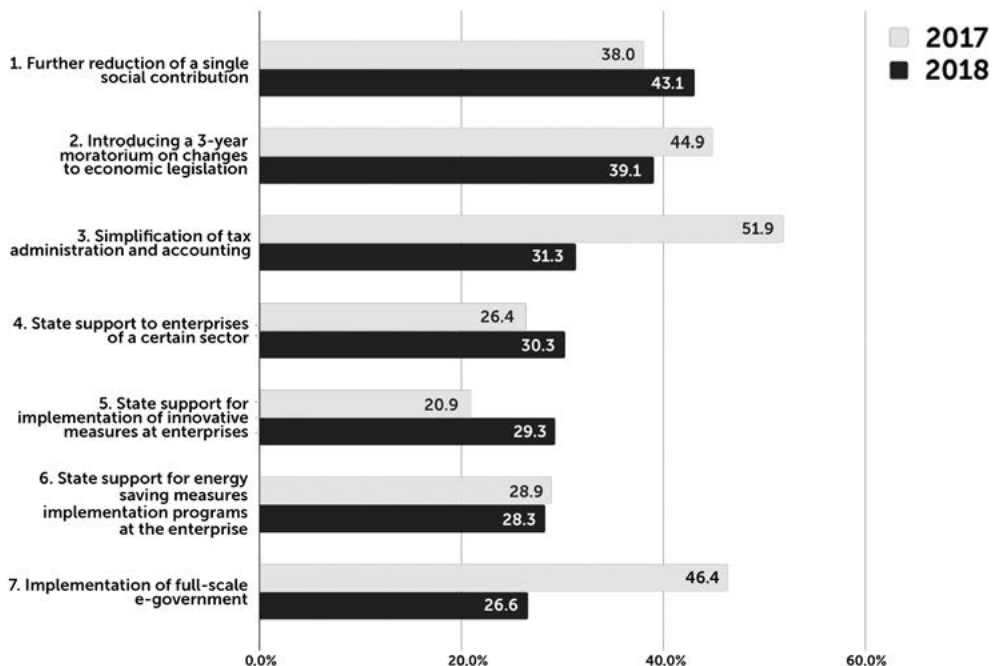
Source: IER (1998-2019) *Business Opinion: Industry* [own calculations]

a reform of tax administration. The share of those who are waiting for simplification of tax administration and accounting decreased by 20 percentage points. This drop means that the measures undertaken to improve the situation in the field were significant, although it still requires more efforts to improve the quality of tax administration in the country. The third important change in 2018 versus 2017 occurred in the last places in the rating, which were held by such measures as, for instance, the provision of a full VAT refund. This result indicates that by introducing the system of automatic VAT refund the problem with no refund of VAT that existed during Viktor Yanukovich's time has already been solved. Moreover, the introduction of a three-year moratorium on implementing the reform has taken

a higher place in the ranking (2nd compared to 3rd in 2017) – however, the proportion of respondents who identified this measure has decreased by 5 percentage points. This result is a clear message from business to policy makers – business needs a stable and predictable environment.

In summation, the abovementioned results show that the policy measures aimed at improving the business environment became less demanded by enterprises. This trend may indicate some progress in these areas – in particular in deregulation, the introduction of e-governance, and the imposition of VAT refunds. At the same time, enterprises expect the state's support. What caused this change? Perhaps businesses felt the results

Figure 8: Top 7 expected reforms in Ukraine [% of respondents]



of relevant reforms at improving the business environment and creating equal rules of the game for all business entities and now want to get preferential treatment for themselves? Is it an indicator of rising populist tensions among businesses? So far, it is difficult to provide answers to these questions. However, given the fact that surveys of the population show the attractiveness of populist slogans, and the business sector reflects public opinion because it simply is a part of society, there is a reason for reflection: why have the expectations for receiving state support increased in 2018? Regardless of this fact, the measures aimed at improving the business environment should be actively implemented in future.

LONG-TERM CONCLUSIONS

Summarizing, in terms of business expectations, positive assessments and forecasts dominated over the negative ones in the year 2018. Nevertheless, it became clear that businesses typically remain cautious in their plans in the years of a possible political change (election years). Despite this phenomenon, in a two-year perspective, entrepreneurs remain quite optimistic towards their business activities. Still, the growth of production is unstable, and the rate of growth is not enough. The shortage of skilled staff can be one of the factors inhibiting economic activity in the future. Additionally, long-term business plans vary by the size of an enterprise, with large companies being commonly very optimistic, unlike small and medium-sized companies. Finally, business plans for the next six months (the 4th quarter of 2018 and the 1st quarter of 2019) are under the influence of expectations of the result of the presidential election. (The results of the parliamentary election will depend on the results of presidential election).

It must, therefore, be emphasized that in Ukraine, where institutions and rules are



POLICY MEASURES AIMED AT IMPROVING THE BUSINESS ENVIRONMENT BECAME LESS DEMANDED BY ENTERPRISES

“under reconstruction”, economic policy is becoming predictable only now, and informal relations with representatives’ authorities are still important or even crucial for being successful in business, the very possibility of any personal changes “at the top” contributes to economic uncertainty. Thus, it is paramount to strengthen institutions, establish clear “rules of the game”, and stick to them.

Special attention needs to be paid to the findings regarding business expectations of stability of the legislative environment, discussed in this article. From 2015 to 2018, the share of enterprises that would have expected a moratorium on changes in the legislative for economic activity increased sharply from 17.6% in 2015 (12th position in the rating of the expected reforms) to 39.1% in 2018 (2nd position). Noteworthy, the support for this measure peaked in 2017 (44.9%), while ranking 2nd place in 2018, which should serve as a strong signal to policy makers, politicians, and reformers.

Against the backdrop of a further need to complete the reforms and implement legislation in line with Ukraine’s EU Associa-

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tion Agreement, such results indicate the complexity of the tasks ahead – it is, indeed, necessary to conduct reforms, but at the same time crucial to maintain stable conditions for business. This means that the planned changes must be predictable and done in a timely and orderly fashion. Taking into account the situation with the implementation of reforms (such as the reforms of tax administration, of customs authorities, court reforms, etc.), there is only one mandatory recommendation – the reforms must be sped up. And Verkhovna Rada must play the key role in the process of introducing the vital change for Ukrainian society.

As a window of opportunity for conducting successful reforms quickly closes, no time should be wasted. Whichever presidential candidate or a party wins the 2019 elections; they must continue to keep the focus on cultivating a friendly environment for business. ●



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