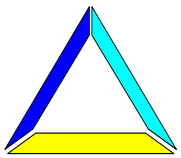
**INSTITUTE FOR ECONOMIC RESEARCH AND POLICY CONSULTING IN UKRAINE**
**GERMAN ADVISORY GROUP ON ECONOMIC REFORM**

Reytarska 8/5-A, 01034 Kyiv, Tel. (+38044) 228-6342, 228-6360, Fax 228-6336
E-mail: institute@ier.kiev.ua, http://www.ier.kiev.ua



**T30**

# Institutional reforms versus selective targeting? Comments on the draft law "On state support of investment and encouraging investment activity" drafted by the Ministry of Economy

**Note**: The draft law was handed over to IER/GAG only upon personal intervention by Mrs. Lyudmila Musina, Deputy Minister in the Ministry of Economy and European Integration (MoEEI). Accordingly, these comments are meant exclusively for discussion with MoEEI, rather than for distribution to the public.

## Summary and policy recommendations

Elements of the institutional framework, i.e., the rules and regulations of the economy and the institutions that enforce them, are the main long-run criteria for private investment decisions. In particular, it is openness to trade and transparency that increase the chances of enhancing domestic investment and increasing FDI. Against the background of Ukraine's still rather poor institutional framework, specifically targeted investment incentives for pre-defined sectors, regions, and/or types of investment, can be both costly and ineffective. Leaning towards selective targeting, the draft law does not sufficiently serve to sustainably enhance private investment in the long run.

We recommend to consistently re-draft the law to represent *Ukraine's Guidelines for Public Support of Private Investment*, in line with private investor preferences and international experience. Compared to the first draft, we specifically suggest:

- to focus on improvements of the institutional framework and eliminate all specific targeting elements from the law;
- to eliminate all references to public investment from this draft law, which should concentrate on public support for private domestic and foreign investment;
- not to revert to state aid in order to support private investment activity;
- to expand the final provisions of the draft law and explicitly mention supplementary legislation necessary to improve the institutional framework for investment in Ukraine. In particular, we recommend to focus on the adjustment of the tax legislation according to international standards, employment standards, and provisions that define property rights, to improve law enforcement, the transparency of the public sector, and the efficiency of public spending by cutting state aid. This would serve to demonstrate that institutional framework reforms need a broad and concerted effort from all sources of legislative action.

**Contents**

1. The background
2. Alternatives to support private investment
2.1. Selective targeting
2.2. The institutional framework for private investment
3. The current status of the institutional framework for private investment in Ukraine
4. Does the draft law contribute to support private investment in Ukraine?
5. Conclusions and policy recommendations

## 1. The background

In consequence of the recent increase in investment demand, Ukraine's share of fixed capital formation in GDP was both in 2002 and 2003 around 20%, which is within reasonable limits for a transition economy. Understandably, policy makers in the country are concerned with the long-run sustainability of high rates of investment.

The investment activity in Ukraine is regulated and influenced by numerous laws, international treaties, bilateral agreements, and other legislative documents. However, so far there has been no consistent policy towards private domestic investment and foreign direct investment (FDI). The draft law "On state support of investment and encouraging investment activity" attempts to fill the gap. It was drafted within MoEEI, partly in response to the Presidential Act #580 "On additional measures for FDI attraction in Ukraine" of 7 July, 2003, which required to draft a Law that should especially:

1. define the priorities for investment activities to receive state support and the mechanisms to encourage investment attraction; strengthen investors' rights;
2. simplify the registration of foreign investors, the procedure of investment project implementation, and product licensing.

The first requirement calls for a law that gives *specific support* to FDI versus domestic investment and to investment in pre-defined priority sectors and regions. The second requirement demands provisions to improve the business environment, or *institutional framework,* for investment. The next section will show that these two requirements in fact represent two very different approaches to investment support.

*While the draft law indeed tries to address both approaches, we recommend to improve all aspects of the institutional framework for private investment in Ukraine rather than apply selective targeted policies, which are not to yield any benefits on their own within an insufficiently developed institutional framework. Especially, we recommend against discrimination by type of investment under any circumstances and cannot recommend the use of incentives targeted at specific sectors or regions without prior substantial institutional framework reforms.*

Whereas the Presidential Act #580 calls explicitly for measures to attract FDI to Ukraine, the MoEEI draft law nowhere limits itself to this topic, but rather aims at streamlining all the scattered legislation into providing general guidelines and instruments for public support of all types of investment in Ukraine. The first draft (see Appendix A), which is the basis of this comment, was forwarded to the Cabinet of Ministers (CMU). CMU comments on the first draft are summarized in Appendix B.

## 2. Alternatives to support private investment

The growth impulses from private investment, and from FDI in particular, are commonly recognized by economists and policy makers. In fact they form the small core of empirically safeguarded knowledge on growth: while many other results are fragile, one can identify a positive, robust correlation between growth and the share of

investment in GDP.[1] Specifically, a recent OECD study concludes that FDI supports growth in developing, emerging and transition economies, irrespective of their initial state of development.[2]

However, these benefits do not come about automatically but need public policy support. Public policy to further private investment may in principle follow two different patterns, a *selective targeting* versus an *institutional framework* approach:

- Public policy towards private domestic investment and FDI may be based on *specific support* for pre-defined priority sectors, regions, and/or types of investment. This policy appears to be the advocated in the Presidential Decree as well as in the CMU comments on the first draft of the law (see Appendix B).
- Public policy towards private investment may concentrate on providing a good business environment, or *institutional framework,* for investment. This is the policy advocated by international organizations as well as in this paper.

### 2.1. Selective targeting

Targeted policies involve offering incentives (tax reductions and other fiscal concessions, cash grants and loans, start-up assistance to investors, etc.) either generally or to attract prioritized investment projects. These incentives may be suitable when they are non-discriminatory (i.e. offer similar incentives to similar investors, whether domestic or foreign) and correct weaknesses in the domestic environment that cannot otherwise be addressed. Also, where authorities aim to jump-start economic activity in a given sector, investment incentives have sometimes proved instrumental in attracting a critical mass of relevant enterprises. The experiences of recent decades in both OECD countries and developing economies, notably in South East Asia, seem to include several apparent success stories.

[1] http://www.worldbank.org/research/growth/aer92lr.htm

[2] OECD, Foreign Direct Investment for Development: Maximising Benefits, Minimising Costs, Paris, 2002.

**Box 1: Legal limits to state support for foreign direct investment**

State investment policy measures are a topic for EU and WTO discussions due to their impact on competition and trade. With the exception of the OECD *Investment Declaration* (1976),[3] countries have failed to reach agreements on FDI attraction policies. Measures that prohibit, limit, or moderate incentives to attract FDI are found in the following documents.

(1) *the WTO Agreement on Subsidies and Countervailing Measures*

1. Subsidies that require the recipient to meet certain export targets or to use domestic goods instead of imported goods are prohibited.

2. Subsidies are limited if a complaining country shows that they have an adverse effect on its interests.[4]

(2) *the WTO Agreement on TRIM* that prohibits certain trade-related investment measures.[5]

(3) *the State Aid Provisions of the EU* ban support that may distort competition and are the only agreement imposing disciplining devices.

References to competition-distorting measures are contained in Article 87 of the EC Treaty. Article 89 provides the Commission with the power to define aid compatibility with the Treaty. In particular, state aid provisions are subject to principles of *laissez faire, adequate institutions, accountability, transparency, and limited continuity and scope.*[6]

However, few international disputes have ever challenged an FDI incentive program.[7]

However, the use of such instruments represents a risky strategy. Deciding how much to subsidize which investment projects, and by means of which instruments, involves difficult political and economic choices. Authorities are at the risk of finding themselves over-subsidizing projects or creating unintended economic disturbances if they get "picking the winners" wrong. At the more practical level, many authorities lack the data and expertise required by incentive programs, which are resource intensive to finance and to manage. Most incentives are administratively burdensome.

A final *caveat* relates to the value of incentives to investors. It is one thing for governments to share the risk of an investment, but the investment has to make sense without the support of public funds. In fact, many incentives are of little relevance to the investors being targeted, despite the possible costs to the implementing authority. As an example, investment in research and development requires a functioning patent protection to secure long-term benefits. In the absence of such an effective legal protection, direct subsidization is a very costly and ineffective substitute. As another example, imagine a tax cut for FDI in an otherwise corrupt environment. Increasing future net profits might land in the pockets of a bureaucrat with regulatory power, which is to show that targeted policies are not sufficient to induce investment.

---

[3] http://www.oecd.org/document/53/0,2340,en_2649_34887_1933109_1_1_1_1,00.html

[4] Fadzil, Mohamed, "Antidumping and countervailing duties: a postscript to the 1995 WTO Law." Available online at www.mlj.com.mu/free/articles/rozlinda&maharom.htm

[5] UNCTAD, *World Investment Report 2003*, Chapter 3: FDI Policies for Development. National and International Perspectives, United Nations, New York and Geneva, 2003.

[6] For details see IER/GAG, "Comment on the draft law 'On state aid' ", Policy Paper A10-2003, Kyiv, October 2003.

[7] OECD*, Regulation of Investment Incentives: The Impact of Trade Agreements*. Abstract available at http://www.oecd.org/document/37/0,2340,en_2649_34863_11082405_119690_1_1_1,00.html

## 2.2. The *institutional framework* for private investment

Since it concentrates on a narrow range of the economy, the specific targeting strategy for private domestic investment support or FDI attraction is limited in its benefits, which in the absence of a good overall business environment may not even be realized.

Policies, which create a level playing field for all types of private investment thus matter more. As evidence from many countries shows,[8] the provision of an *institutional framework* of an economy, i.e. the rules and regulations and the institutions that enforce them, is the most important long-run factor to influence investment decisions. Accordingly, national governments are well advised to focus their efforts at enhancing domestic investment and at attracting FDI largely on improving the institutional framework, comprising such public goods such as economic stability, the rule of law, and transparency. In a good institutional framework,

- institutions and laws favour production over rent-seeking activities;
- the economy is open to international trade and competition in the global marketplace; and
- the economic institutions are stable.

In particular, it is openness to trade and transparency that increase the chances of enhancing domestic investment and increasing FDI in the long run. In terms of transparency, investors are in general very sensitive to the respect of the law, the quality of public and private governance, the pervasiveness of corrupt practices, and the degree to which authorities adhere to the principle of non-discrimination.

# 3. The current status of the institutional framework for private investment in Ukraine

In spite of the long-run predominance of elements of the institutional framework in shaping private investor decisions, public policy in Ukraine has so far not succeeded to establish a good institutional framework for private investment.

Ukraine is a very open economy in terms of export and import to GDP ratios of above 55%, respectively. A recently signed agreement to join a Single Economic Space with Belarus, Kazakhstan and Russia, however, has questioned the government's commitment to free trade and openness, as this agreement challenges the Ukraine's completing negotiations on a WTO accession.[9]

---

[8] According to an OECD survey, *Checklist for Foreign Direct Investment Incentive Policies*, Paris 2003. Available online at http://www.oecd.org/dataoecd/45/21/2506900.pdf; Singapore considers skill creation, institution building and infrastructure development an integral part of its FDI attraction strategy. Trade liberalisation is part of China's FDI policies. United Nations, *Investment and Technology Policies for Competitiveness: Review of Successful Country Experiences,* New York and Geneva, 2003.

[9] IER/GAG, "Which priority for Ukraine's trade policy? 'Single economic space' (SES) vs. World Trade Organisation (WTO)", Policy Paper T14, Kyiv, October 2003.

Appendix C presents *public governance* indicators that, besides openness, shape the most important aspects of the institutional framework for investment. According to the charts, in five out of six indicators Ukraine scores extremely low, in the bottom quarter of all the world's countries. Given these shortcomings, if the Ukrainian government were to offer targeted investment incentives within this existing institutional framework, such a policy would constitute a costly and ineffective state activity to compensate for state failure.

*We recommend to improve all aspects of the institutional framework for private investment in Ukraine rather than apply selective targeted policies, which are not to yield any benefits on their own within an insufficiently developed institutional framework. In order to increase the credibility of its commitment to openness to international trade and competition in the global marketplace, the government should concentrate on WTO accession rather than regional re-integration.*

## 4. Does the draft law contribute to support private investment in Ukraine?

Objectives, objects and instruments of the law should support private investment in Ukraine by contributing to a better institutional framework. Leaning towards selective targeting, however, the first version of the draft law does not serve to sustainably enhance private investment activity.

### 4.1. Objectives

The explicit objective of this law should be to support private investment in Ukraine. However, Article 4 of the draft law states the objectives of state investment support in terms of both the institutional framework and the selective targeting approach, as "increasing the volumes of investments, concentrating investments in spheres that are of high priority for economic development, creating a favourable investment environment."

*We recommend to state "creating a favourable institutional framework for private investment" as the sole objective of the law.*

### 4.2. Objects

Within the institutional framework reforms approach, all private investment should be the object of this law. Although a complete list of priority sectors is not specified, Article 5 of the draft law explicitly refers to selective targeting of investment support: "State investment support is granted to separate sectors of the economy, separate administrative and territorial units according to the priorities of economic and social development stated by the State Program of Economic and Social Development of Ukraine, state targeted programs, programs of economic and social development of the Autonomous Republic of Crimea, oblasts, rayons, and cities."

This preference for a selective targeting approach conflicts with the substantial shortcomings in Ukraine's institutional framework for private investment identified above, such that this approach can hardly be effective.

*We therefore recommend to explicitly state the principle of non-discrimination between types of investment.*

The list of types of public support of investment activities (Article 6, Appendix A) includes public investment. However, investment in public goods, which is the domain of public investment, by definition follows very different purposes, criteria and decision rules than private investment. Public investment, like all public expenditure, requires a market failure argument based on that social rates of return on such expenditures differ considerably from private returns. E.g., to continue the example from above, even effective patent protection may give too little incentive to privately invest enough in basic research and development, due to knowledge spillovers. However, there is a clear-cut need to differentiate the topics of justifying public investment, the involvement of private investment in the provision of public goods, and the efficiency of both from the topic of public support for private investment.

*We recommend to eliminate all references to public investment from this draft law, which should concentrate on public support for private domestic investment and FDI. We recommend to completely relegate public investment issues to supplementary legislation that should also includes additional considerations such as,[10] the limits of useful state intervention; the clear definition of and transparent procedures for public investment project selection; clear and explicit formulae on granting intergovernmental capital transfers to local budgets.[11]*

### 4.3. Instruments

To match the institutional reforms approach, instruments of private investment support should be compatible with the seven *OECD Guiding Principles for Policies Toward Attracting FDI*,[12] bearing in mind that these principles are applicable to domestic private investment as well.

1. Safeguarding public sector transparency, including an impartial system of courts and law enforcement

While the draft law does not address this principle, item 9 of Article 7 (Appendix A), however, refers to procedural transparency improvements that should favour the reduction of corruption, red tape and reduce the administrative costs of business.

*We suggest to include an explicit requirement to make all information relevant for investment decisions publicly available.[13]*

2. Ensuring that rules and their implementation rest on the principle of non-

[10] We commented on these issues in IER/GAG, "How to improve public investment efficiency in Ukraine?", Policy Paper T22, Kyiv, February 2004.

[11] The MinFin draft law "On the Basics of Granting Subsidies from the State Budget of Ukraine to Implement Investment Projects" has neither been re-drafted nor enacted for about a year.

[12] OECD, *Checklist for Foreign Direct Investment Incentive Policies*, Paris, 2003.

[13] Most common exceptions from transparency are to protect confidential information for commercial interests, national security, public order, and the pursuit of monetary and exchange rate policies. OECD, *Framework for Investment Policy Transparency*, Paris, 2003. Available online at http://www.oecd.org/dataoecd/15/13/16793978.pdf

discrimination between foreign and domestic enterprises and are in accordance with international law

Article 7 of the draft law nowhere explicitly differentiates types of investors. But the reference to "free economic zones" in item 8 of article 7 may be understood in terms of potential attempts to give special investment incentives to FDI. However, in the institutional framework approach for investment, attractive terms to investors should be part of the overall industrial policy and be equally available to all foreign and domestic investors. Incentives should follow the same logic and focus on activities with the strongest potential for spillovers, including linkages between foreign and domestic firms, education, training and R&D.

*We recommend to explicitly state the principle of non-discrimination. We also recommend to more clearly state the mechanism of implementing the provisions in items 1, 3, 5, and 8 of article 7 to guarantee non-discrimination by type of investment, taking into account the legal limits to state support of investment as stated in Box 1.*[14]

3. Providing the right for free transfers related to and protecting against arbitrary expropriation

The law does not explicitly contribute to this principle.[15] Concerning other investors' rights, these should first of all be addressed by provisions favouring non-discrimination of foreign investors in land ownership,[16] and protecting the rights of small investors that in turn should create more possibilities for enterprises to diversify. The draft law also does not suggest simplifying the registration of foreign investors.

*We recommend to expand the final provisions of the draft law and explicitly mention supplementary legislation necessary to improve the institutional framework for investment in Ukraine.*

4. Putting in place adequate frameworks for a healthy competitive environment in the domestic business sector

The draft law does not correspond well to this fundamental principle. Article 6 refers to selective targeting and priority setting following the Program of Economic and Social Development. The suggested instruments are, however, outright state aid via state guarantees and public subsidization of interest cost.[17] State aid provisions are implicitly referred to again in the "special regimes" of item 8 of Article 7.

*We recommend not to revert to practices that are either state aid to private investment and/or discriminatory. Together with the comment in section 4.2, this*

[14] In this respect, the draft law should be also supplemented by additional legislative acts such as a Law on State Aid. For details see IER/GAG, "Comment on the draft law 'On state aid', Policy Paper A10-2003, Kyiv, October, 2003.

[15] The Law of Ukraine #1540a-XII on Protecting Foreign Investments contains clear guidelines in this respect consistent with international practice.

[16] Several empirical studies suggest a strong positive correlation between land ownership rights and FDI, for example see Besley, T., "Property rights and investment incentives: theory and evidence from Ghana," *The Journal of Political Economy*, Vol. 103, No. 5, 1995, pp. 903–937.

[17] This is not consistent with international guidelines (Box 1). In particular, EU rules restrict the use of granting loan guarantees, co-financing, and interest subsidisation. Cf. IER/GAG, "Comment on the draft law 'On state aid', Policy Paper A10-2003, Kyiv, October, 2003.

*amounts to our recommending to drop Article 6 of the draft law altogether.*

Items 4 – 7 and 9 of article 7 have the potential to improve the domestic investment infrastructure and to reduce administrative costs if applied without discrimination by types of investment.

*However, provisions could be more clearly stated not to leave room for interpretation in favour of targeted strategies. Provisions should be supplemented by additional legislative action, e.g. the creation of a state registry of immovable property.*

5. Removing obstacles to international trade

The draft law does not explicitly address international trade. However, items 6 and 9 of article 7 envisage the improvement of the licensing and standards system.

*We recommend international standards to be taken into account in order to avoid wasteful practices for FDI competition.*

6. Redress those aspects of the tax system that constitute barriers to FDI

Properly implemented, items 1 and 3 of article 7 can serve towards improving the institutional framework for investment.

*Provisions should, however, be re-drafted to foresee the elimination of double-accounting procedures that increase the administrative costs of business to move closer to international taxation requirements and to ensure equal treatment of taxpayers.*[18]

Additional legislative action requires that depreciation policies be oriented at best practice accounting rules in order to avoid distorting the firms' production decisions. In relation to the foreign investors, the government should follow the provisions of bilateral agreements that ensure the avoidance of double-taxation.

7. Ensuring that public spending is adequate and relevant

Item 2 of article 7 on the support of commercial banks' liquidity can be read as potentially favouring quasi-fiscal activities.

*We recommend to exclude this provision from the draft law.*

### 4.4. SME policies

While the share of employment in small enterprises is now between 45% and 55% in most of the Eastern European economies, where small and medium enterprises (SMEs) are considered to be one of the engines of growth, the respective share in Ukraine has not yet reached 20 per cent of the total.[19] Barriers to SME entry have so far been connected to the low level of the institutional framework, mainly the tax system, unequal treatment, corruption, over-regulation, underdeveloped financial services

[18] Although the principle of equal treatment of taxpayers is stated in the Law on the System of Taxation, it is not fulfilled in practice: IER, *Openness and Transparency of Public Finance in Ukraine: Analysis and Recommendations*, Kyiv, December 2003.

[19] *Economic Survey of Europe*, 2003, No. 1, Chapter 5: Progress in Systemic Reforms in the CIS,

markets and property rights protection.[20]

Our guiding principle towards policies to support private investment is the creation of a good institutional framework, removing incentives that distort competition. However, as stated above, non-discriminatory targeted investment incentives may be suitable when they correct weaknesses in the domestic environment that cannot otherwise be addressed. Such imperfection may exist in the limited access of SMEs to the capital market, costly access to information, and relatively high administrative costs.

In order to create a level playing field here, Article 8 of the draft law foresees vital but not really specific policies to enhance SME investment activity.

*We agree with these provisions unless they imply direct support from public budgets. However, this should not remain the only type of SME support, but needs to be complemented with easing the entry and exit of enterprises, ease of information and tax administration.*[21]

## 5. Conclusions and policy recommendations

Elements of the institutional framework are the major criteria for domestic and foreign private investment decisions. In case of a poor institutional framework, as is still the case with Ukraine, the provision of targeted selective investment incentives can constitute a costly and ineffective state activity to correct for state failure. Specifically, the use of investment incentives focusing on foreign firms is not recommendable, as spillovers of technology and human capital do not follow automatically from foreign direct investment. Attractive terms to all investors should be seen as part of a country's overall industrial policy. In its current form of leaning towards selective targeting, the draft law serves little to sustainably enhance private investment activity.

We recommend to consistently re-draft the law to represent *Ukraine's Guidelines for Public Support of Private Investment*, in line with private investor preferences and international experience. Compared to the current draft, we specifically suggest:

- to focus on improvements of the institutional framework and eliminate all specific targeting elements from the law;
- to eliminate all references to public investment from this draft law, which should concentrate on public support for private domestic and foreign investment;
- not to revert to state aid in order to support private investment activity;
- to expand the final provisions of the draft law and explicitly mention supplementary legislation necessary to improve the institutional framework for investment in Ukraine. In particular, we recommend to focus on the adjustment of the tax legislation according to international standards, employment standards, and provisions that define property rights, to improve law enforcement, the

---

Economic Commission for Europe, United Nations, Geneva.

[20] IFC, *Ukrainian Enterprises in the Year 2000*, Kyiv, 2001. No more recent update available.

[21] For more details see IER/GAG, *Development of Domestic Markets in Ukraine: Welfare through Competition*, Kyiv, May 2003.

transparency of the public sector, and the efficiency of public spending by cutting state aid. This would serve to demonstrate that institutional framework reforms need a broad and concerted effort from all sources of legislative action.

N.L., R.F., Lector: F.P.

April 2004

## Appendix A. Selected articles of the Draft Law

### Article 6. Types of state support to investment activity

1. Intergovernmental transfers to implement investment projects;

2. Partial or full compensation of interest payments on loans granted by commercial banks and other financial-and-credit institutions;

3. Providing state guarantees for loans granted by international financial organizations or under conditions of co-financing (simultaneously with state support to investment activity);

4. Allocation of state capital investments to develop the infrastructure.

### Article 7. State measures to stimulate investment activity

1. Reform of the tax system in order to decrease the tax burden and to improve tax administration;

2. Creation of conditions to increase the rate of concentration of bank capital, to increase the amount of long-term credits, and to support the liquidity of commercial banks that provide long-term loans to investment projects;

3. Reform of depreciation deduction rules, increasing its role in the accelerated renovation of fixed assets;

4. Improvement of the management of corporate rights;

5. Enhancement of the development of investment insurance, creation of non-bank financial institutions;

6. Improvement of the system of licensing, tariff regulation, certification and standardization;

7. Support the signing of agreements on product assessment, concessions, leasing;

8. Creation of special (free) economic zones; introduction of a special regime of investment activities in technology parks, in territories of priority development, in depressive regions; formation of tax, exchange-rate, and customs regime;

9. Simplification of the procedure of obtaining permissions (i.e., licenses etc.);

10. Organisation of and providing state training for specialists on investment activity.

### Article 8. Particularities of enhancing the investment activity of SMEs

The state enhances the investment activity of SME according to the following directions:

1. Favoring the involvement of the SMEs in the programs of economic and social development of Ukraine, Crimea, oblasts, rayons, and cities;

2. Creation of conditions for development of micro-credits to SMEs;

3. Support for provision of informational and consultation services in investment activity;

**Appendix B: Comments of the Cabinet of Ministers on the first draft**

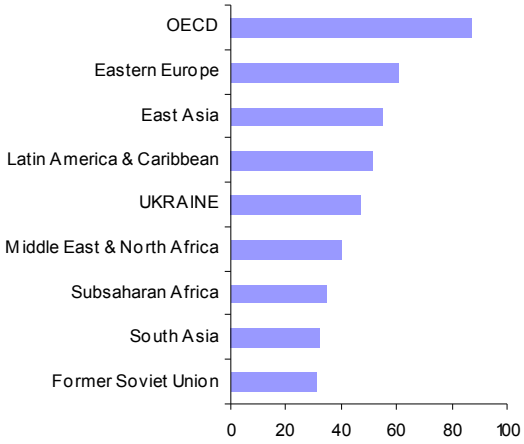
The comments call for correspondence with the Presidential Act #580. According to the Act, the draft law should include clear statements on:

1. a clear definition of high priority areas;
2. a clear definition of types of state support;
3. Mechanisms to regulate the attraction of investments;
4. Stronger respect for the rights of investors.

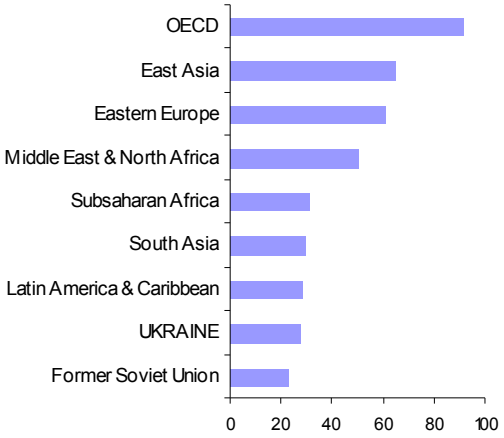
*Note*: CMU comments were communicated via the MoEEI.

**Appendix C: Percentile ranks of governance indicators, 2002. Ukraine versus regional averages**

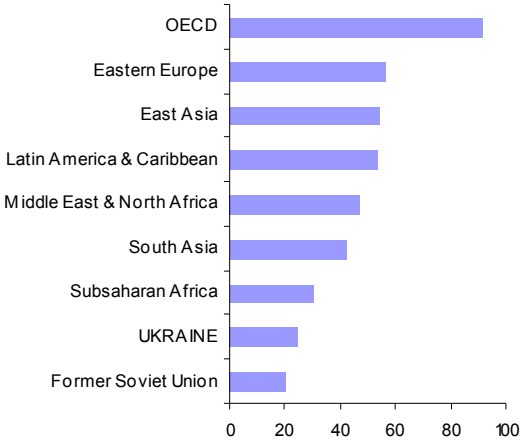
*Political stability*



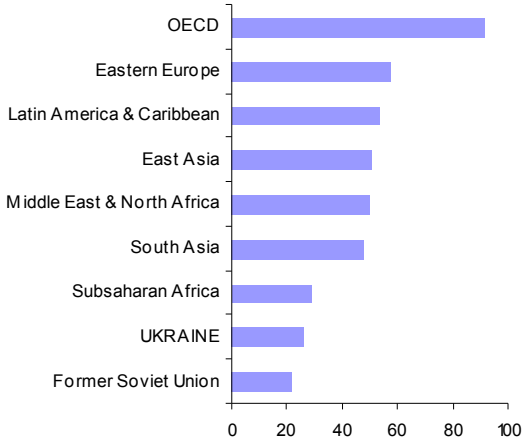

*Voice and accountability*



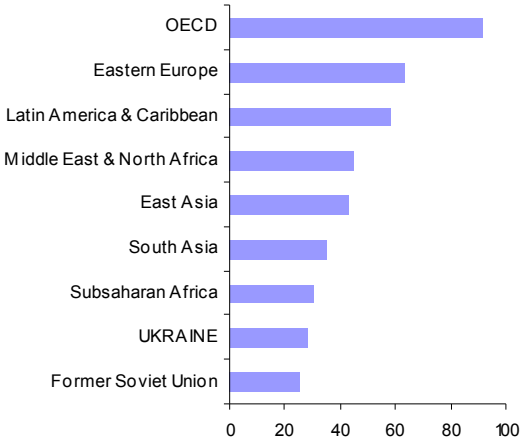

*Rule of law*



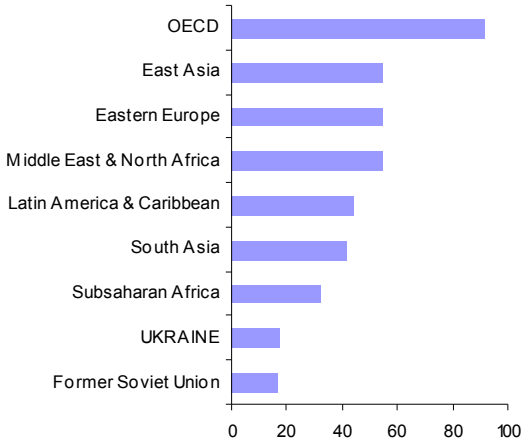

*Government effectiveness*




*Control for corruption*




*Regulatory quality*



*Source*: D. Kaufmann, A. Kraay, and M. Mastruzzi, "Governance matters III: governance indicators for 1996-2002", World Bank, draft, 2003. Available at http://www.worldbank.org/wbi/governance/pubs/govmatters3_other.html

*Notes:* Indicators are constructed for 199 countries. Ukraine's percentile rank indicates the percentage of countries faring worse than Ukraine.

Political stability reflects the likelihood that the government in power will be destabilized or overthrown by possibly unconstitutional and/or violent means.
Voice and accountability covers various aspects of civil liberties and political rights, measuring the extent to which citizens of a country are able to participate in the political process.
The rule of law represents the incidence of crime, the effectiveness and predictability of the judiciary, and the enforceability of contracts.
Government effectiveness describes the credibility of government policies, incorporating the quality of public service provision, the quality of bureaucracy, the proficiency of general government employees and their political independence.
Control for corruption reflects a perception of corruption, conventionally defined as the exercise of public power for private gain.
Regulatory quality aggregates subjective responses of the investors on government regulation, e.g. excess regulation in foreign trade and business development.