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INSTITUTIONAL PERFORMANCE IN EASTERN EUROPE

The transition period in Central European countries from command to market economy started from the basic transformation of economic system. It includes the development of economic basics of market economy: privatization, liberalization, and stabilization. The institutional approach is based on the concept of the significant role of institutional system in the transition process. Institutional arrangements and determinants of the system of laws are the main preconditions of the successful implementation of reforms in transition. Replacement of old institutions by new economic institutions, renovation of old institutions, and foundation new institutions are directed to accelerate transition period. New institutions are directed to stabilize economic situation, reduce conflicts, contribute to better control, and diminish coordination costs. The new institutional economics are based on definition of transaction costs, system of property rights and asymmetrical information.

Government may encourage foreign investment through special policy. Yet several factors have discouraged potential investors: political instability and corruption on every level; insecure property rights; lack of developed internal markets. Legal norms and laws of such society do not provide functioning mechanism of control an economic behavior of entrepreneurs. Main tasks of transition period have not been solved. New society does not provide the creation of new wealth. It is based on redistribution of already existed wealth. Russian as well Ukrainian economy is subsidized by overpriced raw materials, capital, doesn't provide production goods with added value, and it is called virtual economy.

Source: UNCTAD survey.

The UNCTAD survey considers the factors to be strengthened and weakened in Central and Eastern European countries. Taking into account the results of the survey responses small markets, low growth, and inadequate resource endowments constrained investment. Macroeconomic stability and currency convertibility contribute positively in attracting FDI. Privatization was assessed differently. The progress in privatization is enhancing FDI flows factor. Legal uncertainties are major impediments to attracting FDI. Financial incentives were cited as the most important business-facilitation factors. Table 1 is about it.

Table 1. Central and Eastern Europe: factors enhancing or constraining inward FDI, 1993-1997 (number of responses)

Factor	Enhancing factor	Constraining factor
Economic factors Labour cost	13	-
Labour skills	12	1
Integration prospects	7	1
Market size	2	8
Market growth	2	3
Natural resources	1	5
Management skills	1	1
Physical infrastructure	1	4
Financial infrastructure	1	3
Access to Russian market	-	1
Niche industries	-	1
Policy factors Macro-economic stability	9	1
Currency convertibility	5	-
Favourable privatization	4	3
Readiness of local firms	3	2
Economic reconstruction possibilities	3	3
Progress of privatization	2	2
BITs	1	2
Legal stability	-	5
Enterprise restructuring	-	3
Business facilitation Subjective proximity to investors	11	-
Information	3	5
Political environment	3	2
Country image	1	8
Financial incentives	1	8
Market incentives	1	3
Enterprises registration		

The comparative analysis of the situation in Central and Eastern Europe shows the growing diversity in economic activities in capital movement, and institutional transformation. Successful realization of economic reforms toward market is closely connected with the process of economic reforming. Privatization and economic opening up were fully and effectively realized in Central European countries. Successful implementation of economic reforms became the base for development of foreign trade and of attracting foreign capitals into countries. These processes stipulated production of competitive products, development effective foreign specialization, and change of export structure, where prevalence has been given to finished products.

A slow progress of economic reforms prevented quick transformation from command to market economy in Ukraine. Privatization process did not provide change of system of corporate governance, transfer of control from insiders to outsiders, emergence and existence of stable system of property rights.

Source: Constructed on data of Ukrainian-Economic Trends. September 1998.p79.

The main ways of privatization are: purchase of small -scale enterprises by buyers partnership, organized by its workers; purchase of state property, auction; commercial or non-commercial competition, selling of shares of joint -stock companies in Ukraine.

Table 2. Development of new forms of ownership in Ukrainian industry (end of the period)

	Number of large and medium scale industrial enterprises	Including		
		State ownership	Collective ownership	Mixed ownership
1992	6850	5159	151	1535
1993	7963	5421	472	2053
1994	8826	4763	2412	1631
1995	8931	3882	5030	
1996	9120	2715	6405	
1997	9710	2516	7194	

Table 2 shows the results of the development of new forms of ownership in industry. The share between state ownership and other forms changes in favor of collective and mixed ownership. In spite of change of ownership of large and medium scale industrial enterprises there are state enterprises in strategic sector which are under state control. Privatization and release of state control of such enterprises can be beneficial from the point of view utilization of new technologies, the modernization of the domestic capital stock, stimulus production, promotion the regeneration and development of infrastructure branches, increase employment, rise export and tax revenues.

Capital flows falls to $45 billion from $61 billion in 1997 because of a reduction in financial investment. Direct investment in Russia dropped from $3.75 billion to 1.1 billion, and across the whole CIS decreases from $7.6 billion in 1997 to $5.1 billion. Existence of impediments of transfer foreign capitals to East European countries resulted in a regressive change from elaboration and creation of new technologies to application already obsolete technologies exported from the developed countries.

The world experience depicts that FDI, together with international trade stimulate economic growth, create additional jobs and increase level of living standards. A World Trade Organization's study reports that "low levels of trade and inflows of FDI are symptoms rather than causes of the plight of many of the poorest countries. Without an increased inflow of FDI in these countries and increased trade, it is difficult to imagine how a major improvement in their prospects can be achieved. FDI brings with it resources that are critically short supply in poor countries, including capital, technology and such intangible resources as organizational, managerial and marketing skills."

Since of limited natural resources and a lack of the internal investments FDI are considered as an alternative source of financing the development of branches of economies. Major factors inducing multinational companies (MNCs) to invest in other countries, are the advantages of allocation, large stocks of natural resources, and free access to the market in these countries.

Data of the table 3 compares the growth rate of the number of enterprises with foreign investment and foreign capital. The growth rate of foreign capital is higher of the growth rate of the number of enterprises. Foreign investors prefer to make short-term investment.

In accordance with State Statistics of Ukraine data the cumulative volume FDI reached 2.7 billion US dollars in 1998 since 1991. FDI inflow to Ukraine made up 807 million US dollars in 1998. According to State Statistics on 1 October 1999 the cumulative volume of FDI to Ukraine made up 3.122 billion US dollars. The USA invested 18,3 %, Netherlands – 9.5 %, Russian Federation – 9.2 %, Germany – 7.7 %, United Kingdom of Great Britain – 7.6 %, Cyprus – 5.5 % to Ukraine. The branch structure of FDI includes machinery and metal processing – 11%, oil processing – 6 %, food catering – 20 %, foreign trade – 17 %, finance, credit – 6 %, building – 4 %, other – 36 %. Absence of effective export specialization shows low share of finished articles in the total volume of export. Reorientation of export mechanism from natural resources to finished articles will stipulate the accumulation of export revenues. The capital account of the host country's balance of payments can benefit from the establishment of multinational company 's (MNC)

Table 3. Number of Enterprises with Foreign Investment and Total Volume of Foreign Investment in Ukraine in 1994-1996

Total per year	Number of enterprises With foreign investment		Number of joint enterprises	Number of enterprises, producing goods	Foreign capital (Million US dollars)	
	Total	Growth rate, % before 1994			Total	Growth rate, % before 1994
On 01.01.1995	2123	100,0	1856		483,5	100,0
On 01.01.1996	3842	181,0	3328		880,6	182,1
On 01.04.1996	4360	205,4	3617	1172	990,4	204,8
On 01.07.1996	4669	219,9	3814	1254	1082,9	224,0
On 01.10.1996	4904	231,0	3941	1326	1223,2	253,0

Source: Official data of the Ukrainian Ministry of Statistics in 1996.

subsidiaries used as export supply source.

The analysis of economic situation in Eastern Europe and in Ukraine shows the necessity acceleration of economic reforming. Economic reforms should be aimed on reducing budget deficit, foreign debt, and setting up monetary, fiscal stabilization. Investment climate is an important factor in decision making process for foreign investors. The establishment of MNC subsidiaries positively influences the .capital account of the host country's balance of payments.

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