# Foreign economic activity and priority directions of economic integration of Ukraine

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- **The number of exporting enterprises has grown, and the export dimensions became more diversified.**
- **Customs barriers and reluctance of prospective partners to cooperate with Ukrainian business because of unfavorable economic environment are the main obstacles for the development of foreign economic activity of enterprises.**
- **The past tendency of increase only one direction of the economic integration of Ukraine is cut. The rise of the number of followers the both East and West integration directions is observed.**
- **The share of the respondents that consider positive impact of WTO assessing on economic growth has increased.**

*A panel of 300 manufacturing enterprises is used to monitor their managers' assessments and expectations about the changes of the business climate in general and the performance of their firms.*

***In this issue: Results of the special survey conducted in November 2006 and April-May 2007***

*Content*



*The annual monitoring surveys[1] of the business attitude to the problems and prospects of foreign economic activity of enterprises show that in 2006 the manager's point of view on key directions of economic integration continued changing. In particular, the western vector of integration remained a priority and the number of its followers kept on growing, however, the number of the Eastern vector supporters rose again in 2006 after decreasing in 2000. It should be mentioned that the rotation of the executive branch of authority in the second half of 2006 was followed by some change of the external course, which was immediately reacted by the business representatives – the fact that resulted into the rise of the Eastern integration vector supporters.*

## Key directions of export activity

In the recent years, the presence of Ukrainian industrial enterprises on the international markets has been growing. In particular, the share of exporters among enterprises subject to monitoring increased from 25% in 1998 to 40% in 2005. This item did not change in 2006. The key destinations of exports did not change significantly in 2006, compared to 2005. Exception was only about the growth of the number of the respondents who work and plan to work on CIS states markets for two years. Compared to 2005, respective indicator grew from 79.8% to 93.2%[2]. 35.6% of the respondents conduct trade operations with West European countries, 25.6% — with East European. The respective values rose almost for 10%.

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[1] The survey that is dedicated to the problems of foreign economic activity of the enterprises and to the attitude of enterprise managers to different directions of economic activity is conducted at the end of October – the beginning of November every year. In 2006, the field part of the survey was held from October 25th to November 10th.

[2] The enterprises were asked about the key, on their point of view, foreign markets, while the volumes of export to any state were not specified.

***Table "Main markets of exporting enterprises", % of enterprises***

| | 1998 | | 1999 | | 2001 | | 2003 | | 2004 | | 2005 | | 2006 | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | Now | In 2 years | Now | In 2 years | Now | In 2 years | Now | In 2 years | Now | In 2 years | Now | In 2 years | Now | In 2 years |
| Russia and CIS | 61.8 | 90.8 | 62.1 | 72.2 | 81.8 | 84.1 | 81.7 | 88.5 | 82.1 | 85.3 | 79.8 | 80.9 | 93.2 | 90 |
| Western Europe | 15.8 | 23.7 | 25.3 | 37.3 | 29.5 | 37.5 | 28.8 | 34.6 | 26.1 | 30.4 | 28 | 38.7 | 35.6 | 35.6 |
| Eastern Europe | 13.2 | 23.1 | 18.7 | 24 | 15.9 | 28.4 | 16.3 | 23.1 | 15.2 | 29.3 | 17.2 | 24.7 | 25.6 | 27.8 |
| USA and Canada | 7.9 | 9.2 | 8 | 14.7 | 10.2 | 12.5 | 9.6 | 15.4 | 10.9 | 14.1 | 9.7 | 8.6 | 8.9 | 10 |
| Middle East and Africa | 7.9 | 7.9 | 10.7 | 16 | 13.6 | 21.6 | 15.4 | 21.2 | 16.3 | 25 | 11.8 | 16.1 | 12.2 | 10 |
| Eastern Asia | 9.2 | 10.5 | 10.7 | 13.3 | 11.4 | 15.9 | 9.6 | 12.5 | 6.5 | 17.4 | 5.4 | 8.6 | 10 | 12.2 |
| Other | 5.3 | 5.3 | 4 | 5.3 | 2.3 | 6.8 | 1 | 3.8 | 2.2 | 3.3 | 3.2 | 2.2 | 8.9 | 7.8 |

Meanwhile, the export operations of enterprises became more diversified: the share of enterprises among the exporters that have more than one export market increased from 44.2% in 2003 to 76.0% in 2006 (the same indicator was 31% in 1998). According of the enterprises mangers' expectations, the trend will be continued in the future.

## Obstacles for foreign economic activity

***The obstacles rating.*** As the exporting enterprise managers reported, in the end of 2006, the main obstacles for the development of foreign economic activity of their enterprises included customs barriers[3] (50% of the polled) and the reluctance of the foreign partners to work with enterprises like theirs because of the unfavorable business and political climate (31.1%). It should be mentioned that the last obstacle rose sharply in 2006 contrary to 2005: the number of the respondents who believe that the reluctance of foreign partners to work with our producers for the unfavorable business and political climate hinders the growth of the enterprise foreign economic activity rose more than **three (!) times**.

Generally, compared with 2005, the list of the obstacles has changed. The custom barriers become more important as the obstacles to the foreign economic activity of the enterprises after the considerable reduction in 2005 (50% to 46.8% in 2005).

Furthermore, on the opinion of managers from the exporting enterprises, Ukrainian enterprises became very unattractive partners for cooperation in 2006. The number of the respondents who believe that the reluctance of foreign partners to work with such enterprises as theirs because of the unfavorable business and political climate rose from 9.6% in 2005 to 31.1% in 2006 and took the second place. This value of indicator is the highest for all years of the survey.

***Obstacles for foreign economic activity of the enterprises, % of enterprises (part 1)***

| | 1999 | 2001 | 2003 |
|---|---|---|---|
| Low quality of goods | 12.0 | 8.0 | 4.7 |
| High cost of produce | 56.0 | 40.2 | 26.4 |
| Absence of effective marketing | 32.0 | 21.8 | 29.2 |
| Custom barriers | 60.0 | 67.8 | 58.5 |
| Reluctance of the foreign partners to work with enterprises because of the unfavorable business/political climate | 22.7 | 9.2 | 26.4 |
| Shortage of finance to promote the product | 45.3 | 44.8 | 28.3 |
| Discrimination measures for Ukrainian goods in the foreign markets | - | - | 23.6 |
| Hard to say | 5.3 | 4.6 | 6.6 |

[3] The respondents usually mean both procedures of custom registration of the goods and VAT reimbursement as custom barriers.

The importance of high cost of produce decreased compared to 2005 (-16.9%). And the importance of such an obstacle as the "absence of effective marketing" rose *vice-versa* (+6.1%).

Meanwhile, it is recorded the decrease in number of the polled who consider that the foreign markets discriminatory measures applied to their goods has been the obstacle for the triggering the foreign economic activity. The respective indicators were 18.1% in 2005, and 12.2% in 2006.

***Corruption.*** Corruption is the component of the concept "custom barriers" for the respondents. Every year they answer the question to what extent the word combination "corruption at carrying out the export-import activity" associates with any regulating authorities[4]. The part of the respondents who choose "associates strongly" and "very strongly" is taken into account. In 2007, similarly as in 2006, the respondents named State Custom Service (60.5% and 51.7%) and State Tax Administration (51.9% and 45.8%) most frequently in the answers. It should be mentioned that in 2007 the rate of these items rose for all the authorities that were included in the list.

## Attitude of enterprise managers to the directions of economic integration of Ukraine

***Integration trends.*** In 2006, for the first time since 2001, the trend of steady reduction of the adherents of the Eastern direction of economic integration and the rise of the adherents of the Western one has changed. The number of supporters of economic integration with the EU states continues to grow, but this year, for the first time for the last 3 years of observations the number of supporters of integration with Russia and CIS states has grown as well. The number of managers who believe that the economic integration with the EU states is important for Ukraine rose to 34.6%. At the same time the numbers of the questioned who view the economic cooperation with Russia and the CIS states as a priority rose sharply: from 24.2% to 37.3%. Such a growth of the division of the trends of economic integration within the business community, besides the other reasons, can be the result of the sharp polarization of the Ukrainian society, which can be observed for the last two years. The grounds for speaking about it are given by the analysis of the priority integration trends separately for exporting enterprises and the enterprises with no export activity. If the opinion forming of the first ones is influenced, along with the other factors, by their personal experience of international market work, then the last ones, not having such an experience, are subjected to the influence of personal values and orientations to significant extent. Among the exporters, the number of supporters of economic integration with the EU has grown, and the number of ones with the CIS has not changed. However, among these without export activity the

***Obstacles for foreign economic activity of the enterprises, % of enterprises (part 2)***

| | **2004** | **2005** | **2006** |
|---|---|---|---|
| Low quality of goods | 10.2 | 8.5 | 5.6 |
| High cost of produce | 39.8 | 44.7 | 27.8 |
| Absence of effective marketing | 26.1 | 18.1 | 24.4 |
| Custom barriers | 60.2 | 46.8 | 50 |
| Reluctance of the foreign partners to work with enterprises because of the unfavorable business/political climate | 18.2 | 9.6 | 31.1 |
| Shortage of finance to promote the product | 29.5 | 22.3 | 24.4 |
| Discrimination measures for Ukrainian goods in the foreign markets | 11.4 | 18.1 | 12.2 |
| Hard to say | 6.8 | 11.7 | 12.2 |

***The word combination "corruption at carrying out the export-import activity" strongly and very strongly associates with these regulatory authorities, % of the enterprises***

| | 2004 | 2005 | 2006 | 2007 |
|---|---|---|---|---|
| State Custom Service | 35,3 | 50,0 | 51,7 | 60,5 |
| State Tax Administration | 56,4 | 31,9 | 45,8 | 51,9 |
| Ministry of Economics | 16,3 | 3,6 | 19,0 | 22,0 |
| State Standard | 19,4 | 4,8 | 19,7 | 27,7 |

***Economic integration direction, % of enterprises***

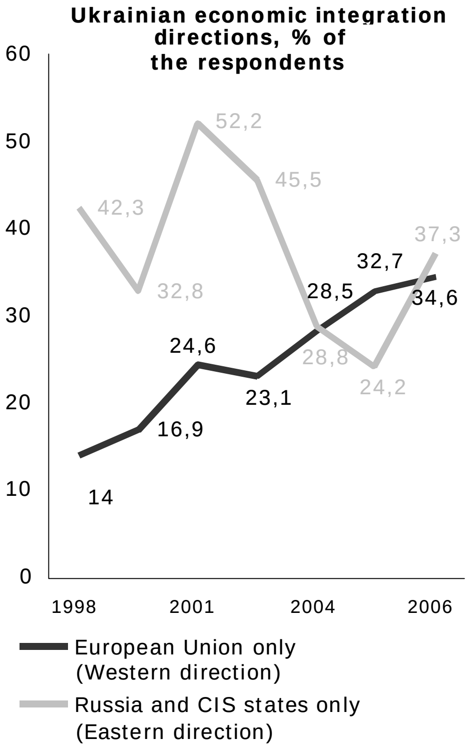
| Exporting enterprises | | | |
|---|---|---|---|
| | 2005 | 2006 | |
| EU | 36.2% | 42.2% | + |
| CIS | 28.7% | 28.9% | = |
| **Enterprises with no export** | | | |
| | 2005 | 2006 | |
| EU | 31.1% | 29.2% | = |
| CIS | 22.4% | 43.1% | + |

[4] After conducting focus groups and interviews, State Custom Service, State Tax Administration, Ministry of Economics and State Standard have been included in the list.

opposite trends are observed, while the number of supporters of the integration with the CIS has almost doubled.

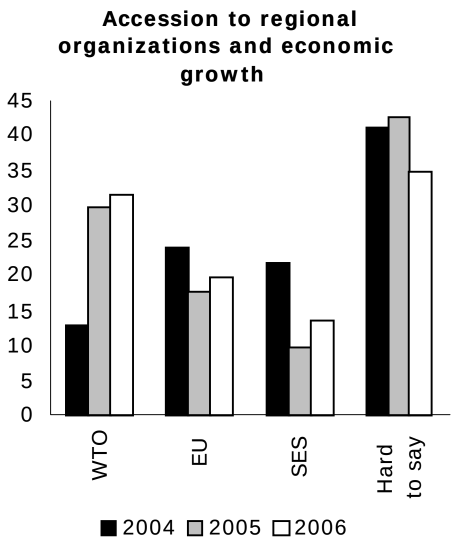
***Multi vector opinions.*** It should be mentioned that the mentality of business community remains multi vectored. That means that there are respondents who cannot detach one direction of economic integration – neither East nor West. But the number of those who choose only one direction growth every year. Besides, in 2006 the numbers of those who were not able to determine the way for integration for Ukraine decreased more than twofold, and amounted 12.3% contrary to 26.4% in 2005.

***Regional dispersion.*** The majority of the supporters of the integration to the EU are among the managers of Lviv and region, as well as of Kyiv city and Kyiv region (relatively 62.5% and 67.7%). At the same time the number of the supporters of the SES integration among the managers of these regions is as much as 8.3% and 25.8% relatively. The majority of the supporters of the integration to the SES are among the enterprises of Kharkiv and the region (57.7%). The feature is smaller among the enterprises of Odesa and the region (28.6%). The number of those who view only the EU integration trend as a priority compiles relatively 4.8% and 7.1% of the questioned in these regions. Besides, it should be mentioned that the representatives of the capital circles have the most distinct opinions: 90% of them choose one of, but ONE, the trends of economic integration. And the minority of those who choose only one trend of integration are in Odesa and the region (35%).




## Accession to regional organizations and the economy growth of Ukraine.

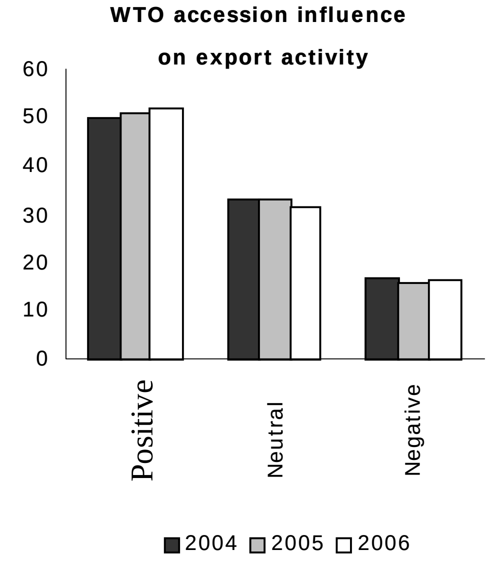
***Accession to regional organizations and the economy growth***. In the end of 2006 the number of managers convinced that Ukraine's accession to the WTO would promote the growth of the national economy increased to 31.4%, against 12.8% in 2004. After the reduction in 2005, the number of those who believe that accession to EU will have a positive effect on economic growth increased in the end of 2006. At the same time, the frequency of the opinion that cooperation within the SES will promote the economic growth in Ukraine rose again after the sharp fall in 2005: from 9.7% (2005) to 13.9%. The number of those who could not answer the question decreased from 42.6% to 35%.




***Accession to the WTO and foreign economic activity of the enterprises.*** We carried out a particular research of the enterprises managers assessment of the impact on enterprise import and export activity in case of Ukraine's accession to the WTO. 52.1% of the polled mangers of exporting enterprises who answered this question[5] are sure that the accession to the WTO will positively influence export activity of their enterprises, 31.5% expect no influence, and only 16.4% believe that the influence will be negative. Compared to 2005, their positions actually did not change. Among the respondents who assessed the effects of Ukraine's

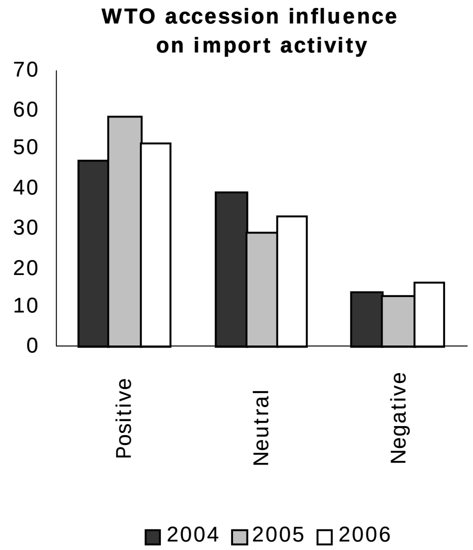
[5] 34,2% of exporting enterprises answered the question. There are about 40% of exporting enterprises in the panel sample.

membership in the WTO for the import activity of their enterprises[6], 51.1% believes that its effects will be positive, 33.3% — neutral, and 16% expects negative effects. Compared to 2005, the dispersion of the answers virtually did not change.




## Conclusion

The results of the current year survey of the foreign economic activity problems and the companies executives' orientations prove Ukrainian all-scale industrial business' ever greater understanding of the need of establishing business contacts with partners from the developed European countries. It is a positive fact that will encourage further pursuit by Ukrainian business of its place in global work distribution. At the same time the survey results indicate the more definite position of companies executives towards the integration processes: on the background of preservation of business share with mixed priorities perception, two opinion groups – the pro-western and pro-eastern oriented ones – are distinctly outlined and keep on growing. The growth of such a division of the economic integration trends within the business circles representatives can result from the sharp polarization of Ukrainian society that has been observed for the last two years. Besides, anxiety is produced by more than threefold increase of the spreading of the belief of unfavorable political and business climate in Ukraine. Every third exporter from our sample noted that an absence of the wish of foreign partners to work with us due to the business and political climate is an obstacle for the growth of enterprises foreign economic activity.




## Sample characteristics

The research sample is based on the panel, which is used for the Quarterly Enterprise Survey and which includes 300 enterprises of manufacturing industry located in four regions of Ukraine. Response rate is 94,0 %. The structure of sample reflects panel structure.

The enterprises are situated in Kyiv, Lviv, Charkiv and Odesa regions. About 2/3 of the enterprises are sited in the region centers, 1/3 represent other settlements. The average size of an enterprise estimated by the number of employees is 437. We divided the enterprises into 3 groups: small enterprises (from 10 to 50 employees), middle enterprises (from 50 to 250 employees) and big enterprises (more than 250 employees).

[6] 33,5% of enterprises answered the question.