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ІМЕНІ ТАРАСА ШЕВЧЕНКА  
ІНСТИТУТ МІЖНАРОДНИХ ВІДНОСИН**

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### **РЕДАКЦІЙНА КОЛЕГІЯ ЗБІРНИКА НАУКОВИХ ПРАЦЬ «АКТУАЛЬНІ ПРОБЛЕМИ МІЖНАРОДНИХ ВІДНОСИН»**

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## **ПОЛІТИЧНІ ПРОБЛЕМИ МІЖНАРОДНИХ ВІДНОСИН**

УДК 327(540:510)

### **CHINA-INDIA'S CONFLICT OF INTEREST IN THE REGION OF SOUTH ASIA**

### **КОНФЛИКТ ІНТЕРЕСІВ ІНДІЇ ТА КИТАЮ У РЕГІОНІ ПІВДЕННОЇ АЗІЇ**

### **КОНФЛИКТ ИНТЕРЕСОВ ИНДИИ И КИТАЯ В РЕГИОНЕ ЮЖНОЙ АЗИИ**

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**Abstract.** *The trends of the growing confrontation of international relations and the increasing role of Asian countries in world politics directly affect the issue of China-India interaction in the strategically important region of South Asia. It is clear that the role of the region for each of the sides has a different weight: if India considers leadership in South Asia as a key geopolitical goal, for the PRC it is only one element of the global expansion strategy. Both states are trying to consolidate their influence in the region through various kinds of collaboration and assistance, using bilateral and multilateral formats of cooperation. In particular, at the level of competition of geoeconomic initiatives, China is actively promoting the "One Belt, One Road" project, while India seeks to balance using a wider range of integration tools – SAARC, "North-South", "Spice Route" and "Look East" policy. However, the Chinese side is achieving success due to great financial opportunities and promises, the needs of the countries of the region for external impulses for economic development, the lack of determination in Indian regional politics, and the rejection by South Asian countries the prospect of Indian domination, key reason of what is various kinds of problems in relations with official New-Delhi. This concerns primarily Pakistan, which at the same time is a key regional partner of China. Now the regional policy of India has a clear advantage over the Chinese strategy of "geopolitical ticks" only in Bhutan and tactically in the Maldives. However, Chinese influence is increasingly causing concern among the regional*

*given the growth of financial dependence, the use of so-called “debt-trap diplomacy” and even a demonstration of strength, the most colorful evidence of what is the experience of Sri Lanka.*

**Keywords:** *India, China, South Asia, region, “One Belt, One Road”, strategy of “geopolitical clutches”*

**Анотація.** *Тенденції зростання конфронтаційності міжнародних відносин та посилення ролі азійських країн у світовій політиці напрямку зачіпають проблему індо-китайської взаємодії у стратегічно важливому регіоні Південної Азії. Зрозуміло, що роль регіону для кожної із сторін має різну вагу: якщо Індія розглядає лідерство у Південній Азії як ключову геополітичну мету, то для КНР – це лише один із елементів глобальної стратегії експансії. Обидві держави намагаються за рахунок різного роду співробітництва і надання допомоги закріпити свій вплив у регіоні, використовуючи двосторонні та багатосторонні формати співпраці. Зокрема, на рівні конкуренції геоекономічних ініціатив Китай активно просуває проект «Одного поясу, одного шляху», а Індія прагне балансувати, використовуючи більш ширший діапазон інтеграційних інструментів – СААРК, «Північ-Південь», «Маршрут прянощів», політика «Дивись на Схід». Втім, успіхів досягає саме китайська сторона завдяки більшим фінансовим можливостям та обіцянкам, потребі країн регіону у зовнішніх імпульсах для економічного поступу, відсутності цілеспрямованості у індійській регіональній політиці, несприйнятті країнами Південної Азії перспективи домінування Індії, що також зумовлено різного роду проблемами у відносинах із офіційним Нью-Делі. Це стосується, у першу чергу, Пакистану, який водночас є ключовим регіональним партнером КНР. Наразі регіональна політика Індії має чітку перевагу перед китайською стратегією «геополітичних кліщів» лише у Бутані та тактично на Мальдівах. Однак китайський вплив все більше викликає занепокоєння серед держав регіону з огляду на зростання фінансової залежності, використання так званої «дипломатії боргової пастки» та навіть демонстрації сили, найбільш яскравим свідченням чого виступає досвід Шрі-Ланки.*

**Ключові слова:** *Індія, Китай, Південна Азія, регіон, «Один пояс, один шлях», стратегія «геополітичних кліщів»*

**Аннотация.** *Тенденции роста конфронтационности международных отношений и усиление роли азиатских стран в мировой политике напрямую затрагивают проблему индо-китайского взаимодействия в стратегически важном регионе Южной Азии. Понятно, что роль региона для каждой из сторон имеет разный вес: если Индия рассматривает лидерство в Южной Азии как ключевую геополитическую цель, то для КНР – это лишь один из элементов глобальной стратегии экспансии. Оба государства пытаются за счет разного рода сотрудничества и оказания помощи закрепить свое влияние в регионе, используя двусторонние и многосторонние форматы сотрудничества. В частности, на уровне конкуренции геоекономических инициатив Китай активно продвигает проект «Один пояс, одного пути», а Индия стремится балансировать, используя более широкий диапазон интеграционных инструментов – СААРК, «Север-Юг», «Маршрут пряностей» и инициатива «Глянь на Восток». Впрочем, успехов достигает именно китайская сторона благодаря большим финансовым возможностям и обещаниям, потребности стран региона во внешних импульсах для экономического развития, отсутствия целеустремленности в индийской региональной политике, неприятия странами Южной Азии перспективы доминирования Индии, что также обусловлено разного рода проблемами в отношениях с официальным Нью-Дели. Это касается, в первую очередь, Пакистана, который в то же время является ключевым региональным партнером КНР. Сейчас региональная политика Индии имеет четкое преимущество перед китайской стратегией «геополитических клещей» только в Бутане и тактически на Мальдивах. Однако китайское влияние все больше вызывает беспокойство среди государств региона в связи с ростом финансовой*

*зависимости, использованием так называемой «дипломатии долговой ловушки» и даже демонстрации силы, наиболее ярким свидетельством чего выступает опыт Шри-Ланки.*

**Ключевые слова:** *Индия, Китай, Южная Азия, регион, «Один пояс, один путь», стратегия «геополитических клещей»*

**Formulation of the problem.** The current state of international relations is marked by growing turbulence. From time to time, new points of confrontation appear on the geopolitical map of the world, or at the same time the old contradictions between the states receive a new impetus. The interdependence is increasing, but meanwhile the world is becoming more conflictual due to the growing need of countries for various limited resources and markets. On this background, the tendency of intensification of the struggle between geopolitical centers aimed to achievement of influence in regions is clearly evident. A significant number of experts predict that the 21st century will be the so-called “Asian Age”, which means relocation of the center of international affairs to this geopolitical space. In this context, the relationship between the two neighboring Asian giants – China and India, which have a number of similar characteristics, including thousands of civilizational traditions, demographic potential, numerous armed forces and economical success, becomes a point of great interest. Therefore, it is not surprising that both countries are striving to strengthen their role in world politics, which, in turn, causes a lot of dimensions of competition between them, in particular in the region of South Asia, which occupies a strategically important position on the crossing of routes between the Middle East and the East Asia.

**The purpose of the study** is to analyze the peculiarities of China-India confrontation in South Asia, focusing on the tools used by the sides in order to achieve geopolitical goals, and to outline the successes and failures of regional policies of both countries.

**Analysis of recent research and publications.** The question of China-India interaction has always been the focus of attention of scientists and analysts. In particular, among the domestic experts, we can mention the fundamental works and analytical investigations of O. Bordilovskaya, V. Kasprook [16], O. Klimenko, V. Taran, G. Kukhaleishvili [21]. It is noteworthy that more actively Sino-Indian relations are being explored by foreign experts, where current analytical investigations of A. Aamir [1], S. Denyer and A. Gowen, S. Ganguly and R. Menon, Ghoshal, S. Haider [4], A. Hossain [5], should be noted. Kupriyanov, A. Panda [7], S. Ramachandran [9], covers a wide range of bilateral relations issues from the balance of military capabilities to India's implementation of “Look East policy” in the context of competition with the PRC. However, the domestic researchers do not pay much attention to the study of the relations between China and India in the region of South Asia that determines the relevance of this article.

**The important research results.** It should be noted that the actual vision of India and China at each other significantly feels the inheritance of the historical development of bilateral relations. In particular, these are territorial problems which started in 1962 when official Beijing defeated India during the short-term war and took control over the Aksai Chin and Arunchal Pradesh regions. However, the armed clash was preceded by the emigration of the spiritual and political leader of Tibet (a region that was finally incorporated by force into the Chinese state) – the Dalai Lama – to India in 1959. This is a reason of accusations of the official New Delhi in sheltering of Tibetan insurgents, especially at times when the Indian leadership invites the Dalai Lama to official events. China's statements appear to be understandable in view of the implementation of the ethnic policy aimed to the radical change in favor of the Han population in order to establish final control over the separatist region. This policy is also followed by significant financial inflows and the implementation of infrastructure projects that connect Tibet with other regions of China.

Characteristically, that since the early 1960s territorial disputes have not led to large-scale military confrontation. However, occasionally there have been insignificant incidents at the disputed border. In particular, a new moment of tension was marked by 2017, when an explosive situation arose over the Plateau Doklam that is the object of contradictions between China and Bhutan. The reason is the construction of a PRC's road through Bhutanese territory has provoked protests from official Thimphu. India, using the military force, has supported its regional ally,

displacing Chinese military builders from Bhutan territory. China, in turn, has deployed its own military contingent that was located just before the Indian military personnel, accompanying such steps with accuses that the Indian side had violated China's territorial integrity. At the time of the greatest tension soldiers from both sides threw stones at each other.

This reaction of the official New Delhi to the attempts of the Celestial to improve the infrastructure on that part of common border follows from the military-strategic calculations. The Plateau Doklam is strategically important for India because control over it poses a threat to the so-called Siliguri corridor (the so-called “Chicken’s Neck”) – an extremely narrow stretch of Indian territory that connects the main part of republic with 7 eastern states and is locked between Bangladesh and Nepal.

Indian military experts say that in case of China's control over the Southern Doklam it would be necessary to deploy 9-16 Indian troops against every equipped Chinese detachment in the highlands. Herewith China's conflict strategy is based on the slow depletion of its opponent [18].

It is important to emphasize that it has been the most serious aggravation of bilateral relations over the last few decades which also affected for the first time a third party – the tiny kingdom of Bhutan.

However, the confrontation has not come to a large-scale clash and this could serve as a evidence the unwillingness of parties to complicate significantly relations. The nuclear status of both countries (in the case of India – unofficial) plays a crucial role in this. It is interesting that despite India's key military threat is also the nuclear-capable official Islamabad, the official New Delhi is developing a program of intercontinental ballistic missiles, the hypothetical target of which is, of course, not Pakistan's geographically close territory, but more remote territory of the Celestial.

Another point in this confrontation is that Bhutan has been steadily expanding its cooperation with India without establishing diplomatic relations with the PRC. In addition, this small country, as well as India, did not join the China’s New Silk Road, clearly underlining its geopolitical orientation.

India, as the largest country in the region by the cumulated potential, seeks to fix its leadership status. In particular, this is achieved through cooperation with other countries of the South Asia. It should be noted, that in order to create its own positive image in the international environment and to form a network of international economic tools of influence, India uses the so-called “Indian Development Initiative” that is focused on assisting other developing countries.

With regard to already mentioned Bhutan, India has become the largest donor to this country's economic development since the 1960s, fully funding the first five-year plan for its development. Bhutan is currently accumulating about a third of India's foreign aid. The Indian projects include the construction of a number of hydroelectric power plants that have positive effects for both sides, especially considering the fact that the large part of the produced energy goes to the needs of India, the construction of a single airport in the town Paro, all helicopter platforms, as well as 1,600 kilometers of highways [Ura, 2014]. Indian assistance plays an important role in the development of the armed forces, the health care system and the development of Bhutan's human potential.

Nepal, another small Himalayan country, has long been actively using Indian aid for economic development. In particular, much of the foreign assistance in the 2000s to this country came from India. India has provided substantial assistance in building health care, road and rail infrastructure, staff training on its territory through grants, and construction of hydroelectric power stations [12]. India and Nepal are characterized by the common religious orientation (the majority of the country's population is Hindu). In addition, bilateral trade are also systematically increasing .

However, significant tensions arose between the parties in 2015-2016 that became the point of impulse for seeking economic opportunities by the Nepalese leadership with the aim to reduce dependence on India [Ramachandran, 2019]. The point of contradiction between the parties was, according to the Nepalese authorities that, with the tacit consent of the Indian leadership, there was the stoppage of supply of fuel and food that caused significant problems for the Nepalese people.

Given the peculiarities of the geographical location, official Beijing is the only option to counteract Indian influence for Nepal. China, for its side, pragmatically has taken advantage of this

situation and as result in 2016 Nepal joined the One Belt, One Road project by signing an Agreement on Economic Co-operation and Transport Infrastructure with official Beijing. Moreover, in 2019, the Chinese leader visited Nepal for the first time in the history of bilateral relations [Panda, 2019]. However, as revenge the Nepalese leadership preferred the Chinese company Gezhouba Group Company instead of the Indian one in the Budhi Gandaki hydroelectric project [Bansh, 2019]. In addition, the ability to circulate the Indian rupee, as well as the activities of Indian workers and businessmen on the Nepal's territory has been complicated. We also note that the orientation towards the Middle Kingdom is strengthened by the fact that the authorities in this country are adherents of communist ideology, whose functionaries are being ideologically trained on the territory of the PRC. Currently, China is also developing transport infrastructure where could be noticed the rail link between Kathmandu and other tourist centers of Nepal – Pokhara and Lumbini with the city of Kerung in Tibet. This project will obviously enhance the tourist flow to this mountainous country [Ramachandran, 2019].

Sri Lanka is also one of the largest recipients of Indian aid, totaling \$ 3 billion, out of which around \$ 560 million are purely in grants [13]. The multidimensional assistance includes areas such as infrastructure, education, emergency assistance, humanitarian issues related to the Sinhala-Tamil conflict, in other words, spheres in what Sri Lanka often suffers.

In this context we should admit the necessity of post-war construction of Sri Lanka and the refusal of Western institutions to provide finance in view of the unwillingness of the country's leadership to investigate crimes during the civil war that, in turn, allows the penetration of Chinese capital. In particular, due to Chinese funds, were realized the construction of the seaport of Hambantota, the international airport in Mattala, as well as thermal power stations [Ramachandran, 2019].

Moreover, China has succeeded in turning Sri Lanka into a pillar in its so called the “string of pearls” strategy [Hossain, 2018], successfully using the “debt-trap diplomacy” approach, in which official Beijing, in case of a partner's failure to pay its loans, take under control important logistical or resource capabilities. For example, due to financial insolvency, Sri Lanka's leadership transferred the port of Hambantota and 15,000 acres of land around it to China for a 99-year lease [Ramachandran, 2019]. It should be noted that the essence of the unofficial strategy of the Celestial “string of pearls” is to build the maritime, including military, infrastructure of China along the key routes of maritime trade of which official Beijing is highly dependent and at the same time vulnerable due to the advantages of US naval military capabilities.

True, Sri Lanka's compliance was provoked not only by economical factor. Thus, the complaint of local business elites found expression during the presidency of M. Sirisena, who decided to declare the end of the era of Chinese influence and stopped the construction of Port City in Colombo. However, the Chinese side demonstrated strength by sending its submarine to the island. As a result, construction was restored and local businessmen suppressed [Polevik, 2018].

Since 1988 India's economic assistance to the Maldives has been stepped up. The precondition was a successful prevention by the Indian military the attempt of coup d'état by Tamil rebels in that country. On this basis, India placed its own military objects on the territory of the island republic in order to ensure stability there. Moreover, the leadership of Maldives proclaimed “India First” in foreign and domestic policies. These moments were a demonstration that the country was entering in orbit of the exclusive geopolitical influence of the Republic of India.

In turn, the Indian party continued to provide substantial assistance to the Maldives in disaster relief, including through the supply of medicines, medical equipment, food, drinking water and rescue units.

However, by the time the Maldivian leadership began to consider options for creating a geopolitical balance for Indian influence. This has been successfully exploited by the Chinese state that traditionally uses a strategy of developing economic cooperation, the real purpose of what is to establish the economic dependence of the country-partner. Among the successes of the PRC is the growing economic dependence of the official Male, what is reflected in the fact that China is the largest supplier of tourists to the Maldives (the economy of this Muslim country is based on the

tourism industry), as well as holding much of the national debt of the republic [Kupriyanov, 2018]. The Maldives took a favorable step for China in 2015 by allowing foreigners to buy its land. In addition, the situation with the contract for the construction of the Nasir Airport, initially received by an Indian company in 2010, was a very unpleasant moment for official New Delhi, because in 2014 the Maldivian administration terminated it in favor of the Chinese company, arguing such step by infractions in the process of concluding an agreement [Kupriyanov, 2018].

A critical moment was the domestic political situation ahead of the 2018 parliamentary elections, where each party had its supporters. India, increasingly sensing its position in the Maldives, supported opposition politicians who had even called for India to use its armed forces on the territory of the island republic. Interestingly, similar statements were made by the Indian political establishment which identified the situation in the Maldives as a threat to national interests [Kupriyanov, 2018]. But official Beijing, in turn, sent a message through the article of its own English-language newspaper Global Times, emphasizing the inadmissibility of the Indian military force use in the Maldives [Ai, 2018].

However, the situation has not come to the using of military power. Besides, in the island republic pro-India-minded president came to power – Mohamed Solih, which right away declared the necessary of increase of India's assistance and meanwhile raised the issue of debt to China, in particular in the context of one of the already implemented bilateral large-scale infrastructure project – Sino-Maldivian friendship bridge that linked the capital city of Male with the island of Hulhumale, where the international airport is located [14]. In turn, the problem of debt has a negative impact on China's international image and activity, specially taking into account the point that cooperation with the Maldives has been considered as a successful example in demonstration that “One Belt, One Road” really could help the economic development of small countries [Mundy, Hille, 2019].

Bangladesh, despite the fact that India played a key role in declaring the country's independence from official Islamabad in 1971, also demonstrates a desire to limit India's influence in the region by building cooperation with the PRC. This clearly demonstrates the official Beijing's has got access to the strategically important port of Chittagong, the use of which has been unsuccessfully claimed by the official New Delhi for the purpose of transporting natural gas from Myanmar [Casprook, 2012]. Bangladesh, besides its location, is also the place of interest given the significant deposits of natural gas. Moreover, by joining the NSR, Bangladesh has agreed to emphasize a new level of relations with China – by declaring a strategic partnership in 2016 [23].

This step seems logical given that China has invested more than \$ 10 billion in the country, in particular, focused on the development of a special economic zone and the construction of thermal power station near the Chittagong, as well as the construction of a port in Cox's Bazar [Polevik, 2018].

The aspirations of official Dhaka to curb India's influence can be explained by the problems of bilateral relations, such as the division of water resources of 54 common rivers, accusation in purchasing by anti-Indian rebel weapons in Bangladesh, and illegal migrants.

Moving away from the cooperation with the United States, at present Pakistan has become the most close regional ally of China and the fundamental reason for the Sino-Pakistani partnership is objective – its complex relations with India. This was the precondition for the rapprochement of parties in the 1960's on the background of Indo-Pakistan conflicts. Moreover, the official Islamabad has given in favor of the PRC the Karabulak valley in the north of Kashmir that is a strategically important pass through Karakoram [Borisov, 2019: 149]. China, in turn, has made a significant contribution to the national security of Pakistan.

After Indo-Pakistani military clash in 1965, the first phase of military-technical cooperation (MTC) between Pakistan and China has begun with supply of a significant number of tanks, aircraft and artillery systems to official Islamabad. Much more important in this context was the transfer of the military technologies and the Chinese assistance in building-up of Pakistan's own military-industrial complex.

The readiness of China to assist played the key role in the second phase of the MTC, which began in the 1990s and continues today. In particular, Pakistan's armored, aeronautical, missile and shipbuilding industries were started thanks to the PRC [Borisov, 2019:159-169]. Moreover, a significant number of experts believe that nuclear weapons technologies have emerged in Pakistan thanks to the Middle Kingdom.

At present Sino-Pakistani relations have been significantly supplemented by economic cooperation related to the active involvement of Pakistan in the Belt and Road project, especially since 2015 when the China-Pakistan Economic Corridor (CPEC) Agreement was signed according to what Beijing has declared the intention to provide \$ 42 billion to \$ 62 billion for the construction of infrastructure on Pakistani territory [Ramachandran, 2019]. Obviously, suffering economic and security difficulties, Pakistan through relationship with the PRC hoped to gain additional job places, power generation capacity, attract of investment and ultimately stimulate the economic development of its own economy.

In 2019 was a significant military aggravation with the use of aviation and artillery in Indo-Pakistan relations based on the ancient cause of Kashmir affiliation. But as in case of territorial contradictions between Bhutan and China, clashes have not come to a serious escalation. It is clear that moment of confrontation has touched the issue of CPEC implementation as Pakistan's investment attractiveness has been diminished because of arising risks to Chinese companies's activities. It should be noted that in 2018 was announced information on the intention to create a special economic zone in Pakistan-controlled part of Kashmir for the production of space satellites and the production of new generation Chinese aircraft [Kukhaleishvili, 2019]. It is also logical to assume that a new moment of conflict with India will add arguments for the possible transformation of Gwadar into a Chinese military base and help boost Chinese arms imports to Pakistan.

At an official level, during the Russia-India-China meeting in February 2019 on the background of Kashmir confrontation China took a neutral stance, calling for a peaceful settlement and condemning terrorism (the terrorist attack on the Indian territory of Kashmir was the occasion for aggravation) [Korostikov, 2019]. Meanwhile, the PRC did not allow to include in the UN list of global terrorists the leader of the Jaish-e-Muhammad group that had been accused responsible for the Kashmir terrorist attack [Strokan, 2019].

It should be emphasized that India has an ally within Pakistan both in the context of confrontation with official Islamabad and the growing Chinese influence in that country. Pakistan is a state made up of individual ethnic groups, most of what are demonstrating separatist tendencies. The most privileged position in Pakistani society belongs to the residents from the Punjab region, while the most depressed are Baloch, a multimillion ethnic group without its own statehood which is divided by the borders of Pakistan, Iran and Afghanistan. The Baloch of Pakistan are trying to achieve independence by force tools. Important point is that Balochistan is rich in energy resources and has a strategically crucial position because a lot of infrastructure projects can be implemented through its territory, including pipelines for the transport of energy from Iran to China. Therefore, it is not surprising that Chinese companies are active in Pakistani Balochistan. It is also important to remind that in the province is located a deep-water port of Gwadar.

However, the Baloch have a very negative perception of Chinese presence on their territory, believing that the representatives of the Celestial are exploiting the resources of their land only for own enrichment and the welfare of Pakistani non- Baloch. As a demonstration of the rejection of the Chinese presence growth, Baloch attack not only Chinese citizens in their region, but also the Chinese Consulate in Karachi [Aamir, 2019]. The purpose of this kind of action, according to the statements of the Baloch rebels, is to end Chinese activity in their region. Moreover, the Baloch called on India to take more aggressive action against Pakistan in the context of confrontation in 2019, promising to open a second front within the Islamic republic in case of a massive escalation [Thakuria, 2019].

Of course, Chinese loans for infrastructure projects meet the interests of economic development of receiving countries which are looking for economic opportunities. However, in cooperation with the Chinese part, it important to remember that the PRC puts always on the first

place its own interests. This obviously prompts the growing fears of recipient countries of economic dependence from official Beijing. Such alarming has strengthened taking into account the experience of Sri Lanka.

It is interesting that even the closest regional ally, Pakistan, expresses dissatisfaction with cooperation with China. In particular, the imposition of financial constraints on the construction of the Diamer-Bhash dam in 2017 prompted the Pakistani leadership to exclude this project from the CPEC list [Ramachandran, 2019]. Later, official Islamabad announced a reduction of Chinese loans.

However, the success of the fulfillment of the Silk Road project in South Asia has led Indian experts to the opinion that the PRC is realizing a “geopolitical clutches” strategy against India, aimed at surrounding the official New Delhi with allied states to China and, accordingly, curbing its ambitions.

In response to the implementation in the region of the Chinese project, India is attempting to propose its own geo-economic projects, which, however, extend beyond South Asia. In particular, as a counterbalance to the CPEC, the official New Delhi is trying to develop the so-called “North-South” infrastructure project, the idea of which emerged in 2000 with the involvement of India, Iran and Russia. The essence of it is to connect the ports of the Indian Ocean, the Persian Gulf with the Caspian railway centers, and further through the Russian Federation with the Scandinavian countries [Haider, 2019].

The key point of Indian interest is the Iranian port of Chabahar, located in the east of the Persian Gulf. India's interests in this strategic point are the possibility of using it as an alternative to Pakistan's Gwadar, including the place of the Indian naval forces location in the case of Gwadar could be converted to Chinese navy base. The Indian leadership managed to reach an agreement in 2016 with Iran and Afghanistan (which also did not join the New Silk Road because due to existing Afghan-Pakistani controversies over the issues of demarcation of the common border, the role Pakistan's role in the activities of the Taliban and the undesirability to give Pakistan access to Central Asia) to transform Chabahar into a transit point.

However, Indian activity is not achieving the desired results, as Iran is highly dependent on cooperation with China. In addition, official Beijing, after the activation of India's policy towards Iran, and possessing huge amount of financial resources, began to pay more attention to the Tehran's necessary of infrastructure development. Such step from the PRC even led to statements by the Iranian leadership about the possibility of Chabahar's connection with Gwadar [Haider, 2019].

Another project to counter China's influence is an attempt to restore the medieval “Spice Route” that aims to connect Indian ports with Middle Eastern countries. In this regard, India has succeeded to establish maritime communications with its key Middle East trading partner – Oman. However, the financial weakness and lateness of Indian proposals do not compete with the Chinese initiative and, as a result, this leads to the lack of interest from potential participants [Pandit, 2015].

Also we cannot but mention The South Asian Association for Regional Cooperation (SAARC) – the single institution that embraces all the regional countries. At present, India is losing interest in it as tool of regional influence spreading in favour of sub-regional cooperation projects, particularly the Bay of Bengal Initiative for Multi-Sectoral Technical and Economic Cooperation (BIMSTEC), South Asia Growth Quadrangle (SAGQ – Bangladesh, Bhutan, India, Nepal), which are more effective instruments to curb the PRC and to counteract Pakistan's intentions. Among the reasons of the ineffectiveness of the SAAR are the lack of trust between the participating countries, China's generous promises and financial insufficiency in conjunction with lack of goaloriented activity from India, the desire of small countries to avoid the exclusive influence of New Delhi [Unnikrishnan, Purushothaman, 2019].

Last point we need to admit – the Indian initiative “Look east policy”, in which the official New Delhi seeks to turn the geostrategic weakness of the seven remote Northeast regions (so-called “Seven Sisters”) into a point of its influence in ASEAN countries. The Indian side's argument is that its North East is a single region that physically contacts with ASEAN countries, emphasizing that

through cooperation it is possible to earn significant success, such as the EU, specially given the enormous human and market capacity of ASEAN, Bangladesh, Bhutan, Nepal (BBN) and mentioned part of India (800 million people). Among the practical steps are the implementation of the India-Myanmar-Thailand Trilateral highway and the establishment of the Assam Act East Policy Affairs Department in Assam devoted to build up relations with ASEAN and BBN [15].

**Conclusions.** India, as a biggest state in the region, aimed at leadership in South Asia, is seeking through a wide range of measures to promote its influence, providing regional countries with assistance in the creating of educational and social infrastructure, the construction of hydropower and thermal power stations, the provision of financial aid, the supply of medicines, the construction of transport infrastructure, and even in cases military support. However, India's positions in the region are weakening by the increasing influence of China which is trying to surround the growing "South Asian giant" with loyal countries.

China is realizing economic penetration and strengthening of its position in South Asia, actively using the contradictions between the countries of the region and the major regional state – India. In case of Pakistan, this is a long-term military and political confrontation, considering Bangladesh, Nepal, Sri Lanka and the Maldives – intention to avoid a one-sided geopolitical orientation towards official New Delhi. Factors contributing to the strengthening of the PRC's influence are the economic weakness of the South Asia's countries and their need to attract foreign financing, the lack of economic capacity of India and the refusal of Westerners to lend money in the face of criticism of non-observance of democratic principles and corruption. However, increasingly raising cooperation with China provokes alarming among countries of the region because of increasing economic dependence on the Middle Kingdom. As a result, most South Asian countries attempt to maneuver between India and China's ambitions in the region, often receiving funding from each party.

The confrontation between India and China in South Asia is now marked by several points: 1. India's closest regional ally is Bhutan which also has territorial disputes with the PRC and has refused to join the China's Silk Road as India; 2. the official New Delhi received a tactical victory in the Maldives where president-supporter of deeper cooperation with India came to power; 3. the PRC has substantially strengthened its influence in Bangladesh, Nepal, Sri Lanka, and has increasingly enhanced its partnership with Pakistan; 4. more and more moments are appearing between India and China that can lead to direct military clashes. However, military and, firstly, nuclear capabilities, interest in economic cooperation and at the highest level dialogue allow to avoid massive military confrontation; 5. in order to create a balance for the New Silk Road and prevent the geopolitical surrounding by of the Celestial Empire, India is trying to promote geo-economic projects – SAARC, "North-South", "Spice Route" and "Look East" policy. True, lack of financial resources, lateness, various contradictions with regional countries and more attractive China's proposals are preconditions of a failure of Indian efforts.

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## **A NEW PARADIGM OF HUMAN EXISTENCE AS LEGAL IDENTITY IN THE ENTROPY SYSTEM**

### **НОВА ПАРАДИГМА ЛЮДСЬКОГО БУТТЯ ЯК ПРАВОВОЇ СУБ'ЄКТНОСТІ В СИСТЕМІ ЕНТРОПІЇ**

### **НОВАЯ ПАРАДИГМА ЧЕЛОВЕЧЕСКОГО БЫТИЯ КАК ПРАВОВОЙ СУБЪЕКТНОСТИ В СИСТЕМЕ ЭНТРОПИИ**

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***Abstract.** In the article, the authors substantiates the modern model of the interman as a creative cyber personality, which has the potential to be identified with the correspondence of virtual bodies as a problem of modern culture. It is emphasized that it is precisely this functional possibility that finds out a new paradigm of human existence, in which entropy as a criterial device modernizes modern society. It is determined that the most intelligently gifted people are able to master the noosphere space of being through the phenomenal wisdom recipes. This content shows entropy as a defining modus of probable processes, in which modernization of a modern person, state and society takes place, since the criterion of the entropy apparatus is the recognition of that random fact (events, situations) that becomes logical. It is emphasized that the main direction of risk processes in the phenomenal wisdom recipes for the personality, the state and society should be truly chosen in the entropy system, carefully studying the theory of probable functions. It is revealed that ideological borrowings contain a considerable danger, since ideology has a class modification due to the modernization of a certain class on the basis of samples of another's experience. It is concluded that this may lead to an urgent inter-class conflict, to strengthen, oppositional sentiment. An overview of modernization as an entropy of risk processes is given, which is the mainstream in a particular historical retrospective of phenomenal consciousness. It is emphasized that modernization means the creation of a new type of world order, in which human being plays an*

*anthropocentric role at the level of legal subjectivity. The constructive and destructive Spirit of Time according to the entropy criteria is confirmed. Different forms of crisis are revealed when exhausting the established norms and rules of behavior of individuals, groups, classes, ethnic groups, communities. It is envisaged that science is such a fundamental innovation in which entropy depends to a large extent on the mental and value orientations of an individual people, based on consciousness, language, culture, etc. Creation of complex of measures and procedures is envisaged including the risks concerning maintenance of human life and health in the legal state.*

**Key words:** *paradigm, being, interman, modernization, legal subjectivity, crisis, legal entropy, information policy.*

**Анотація.** *У статті автори обґрунтовують сучасну модель інтермена як креативної кіберособистості, що має потенційну можливість ідентифікуватися з відповідними віртуальними тілами як проблематизація сучасної культури. Підкреслено, що саме така функціональна можливість і з'ясовує нову парадигму людського буття, в якій ентропія як критеріальний апарат модернізує сучасне суспільство. Визначено, що саме розумно обдаровані люди завдяки духовному капіталу мудрості здатні освоїти ноосферний простір буття. У цьому змісті показано ентропію як визначальний модус імовірних процесів, в якій відбувається модернізація сучасної особи, держави та суспільства, оскільки в основі критеріального апарату ентропії є визнання того випадкового факту (події, ситуації), що стає закономірним. Підкреслено, що має бути істинно обраний в системі ентропії магістральний напрямок ризикових процесів у феноменальних рецепціях мудрості для особистості, держави та суспільства з огляду ретельного вивчення теорії імовірних функцій. Виявлено, що ідеологічні запозичення містять у собі значну небезпеку, оскільки ідеологія має класову модифікацію в силу осучаснення певного класу за зразками чужого досвіду. Зроблено висновок, що це може спричинити неминучий міжкласовий конфлікт та посилити опозиційні настрої.*

*Дається огляд модернізації як ентропійному засобу ризикових процесів, яка є магістральним напрямком у конкретній історичній ретроспективі феноменальної свідомості. Підкреслено, що модернізація означає створення нового типу світового порядку, в якому людське буття на рівні правової суб'єктності відіграє антропоцентричну роль. Стверджено конструктивний та деструктивний Дух Часу відповідно до ентропійних критеріїв. Виявлено різні форми кризи, коли вичерпують себе усталені норми та правила поведінки окремих осіб, груп, класів, етносів, спільнот. Передбачено, що наука – це така фундаментальна інновація, в якій ентропія значною мірою залежить від ментально-ціннісних орієнтирів окремого народу, виходячи із свідомості, мови, правової культури тощо.*

**Ключові слова:** *парадигма, буття, інтермен, модернізація, правова суб'єктність, криза, правова ентропія, інформаційна політика.*

**Аннотация.** *В статье авторы обосновывают современную модель интермена как креативной киберличности, что имеет возможность идентифицироваться с соответственными виртуальными телами как проблематизация современной культуры. Подчеркнуто, что именно такая функциональная возможность и выясняет новую парадигму человеческого бытия, в которой энтропия как критериальный аппарат модернизирует современное общество. Определено, что именно разумно одаренные люди благодаря духовному капиталу мудрости способны освоить ноосферное пространство бытия. В этом смысле показано энтропию как определяющий модус возможных процессов, в котором происходит модернизация современной личности, государства и общества, поскольку в основе критериального аппарата энтропии является признание того случайного факта (события, ситуации), что становится закономерным. Подчеркнуто, что должно быть истинно избрано в системе энтропии магістральное направление рискованных процессов в феноменальных рецепциях мудрости для личности, государства и общества с учетом*

тщательного изучения теории возможных функций. Выявлено, что идеологические заимствования включают в себя значительную опасность, поскольку идеология имеет классовую модификацию в силу осовременивания определенного класса по образцам чужого опыта. Сделан вывод, что это может привести к неизбежным межклассовым конфликтам и усилить оппозиционные настроения.

Дается обзор модернизации как энтропийного средства рискованных процессов, которая является магистральным направлением в конкретной исторической ретроспективе феноменального сознания. Подчеркнуто, что модернизация означает создание нового типа мирового порядка, в котором человеческое бытие на уровне правовой субъектности играет антропоцентрическую роль. Утверждено конструктивный и деструктивный Дух Времени согласно энтропийных критериев. Выявлены различные формы кризиса, когда исчерпывают себя устоявшиеся нормы и правила поведения отдельных лиц, групп, классов, этносов, сообществ. Предусмотрено, что наука – это такая фундаментальная инновация, в которой энтропия в значительной степени зависит от ментально-ценностных ориентиров отдельного народа, исходя из сознания, языка, правовой культуры и тому подобное.

**Ключевые слова:** парадигма, бытие, интермен, модернизация, правовая субъектность, кризис, правовая энтропия, информационная политика.

**Research rationale.** In the modern information world, due to computer technologies, a person has the opportunity to experience a huge number of different feelings. It is a kind of “digital physicality” of irrational nature that has a purposeful extrasensory action as a way out to a new electronic environment of existence. In this context, cyber-personality as a creative interman has a potential opportunity to identify itself with any virtual bodies selected by it, which moves it away from its own living corporeality. Just this constitutes one of important problematizations of modern culture.

As a matter of fact, virtual space is designed for a “living body”, which aims to provide the biological organism mainly with matter and energy, endangering the existence of the physical body of a person. In other words, potential social worlds generated by intermen do not remain aloof from the universal planetary life generated by them, but continue to cooperate actively with it. Therefore, modern mankind approaches the field form of human existence as a qualitative new totality discovered from without. It binds to an appropriate view of it from within as of something concrete, something, which “unfolds in itself and maintains unity, that is, totality” [Hegel, 1974: 100].

Thus, this conclusion is in compliance with the idea of K.E. Tsiolkovsky of the transition of humanity in the future to the phase of the existence of pure energy, which is called “radiant humanity”. This corresponds to a certain extent with the ancient esoteric teachings which affirm that humanity, in the process of its evolution, undergoes phases of the gradual embodiment of pure spirit in matter (spirit as body, and body as spirit).

Taking into account it, self-determination of individual and state occurs in the entropic process of modern development of Ukraine when the system of legal market relations is only formed. Therefore the problem of investment activity becomes urgent in cryptooperationsystem of information capital that contains inter-branch character [Kovalchuk, 2017:47]. It is thus considered that investments as the component of clean spending embrace spending on the infrastructure, health protection, various service business and so forth. The mentioned problem is in the centre of debatable attention of scientists, as it is related to the entropic process of self-determination. Just the same process presents the theory of accidentally-natural functions where effectively numerical parameters operate in the nonlinear system of the informatively legal and financial legal field.**Methods.** The author used systematic, logical, axiological and other methods of research.

**Formulation of the problem.** With the current development of intelligence science and the ability to exert active influence on the world of “raw” matter, a new stage in the development of the spiritual capital of wisdom in modern times begins as a transition to the energy level of life. In this case, the organizational existence of the planetary community during the XXI century takes possession of qualitatively new space, namely, the noosphere. Therefore, there is a topical

contradiction between the biological body of a person that makes the latter stay in the planetary space and cultivation by the human mind of new source meanings (semantic structure of consciousness). It is to this end that man appeared in the universe, which nourishes him with creation of meanings, and therefore just the meaning of the life of a person determines his behavior. According to V.V. Nalimov, “the meaning of our lives consists, first of all, in looking for the meaning” [Nalimov, 1989: 20].

In such a context, the most probable is that it is intellectually gifted people, as the manifestation of their phenomenal receptions of wisdom, who are capable of mastering the noosphere space of being. In this case, a fundamental factor that changes the world is the brewing of a new era, about which American thinker Charles Kupchan wrote: “Now, a new era – the digital era – has come. The industrial society is decaying increasingly apparently as the introduction of digital technologies takes place. The decline of the industrial era and the transition to a digital economy are capable of shaking the foundations of democratic statehood. This turbulence will accompany the return to a multipolar world and ensure growing tensions between the leaders and outsiders of the digital technological race” [Kapchen, 2004: 526].

In the case of assessing the future condition of man, scientists single out challenge man, network man or networker, pontiff man, navigator man, who, in the words of Russian researcher S. Smirnov, are also “men of transition” or *homo ludens* [Smirnov, 2006: 122]. It is the new image of man that is determined as post-man being a hybrid of man and machine, that is, a “cyborg”, which is disconnected from external stimulants of irritation.

In our opinion, interman is the person of the future, whose life is closely connected with social networks of the Internet, and who is a network co-author. Psychologically, interman is tied to processes in the Network as a “member of this family”. Based on the nature of social activity, interman, if necessary, acquires creativity, which ensures his pioneering existence. Among such features, the activation of interman in a social network, his self-creation and self-design with the aim of the desired volitional self-image, which is maximally harmonized with the existing social reality, are worth noting.

As Ye. Gornyy finds, in the absence of corporeality in a virtual personality, we have to perceive it as something created exclusively from signs and actions. In this case, “it is not the nature of the carrier, but the effect produced in the psyche by the responsible complex of signs that is important” [Gornyy, 2004: 78].

Thus, there is every reason to put forward a hypothetical picture that intermen are an embodiment of the information community due to the activation of attribute properties. Such a newly formed community, an example of which is interman, can acquire during the 21st century the transition state from planetary to cosmic being, objectivizing voluntariness and legal independence in the civilization field.

**Analysis of recent research and publications.** Analysis of literary sources allows testifying that questions of the paradigm of human existence as legal identity, in which culture constructs the future, aroused interest in all periods of the development of personality, state, and society. In turn, human activity, in which culture is the spiritual core of wisdom, was considered in the age of Enlightenment by such thinkers as F. Bacon, T. Hobbes, J.-J. Rousseau. Another approach to the vision of culture as legal identity in human existence was proposed by I. Kant, who singled out the culture of skills and the culture of discipline in the system of science and art. According to the teaching of N. Machiavelli, there must be a law in the state that establishes stable and inviolable rules of legal policy. With the powerful development of science, technology, and man himself, the approaches to the necessary awareness of the essential characteristics of culture as a driving force of new progress, in which the new information person is the source, change, too. It is the system of information values that occupies a fundamental position in the structure of human consciousness. In this case, various interpretations of the unity of the historical and cultural process that were substantiated in writings of O. Spengler, W. Dilthey, G. Simmel, E. Husserl, M. Weber as well as in the field of the theory of mentality – in works of F. Braudel, A. Moles, E. Fromm, T. Parsons, C. Kupchan, R. Merton, and others, played an important role. Among contemporary Ukrainian

researchers, it is necessary to mention: V. Andruschenko, V. Bekh, V. Voronkova, L. Huberskyi, I. Nadolnyi, M. Kurko, M. Popovych, M. Nedyukha, M. Ozhevan, and others. It is their scientific research that reveals a new paradigm of man in the context of information values of ideologies, language, and legal culture.

Besides, such modern home researchers as O. Baranivsky, E. Boichenko, I. Hrytsenko, L. Lazbenyk, A. Peresada, T. Cheknina, E. Ostrovska and others touch upon the problem of investment activity in the informatively-legal field of entropy. Therefore the mentioned range of problems is complicated and little-investigated, and causes debatable interest. At the organisation-theoretical basis of investing it is necessary to use a legislative base, in particular the Law of Ukraine "On investment activity". **Singling out previously unexamined parts of the overall problem.** The significance of the new paradigm of human existence as legal identity just in the modern information culture has a discursive nature, since it is interpreted not only in terms of meaning but also in ways and methods of social communication. Such information interaction is connected with the process of production of information, the basis of which is represented by systems of values that contribute to the formation of ideology in the structure of human consciousness [Lisovska, 2017:26]. At the heart of informational axiology there is motivation of human activity, which expresses the self-awareness of an individual or any social group. In this case, the methodological foundations of the study of the new paradigm of human existence are represented by the interdisciplinary approach that is based on such sciences as cosmobiology, cosmopsychology, virtuality science, transhumanism, eco-ethics, personal psychology as sciences about reflection and technology of transformation of man and universe, as well as by methods and means that are used for analysis - the informological one, the axiological one, the entropy one, etc.

**Setting the objective.** The objective of the article is: to consider and substantiate the new Man of the XXI century as legal identity in the socio-cultural field of activity; to reveal the noosphere space of human existence; to show entropy as a fundamental modus of probable processes; to define modernization as an entropy means of risk processes; to predict for the future entropy criteria in the phenomenal matrix of human existence.

**Presenting the main material.** It is advisable to take as a basis for theoretical and practical conceptualization of human existence entropy as the defining mode (tool, attribute, technology, etc.) in the system of randomly-regular functions. It is such a functional possibility that establishes the new paradigm of human being, in which entropy as the criterial apparatus modernizes modern society [Lisovskyi, Lisovska, 2017: 181].

Therefore, it became clear that modernization means creating a new type of world order, in which human existence plays an anthropocentric role. It is particularly intensively developed within the framework of UNESCO research centers and consists of three main autonomous and interconnected components: a new economic order, a new political order, and a new cultural order [Banga, 2013:18].

At the heart of these entropy approaches there is the recognition of the random fact (event, situation) that becomes logical as the modernization of the world community, and not of a single country or region.

Because borrowing, assimilation, and imitation are practices of entropy examples. In this case, imitation is necessary for two reasons: a) due to the objective impossibility to fluctuate (single out) certain phases of historical development; b) in order to save resources. It is assumed that borrowing already existing examples, taking into account mistakes and others' negative experiences, allows the recipient to avoid different turns, to operate more efficiently, economically, and systematically.

However, modernization is rather a contradictory probable process. In this way, first of all, there are purely objective obstacles, including those of systemic nature. This, in particular, was noticed by American researcher R. Merton, who put forward a thesis about fundamental limitation of system borrowing, of mutual or unidirectional transformation of systems. Its essence lies in that random elements of one system cannot be transferred to another system without their prior significant transformation, since the system itself has a hierarchical structure [Lisovskyi, Podolyaka,

*Lisovska*, 2019: 85]. Previously, the transformation should be carried out by a reformer or innovator, who forces a new element that got accidentally (mysteriously) in its environment, to act according to its own, specific only to it, rules and laws. If this happens, then the recipient system enters a range of internal tension, social arrhythmia, and therefore it makes mistakes, experiencing structural and functional losses.

According to the laws of the nature of human existence in the universe (in the coordinates of human-centeredness and human-cosmicity), there must be a correspondence between the proper levels of power of the borrowing system and the borrowed (sample) element [*Lisovskiy*, 2017: 59]. The discrepancy of the levels leads to dysfunction of the system of adaptive and socio-creative possibilities.

For example, the western model of education, which is effective in itself, if transferred to a tribal environment, in which traditionally oriented persons with magic-mythological perception of reality inherent in them operate, will function ineffectively. Because it does not correspond to the mental nature of this social environment, since it can only be transformed according to local conditions (thus, scientific and technical knowledge, other forms of rationalization of thinking and actions acquire a magic-mythological interpretation, and practical actions based on them fit into the structure of the traditional human lifestyle) [*Lisovskiy*, 2019: 155].

In the case when borrowed elements appear stronger than their new environment, they can undermine traditional functions of the system, but do not guarantee its overall effectiveness. In order for this to happen, Time in Time as a naturally determined event (opportunity) of Life is needed.

In addition, the number of borrowed new elements should not exceed the number that the system can assimilate. Otherwise, there is a new dependence: the power of borrowed elements prevails over the adaptive capabilities of the recipient system. The former undermine the basis of the existence of the system; deprive it of the internal order and integrity, autonomy and tradition of the existence. Therefore, the very formation of new man, morals, law, collective psychology, ideology, mental-value orientations, regulatory mechanisms, etc. will be accompanied by the loss of what will already have been acquired.

In other words, the dramatic nature of the situation is just in the fact that in today's information society just those random elements to create which modernization is introduced are absent.

### **Modernization as an entropy means of risk process**

It is common knowledge that modernization, especially at the initial stage, does not provide for significant amounts of the accumulation of social wealth, since it is the accumulation of modes of action – scientific knowledge and technology. Only having reached a new level of maturity, such fundamental modes can ensure accumulation on such a scale that the society in question transits to spiritual production – its own science, culture, and education.

In such a context, it is economic modernization as an important instrumental matrix of the mode definition of entropy that largely occurs due to equipment of labor force based on the import of technology. After all, the reorganization of the social and technical organization of labor involves a certain reform of property relations, approval of new management technologies with obligatory consideration of risk processes based on the theory of random functions. Hence, a significant transformation of existing industrial organizations as a new paradigm of human existence is created.

In general terms, it can be argued that, at the time of modernization, the division of labor between the subjects of ownership should be consistent with the effective economic activity. After all, it is possible to carry out painless and accelerated accumulation if in the entropy there are hard-to-get natural resources and a responsible, organized, and disciplined political elite. This is exactly the case of the Arab Emirates and other Middle Eastern countries, which, on the basis of oil exports, turned the desert into a blossoming garden.

If, on the other hand, the political strategy of the elite is not truly correct, but only irresponsible, corrupt, and uncontrollable, then sooner or later such a strategy can be defeated, that is, it leads to self-destruction as the implementation of utopia at the international level. Therefore,

the main direction of risk processes in the phenomenal receptions of wisdom for the individual, the state, and society should be truly chosen based on careful studying the theory of probable functions [Lisovskyi, Lisovska, 2019: 27].

In this sense, ideological borrowings are a considerable danger, since ideology has a class modification due to the modernization of a certain class on the basis of examples of outside experience. This can lead to an acute inter-class conflict, to strengthen oppositional sentiments.

Therefore, in the state, a law must be in force which would establish solid and inviolable rules for all, equal opportunities, and clear limits for the permissible that nobody has the right to step over. At the same time, the rules of politics, according to N. Machiavelli, are rigid, cynical, immoral, and unprincipled. But it is with the help of such political technologies that one can get, and, most importantly, hold power, carry out reforms and transformations in the state system.

Thinker N. Machiavelli comes to the conclusion that change of ruling elites is a regularity of politics, since it is based on objective needs of social groups as well as on the psychology of man. The researcher believes that, for the safety of a new state, it is best to destroy all the memories of the old ones [Machiavelli, 1982: 143]. According to the teachings of Machiavelli, it is the nobility that is the main cause of the collapse of states and the destruction of all morality and civic virtues [Machiavelli, 1982: 227].

Consequently, borrowing an outside religious or secular utopia can lead to a significant sign and symbolic transformation of the consciousness of the individual or nation in question. In order for this to happen, it is necessary to study entropy as a criterial apparatus in the theory of random functions, which is important for the self-determination and identification of each individual, state, and society. It is advisable to achieve such a preservation of the originality (identity) by reorganizing the elements of one's own cultural capital on the basis of its harmonious combination with the context of wise borrowing from other countries of the world. In this context, the possibilities of the development of a particular society in a particular historical retrospective are determined by a phenomenal nature of consciousness as a property of human existence.

### **Legal entropy as important criterion of investment activity of Ukraine**

Under the Law it is worth to refer such totality of values to the property and intellectual necessities that circulate through the market as: "monetary funds, specific banknote deposits, shares and other securities; chattels and real assets (buildings, constructions, equipment) and other tangible assets; property rights, that follow from a copyright, experience and other intellectual values (The law of Ukraine "On investment activity"). In fact our country is at a level, when main legal control is spared to the material assets - real estate, equipment, land and etc. Thus clear and faithful determination of rights on its possession and use must be preceded registration of object. Legal entropy (indefiniteness) of this question results in a situation when a product that got a patent in Government service of intellectual property of Ministry of Science and Education of Ukraine is being used or sold to quite another organization. However organization as an owner of product under the law cannot own information about the illegal use of the created product. It is possible both at the terms of conspiracy of extraneous organization with one of authors and without direct participation of author. Thus, totality of the mentioned values is accepted to refer to the objects of investment activity in which an intellectual investment must be lawfully valuable as a contribution to beneficent potential of society. All of it follows from the copyright, and the right of industrial ownership. Such an investor as a subject of legal entropy makes decision about investing of the personal, borrowed and attracted property and intellectual values in the objects of investing.

### **Legal powers of investor in the modern terms of market**

As the Law provides, an investor can come forward as depositors, customers, creditors, and execute the legal functions of any participant of investment activity, that is invest, buy securities, and also perform the duties of customers. If an investor is a person who invests the personal and borrowed assets, then in relation to a creditor such person is partly a debtor [Lisovskyi, Lisovska, 2019: 27]. In turn, the legal subjects of investment activity implement their purposes, directions,

kinds and volumes of investments in the entropic process of legal mutual relations, when investment climate as one of nonlinear parameters of entropy plays a considerable role in modern market conditions. Exactly these markets regulate the process of exchange investments and investment objects (merchandise). The forms of capital exports are direct capital investments, portfolio investments, and also loans and credits, functioning industrial, bank, trade and other capital of foreign countries that provide an investor of control over enterprise. Direct investments are the most typical for activity of transnational corporations (TNC) [9]. Besides, it is necessary to indicate that portfolio investments contain capital investment in bonds and shares of foreign companies, which are insufficient to establish direct performance monitoring. The main purpose of portfolio capital investments is profit earning, but not providing of direct economic performance monitoring of investing object. Thus, direct and portfolio investments are the varieties of enterprising capital that is meant for an investment in a production and aimed at the creation of new enterprises or on the purchase of part or absorption of already existent companies. Branches, subsidiary companies or mixed enterprises appear as a result of enterprise capital export [Holovaty, 2014: 16]. During the use of foreign sources of raw materials on the base of direct investments the differences of ecological norms and standards of different countries are taken into account [4]. The developed countries try to carry such production capacities that result in considerable pollution of environment to less developed countries. Capital investment is an active motivation instrument of demand on domestic products. It is achieved due to, firstly, new markets are created abroad, and secondly, part of export of TNC is constantly used in foreign branches. Their part for today comes to over 1/3 the exports of Canada, Germany, France, Sweden, to 1/2 the export of the USA. For the purpose of legal introduction of the entropic process in the system of investment it is envisaged to: - make changes and addenda to the foreign investment legislation; - maximally simplify procedures for regulation of legal mutual relations in sphere of attraction of foreign investments; - create a legislative base on issues of the relations settlement regarding foreign investments attraction in development of minerals and geodesic monitoring on the oil and gas deposits, and also define the proprietorship of investees. Such realization will facilitate the investment climate growth in Ukraine, creates preconditions for the appearance of permanent investment motivations at international partners [6]. It is necessary to agree that a "modern administrative law must be examined mainly as a means of ensuring of the proper abundance and effective protection of citizen rights and freedoms in the field of the state functioning". If the administrative methods of government control of economy are based on the state authority and involve prohibitions, permissions and duress, then they must be used for violations prevention including the sphere of investing. On the stage of legal reform the question is about the qualitatively new system of regulation of relations. Such mechanism can be effective, as it operates not arbitrarily, but on the basis of the scientifically weighted facilities of investment activity, in particular at responsibility application. It is worth to consider administrative and criminal responsibility as such effective facilities. It should be emphasized that the definition of the concept of responsibility is still actual. Some of the scientists consider administrative responsibility as a reaction on offence, in fact without offence there is no responsibility. Thus, to better the investment climate in Ukraine it is necessary: - to improve a legal sphere and provide stability of investment legislation; - to extend an informative sphere for investment activity and projects worked out as per international standards. The legal grounds of information protection are stated by the legislation of Ukraine that envisages the legal regulation of information circulation in the society and defines the access mode to information.

Depending on the type of information there are appropriate rules of behaviour during realization of investment activity. According to the article 28 of the Law of Ukraine "On information", they are defined as the access mode, that envisages legal norms, an order of information getting, using, dissemination and storage [Lisovskyi, Lisovska, 2016: 127]. The legal mode content is defined by norms that set: an order of access to information, its use and protect; administrative and legal responsibility. Information that contains entrepreneurial interests under the Law "On information" by the access mode is divided on open information and restricted access information. According to the law a task of control on the access mode to information consists in

providing of keeping of legislation requirements after the sphere of investment activity, non-admission of the groundless information attribution to the category of information with restricted access. Confidential information belongs to restricted access information. The article 30 of the Law defines confidential information as information that is in possession, use or distribution by certain natural persons and legal entities and spreads at their desire subject to conditions established by these persons. Access mode to commercial information, including its belonging to confidential information, is defined independently by the owner of information. Commercial secret is one of the types of confidential information. Attributing of information to the commercial secret does not touch secret information that is a state secret circulation of which is governed by the Law of Ukraine "On a state secret". Attributing of information to the commercial secret is defined by the economic entity and specifies on a right of the owner on information that is guarded by legislation and contains a commercial value. Question of human rights and freedoms providing in networks of the Internet is resolved by the Decree of the President of Ukraine "On events concerning development of national constituent of global informative network the Internet and providing of wide access to this network in Ukraine" of July, 31, 2000. The law of Ukraine "On electronic documents and electronic circulation" lays down the unified requirements to the essential elements of electronic document that has legal force. This law defines electronic circulation of documents as "totality of the processes related to making, processing, sending, transfer, receipt, storage, use and elimination of electronic documents, which are performed applying integrity verification and, if required, with confirmation of fact of receipt of such documents." An electronic signature is an important essential element of electronic document, which is set for its authentication. The order of its use is regulated by the Law "On an electronic digital signature".

### **Conception of safety in the banking system**

There are some regulatory and legal acts that govern the principles of information protection in investment activity that is inherent for the banking system. Thus, the legal mode of information protection in automated systems is separately defined as over 65 percents of bank information circulate in automated systems. According to the legislation, access to information that is kept, processed and transferred in automated systems, is implemented as per rules of access delimitations, that is set by an information owner or a person authorized by him (article 6 of the law of Ukraine "On protection of information in automated systems"), as in this case a right for protection of information is entrusted to its owner – bank [3]. Activity of the Ukrainian banks concerning providing of their safety is governed by not only a current legislation but also internal normative acts. Banks develop Provision for safety department and other documents concerning safety measures realization in accordance with conception of bank safety. To secure normatively, an order that approves Provision for information of bank with a restricted access is issued. Provision envisages the information list that is commercial secret and confidential information of bank, composition, persons, whom this information can be conveyed in full, measures of information protection that is a commercial secret, banking secrecy and confidential information. The analysis of safety results of banks activity shows that not all banks fully create a normative base and use it effectively. Small experience on these questions is only in particular banks. Such banks have normative documents (orders, instructions, provisions, recommendations) for realization of informative audit and informative monitoring in their organizations. The informative monitoring envisages information receipt control to define its importance, value and possibility of the use in the integrated databases of safety departments [Sinha, 2009: 40]. Permanent realization of such work in banks gives possibility to create an informative base of investment activity, and combination of this work with other measures of the information and analytical providing gives an opportunity to create a necessary informative resource.

### **Collaboration of Ukraine with the countries of the Islamic world in investment sphere**

Among the complex of measures to form investment principles, it is necessary to distinguish the following. For realization of existent possibilities of providing qualitatively new level of collaboration of Ukraine with the Muslim countries of Near and Middle East and South-East Asia in

an investment sphere it is expedient to involve Consultative board concerning the foreign investing of representatives of financial and business circles of above mentioned territories. It is necessary to create the system of guarantees from the side of the Ukrainian state for the Near-Eastern and South-East-Asian partners, by effecting bilateral agreements with the interested partners to protect investments. And also to work out legislative safety guarantees of investment collaboration of Ukraine with an Islamic bank capital. At the same time, it is necessary to conclude an appropriate agreements with the Islamic bank of development and form with it and other leading financial structures of Near and Middle East, Persian bay, South-East Asia (Fund of investments of Kuwait etc.) a package of attractive investment projects in major industries of economy, development of science and nanotechnologies, tourist country-specific studies, education and art. Organization in Ukraine of business forums for businessmen and financiers from Muslim countries with an active participation of leading financial structures of the Islamic world is an inalienable constituent of the mentioned work direction. The special attention must be concentrated on setting up of a system of proper consulting services by creation of information and analytical centres that would be able to render necessary services in setting up contacts of Ukrainian business and entrepreneurship with the financial structures of the Islamic world, to provide necessary legal accompaniment of business-projects preparation, conclude agreements and other services. Preparation of necessary training aids on activity of Islamic banks and a dictionary of Islamic terms is acquired an important significance. It is important to translate into the Ukrainian language of the proper scientifically-methodical literature of the mentioned problem, especially when an experience of collaboration of Europe and North America countries with an Islamic bank capital is summarized. Foremost, it relates the sphere of the administrative and legal regulation and realization of collaboration organizational measures.

#### **Predictions of the future in accordance with entropic criteria**

In accordance with entropic criteria phenomenal forms and types of risks are possible in the system of accidental and logical functions, especially for the economic entity as constructive and destructive Time Spirit [Rouzet, 2014: 28]. The different forms of crisis appear thus, namely: the simplest is incongruity between the system and its particular accidental and logical elements and the most complicated are antagonism, severance of connection with greater part or even all elements.

Severance on axis "valued orientations - resources" gives rationality to crisis, the opposed directed divergence of aims and facilities of their achievement [De Backer, 2012: 8]. The extreme points of this crisis display can be excessive, expressive verbalism, empty political and ideological rhetoric or narrow pragmatism, vulgar productivism and virtual activism. Severance of public connection "man is a spiritual capital - society" lead to integration crisis, as the excessive cultural symbolism torn off from the real social structures prevails, when entrenched norms and behaviour rules of individuals, groups, classes, ethnos, community are exhausted.

**Conclusions.** For the future nature of the spiritual capital of wisdom, which tends in the modern information society to production, appropriate conditions should be created in order to further produce not only nanotechnologies, but also nootechnologies. To do this, a noosphere consciousness should be formed in the coordinates of human-centeredness and human-cosmicity. In this case, science should be used as a source of fundamental innovations, in which entropy occupies a decisive place, which to a certain extent depends on the mental and value orientations of an individual nation that has to choose its future based on consciousness, language, culture, etc.

Thus Ukraine in XXI century has actually unlimited reserves of some types of natural resources, extracting of which is the most attractive for foreign companies. Therefore a foreign capital is able to bring not only new equipment and technologies but also working assets, experience of marketing and modern management. For this purpose it is necessary to: make changes and addenda to the foreign investment legislation; maximally simplify procedures that govern legal mutual relations in foreign investments attraction sphere; extend an informative sphere for investment activity; systematize and regularly update the data bank of these investment projects according to the administrative and legal regulation and develop them under international approaches.

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## **“THE RUSSIAN WORLD” ON THE BUDVA RIVIERA: TOURISM AND FOREIGN POLICY PROCESS IN THE MONTENEGRO**

### **«РУССКИЙ МИР» НА БУДВАНСЬКІЙ РИВ’ЄРІ: ТУРИЗМ І ЗОВНІШНЬОПОЛІТИЧНИЙ ПРОЦЕС У ЧОРНОГОРІЇ**

### **«РУССКИЙ МИР» НА БУДВАНСКОЙ РИВЬЕРЕ: ТУРИЗМ И ВНЕШНЕПОЛИТИЧЕСКИЙ ПРОЦЕСС В ЧЕРНОГОРИИ**

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**Abstract.** *The article is devoted to the study of the role and place of tourism in the transformation of the foreign policy course of post-Yugoslavian Montenegro. The focus is on the impact of Russian tourism on key directions and foreign policy problems of the country. The work is based on the concept of transnationalism. Within this approach, global tourist flows are considered as a kind of transnational social space, in which the tourist is always an actor, performing various social actions related to interaction with the different environment.*

*The publication reveals a historical retrospective of geopolitical presence of Russia in the Western Balkans. The cultural, investment and tourism components of Russia's influence on the social and political life of post-Yugoslavian Montenegro are highlighted. Principal indicators of tourism development in the country, the contribution of Russian tourism to the total volume of international tourist arrivals are investigated. Significant politicization of the tourist process in Montenegro is claimed. In mono-dependent on international tourism economy of Montenegro, tourism has influenced the politically-motivated rethinking of the traditions of relations with Serbia, Russia and the West. It has become a factor in the electoral struggle in the society and affected the transformation of Montenegro's geopolitical landmarks. The publication analyzes Russia's attempts to destabilize the country's political situation in the context of its accession to NATO. First of all, by exploiting Montenegro's dependence on Russian investment and tourist flows, the application of information warfare technologies.*

*Culture and tourism are said to be an important component of the new concept of sovereignty, where demonstration of openness and a new European identity have underpinned Montenegro's geopolitical transformation – from the Balkans to the country that has come close to the EU. At the same time, Montenegro's example reflects the increasing political and economic importance of tourism in the world political processes and ensuring international political interaction.*

**Key words:** *Montenegro, Yugoslavia, Western Balkans, International Tourism, Tourist Flows, Foreign Policy, Geopolitics, European Integration.*

**Анотація.** *Статтю присвячено вивченню ролі та місця туризму у трансформації зовнішньополітичного курсу постюгославської Чорногорії. В центрі уваги – вплив*

російського туризму на ключові напрямки та проблеми зовнішньої політики країни. Робота спирається на концепцію транснаціоналізму. В межах даного підходу глобальні туристичні потоки розглядаються як своєрідний транснаціональний соціальний простір, у якому турист завжди є актором, оскільки виконує множину соціальних дій, пов'язаних із взаємодією з іншим середовищем.

Публікація розкриває історичну ретроспективу геополітичної присутності Росії в регіоні Західних Балкан. Висвітлено культурну, інвестиційну та туристичну складові впливу Росії на суспільно-політичне життя постюгославської Чорногорії. Досліджено основні показники розвитку туризму в країні, внесок російського туризму у загальний обсяг міжнародних туристичних прибуттів. Стверджується про значну політизацію туристичного процесу в країні. У монозалежній від міжнародного туризму економіці Чорногорії туризм вплинув на політично-мотивоване переосмислення традицій відносин з Сербією, Росією та Заходом. Він став чинником електоральної боротьби в суспільстві та позначився на трансформації геополітичних орієнтирів держави. В публікації проаналізовано спроби Росії з дестабілізації політичної ситуації в країні у контексті її вступу до НАТО. Передусім, шляхом експлуатації залежності Чорногорії від російських інвестицій та туристичних потоків, застосування технологій інформаційної війни.

Стверджується, що культура та туризм виступили важливою складовою нової концепції суверенітету, де демонстрація відкритості та нової європейської ідентичності виступили основою геополітичної трансформації Чорногорії – від Балкан до країни, яка впритул наблизилася до ЄС. Водночас, приклад Чорногорії відображає чимраз зростаючу політико-економічну вагу туризму у світових політичних процесах та забезпеченні міжнародно-політичної взаємодії.

**Ключові слова:** Чорногорія, Югославія, Західні Балкани, міжнародний туризм, туристичні потоки, зовнішня політика, геополітика, європейська інтеграція.

**Анотація.** Стаття посвячена изучению роли и места туризма в трансформации внешнеполитического курса постюгославской Черногории. В центре внимания – влияние российского туризма на ключевые направления и проблемы внешней политики страны. Работа опирается на концепцию транснационализма. В рамках данного подхода глобальные туристические потоки рассматриваются как своеобразное транснациональное социальное пространство, в котором турист всегда является актером, поскольку выполняет множество социальных действий, связанных с взаимодействием с другой средой.

Публикация раскрывает историческую ретроспективу геополитической присутствия России в регионе Западных Балкан. Освещены культурная, инвестиционная и туристическая составляющие влияния России на общественно-политическую жизнь постюгославской Черногории. Исследованы основные показатели развития туризма в стране, вклад российского туризма в общий объем международных туристических прибытий. Утверждается о значительной политизации туристического процесса в стране. В монозависимой от международного туризма экономике Черногории туризм повлиял на политико-мотивированное переосмысление традиций отношений с Сербией, Россией и Западом. Он стал фактором электоральной борьбы в обществе и сказался на трансформации геополитических ориентиров государства. В публикации проанализированы попытки России по дестабилизации политической ситуации в стране в контексте ее вступления в НАТО. Прежде всего, путем эксплуатации зависимости Черногории от российских инвестиций и туристических потоков, применения технологий информационно-войны.

Утверждается, что культура и туризм выступили важной составляющей новой концепции суверенитета, где демонстрация открытости и новой европейской идентичности выступили основой геополитической трансформации Черногории - от Балкан до страны, которая вплотную приблизилась к ЕС. В то же время, пример

*Черногории отражает все более возрастающий политико-экономический вес туризма в мировых политических процессах и обеспечении международно-политического взаимодействия.*

**Ключевые слова:** Черногория, Югославия, Западные Балканы, международный туризм, туристические потоки, внешняя политика, геополитика, европейская интеграция.

**Research problem setting.** Contemporary international tourism is a complex, transnational entity that is developing globally, and is deeply integrated into global economic and trade relations. The structure of global tourism flows has not only its economic logic but also its political tradition, political connections and deep-rooted political implications. Mass travel practices that, through the proliferation of modern means of communication, are actively expanding their network, form a kind of transnational social space, in which the tourist is always an actor, because they perform a variety of social actions related to interaction with a different environment.

The foregoing can be fully applied to such a small Balkan country as Montenegro, with a population of about 625,000. The Budva Riviera occupies the central part of its coast and is the most attractive tourist where beautiful beaches, bays and gulfs of such localities as Budva, Sveti Stefan, Petrovac, Becici, Rafailovichi, Pržno and etc. blend harmoniously into the 38-kilometer coast. This is one of the sunniest places in the Adriatic, which has become widely known in the world tourist markets and is used in the title of the proposed publication as a symbol of Montenegro tourism mono-dependence. The aggregate contribution of tourism and travel to Montenegro's GDP is about 22% [WTTTC, 2019], which is one of the highest indicators in Europe, along with Malta and Croatia. Moreover, this applies not only to the economy but also to politics, since Russia is one of the main tourist-generating flows for the country, for which the resort "capital" – Budva – is sometimes called "Moscow at Sea". Tourism and related investment flows have become one of the major factors in the Kremlin's foreign policy influence to destabilize the region and prevent Montenegro from joining the NATO. Considering this, the study of the international political impact of tourism in such mono-profile countries as Montenegro deserves full attention.

For Ukraine, the relevance of Montenegro's foreign policy research is also related to both a similar communist past within the Allied states and features of democratic transit, a commonality of foreign policy strategies based on European and Euro-Atlantic integration, identical challenges caused by Russia's attempts to resume political influence through the exploitation of Orthodox faith, Pan-Slavic identity and economy.

**The objective of the article.** The purpose of the proposed study is to define the role and place of tourism in the transformation of the foreign policy of post-Yugoslavian Montenegro, including the impact of Russian tourism on key directions and problems of the country's foreign policy. The focus is on the analysis of international political processes that have determined the increase in tourism in the region and the impact of transnational tourism flows on economic, cultural and foreign policy processes in the host country.

**Analysis of recent research and publications.** As a rule, international political processes in Montenegro are considered in the context of the foreign policy of former Yugoslavia, the Balkan wars of the 1990s, the post-communist transformations in the countries of Europe, against the background of other processes, and comprises thousands of publications. In fact, Montenegro's foreign policy coverage is represented by a relatively limited body of scientific research, which is explained by the country's recent independence (2006). Among the relevant works it is worth noting the publications by K. Boeckh [Boeckh, 2014], B. Vukićević [Vukićević, 2017], J. Džankić [Džankić, 2014], G. Djurović [Djurović, 2012] and others, which consider the adaptability of the country to changes in the global and regional geopolitical environment, relations with allies, European integration policy, foreign and security policy priorities. Montenegro-Ukrainian relations are considered against a broad background of political, economic and cultural processes in a monograph by O. Slyusarenko [Slyusarenko, 2012] and a publication by M. Frolov [Frolov, 2016]. With regard to tourism, its impact on socio-economic processes in the republics of former

Yugoslavia is partly reflected in the collective publication, edited by Grandits H. and Taylor K. [*Grandits, Taylor, 2010*]. Within the scope of the proposed publication, special attention is paid to the section of a monograph by A. Violante [*Violante, 2017*], devoted to revealing the relationship between Russia's financing of tourism projects in Montenegro and the achievement of relevant geopolitical influences. Nevertheless, rapid dynamics of socio-political processes in the country, triggered by the accession to NATO and EU membership prospects, led to a significant politicization of the tourism process in the country, necessitating the need for further study of the international political impact of tourism in Montenegro's foreign policy development.

**Outline of the base material.** The always tense geopolitical situation in the region has branded it the status of a troubled one, which is associated not with tourism and travel but with war and conflict. The development of mass tourism on the Adriatic coast of Montenegro dates back to the 1960s, and also depends on the foreign policy pursued by Yugoslavia. However, to understand the general context of Russia's cultural and political presence in this small country, first, we propose to consider the main stages of their interaction concisely.

Russia has never concealed its geopolitical interests in the Balkans, identifying them as the sphere of its strategic priorities. Along with the traditional guardianship of the Orthodox Slavic peoples, this interest had a very practical political level associated with rivalry with Turkey, Austria-Hungary, Germany and others states. At the beginning of the XXI century, the traditional for Russia problem of controlling the Black Sea straits have been compounded by ensuring the presence of the fleet in the Adriatic and Mediterranean seas, as well as the problem of controlling the routes for the transport of energy resources to the countries of Southern and South-Eastern Europe. It is known that the presence of strategic partners in the region determines the success of the implemented policy. For Russian politics in the Balkans, such countries as Bulgaria, Serbia, and Montenegro became the partners both in the XIX and early XX centuries. Moreover, both then and these days, the degree of effectiveness of international political interaction is determined by cultural, religious as well as economic and investment instruments. However, as political practice shows, they are not always crucial, since as the subjectivity of the Balkan countries increases, each of them sought to define a circle of their own priorities that did not always coincide with the ideas of Slavic "unity and brotherhood" under the patronage of the Russian state.

Despite the fact that Montenegro withdrew from the State Union with Serbia in 2006 and joined NATO in 2017, the country has always been an active subject of ethno-political processes in the Balkans. Despite attempts by Serbian patriotic circles to represent Montenegro as a "historic state of the Serbian people" and integration into Western structures as a "mafia anti-state for Serbia" [*Раковић, 2017: 71*], Montenegrin statehood has a steady historical tradition embodied in various forms of state administration – a theocratic and secular principality, monarchy, and finally the present parliamentary republic. Neither being part of the Byzantine Empire, nor the Serbian state, nor Venice (where, in fact, it was called "Monte Negro"), did not break the invincible spirit of the Montenegrin people. Despite the fact that since the late XV century much of present-day Montenegro was under the control of the Ottoman Empire, for a long time the center of the liberation movement remained in the city of Cetinje (now one of the capitals of the country) – the residence of Metropolitans and political leaders. During the XVIII-XIX centuries Montenegrin lords of the Petrovich-Negosha dynasty traditionally focused on political and economic support of Russia, which considered the territory as an outpost in the fight against the Ottoman Empire. At the end of the XVIII century, Montenegro was the first of the Southern Slavic countries to regain de facto independence. This was confirmed at the 1878 Berlin Congress, which, through the support of Russia, recognized its sovereignty at the international level. As a result of the First World War, despite the fact that Montenegro supported the Entente, it was annexed to Serbia and subsequently joined the unitary Kingdom of Yugoslavia. In 1946 it became one of the republics of the Federal Yugoslavia (SFRY).

The transformation of Montenegro into a popular tourist destination is closely linked to the Yugoslav model of socialism created by the charismatic leader J. Broz Tito. It effectively combined international tourism with the priorities of multi-vector foreign policy, thereby achieving certain

economic and political benefits. Thus, in the conditions of the Cold War, Yugoslavia becomes the leader of the Non-Aligned Movement and a global player between Western democracies and the political regimes of the socialist camp. Interested in preventing the entry of Yugoslavia into the orbit of foreign policy influence of the USSR, the US political elite promoted comprehensive economic assistance to the Tito government to preserve his independent policy [Pavlov, Pashintseva, 2010]. Yugoslavia's investment tourism projects were firmly based on a liberalization policy of the mobility regime. By the 1960s, most foreigners arriving in Yugoslavia received a visa at the border. Montenegro's transformation into a popular tourist destination was facilitated by the grand "Southern Adriatic" tourism development plan, developed in 1962 in close collaboration with the United Nations Development Program with the involvement of the world's best experts [Touristic Masterplan, 2001]. With the construction of the 1965 Adriatic Highway and the construction of large hotel complexes, the Budva Riviera has become a place of attraction for both the western star bohemian and the representatives of the so-called "middle class", mostly from Austria, the United Kingdom, Italy, Germany, France, the Czech Republic and other countries.

In the early 1990s, Montenegro was drawn into the Yugoslav crisis, during which only Serbia and Montenegro maintained allegiance to the allied state. The development of the economy and tourism, as its component, faced a longstanding stagnation that lasted until almost 2003. Thus, in the late 1980s – early 1990s, the financial system of Yugoslavia, which was constantly fueled by international loans, collapsed. In the context of ethnic and religious conflicts, political instability associated with the formation of sovereign states in the former SFRY (Croatia, Slovenia, Bosnia and Herzegovina, Macedonia), the further development of foreign tourism was impossible. The decrease in the volume of inbound tourist flow was particularly noticeable from 1987 to 1993. The number of tourist arrivals in this category decreased from 1.3 million to 76.6 thousand people [Ковачевић, 2018: 67].

The formation of a modern tourist infrastructure and the development of international tourism in the Federal Republic of Yugoslavia (the so-called "The Third Yugoslavia"), created in 1992 by Serbia and Montenegro, were impossible due to harsh international sanctions. They were imposed by the UN through the involvement of the Union State army in the Balkan Wars (1992-1996) and the Kosovo policy (1998-1999) that led to the 1999 bombing of NATO.

The division of powers in the Union State and economic contradictions exacerbated the differences between Serbia and Montenegro. Montenegro's tourism-dependent economy was more open to the outside world than the Serbian economy, and was more affected by conflict and sanctions [Tyagunenko, 2001: 43]. In such circumstances, the efforts of the ambitious Prime Minister M. Đukanović were aimed at accelerating reforms, overcoming the "outside wall" of economic sanctions, conducting privatization and attracting investments in the tourism sector. According to Montenegrin researcher B. Vukićević, despite the predominance of "anti-Western, pro-Russian and pro-Serbian positions" in the country, the resources for further isolation were "exhausted" [Vukićević, 2017: 114]. Under these circumstances, in 1997, M. Đukanović disassociated himself from the odious allied President S. Milošević and became a pillar to fight his regime. With the victory of M. Đukanović in the presidential election on October 19, 1997, begins the resumption of bilateral relations with Moscow bypassing Belgrade. In particular, as early as 1998, Moscow, interested in using the Adriatic port infrastructure by oil and gas companies and penetrating the region of the Russian capital, in support of M. Đukanović, opened a Russian consulate in Podgorica [Sysoev, 1998: 28]. At the same time, M. Đukanović develops and deepens relations with EU countries and the USA, which allows to obtain political and financial support for the reforms.

Montenegro started to conduct its own monetary, fiscal, foreign trade and other policy, initiated its own central bank, introduced the German Mark (1999) as a means of payment, which was replaced by the euro in 2002 [Uvalić, 2018]. Against the backdrop of the West's explicit support for the course pursued by M. Đukanović, such a policy created a nourishing basis for intensifying the internal political struggle between the supporters of independence (Liberal Alliance Party, Social Democratic Party) and the preservation of the Yugoslav Federation (Socialist People's Party)

[Tyahunen, 2001]. The Yugoslav leadership refused to accept the idea of the "loss" of Montenegro, and accordingly – the exit to the sea. With the introduction of Montenegro's two-currency system, Serbia is establishing a serious trade blockade for its partner. The corresponding policy was fostered by "reverse nationalism", which in the International Crisis Group's report was called a "model of coercive self-determination" [Montenegro, 2000].

The aforementioned internal conflict was reasonably incited by the success of tourism sector in Croatia, which, despite the bloody war of independence, since mid-1990s had been using the opportunities of open political borders to attract tourists from Central and Eastern Europe. As early as 1998, 32.8 million overnight stays were recorded on the Croatian Adriatic [Ateljevic, Corak, 2006], which helped stabilize the country's economic and political system. Appropriate aspirations aimed at restoring foreign tourism were cultivated in Montenegrin society. They were promoted by President M. Đukanović himself, a professional economist in the field of tourism, who received a corresponding higher education at the University of Montenegro in Podgorica. He repeatedly invited Western and Russian tourists to visit the country. In a somewhat non-fiction form, the corresponding sentiment was echoed by Russian Balkanist M. Bondarev, noting that even Montenegro's separation from Serbia in 2006 should be seen as a "triumph of the tourist mentality over common sense." In his opinion, this was reflected by a referendum on independence, in which the tourist Primorye voted for the exit while the Montenegrin "hinterland", inland regions of the country – against [Bondarev, 2017]. It should be noted that the independence of Montenegro was possible only because of a slight preponderance of the votes – 55.5% supported the sovereignty of Montenegro, while 44.5% of those who participated in the referendum favored a common state with Serbia [Vukićević, 2017: 113].

The resumption of Montenegro's sovereignty in 2006 marked the final disintegration of Yugoslavia and continued the evolution of political processes in the country towards accession to the European Union and NATO, which was enshrined in the foreign policy doctrine [Vukićević, 2017: 115]. In post-socialist countries, tourism has played a traditionally important role in the provision of European integration, both in terms of the revitalization of old industrial areas and depressed rural areas, as well as in terms of democratic and national development. For the post-Yugoslavian Adriatic countries, tourism had to directly promote integration into European structures through the formation of employment, a shared space of values and European identity. This is evidenced by the Integrated Tourism Development Master Plan in Croatia and Montenegro, developed in 2001 with the assistance of the Ministry of Economic Cooperation and Development of Germany, which was implemented within the framework of the Stability Pact for South Eastern Europe [Touristic Masterplan, 2001].

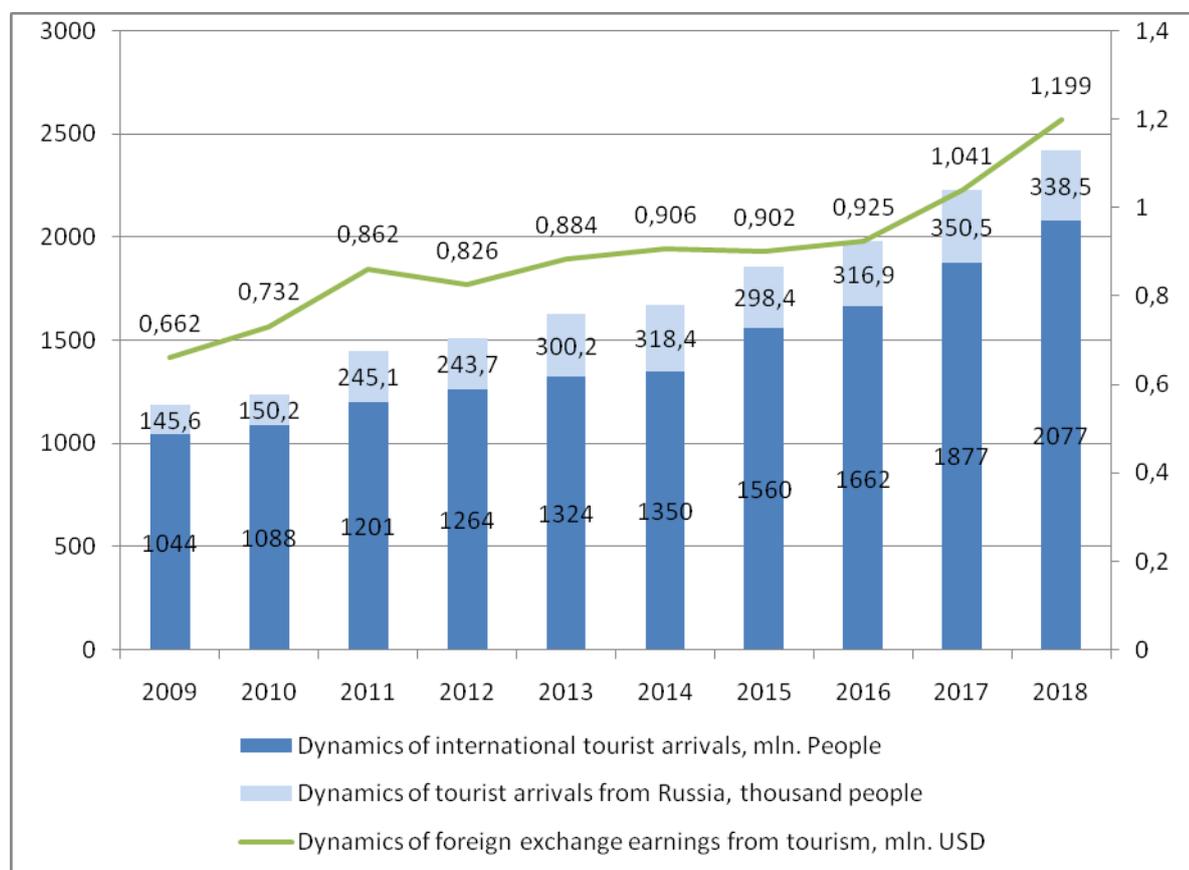
At the same time, it was noted that in the late 1990s and early 2000s Russia was "returning" to Montenegro. The resumption of diplomatic ties was underpinned by the economic and investment activity of Russia, whose economy was growing in the 2000s. The rapid penetration of Russian capital was facilitated by the proximity of Russian political and business elites to the local top. The most famous examples are the construction of a resort village by Moscow Governor Y. Luzhkov close to Sveti Stefan, and in 2005 the acquisition by Russian billionaire O. Deripaska of an aluminum plant in Podgorica, the largest industrial enterprise in the country, which at that time produced 51% of export and 15% of GDP [Bechev, 2018: 6].

Liberalization of economic policy, alongside the development of the shadow sector, contributed to the attraction of Russian investment in the hotel sector and residential construction. Simplified conditions for starting a business, taxation and real estate acquisition have caused a real construction and tourism boom. The entire territory of the country has been designated as a free trade and development area. The peak of investment activity occurs in 2008-2014 and is quite stable. Thus, during 2010-2014 alone, the average annual volume of Russian investments amounted to \$ 1,100 mln. USD [Direct Investment, 2014], which is quite high per capita in Montenegro. Visa-free travel, linguistic accessibility, friendly Montenegrins to Russians are quickly turning the country into a favorite vacation spot for the new Russian middle class. From 2006 to 2014, the number of Russians visiting Montenegro increased from 61,000 to almost 320,000 (Figure 1). In

terms of inbound tourist flow, the share of Russia at that time reached 20-30% (Fig. 2), which was the largest market for Montenegro. About 70,000 Russians have purchased relatively inexpensive real estate in Adriatic resorts [Conley, Melino, 2019: 4], accounting for 40% of the country's resort real estate [Mamchitz, 2018]. Overall, the number of Russians who are permanent residents of Montenegro is estimated at 5-7,000 people [Strategic Analysis, 2016], while the Russian-speaking diaspora reaches 15,000 [Assessing Russia's, 2018: 4]. The proportion of Russians who reside permanently in Montenegro is particularly high at the seaside resort of Budva.

Figure 1

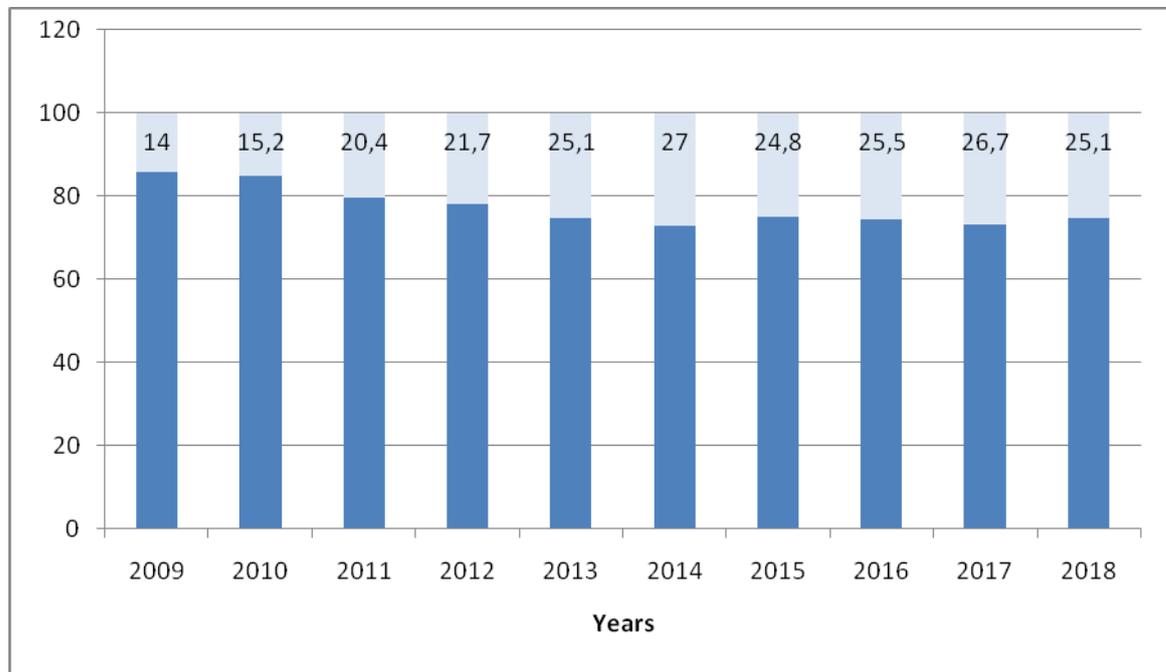
**Dynamics of the of inbound tourist flow structure in Montenegro and foreign exchange earnings from tourism**



Source: author's development based on materials [Monstat, 2009-2018]

Figure 2

**Development of Russia's share in the structure of inbound tourist flow to Montenegro, total nights spent (%)**



Source: author's development based on materials [Monstat, 2009-2018]

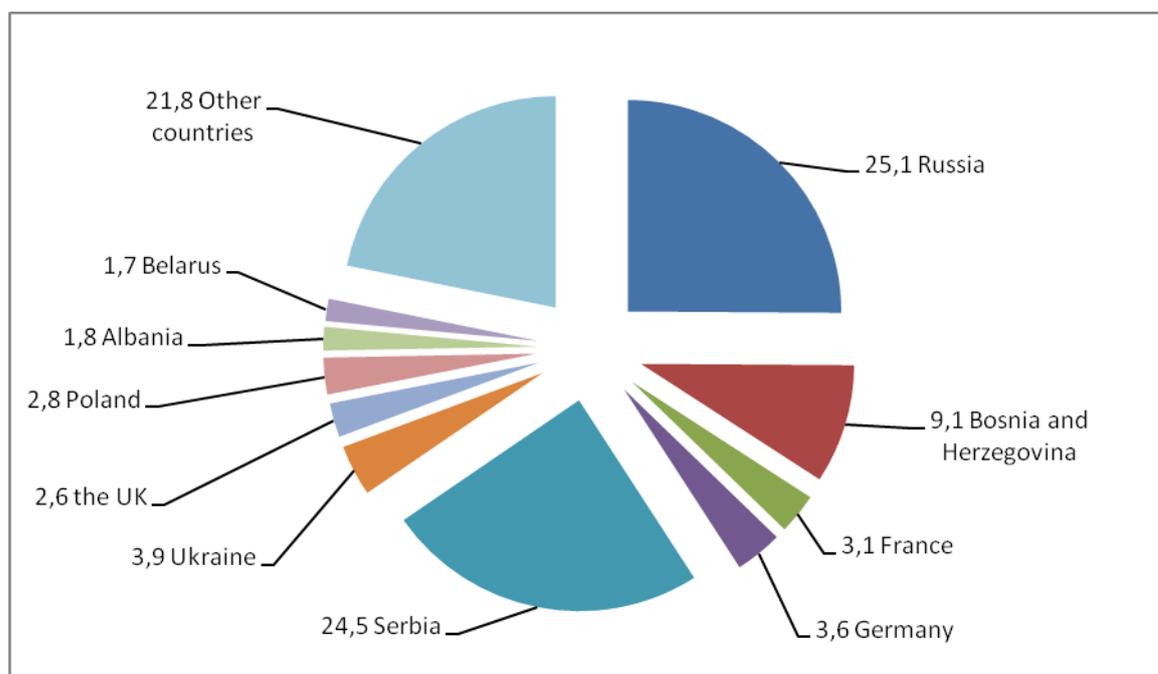
The flow of Russian investment into Montenegro was also fueled by a ban on gambling in Russia in 2009. Instead, the Adriatic coast of Montenegro, where gambling was legalized with the accession of independence in 2006, has been a safe haven for Russian capital. Montenegro quickly acquired the image of a "gaming capital" that has established itself even at the level of popular culture. A prime example of this is the famous spy movie "Casino Royale" (2006), in which the main character, a British intelligence officer, J. Bond, takes part in a poker tournament at the Montenegrin five-star Splendid Hotel to complete his mission. At the same time, its plot reflects some of the negative connotations that have formed around the Balkans as a route for global drug trafficking and organized crime, as a whole. A. Violante's publication states that the origin of Russian money used to acquire Montenegrin real estate was dubious [Violante, 2017: 93]. Thus, one of the largest casinos in the Balkans – Casino Avala Budva – until recently belonged to T. Ismailov – the son of the former owner of the Cherkizovsky market in Moscow – whose assets were arrested in 2019 [Minak, 2019]. Overall, relations between Moscow and Podgorica remained so dense that by 2014, up to 32% of Montenegrin enterprises were Russian-owned [Tomovic, 2016]. Most Russian assets in the country are real estate holdings, hotels, cafes, restaurants.

At the same time, Moscow's interests in the Balkans cross the limits of investment in coastal real estate and recreation on the Adriatic coast. Ever since the mid-2000s, the concept of the so-called Russian world (Russkiy Mir), as a trans-state community united on the basis of loyalty to Russia, Orthodoxy, Russian culture and language, has become one of the ideological imperatives of Russia's foreign policy. In the Western Balkans, this concept has been projected to counteract NATO's activities, viewed by Russia as an attempt to oust it from its traditional region of influence. The use of the ideas of Pan-Slavism, the appeal to a common Slavic culture, Orthodox Christianity and the historical role of Russia as a defender of the Slavic peoples has become widespread political

practice. Signs of close relations with Russia were everywhere – the central pedestrian bridge in Podgorica was built as a gift from Moscow and named "Moscow Bridge", the monument to A. Pushkin was opened in front of the constitutional court, the monument to V. Vysotsky was built in the park in front of the Ministry of Defense. The Serbian Orthodox Church, which traditionally stands for the unity of the Montenegrin and Serbian peoples and supports anti-Western and anti-NATO discourse, remains a special tool of influence of the Kremlin in Montenegro. In Montenegro, ethnic Serbs make up 30% of the population, some of them identify themselves with their Slavic heritage, advocating the restoration of "Greater Serbia" and strengthening relations with Moscow [Conley, Melino, 2019: 3]. Overall, about 70% of the country's residents are Orthodox. It should also be noted that Serbian tourists, as well as Russian tourists, are one of the largest market segments (Fig. 3).

Figure 3

**Geographic structure of inbound tourist flow to Montenegro, total nights spent (%), 2018**



Source: author's development based on materials [Monstat, 2009-2018]

Rates around Montenegro's geopolitical choice began to rise as it became integrated into NATO, in particular since joining the Membership Action Plan in 2009. Obviously, the foreign policy of M. Đukanović government for joining the Euro-Atlantic community, in the context of NATO membership of neighboring Croatia and Albania in 2009, went beyond the realistic paradigm of national security interests that Russia could not offer. Prospects of becoming a "Trojan horse" of Russia in the pro-Western camp, with further confrontation of relations, could have put an end to Montenegro's economy dependent on foreign tourism. For Russia, this meant losing the last part of the non-NATO Adriatic coast and undermining its influence in the region. Confidence in Montenegro as a reliable partner of Russia was questioned as a result of the nationalization of the assets of a Russian named A. Deripaska in the aluminum plant in 2012 without compensation to

him for material damage. In 2013, an official Podgorica rejected proposals to discuss with the Russian delegation the conditions of stay of Russian ships in the deep-sea ports of Bar and Kotor, for which the Russian side seemed to have proposed several billion dollars [Vukićević, 2017: 126].

The point of no return in bilateral relations between Moscow and Podgorica was the occupation of Ukrainian Crimea by Russia and the use of hybrid war technologies, which accelerated Montenegro's determination to join NATO. The Montenegrin authorities remained a consistent supporter of the independence and territorial integrity of Ukraine [Frolov, 2016: 342-343]. Montenegro's involvement in Western sanctions against Russia, applied in 2014 in response to aggression in Ukraine, caused an unprecedented annoyance with Russia. In the socio-political discourse of Montenegro, this was reflected in the spread of anti-Ukrainian and in the broad context of anti-NATO and pro-Russian rhetoric. X. Semanić's study on pro-Russian media in Montenegro states that a wide network of Russophile editions, prominent among which are the IN4S news portal (www.in4s.net) and the DAN daily, have become leaders of Russia-backed anti-Western attitude [Semanić, 2019]. Russian counter-sanctions in the form of an embargo on the supply of wine and meat products, as well as threatening statements by officials of the Kremlin, negatively affected the dynamics of the inbound tourist flow from Russia, which for the first time in many years decreased by 6.3% (Fig. 1).

Russia's support for nationalist pan-Slavic attitudes and parties [Bajrović, Garčević, and Kraemer, 2018: 6], as well as outspoken protests against the expansion of Euro-Atlantic institutions into the Balkans, has intensified NATO's resolve. In early 2016, Montenegro was finally invited to become a member of this organization. In such circumstances, the coming to power of the pro-Russian government could be an effective way out. Numerous calls for the preservation of cultural, historical and religious identity were embodied in a failed coup attempt. In October 2016, on the eve of the parliamentary elections to Skupština, Podgorica police arrested 19 people suspected of overthrowing the government and assassination of Prime Minister. Among the accused who were sentenced in Montenegro in May 2019 were probable Russian intelligence agents and representatives of Serbian political parties who tried to prevent NATO entry [Walker, 2019].

The escalation of political strife around Montenegro's geopolitical choice turned tourist flows from Russia into a component of foreign policy struggle that had already been successfully tested by the Kremlin during the crisis in Russian-Turkish relations in 2015-2016. On the eve of the 2017 tourist season, numerous news stories and articles about the dangers of Montenegro for the Russians appeared on Russian TV channels [Crime, minefields and tetanus, 2017; Alliance at the ready, 2017], which spoke of "flourishing of crime", "anti-Russian attitudes", poor service, dirty and crowded beaches, etc. [Kravtsova, 2017]. On April 20 Russian Foreign Ministry spokesman M. Zakharova claimed the "surge of anti-Russian hysteria" in Montenegro. According to M. Zakharova, against the background of "growing negative attitude to Russian business and our compatriots", the country does not exclude delays of Russians "for dubious reasons" [Ministry of Foreign Affairs of Russia warns, 2017]. In another comment, M. Zakharova advised "to think twice than to travel to this country" [Foreign Ministry Spokesperson, 2017]. The statement of Rosturism referred to "potential threats" and an "unfriendly environment for Russian tourists" in Montenegro. It is significant that the Kremlin propaganda company did not find support in the tourist business environment. Thus, in a statement by the spokesman of the Russian Union of Travel Industry I. Tyurina, it was said that Montenegro lacked anti-Russian attitudes and waiting of tourists from Russia [Tyurina, 2017]. In general, according to the data in Fig. 1. Moscow's efforts to use the tourist flow as a tool for foreign policy influence on Montenegro proved unsuccessful. This is due to the fact that a large part of Russian arrivals in Montenegro is formed by citizens who own property in the country and come independently, bypassing tourist companies. The sustainable dynamics of inbound tourism from Russia was also aided by Podgorica's decision to extend the visa-free travel of Russians in the country for up to 90 days during the holiday season [Montenegro allowed, 2019].

Despite the fact that the Kremlin failed to influence the reformatting of the tourist flow in Montenegro, stable dynamics of tourist arrivals from Russia, along with property owners, investors

and the diaspora, have formed an influential Russian-speaking environment that using the paradigm of a transnational approach, has turned into a "transnational social space" (L. Priss, T. Feist). Its basic characteristics are the simultaneous inclusion in the social space of the country of exit (Russia) and the country of residence (Montenegro), interpenetration in the socio-economic, cultural and political life of both societies. In addition to the constant relocation of Russian tourists, which have become a key link in the interaction, transnational communication is supported through the circulation of migrants, remittances, trade, transport, telecommunications, values and meanings. This situation was exploited by Russia, which in order to strengthen its economic influence, deployed traditional tools of so-called "soft power". These include the presence in Russian-language media (Russkaya Gazeta, Russkiy Vestnik, Komsomolskaya Pravda in Montenegro, etc.), support of public organizations and political parties, use of influence of the Serbian Orthodox Church and others.

With the widespread rivalry of major powers in the region, significant ethnic-religious contradictions, mutual territorial claims, Montenegro's accession to NATO in June 2017 ensured the country's further sustainable development. At the same time, given more than three-hundred-year presence of Russia in the region, one can hardly imagine a scenario related to Moscow's departure from the region. The Turkish Stream gas transport system has significant prospects for expansion into the Western Balkans. Nowadays Montenegro has come close to EU integration and is formally the most successful Balkan candidate. For this reason, China, Russia, Turkey and other players seek to occupy their niche in the country's economy. Montenegro is also successfully benefiting from this, which in 2018 announced a citizenship for investment program, which allows obtaining a passport of a candidate country for EU membership when purchasing real estate. Against this background, it becomes clear that the future geography of tourist flows in the region is about to undergo changes as a result of the geopolitics of further EU enlargement. This can be the basis for political stability, access to EU financial resources, the open market, ensuring the competitiveness of the tourism industry and reformatting the geospatial structure of inbound tourism.

**Conclusions and prospects for further research.** In the context of globalization of world tourist flows, the increasing political and economic weight of tourism in ensuring international political interaction is becoming more and more evident. The politicization of the tourism process in dependent on the coastal tourism Montenegro has gained strong features at all stages of socio-political development. Starting with the emergence of mass holidays in Yugoslavia in the 1960s, tourism has always been linked to the foreign policy goals of the country, first serving as an instrument of escape from political isolation and later as the economic basis of the "third path" that Tito chose after the conflict with the Soviet Union. After the Yugoslav wars, tourism was recognized as a tool for economic recovery and became a factor in politically motivated rethinking of traditions, including relations with Serbia, Russia and the West. Tourism has become a factor in the electoral struggle in society and has influenced Montenegro's geopolitical direction. Despite considerable dependence on investment and tourism flows from Russia and related attempts to destabilize political situation in the country amid NATO accession, Montenegro has chosen a course of Euro-Atlantic integration. This suggests that culture and tourism were an important component of the new concept of sovereignty, where demonstrations of openness and a new European identity were the basis of Montenegro's geopolitical transformation – from the Balkans (with corresponding negative and conflicting connotations) to a country that has come closer to the EU.

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## **СУЧАСНА СИСТЕМА МІЖНАРОДНОГО ПРАВА**

УДК 341.33

### **PROTECTION OF MEDICAL PERSONNEL IN THE CONTEXT OF ARMED CONFLICT IN UKRAINE**

### **ПРОБЛЕМИ ЗАХИСТУ МЕДИЧНОГО ПЕРСОНАЛУ В КОНТЕКСТІ ЗБРОЙНОГО КОНФЛІКТУ В УКРАЇНІ**

### **ПРОБЛЕМЫ ЗАЩИТЫ МЕДИЦИНСКОГО ПЕРСОНАЛА В КОНТЕКСТЕ ВООРУЖЕННОГО КОНФЛИКТА В УКРАИНЕ**

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**Abstract.** *It has been proved that since the beginning of the Russian aggression in the east of Ukraine the problems of international humanitarian law, in particular the protection of medical personnel in the context of armed conflict, have become particularly relevant. It is determined that, through its peaceful policy, Ukraine is not ready for armed aggression. The provisions of international normative legal acts regulating the protection of medical personnel and medical facilities during armed conflicts of international and non-international character are examined. The basics of implementation of the provisions of international humanitarian law by national*

*legislation and peculiarities of criminal responsibility for violations and crimes against physicians in the area of armed conflict are investigated.*

**Keywords:** *armed conflicts, armed conflict in Ukraine, medical personnel, the right to health, international humanitarian law, international human rights law, the rights and responsibilities of healthcare professionals.*

**Анотація.** *Доведено, що від початку російської агресії на Сході України проблеми міжнародного гуманітарного права, зокрема захисту медичного персоналу в умовах збройного конфлікту, набули особливої актуальності. Визначається, що через свою миролюбиву політику Україна виявилась не готовою до збройної агресії. Вивчено положення міжнародних нормативно-правових актів, якими регулюється захист медичного персоналу та медичних об'єктів під час збройних конфліктів міжнародного та неміжнародного характеру. Досліджені особливості імплементації положень міжнародного гуманітарного права в національному управі та особливості кримінальної відповідальності за порушення та злочини проти медиків у зоні збройного конфлікту.*

**Ключові слова:** *збройні конфлікти, збройний конфлікт в Україні, медичний персонал, право на здоров'я, міжнародне гуманітарне право, міжнародне право прав людини, права та обов'язки медичних працівників.*

**Аннотация.** *Доказано, что от начала российской агрессии на востоке Украины проблемы международного гуманитарного права, в частности защиты медицинского персонала в условиях вооруженного конфликта, приобрели особую актуальность. Определяется, что из-за своей миролюбивой политики Украина оказалась не готовой к вооруженной агрессии. Изучены положения международных нормативно-правовых актов, регулирующих защиту медицинского персонала и медицинских объектов во время вооруженных конфликтов международного и немеждународного характера. Исследованы особенности имплементации положений международного гуманитарного права в национальном праве и особенности уголовной ответственности за нарушение и преступления против медиков в зоне вооруженного конфликта.*

**Ключевые слова:** *вооруженные конфликты, вооруженный конфликт в Украине, медицинский персонал, право на здоровье, международное гуманитарное право, международное право прав человека, права и обязанности медицинских работников.*

**Research problem setting.** Despite the titanic efforts of human rights defenders, the situation with the protection of medical personnel in armed conflicts has not been improved in recent years. In particular, according to statistics provided by the Safeguarding Health in Conflict coalition, in 2018 in the world 167 health workers were killed, 710 health workers were injured, 173 medical facilities were attacked or destroyed, 111 medical transport units were damaged or destroyed [14]. These data indicate a total violation of international humanitarian law (hereinafter – IHL) and international human rights law.

In Ukraine, after the onset of the armed conflict in the east, accompanied by the attacks by the Russian mercenaries and regular troops, the situation with the protection of medical personnel has deteriorated. Ukraine is the only European country included into the list of countries with the highest number of violations of international humanitarian law. In particular, in 2018, by indicators of attacks on medical personnel, medical facilities and medical transport, Ukraine outperformed such countries as Burkina Faso, Myanmar, Sudan and Somalia and has the same rates as Pakistan concerning the number of incidents of IHL violations [14]. According to the World Health Organization data for 2017, 'Since the start of the conflict, at least 160 health facilities have been shelled on both sides of the contact line, while some 130 facilities remain either partially or fully nonoperational. Over 400 health facilities in these conflict areas in Ukraine report insufficient stocks of medicines' [15]. Safeguarding Health in Conflict coalition provides some other data for

2018: number of attacks on healthcare was 11, number of healthcare workers killed – 2, number of healthcare workers injured – 7, number of health facilities damaged or destroyed – 2 [14]. Such figures indicate that the problem of medical personnel's protection in the armed conflict in Ukraine is urgent and needs quick and effective reaction at the international as well as national scale.

**The purpose of the article.** The purpose of the article is to investigate the problems of the protection of medical personnel in the context of the armed conflict in Ukraine and to identify promising directions of legal mechanisms for protection of medical personnel in emergency situations.

**Analysis of the latest researches and publications.** The above-mentioned problems in the context of international humanitarian law have been explored by such foreign scholars as Baxter P.P., Blunchli I., de Vattel E., Gasser H.P., Gefer A.V., Grotius G., David E., Gentili A., Kalshoven F., Lieber F., Marteny G.F., Muagne G., Oppenheim L., Pictet J., dePre J., Remacle R., Suarez F., Ferdross A., Hyde C. Among Ukrainian scientists who wrote on the issues of IHL and international human rights law, including in the context of protection of victims of war, it is possible to distinguish the works of Antypenko V.F., Gnatovsky M.M., Gutnik V.V., Korotky T.R. However, it can be stated that the issues of protection of medical personnel in the context of armed conflict in Ukraine remain unexplored in domestic scientific literature, despite their relevance and importance.

**Basic research material.** The provision of medical assistance in armed conflict (international or non-international) is the basis for the realization of the fundamental human right to health which is enshrined in many international treaties, such as the Constitution of the World Health Organization of 1946 (preamble), the International Covenant on Economic, Social and Cultural Rights of 1966 (article 12), Convention on the Rights of the Child of 1989 (article 24), and other international instruments, such as the Universal Declaration on Human Rights of 1948 (article 25). Medical personnel in the context of armed conflict have certain privileges; special distinctive signs and worldwide recognized emblems are used to protect them. The ensurance of the rights of medical personnel in armed conflict is based on customary, treaty legal rules as well as recommendations of international organizations.

IHL prohibits attacks on medical personnel and medical transport without any exceptions. This prohibition is embodied in the four Geneva Conventions of 12 August 1949 [1-3] and the Additional Protocols thereto of 8 June 1977 [4-5], as well as IHL customary rules. This prohibition is effective both in an international and non-international armed conflict. The rules of IHL vary depending on the nature of the conflict (whether international or non-international) and protected groups: medical personnel and sanitation units that are part of the armed forces, in accordance with the rules of the Geneva Convention for the Amelioration of the Condition of the Wounded and Sick in Armed Forces in the Field of 12 August 1949 (hereinafter – Geneva Convention I) and the Geneva Convention for the Amelioration of the Condition of Wounded, Sick and Shipwrecked Members of Armed Forces at Sea of 12 August 1949, or civilian medical personnel and civilian medical units in accordance with the provisions of the Geneva Convention Relative to the Protection of Civilian Persons in Time of War of 12 August 1949. But the universal prohibition of attacks on medical personnel and medical transport remains unchanged. Medical personnel and healthcare units have a higher level of protection than civilians and civil objects. Healthcare workers cannot be targeted, they cannot be intimidated, and they are not allowed to be threatened. Both sides of the conflict must support medical personnel and provide the conditions under which they can perform their functions.

Civilian medical personnel shall be respected and protected during international and non-international armed conflicts, and shall be granted all available help for the performance of their duties in accordance with Article 15 of the Protocol Additional to the Geneva Conventions of 12 August 1949, and Relating to the Protection of Victims of International Armed Conflicts, of 8 June 1977 (hereinafter – the Additional Protocol I) and Article 9 of the Protocol Additional to the Geneva Conventions of 12 August 1949, and Relating to the Protection of Victims of Non-International Armed Conflicts, of 8 June 1977 (hereinafter – the Additional Protocol II). To facilitate

the identification of medical personnel in an area of an international armed conflict with a view to granting the necessary protection, a special identity card must be issued in accordance with Annex I to the Additional Protocol I.

Some of these important guarantees for medical personnel are repeated by the International Committee of the Red Cross (hereinafter – ICRC) in its study on Customary International Humanitarian Law (hereinafter – Customary IHL) of 2005, namely Rule 25 [Henckaerts, 2005: 79]. The work by ICRC is ‘the most comprehensive compilation of legislative and regulatory measures, along with expressions of *opinio juris*, available in this field’ [13, para.7]. Though there is a remarkable progress in codifying international humanitarian law, the ICRC believes that its study presents an accurate assessment of the current state of customary international humanitarian law [Henckaerts, 2005: xvi, xvii].

Medical personnel shall not be compelled to carry out tasks which are not compatible with their humanitarian mission (Article 15(3) of the Additional Protocol I and Article 9(1) of the Additional Protocol II). Persons engaged in medical activities shall neither be compelled to perform acts or to carry out work contrary to, nor be compelled to refrain from acts required by, the rules of medical ethics (Article 16(2) of the Additional Protocol I and Article 10(2) of the Additional Protocol II). Under no circumstances shall any person be punished for having carried out medical activities compatible with medical ethics (Article 16(1) of the Additional Protocol I, Article 10(1) of the Additional Protocol II, Rule 26 of the Customary IHL). Paragraph 3 of the Article 16 of the Additional Protocol I and para. 4 of the Article 10 of the Additional Protocol II stipulate that during armed conflict medical secrecy must be ensured, medical personnel shall not disclose patients’ information. Meanwhile, medical personnel lose their protection if they commit, outside their humanitarian function, acts harmful to the enemy (Rules 25, 28 and 29 of the Customary IHL).

Medical units enjoy respect and protection at all times and cannot be the object of attack. Stationary and mobile medical units cannot under any circumstances be attacked on the contrary, the parties to the conflict are obliged to protect them, in accordance with Article 19 of the Geneva Convention I, Article 12 of the Additional Protocol I and Article 11 Additional Protocol II. Under Article 35 of the Geneva Convention I, transports of wounded and sick or of medical equipment shall be respected and protected in the same way as mobile medical units. The special protection granted to medical units shall cease if and when the civilian medical units are used to commit, outside their humanitarian function, acts harmful to the enemy (Article 13(2) of the Additional Protocol I). At the same time, IHL allows the medical personnel to have light individual weapons for their own defense or for that of the wounded and sick in their charge (Article 13(2) and Article 28(3) of the Additional Protocol I). Attacks directed against medical personnel and objects displaying the distinctive emblems of the Geneva Conventions in conformity with international law are prohibited (Rule 30 of the Customary IHL).

In 2011, in its resolution ‘Health Care in Danger: Respecting and Protecting Health Care’ the ICRC recalled to the states their obligations to respect and protect the health-care personnel and facilities in times of armed conflict or other emergencies, urged all states to adopt domestic implementation measures based on relevant international legal obligations, called on states to ensure that their armed forces and security forces implement all applicable international legal obligations in relation to armed conflict, including situations of occupation, with regard to protection for the health-care services, including through the development and adoption of appropriate doctrine, procedures, guidelines and training, to ensure effective investigation and prosecution of crimes committed against health care personnel [11].

Referring to Ukrainian experience, we should stress that while all above-mentioned IHL treaties have been ratified by Ukraine, national legislation does not provide comprehensive legal mechanisms for the protection of medical personnel and medical facilities. This problem is particularly acute for physicians who are risking their own lives, performing their duties and saving the lives of Ukrainian soldiers at the conflict-affected areas of Donetsk and Luhansk regions where Joint Operations of Ukrainian forces (formerly Antiterrorist Operation) are going on in order to repel the Russian aggression. In 2018, there were 11 attacks on healthcare workers and healthcare

facilities in Ukraine. In these 11 incidents, two physicians were killed, seven were injured, three were threatened and three drivers were injured. Two medical facilities were damaged and four were forcibly closed [14].

Outcrying were the violations of international humanitarian law, which guarantees the protection of medical personnel, in the fighting near Debaltsevo in 2015. In particular, on February 9, 2015, a military surgeon was unable to take a seriously injured person out of the battlefield for nine hours because a Russian tank blocked the road and didn't let a sanitary vehicle to move. On the same day, whole brigade of military doctors (SergiyKatsabin, AnatoliySulima and MykhailoBalyuk) were killed by the direct hit of the shell. They were traveling in a sanitary reanimation car, which had all the necessary distinctive emblems, and it was impossible to mix it with a military vehicle [16]. In 2019, a nurse who assisted civilians during the attack by the Russian mercenaries was killed [20]. No one has been punished at this time.

Though Ukraine and Russia which are parties to the armed conflict are parties to the Geneva Conventions, Additional Protocols I and II, such examples witness that they do not comply with their obligations. The Russian Federation doesn't comply with its obligation to respect and protect the health-care personnel and facilities in times of armed conflict, and Ukraine doesn't comply with its obligation to adopt domestic implementation measures based on relevant international legal obligations and to ensure effective investigation and prosecution of crimes committed against medical personnel.

The violation of the prohibition of attacks on medical personnel or transport during armed conflict amounts to grave breaches of the Geneva Conventions. Acts described as grave breaches in the Conventions are grave breaches of the Additional Protocol I if committed against those medical personnel, medical units or medical transports which are under the control of the adverse party and are protected by this Protocol (Article 85 of the Additional Protocol I). Article 49 of the Geneva Convention I, Article 129 of the Geneva Convention II and Article 146 Geneva Convention IV stipulate that the High Contracting Parties undertake to enact any legislation necessary to provide effective penal sanctions for persons committing, or ordering to be committed, any of the grave breaches of the Conventions and are obliged to search for persons alleged to have committed, or to have ordered to be committed, such grave breaches, and shall bring such persons, regardless of their nationality, before its own courts. Parties to the conflict have to repress grave breaches of the Conventions or of this Protocol which results from a failure to act when under a duty to do so (Article 86 of the Additional Protocol I).

Attacks on medical personnel and units during armed conflict are regarded as war crimes under national and international criminal law. Namely, Article 438 of the Criminal Code of Ukraine stipulates that violations of the laws and customs of war provided for by international treaties ratified by the Verkhovna Rada of Ukraine are crimes under Ukrainian criminal law [7]. Article 8(2) of the Rome Statute of the International Criminal Court (hereinafter – ICC) envisages that intentionally directing attacks against medical units and transport, and personnel using the distinctive emblems of the Geneva Conventions are regarded as serious violations of the laws and customs applicable in international and non-international armed conflicts [6].

In its Reports on Preliminary Examination Activities in Ukraine (2018 and 2019) the ICC Office of the Prosecutor while defining the jurisdiction *ratione materiae* of the ICC stressed that the 'use of heavy weapons by all parties to the conflict not only led to numerous casualties and injuries resulting from severe injuries, but also to large-scale damage and destruction of ... hospitals and other medical institutions, ... both in government-controlled territory and in areas controlled by armed groups' [21, para. 84; 12, para. 275]. The Office of the Prosecutor referred to intentional attacks against protected objects, such as medical institutions, among the alleged war crimes in accordance with Article 8(2)(b)(ix) or Article 8(2)(e)(iv) of the Rome Statute in its Report of 2018 (para. 86). The application of these articles depends on the qualification of the armed conflict in Ukraine, either it is international or non-international, or both. Besides, para. 87 of the Report of 2018 refers to intentionally directing attacks against buildings, material, medical units and transport, and personnel using the distinctive emblems of the Geneva Conventions. For example, the shelling

of a Ukrainian ambulance car, which took place on July 1, 2019 and resulted in the death of Ukrainian military medical personnel [17], may be qualified as a war crime under Article 8 of the Rome Statute of the International Criminal Court.

Many medical workers have been disabled during the Joint Operations of Ukrainian forces as a result of wounds or other health injuries emanating from explosions in the areas in which they perform their duties and in settlements located directly on the line of war hostilities. However, according to national Ukrainian legislation, it is impossible to grant the status of ‘a participant in hostilities’ for such medical workers, which would provide them with a number of social benefits guaranteed by the Law of Ukraine ‘On the status of war veterans and guarantees of their social protection’ of 1993. It is impossible because such a status directly contradicts Articles 43-44 of the Additional Protocol I. Healthcare personnel do not belong to combatants. Ukraine ratified this treaty, thus, recognized it as a part of national law being binding for the Ukrainian state.

Let’s consider the key means of implementation of international humanitarian law at the national level in Ukraine. As already noted, Article 438 of the Criminal Code of Ukraine covers violations of treaties on international humanitarian law ratified by Ukraine [7]. However, this Article is not specific enough, it does not have the same list of grave breaches of Geneva Conventions and its Protocols as these treaties and the Rome Statute do stipulate. Thus, it lacks certainty for the effective prosecution of IHL violations. Meanwhile, there are several draft laws amending the Ukrainian Criminal Code in relation to war crimes. For example, draft law No. 9438 ‘On Amendments to Some Legislative Acts of Ukraine on Ensuring Harmonization of Criminal Law with the Provisions of International Law’ supplements the Criminal Code with a war crime against humanitarian operations and protected emblems – intentional attacks in connection with an international armed conflict or a non-international armed conflict against medical facilities, personnel or transport that, in accordance with the rules of international humanitarian law, use the emblems established by the Geneva Conventions of 12 August 1949 [18]. Draft law No. 2689 ‘On Amendments to Some Legislative Acts of Ukraine on the Implementation of International Criminal and Humanitarian Law’ defines the protected persons as, *inter alia*, medical personnel and prohibits any attacks thereon [19].

The Guidelines on the Application of International Humanitarian Law in the Armed Forces of Ukraine (2017) provide further explanations, details and clarity as to what constitutes a disciplinary or criminal offense with regard to non-compliance with a special protection of medical personnel and units. In particular, it specifies that objects which are under the IHL protection are medical units, sanitary vehicles, and hospitals; persons who are under the IHL protection are medical personnel (belonging to the Ukrainian Armed Forces as well as to the Ukrainian Red Cross Society) who are regarded as non-combatants [8]. The adversary’s medical personnel are respected and protected and cannot be attacked unless engaged in hostile actions. Medical personnel shall be granted all available help for the performance of their duties. Any reprisals against protected objects and medical personnel are prohibited. The Guidelines stipulate that attacks on medical units and vehicles that have proper emblems and signals (although the absence of emblems does not imply the lack of protection afforded to such objects but complicates their identification) are regarded as prohibited methods of warfare. Grave breaches of IHL directed against protected persons are war crimes.

Thus, the Guidelines implemented main provisions of the IHL treaties, but we are of the opinion that for their proper enforcement it is necessary to adopt specific national law, *e.g.* amendments to the Criminal Code mentioned above. The Guidelines approved by the order of the Ministry of Defense of Ukraine are not enough: only a strict legislative framework with criminal penalties may ensure effective investigation and prosecution of crimes committed against health care personnel during armed conflicts. As was previously stated, the Geneva Conventions stipulate that the states enact any legislation necessary to provide effective penal sanctions for persons committing the grave breaches of the Conventions. The ICRC commentary to these provisions supports our conclusion [10].

International governmental and non-governmental organizations paid a special attention to the protection of healthcare workers and facilities in armed conflict and adopted a set of recommendations with this regard. In particular, the United Nations General Assembly adopted resolution 37/194 'Principles of Medical Ethics relevant to the Role of Health Personnel, particularly Physicians, in the Protection of Prisoners and Detainees against Torture and Other Cruel, Inhuman or Degrading Treatment or Punishment'. The Council of Europe adopted resolution 904 (1988) 'On the protection of the humanitarian medical missions'. WHO adopted Resolution WHA46.39 'Health and Medical Services in Times of Armed Conflict' and resolution WHA55.13 'Protection of Medical Missions during Armed Conflict'. NATO has adopted directive MC 326/2 'NATO Principles and Policies of Operational Medical Support'.

**Conclusions.** It has been revealed that due to its long-standing peaceful state policy, Ukraine was not ready for the considerable number of problems that arose from the armed aggression of the Russian Federation in Donbas. It is determined that the pressing need to study IHL as a tool to regulate military personnel's actions and ensure their protection has become particularly acute. The legal protection of medical personnel in armed conflict is directly related to the functions it performs, namely providing healthcare services. The provision of health care in armed conflict is linked to the enforcement of human right to health. Healthcare workers are given certain privileges in armed conflict, and distinctive emblems and symbols are used to protect them. International legal protection for healthcare personnel in armed conflict is ensured by treaty, customary rules as well as recommendations of international organizations. It can be stated that the international legal protection of healthcare personnel, medical facilities and units in the context of armed conflict is clearly defined by international treaties and 'soft law' instruments, they envisage all necessary measures for the real protection of medical personnel and, consequently, victims of armed conflict.

Though Ukraine and Russia which are parties to the armed conflict are parties to the Geneva Conventions, Additional Protocols I and II, instances of killing or injuring the medical personnel as well as damaging medical units and facilities witness that they do not comply with their obligations. The Russian Federation doesn't comply with its obligation to respect and protect adversary's health-care personnel and facilities in times of armed conflict, and Ukraine doesn't comply with its obligation to adopt domestic implementation measures based on relevant international legal obligations and to ensure effective investigation and prosecution of crimes committed against medical personnel. While all above-mentioned IHL treaties have been ratified by Ukraine, national legislation does not provide comprehensive legal mechanisms for the protection of medical personnel and medical facilities.

Attacks on medical personnel and units during armed conflict are regarded as war crimes under national criminal law. Article 438 of the Criminal Code covers violations of treaties on international humanitarian law ratified by Ukraine. However, this Article is not specific enough, it does not have the same list of grave breaches of Geneva Conventions and its Protocols as these treaties and the Rome Statute do stipulate. Thus, it lacks certainty for the effective prosecution of IHL violations. Some secondary legal acts of Ukraine, like the order of the Ministry of Defense of Ukraine on the application of international humanitarian law in the Armed Forces of Ukraine, implemented main provisions of the IHL treaties, but for the proper enforcement of the latter it is necessary to adopt specific national law, including relevant amendments to the Criminal Code. Only a strict legislative framework with criminal penalties may ensure effective investigation and prosecution of crimes committed against health care personnel during armed conflicts.

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## **EU-UKRAINE ASSOCIATION AGREEMENT IMPLEMENTATION COORDINATION MECHANISM**

## **КООРДИНАЦІЙНИЙ МЕХАНІЗМ ІМПЛЕМЕНТАЦІЇ УГОДИ ПРО АСОЦІАЦІЮ МІЖ УКРАЇНОЮ ТА ЄС**

## **КООРДИНАЦИОННЫЙ МЕХАНИЗМ ИМПЛЕМЕНТАЦИИ СОГЛАШЕНИЯ ОБ АССОЦИАЦИИ МЕЖДУ УКРАИНОЙ И ЕС**

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**Annotation.** *The article is devoted to the analysis of the legal nature of the implementation mechanism of the EU-Ukraine Association Agreement in the legal order of Ukraine as well as coordination mechanism of its implementation. It is noted that the principles and provisions enshrined in the Association Agreement become the integral part of the contemporary legal order of Ukraine. Nevertheless, due to the peculiarities of the Agreement, Ukrainian authorities introduced special implementation coordination mechanism. It is pointed out that all major central authorities are included in the implementation mechanism and the Government Office for the Coordination of European and Euro-Atlantic Integration being on the forefront of these activities.*

*It is underlined that the amendments introduced to the Constitution of Ukraine in 2019 played the unprecedented significance for the implementation of the Association Agreement. These amendments provided for inevitable foreign policy course of Ukraine for European and Euro-Atlantic integration.*

*Special attention is paid to the challenges that authorities are facing in the process of preparation for the implementation of the Agreement. The idea of National Implementation*

*Program's (NIP) development was supported and the proposals were made regarding the policy issues that need to be included into the NIP.*

**Key words:** *European Union, Association Agreement, implementation, coordination, the Government Office for the Coordination of European and Euro-Atlantic Integration.*

**Анотація.** *Стаття присвячена аналізу правової природи механізму імплементації Угоди про асоціацію між Україною та ЄС у правовому порядку України, а також механізму координації цього процесу. Зазначається, що принципи та положення, закріплені в Угоді про асоціацію, стають невід'ємною частиною сучасного правового порядку України. Проте, через особливості Угоди, українські органи влади запровадили спеціальний механізм координації імплементації. Вказується, що всі основні центральні органи влади включені в механізм імплементації, а Урядовий офіс координації європейської та євроатлантичної інтеграції перебуває на передовій лінії цих заходів.*

*Підкреслюється, що зміни, внесені до Конституції України у 2019 році, відіграють безпрецедентне значення для імплементації Угоди про асоціацію, оскільки вони закріпили неминучий зовнішньополітичний курс України на європейську та євроатлантичну інтеграцію.*

*Особлива увага приділяється викликам, з якими стикаються органи влади в процесі підготовки до імплементації Угоди. Була підтримана ідея розробки Національної програми імплементації (НІП), а також були запропоновані положення та сфери діяльності, які необхідно включити до НІП.*

**Ключові слова:** *Європейський Союз, Угода про асоціацію, імплементація, координація, Урядовий офіс координації європейської та євроатлантичної інтеграції.*

**Аннотация.** *Статья посвящена анализу правовой природы механизма имплементации Соглашения об ассоциации между Украиной и ЕС в правовом порядке Украины, а также механизма координации этого процесса. Отмечается, что принципы и положения, закрепленные в Соглашении об ассоциации, становятся неотъемлемой частью современного правового порядка Украины. Однако, из-за особенностей Соглашения, украинские органы власти ввели специальный механизм координации имплементации. Указывается, что все основные центральные органы власти включены в механизм имплементации, а Правительственный офис координации европейской и евроатлантической интеграции находится на передовой линии этих мероприятий.*

*Подчеркивается, что изменения, внесенные в Конституцию Украины в 2019 году, имеют беспрецедентное значение для имплементации Соглашения об ассоциации, поскольку они закрепили неизбежный внешнеполитический курс Украины на европейскую и евроатлантическую интеграцию.*

*Особое внимание уделяется вызовам, с которыми сталкиваются органы власти в процессе подготовки к имплементации Соглашения. Была поддержана идея разработки Национальной программы имплементации (НИП), а также были предложены положения и сферы деятельности, которые необходимо включить в НИП.*

**Ключевые слова:** *Европейский Союз, Соглашение об ассоциации, имплементация, координация, Правительственный офис координации европейской и евроатлантической интеграции.*

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**Target setting.** *The new generation of the EU Association Agreements with the EU's eastern neighbours substituted outdated partnership agreements which were concluded in 1994–1998. The solemn signing of the AAs between the EU and Ukraine, Moldova and Georgia took place at the*

EU Summit in Brussels on 27th June 2014, followed by ratifications by national parliaments in Moldova, Georgia and Ukraine. Signing and ratification of the Association Agreement between Ukraine and the European Union (AA) [*European Atomic Energy Community, European Union, The Member States, Ukraine: 2014*] is undoubtedly an important event both for domestic political development, and for relations with the EU. Towards the signing of EU-Ukraine Association Agreement there were external, as well as internal Ukrainian challenges due to the domestic Ukrainian political reforms and changings of international policy.

In January 2016 Ukraine's Deep and Comprehensive Free Trade Agreement (DCFTA) with the EU came into force. One of the most complex accords since the Treaty of Lisbon, it envisages a reciprocal and gradual opening of the two parties' markets. Implementation requires Kyiv to carry out extensive legal approximation across key economic sectors and many in Ukraine hope the agreement will help transform the country into a modern economy. The whole text of the EU-Ukraine AA entered into force since September 1, 2017.

EU-Ukraine AA belongs to the selected group of "integration-oriented agreements", i.e., agreements including principles, concepts and provisions of EU law that are to be interpreted and applied as if the third State is part of the EU [*Maresceau Marc: 2013: 151–92*].

Considering the wide range of issues governed by the EU-Ukraine Association Agreement, its provisions affect almost all the spheres of Ukrainian society. Most importantly, this Agreement provides the outer framework for implanting the European standards and for urgent internal systemic reforms in Ukraine. There should be a thorough and systematic approach to the implementation mechanism of the most ambitious bilateral international treaty in Ukraine's history.

Implementation of the Association Agreement promotes approaching of the Ukrainian regulatory environment to that of the EU, and therefore - not only the customs duties are eliminated, but non-tariff trade barriers as well, that contribute to integration of Ukraine into the European economic and legal field in general, and into the internal market of EU and the European Economic Area, in particular.

One key provision underpinning the Association Agreement sets out the concept of gradual approximation of Ukraine's legislation to EU norms and standards. Specific timelines are set within which Ukraine should approximate its legislations to the relevant EU legislation. These timelines vary between 2 and 10 years after the entry into force of the Agreement [*Van Elsuwege P.: 2015: 9-16*].

Considering the afore, the Association Agreement induces to implementation of measures on administrative modernization in the system of law enforcement and judicial authorities in order to improve their effectiveness, to guarantee the independence and impartiality, as well as to develop measures on fight against corruption.

**The aim of the article.** The aim of this article is to highlight the theoretical and practical problems of the implementation of the EU-Ukraine Association Agreement. The effective activities in the abovementioned sphere need special coordination mechanism and revision of the existing action plan with the view of development of the special National implementation program.

**Analysis of latest researches and publications.** The issues of the association between Ukraine and the European Union were elucidated mainly in the latest works by I. Berezovska [*Berezovska I.: 2011: 95-100*], Ya. Kostiuchenko [*Kostiuchenko Ya.: 2015: 42-52*], V. Muraviov [*Muraviov V. : 2015: 17-32*], R. Petrov [*Petrov R.: 2015: 33-41*]. Unfortunately, so far, the Ukrainian and foreign publications have not paid enough attention to research of the efficiency of the AA implementation coordination mechanisms. However, new challenges connected with implementation of the EU - Ukraine AA require special research on this issue.

**Presentation of basic material of the research.**

*Peculiarities of EU-Ukraine AA*

Furthermore, the AA is founded on a strict conditionality approach, which links the third country's performance and the deepening of its integration with the EU.

The AAs are not just ordinary international agreements, but complex framework legal structure that contain not only specific norms that govern the functioning of the association relations

and DCFTA between the EU and Ukraine, but also envisages a possibility of application of a vast scope of the pre-signature and post-signature EU acquis within the legal system of the eastern neighbouring countries, in particular Ukraine. The scope of the EU acquis to be applied by Ukraine covers not only primary and secondary EU laws, but also EU legal principles, common values, and even case law of the ECJ, as well as specific methods of interpretation of the relevant EU acquis within legal system. Hitherto, the Ukrainian legal system has not faced the necessity to implement and effectively apply a dynamic legal heritage of an international supranational organization. Subsequently, adherence of Ukraine, to the dynamic EU acquis via the AA will encapsulate a plethora of challenges to national legal order.

Implementation and application of the EU-Ukraine AA within the legal system of Ukraine is governed by national constitutional laws. Ukraine has to develop its own solutions to the problem of legislation approximation with EU law, because realization of this mechanism provides opportunities for EU law action under national legal order. This applies primarily to the cases of EU directives transposition into Ukrainian domestic legislation under the Association Agreement, and direct application of EU law's certain provisions at national level. However, it should be considered that the process of approximation of the legislation of Ukraine with the law of the European integration organizations has its own characteristics due to the level of relations between partners.

The fact that the Association Agreement does not provide preparation for Ukraine's accession to the European Union defines the boundaries of cooperation in legal field and particularly in legislation approximation. On the other hand, as practice shows approximation of the implementation at EU level as well as in Union relations with other countries (especially with those, which are under the Association Agreement), it is almost impossible to clear definition of process boundaries. Therefore, Ukraine has enough opportunities for forcing or, alternatively, suspending the legislation harmonizing process with EU law. This relates directly to goals, means and organizational and legal mechanism for harmonizing.

*EU-Ukraine AA's coordination mechanism (competences & duties of state authorities)*

The question of the existence of an effective body for European integration is central to ensuring the success of the process as a whole. So, it is necessary to analyze the system of central bodies of state power, which are empowered in the sphere of AA implementation.

Generally, EU-Ukraine AA implementation coordination mechanism is presented by three levels of state authorities: the President (and the competence of the Administration of the President); the Verkhovna Rada (Parliament) and the Cabinet of Ministers (the executive branch of power).

The powers of *the President of Ukraine*, envisaged by Article 106 of the Constitution of Ukraine regarding the ensuring of the state independence, national security, representing the state in international relations, administering the foreign political activity of the State, in the context of the aim of the political dialogue provided for in the Agreement (Article 4 of the Agreement):

- to deepen political association and increase political and security policy convergence and effectiveness;
- to promote international stability and security based on effective multilateralism;
- to strengthen cooperation and dialogue between the Parties on international security and crisis management, particularly in order to address global and regional challenges and key threats;
- to develop dialogue and to deepen cooperation between the Parties in the field of security and defence.

These issues covered by EU-Ukraine Summits as the forum for political dialogue and dialogue regarding policy at the highest level where the President of Ukraine participates.

Moreover, the President of Ukraine has implemented his mandate for advisory and other subsidiary bodies and services, establishing the National Council of Reforms. In accordance with the Regulation on the National Council for Reforms (Decree of the President of Ukraine dated August 13, 2014, No. 644/2014): "The decisions of the National Council for Reforms, if necessary, shall be implemented through the publication of the acts of the President of Ukraine in accordance

with the established procedure, the submission by the President of Ukraine of relevant draft laws to the Verkhovna Rada of Ukraine or taking by the appropriate members of the National Council of Reforms of public obligations to implement the right to legislative initiative, the right to initiate the adoption of acts of the Cabinet of Ministers of Ukraine and acts of the National Bank of Ukraine, which are documented by public agreements of such members of the National Council of Reforms” [President of Ukraine: 2014].

An important role here is played by the legislature of the country. The Rules of Procedure of the *Verkhovna Rada of Ukraine* stipulate that the Committee on European Integration shall consider draft laws regarding their compliance with the international legal obligations of Ukraine in the field of European integration (Article 93 of the Rules). These findings should be submitted by the Committee to the main committee responsible for reviewing the draft law within 21 days.

The institutional and functional components of the coordination system in the *executive* branch are made up of the following levels:

- the Cabinet of Ministers of Ukraine, which directs, coordinates and controls the activities of ministries and other central executive bodies;
- the Governmental Committee on European, Euro-Atlantic Integration, International Cooperation and Regional Development;
- the Government Office for the Coordination of European and Euro-Atlantic Integration of the Secretariat of the Cabinet of Ministers of Ukraine (hereinafter - the Government Office, GOCEEAI), which performs a number of functions related to the coordination, monitoring and control of the preparation and execution of program documents, examination of draft regulations, as well as functions of the secretariat of the EU-Ukraine Association Council and Association Committee;
- Deputy Ministers for European Integration and specialized units of the ministries responsible for formulating and implementing state policy in the areas of their competence, drafting legal acts in the field of European integration and their implementation, interaction with relevant structural units of EU institutions and agencies.

The Government Office (GOCEEAI) plays the leading role in institutional support of legal approximation of the Ukrainian legislation, as it currently ipso facto performs coordinating activities for approximation of legislation within the framework of the tasks of the Association Agreement implementation.

Originally it was established on August 13, 2014 by the Resolution of the Cabinet of Ministers of Ukraine No. 346 as a separate structural subdivision of the Secretariat of the Cabinet of Ministers of Ukraine. The main tasks of the Government Office are to provide the activities of the Cabinet of Ministers of Ukraine, the Prime Minister of Ukraine and the Deputy Prime Minister of Ukraine for European and Euro-Atlantic Integration. Undoubtedly, the appearance of such an institution is a progressive step, but the status and functions of the Government Office (GOCEEAI) are mainly "coordinating". In particular, the GOCEEAI does not draft legal acts, is not entitled to legislative initiative (submission of normative legal acts drafts for consideration by the Cabinet of Ministers), does not negotiate with the European counterpart at higher levels, has no right to issue instructions to other bodies of state power (only through the Prime Minister and only in exceptional cases). Its main task is to monitor the general situation what is considered to be not sufficient for the role of the sole and main coordinator of European integration in the country.

It is worth mentioning that draft legislation is being considered on a weekly basis by the Governmental Committee for European, Euro-Atlantic Integration, International Cooperation and Regional Development. Coordination of activities regarding drafting of legal acts, as well as their expertise, is carried out by the Government Office for the Coordination of European and Euro-Atlantic Integration of the Secretariat of the Cabinet of Ministers of Ukraine (GOCEEAI) [Cabinet of Ministers of Ukraine: 2017]. The Office is constantly interacting with the ministries where the positions of Deputy Ministers on European Integration were established.

The GOCEEAI also serves as a moderator between the ministries and the European Commission experts. However, precisely the ministries bear the responsibility for the quality and

timing of the implementation activities, their compliance with EU law or other international standards.

Organizational, expert-analytical and informational support of the Cabinet of Ministers of Ukraine activities in the field of European and Euro-Atlantic integration is carried out by the Government Office (GOCEEAI). In the field of European integration, the GOCEEAI has the authority to develop and materialise measures for the implementation of the Agreement, other international treaties of Ukraine and agreements between Ukraine and the European Union; cooperation between Ukraine and the European Union, as well as the Members States of the European Union in accordance with their powers under the TFEU; approximation of the Ukrainian legislation to the European Union law (EU *acquis*); implementation of international treaties of Ukraine and agreements between Ukraine and the European Union; activities of the bilateral bodies envisaged by the Agreement and other international treaties of Ukraine; the target direction of budget financing; the employment and use of international aid from the European Union and other donors aimed at supporting the implementation of tasks; informing the public; involvement of citizens in the process of adoption by the Cabinet of Ministers of Ukraine and other executive authorities of relevant legal acts.

The Government Office (GOCEEAI), in accordance with the tasks entrusted to it, conducts an expertise of draft regulations and other acts (by-laws) submitted to the Cabinet of Ministers of Ukraine for their compliance with the program documents in the field of European integration and the aims of the AA, according to the achieved results the Office drafts conclusions and recommendations and expertise of the compliance of draft legal acts, which are introduced for consideration by the Cabinet of Ministers of Ukraine, with international legal obligations of Ukraine in the field of European integration, and also taking into account the provisions of the EU law (EU *acquis*) (Paragraph 2, Article 12, Clause 4 of the Regulation on the Government Office on European and Euro-Atlantic Integration of the Secretariat of the Cabinet of Ministers of Ukraine) [Cabinet of Ministers of Ukraine: 2017].

In the coordination mechanism of ensuring the implementation of European integration issues in the central executive authorities, there is a significant progress that reveals the strong euro integration commitments of Ukraine: every ministry established the position of deputy minister for European integration, created special units responsible for the euro integration direction.

As for the central executive bodies with a special status, only three of the five bodies established special divisions, departments responsible for euro integration policy. Thus, it is necessary to create a body responsible for European integration in the State Property Fund and the Administration of the State Service for Special Communications and Information Protection of Ukraine, which would contribute to a more effective and dynamic implementation of the provisions of the Association Agreement. Representative for this purpose is the example of the National Agency of Ukraine on Civil Service where the Centre for Approximation of the Civil Service to the European Union Standards [Centre for Approximation of the Civil Service to the European Union Standards: 2020] was established. This Centre in turn ensures the organization of cooperation between the state bodies of Ukraine and the state authorities of the EU Member States in order to share experience and support in matters of public administration and approximation of Ukrainian legislation to the EU legislation [Cabinet of Ministers of Ukraine: 2008]. Therefore, the establishment of the system of bodies and units that would be responsible for the issue of European integration in central executive bodies still needs attention and refinements from the government. Particular attention should be paid to the fact that currently the most important problem is the lack of monitoring and evaluation of the Association Agreement implementation in most state bodies.

#### *EU-Ukraine AA's implementation mechanism*

The framework dimension of AA's implementation consists of the basic documents including originally adopted the Action Plan on Association Agreement Implementation for the period of 2014-2017 (approved by the Resolution of the Cabinet of Ministers No. 847-p dated 17.09.2014). The Plan provided for the task of both organizational and normative character. The tasks of normative character were described in detail in the system of implementation plans of the EU legal

acts, which were endorsed by the specific authorities of Ukraine. These implementation plans specifically defined what the ministry should do to implement qualitatively the provisions of the act of the EU law that needs to be implemented on the basis of the obligations under the Agreement.

The updated AA implementation mechanism was presented in the form of the approval by the Resolution of the Cabinet of Ministers of Ukraine dated October 25, 2017 No. 1106 of the special Action Plan on Association Agreement Implementation, which was developed by the Government Office for the Coordination of European and Euro-Atlantic Integration, together with the Ministry of Economic Development and Trade of Ukraine and other ministries, and is aimed to increase the efficiency of coordination and promotion of the European integration process [Cabinet of Ministers of Ukraine: 2014].

This Action Plan was introduced as a paper variant of tested interactive electronic program “Pulse of the Agreement”. This electronic program (data base) was elaborated by the GOCEEAI with the technical support of European donors. The public access to the “Pulse of the Agreement” was opened November 20, 2019. It reflects the current progress of implementation of measures within each year and the overall progress of implementation, starting with the provisional application of certain provisions of the Agreement in 2014 and until 2024 [Cabinet of Ministers of Ukraine: 2019].

The Action Plan is a large-scale 1199-page document. It formulates 1943 tasks covering 27 spheres. 106 authorities of Ukraine are responsible for implementing its tasks. Each of these tasks corresponds to a separate article of the Agreement or implements the established provisions of European Union law (acquis).

The implementation of the Action Plan envisages amendments to the regulatory acts and the development of new ones in order to bring Ukraine's legislation closer to the law of the European Union in accordance with the obligations under the Association Agreement between Ukraine and the European Union.

The ministries, central and local executive authorities and other bodies of state administration responsible for implementation of the Association Agreement between Ukraine and the European Union will be able to provide consistent and concerted measures to timely implement Ukraine's commitments under the Association Agreement between Ukraine and the European Union.

Monitoring system of AA's commitments is currently based on the abovementioned Action Plan by GOCEEAI staff in the form of systematization of ministry's reports on implementation.

Implementation of the Association Agreement with the EU is the basis of the reform program of the Cabinet of Ministers. That is why the Government should make every effort to successfully implement the Association Agreement as a whole. Successful implementation of the tasks will allow deepening the work of the Free Trade Area with the EU, including the most sensitive areas, namely, in terms of reducing tariff and technical barriers to trade in goods, opening access to services markets and public procurement, approximating Ukraine's legislation to EU law.

In February 2018, the Cabinet of Ministers of Ukraine together with the Verkhovna Rada of Ukraine elaborated and approved the Roadmap of legislative support for the implementation of the Association Agreement between Ukraine and the EU for 2018-2019 [Cabinet of Ministers of Ukraine: 2018]. A document was designed to intensify European integration processes in Ukraine. The Roadmap is a package of 57 draft laws to be considered by the Verkhovna Rada of Ukraine within two years.

From the procedural point of view, all institutional elements are embedded in existing structures and mechanisms, a typical example of which is the consideration of preparation issues and holding of the Association Council and Association Committee at meetings of the Government and the Government Committee respectively. In the past, these issues were considered separately at meetings of the Ukrainian parts of the bilateral bodies (the EU-Ukraine Cooperation Council and the Committee), which subsequently required additional formulation of their decisions within the framework of governmental regulatory procedures. These two distinctive features of the coordination mechanism have made it possible to avoid creating a separate legal regime for

European integration policy and lay the preconditions for its final establishment as an integral part of each area of internal public policy.

Another important element of the monitoring mechanism of the AA implementation is Reporting. Starting from 2015 the Government Office produced a few reports on this issue [Cabinet of Ministers of Ukraine: 2019]. The latest was delivered in February 2019 regarding the implementation activities in 2018. Reporting is considered rather effective way of introducing the European Commission as well as Ukrainian stakeholders and general public to the overview of the Ukrainian actions and results in the field of AA implementation. On the other hand, the Office focuses rather on the achievements that indicating problematic issues. That is why the real picture of the whole implementation process is not made public.

#### *European integration in Constitution of Ukraine*

Ukraine has chosen its strategic direction namely the integration into European economic, political and legal area. Joining the European Union is defined as the main priority and strategic objective of Ukraine at the highest state level. The Verkhovna Rada (Ukraine's Parliament) has backed amendments to the Constitution of Ukraine's path to the European Union & NATO.

On September 20, 2018, The Verkhovna Rada sent to the Constitutional Court a presidential bill amending Ukraine's Constitution regarding the strategic course of the State for obtaining full membership of Ukraine in the EU & NATO (No. 9037). On November 22, 2018, the Constitutional Court of Ukraine green-lighted this Bill. And the same day the Verkhovna Rada adopted the Bill in its first reading. These amendments to Constitution of Ukraine came into force on February 21, 2019.

These amendments focused on Ukraine's irreversible course toward European & Euro-Atlantic integration be stipulated in the preamble of the Constitution of Ukraine along with the confirmation of European identity of the Ukrainian people. Article 85 suggests defining that the powers of domestic and foreign policy, implementing the state's strategic course for obtaining full membership of Ukraine in the European Union and NATO. Article 102 is supplemented with the provision that 'the President of Ukraine is the guarantor of the implementation of the state's strategic course for obtaining Ukraine's full membership in the EU & NATO'. Article 116 is amended with a new clause, according to which the Cabinet of Ministers 'ensures the implementation of the state's strategic course for obtaining Ukraine's full membership in the EU & NATO' [Verkhovna Rada of Ukraine: 1996].

In order to ensure the irreversibility of Ukraine's European and Euro-Atlantic course, based on the third part of Article 102 of the Constitution of Ukraine the special act was adopted - Decree of President of Ukraine "European and Euro-Atlantic integration matters" №155/2019 dated April 20, 2019, that contains Action Plan for implementation of the State's strategic course towards obtaining by Ukraine of the full membership in the European Union and in the North Atlantic Treaty Organisation [President of Ukraine: 2019]. This Decree of the President of Ukraine excludes the possibility of diverting from the strategic course since it enshrines the functions and responsibilities of all authorities in Ukraine to implement this course.

Under this document the Cabinet of Ministers of Ukraine shall ensure the implementation, in cooperation with the relevant state authorities, of the Action Plan for implementation of the State's strategic course towards obtaining by Ukraine of the full membership in the European Union and in the North Atlantic Treaty Organisation, as approved by this Decree, and informing, on a quarterly basis, the President of Ukraine of the status of its implementation; and ensure the reporting on the implementation of the aforementioned Action Plan within the prescribed time periods.

The Action Plan itself consists of 31 items with various objectives for the period of 2019-2020. In particular, the Plan contains an item on the elaboration of proposals for revision of the Association Agreement between Ukraine and the EU in December this year, and during 2019-2020 for cooperation with the EU side on further trade liberalization, the conclusion of an Agreement on the Conformity Assessment and Acceptance of Industrial Goods (Agreement ACAA); integration into the EU internal markets in the fields of energy and digital economy; cooperation in the field of justice, freedom and security.

*Challenges on effective EU-Ukraine AA's implementation*

One of the serious challenges to be faced by the eastern neighbouring countries is the reluctance of the judiciaries in the eastern neighbouring countries to apply and effectively implement international law sources in their own judgments.

Another problem of the EU-Ukraine AA implementation is that law-making activities of the state authorities should consider the dynamic changes in the EU law, to which Ukraine is approximating its legislation. In this regard the possibility to include new dynamic norms of the EU Law to the annexes to the Agreement by the adopting of amendments. Moreover the Association Council has the competence to update or amend the Annexes [I to XLIII] to this Agreement to this effect, taking into account the evolution of EU law and applicable standards set out in international instruments deemed relevant by the Parties (Art. 463 para 3) [European Atomic Energy Community; European Union; The Member States; Ukraine: 2014].

The objective of effective implementation and application of the EU-Ukraine AA may be achieved by issuing a special implementation law that will clarify all potential conflicts of provisions of the Agreement with Ukrainian legislative acts.

For example, we can stress on the comparison of the mechanism of implementation of EU-Ukraine AA with the application of European Convention of Human Rights (ECHR), which Ukraine ratified in 1997. The situation was the following that the ratification of the ECHR by Ukraine took place by means of two laws. The first law was the law on ratification of the ECHR, wherein Ukraine recognised the jurisdiction of the European Court on Human Rights (ECtHR) [Verkhovna Rada of Ukraine: 1997]. The second law was a special one about the strict legal mechanism of application of case law of the ECtHR in Ukraine [Verkhovna Rada of Ukraine: 2006]. In accordance with the art. 17 of the Law "On Execution of Judgments and Application of Case Law of the ECtHR", judgments of the latter become the source of law in Ukrainian legal order. Nevertheless, as Petrov R. stressed and practice shows that, the rate of effective application of the ECtHR case law in Ukraine is considered as unsatisfactory and lags far behind other European countries [Committee of Ministers: 2014].

In comparison with this we can stress on another practical problematic issue of the AA implementation that comes from the application of the EU case law while interpretation of some provisions of the Treaties. We can confidently stress that the application of EU jurisprudence in the judgements of Ukrainian courts is controversial and ambiguous. One thing that has become unique, from our point of view, is that the application of EU law case law can be added only while the interpreting the principles of fair mutual trade between parties.

This way the similar law on the EU-Ukraine AA implementation may solve problems of its application, especially due to the fact of supremacy of the EU law.

The most important question in the process of AA implementation is the legal force of the decisions of the Association Councils and the way how they should be applied in Ukrainian legal order. Direct applicability of the Association Council's decisions will depend on their undisputed acceptance by national judiciaries.

Nowadays this draft law is being elaborated by experts, government officials & parliament members.

The main problems in the process of preparation for the implementation of the Agreement are as follows:

1) No provisions were made to implement the Agenda of the EU-Ukraine Association on time and in full;

2) National mechanism for implementation of Association Agreement was not determined and not presented at the state level;

3) The National Association implementation program which should provide for the detailed list of activities for step by step implementation of the Agreement and their due dates was not approved.

4) The staff of the Ukrainian state authorities is quite often unaware of the peculiarities of the EU legal mechanisms. While implementing decisions and AA Action Plans of the Government they

try to “Ukrainise” EU mechanisms and approaches to legal approximation. As a result, the outcome of those actions does not correspond to the existing aims and objectives of the AA. So, there is an urgent need in development of human resources aware of EU peculiarities.

Ministry of Economic Development and Trade developed the program for the implementation of the EU-Ukraine Association Agreement by Ukraine which is developed to ensure full compliance with obligations made by Ukraine. Implementation of this program will ensure effectiveness of the implementation mechanism for the Association Agreement. The implementation of the Agreement, in turn, will facilitate the transition of EU-Ukraine relations to a new level, i.e. political association and economic integration.

There are the opinions that the National implementation program (NIP) shall be developed in the form of public policies in specific areas, that would provide systematic implementation of the Agreement and structural reforms in the specific areas.

Instead, the mentioned project of the Association Agreement implementation program developed in Ukraine by now does not meet the best practices, but is the list of the EU acquis indicating deadlines (often it simply repeats the provision of annexes to the Association Agreement) and responsible state authorities.

Thus, to develop the NIP, there should be done the following:

1. Make detailed plans for institutional development within all sub-sectors covered by the agreement.

2. Determine the total scope of work including short-, medium- and long-term priorities and phasing within Agreement implementation.

3. Determine the need for funding the actions on the program implementation from the EU technical assistance funds and other national and international donors.

4. Summarize the financial resources for the program implementation activities in a single table including sectoral and time profiles (at the final NIP development stage) and financing sources.

5. Create the NIP updating mechanism at annual bases (optionally bi-annual or as required).

6. Ensure consistency of NIP, the program of activities of the Cabinet of Ministers and programs of central executive bodies between each other, wherefore examine the need for establishing formal procedures that would ensure effective cooperation between the departments in charge for strategic planning, legal matters, and the departments/units of European integration within the ministries.

7. Consider the possibility and format for involving lawyers of the Verkhovna Rada of Ukraine into the working groups of the central executive bodies and interministerial working groups which would develop draft laws with the view of implementing the Association Agreement.

8. While preparing for the development of the statutory legal acts for the implementation of the Association Agreement, central executive bodies shall clear up the availability of EU information and explanatory materials in the field of regulation of statutory legal acts and send them along with the original text of the statutory legal act to EU for translation. These materials shall be available for the working group during development of the statutory legal act and subsequently transferred (e.g., electronically) to all the executives involved in the NIP implementation.

9. Provide adequate funding and start assessing the impact of the scheduled specific executed EU legal acts, and groups such acts to facilitate drawing up the soundly based plans for NIP.

10. Conduct legal trainings for Ukrainian judicial personnel in order to introduce them to the specifics of the EU legal system and the importance of application of European Court of Justice case law while administering justice.

11. In order to prepare the national versions of acquis acts, the following steps should be ensured:

- translation process;
- technical editing by highly experienced representatives of the ministries;
- revision of translated texts by legal experts in specific areas governed by the acquis act;
- editorial proofreading.

Implementation and monitoring of NIP implementation to be performed through the following actions:

1. Approve the NIP by the legal act which shall define the mechanism for monitoring, reviewing, financing, development and organization of work of interagency groups and sub-groups under the leadership of Deputy Ministers for coordination and supervision of the plan revision in each institution, and for other actions in the Agreement implementation through the NIP.

2. Establish a periodic (quarterly or semi-annual) reporting of the central executive bodies to the coordinating body in relation to implementation of the NIP actions.

3. Achieve a common understanding between the coordinating body and ministries and agencies the issues, needs and goals during implementation.

4. Ensure consideration and immediate response to comments by the EU in the Agreement implementation process, that provides the following:

- review and analysis of comments;
- depending on the agreement/disagreement: correction of the implementation plan/measures or submit sound arguments to come to a mutual agreement or compromise.

5. Develop and introduce the information system for on-line monitoring of the NIP actions performance, basing on the deliverables of the preparatory work for the NIP development.

6. Improve the level of assessing the laws conformity with the EU legislation and other international legal obligations of Ukraine in its relations with the EU, and make the approval procedure impossible for the legal acts that do not meet the abovementioned standards.

7. Establish a monitoring system for NIP implementation, which would be of the same significance as the similar monitoring system for the government program implementation.

8. The coordinating body shall trace the orders and instructions of the central executive authorities issued for the NIP performance and introduce the procedure of mandatory informing the coordinating body by the central executive bodies.

**Conclusions.** Thus, at the present stage of modernization of Ukraine shall be carried out considering the chosen path towards European integration. Ukraine faces a task to complete the reform of public governance, taking into account European standards and recommendations expressed by Western experts and the governing bodies of the EU. So, the implementation of EU-Ukraine AA/DCFTA, accompanied by reforms, will bring about the comprehensive approximation with EU legislation and standards leading to the gradual economic integration of Ukraine in the EU internal market and therefore to the creation of an economic area.

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**ОСОБЛИВОСТІ РОЗВИТКУ**  
**СВІТОВОГО ГОСПОДАРСТВА ТА МЕН**

УДК 339.92(075.8)

**THE POLITICAL ECONOMY OF GLOBAL VALUE CHAINS  
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**ПОЛІТИЧНА ЕКОНОМІЯ ПЕРЕБУДОВИ ГЛОБАЛЬНИХ ЛАНЦЮЖКІВ  
СТВОРЕННЯ ВАРТОСТІ**

**ПОЛИТИЧЕСКАЯ ЭКОНОМИЯ ПЕРЕСТРОЙКИ ГЛОБАЛЬНЫХ  
ЦЕПОЧЕК СОЗДАНИЯ СТОИМОСТИ**

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**Abstract.** The article analyzes the international production of multinational enterprises (MNEs). It presents some theoretical approaches to the analysis of international production, such as fragmentation theory, global value chains (GVCs) theory. The article argues that at the present stage of the world economy internationalization, there are two trends in the localization of MNEs global chains. The first trend indicates a slowdown of GVCs growth in the last seven years. The second trend characterizes the restructuring of GVCs. It indicates the backward movement of certain international production fragments to the MNEs home countries. Among the major factors that have slowed the growth of international MNEs production, the article analyzes the political instability and low economic dynamics of some FDI exporting countries. Changes in the location of global value chains are driven by technological, economic and geopolitical factors. Fourth industrial revolution, the robotization of production and new technologies for shale oil and gas in the US are changing the traditional determinants for GVCs localization. They have caused the relocation of many businesses from countries with the cheap labour to MNEs home countries. The article also highlights that the important factors of GVCs restructuring are the fiscal mechanisms implemented by the US administration, including tax reform. But the short-term and long-term effects of such measures differ significantly. Finally, the third important factor in the dynamics and restructuring of multinational enterprise network production is the geopolitical risk and political uncertainty. The trade war between the US and China has had a particularly significant impact on the current global value chains rebuilding.

**Key words:** *multinational enterprises, international production fragmentation, foreign direct investment, global value chains.*

**Анотація.** У статті проаналізоване міжнародне виробництво багатонаціональних підприємств (БНП). У ній представлені деякі теоретичні підходи до аналізу міжнародного виробництва, зокрема теорія фрагментації, теорія глобальних ланцюжків створення вартості (ГЛСВ). У статті стверджується, що на сучасному етапі інтернаціоналізації світової економіки існують дві тенденції локалізації глобальних ланцюжків БНП. Перша тенденція вказує на уповільнення зростання таких мереж за останні сім років. Друга тенденція характеризує реструктуризацію ГЛСВ. Остання тенденція вказує на зворотний рух певних фрагментів міжнародного виробництва до домашніх країн БНП. Серед основних факторів, які сповільнили зростання обсягів міжнародного виробництва багатонаціональних підприємств, у статті проаналізовано політичну нестабільність та низьку економічну динаміку деяких країн-експортерів ПШ. Зміни у розташуванні глобальних ланцюжків створення вартості зумовлені технологічними, економічними та геополітичними факторами. Четверта промислова революція, роботизація виробництва та нові технології видобутку сланцевої нафти та газу в США змінюють традиційні детермінанти локалізації ГЛСВ. Вони спричинили релокацію багатьох підприємств з країн з дешевою робочою силою у країни базування БНП. У статті також підкреслюється, що важливими факторами реструктуризації ГЛСВ є фіскальні механізми, що застосовуються адміністрацією США, включаючи податкову реформу. Але коротко- та довгострокові наслідки таких заходів істотно відрізняються. Нарешті, третім важливим фактором динаміки та реструктуризації виробництва багатонаціональних підприємств є геополітичні ризики та політична невизначеність. Торговельна війна між США та Китаєм мала особливо значний вплив на поточну перебудову глобальних вартісних ланцюжків.

**Ключові слова:** *багатонаціональні підприємства, фрагментація міжнародного виробництва, прямі іноземні інвестиції, глобальні ланцюжки створення вартості.*

**Аннотация.** В статье проанализировано международное производство многонациональных предприятий (МНП). В ней представлены некоторые теоретические подходы к анализу международного производства, в частности, теория фрагментации, теория глобальных цепочек создания стоимости (ГЦСС). В статье утверждается, что на современном этапе интернационализации мировой экономики, существуют две тенденции локализации глобальных цепочек МНП. Первая тенденция указывает на замедление роста таких сетей за последние семь лет. Вторая тенденция характеризует реструктуризацию ГЦСС. Последняя тенденция указывает на обратное движение определенных фрагментов международного производства в домашних стран МНП. Среди факторов, которые замедлили рост объемов международного производства многонациональных предприятий, в статье проанализирована политическая нестабильность и низкая экономическая динамика некоторых стран-экспортеров ПИИ. Изменения в расположении глобальных цепочек создания стоимости обусловлены технологическими, экономическими и геополитическими факторами. Четвертая промышленная революция, роботизация производства и новые технологии добычи сланцевой нефти и газа в США меняют традиционные детерминанты локализации ГЦСС. Они вызвали перемещение многих предприятий из стран с дешевой рабочей силой в страны базирования МНП. В статье также подчеркивается, что важными факторами реструктуризации ГЦСС стали фискальные механизмы, применяемые администрацией США, включая налоговую реформу. Но краткосрочные и долгосрочные последствия таких мер существенно отличаются. Наконец, третьим важным фактором динамики и реструктуризации производства многонациональных предприятий являются геополитические риски и политическая неопределенность. Торговая война между США и Китаем оказывает особенно значительное влияние на текущую перестройку глобальных стоимостных цепочек.

**Ключевые слова:** *многонациональные предприятия, фрагментация международного производства, прямые иностранные инвестиции, глобальные цепочки создания стоимости.*

## **Introduction**

In recent decades international production of multinationals has reached a global scale. Although international statistics do not provide accurate data on the number of these companies, it is estimated that the number of MNEs has exceeded the threshold of 100,000, and the number of their foreign affiliates is estimated at more than 1 million units. The share of multinational firm's gross production in the world GNP is 25%, in the world trade - 65%.

As Narula & Pineli [2019] summarized, the role of MNEs in economic development has been an agenda for research in international business and political economy literature for more than 50 years. The traditional questions of multinational enterprises foreign expansion and their relationships with host countries have recently been complemented by topics of global value chain's benefits distribution and offshoring effects for home and host countries.

Modern MNE's production is different from its 40-year-old prototype. It provides for a complex network hierarchical system of production and market relations, encompassing both enterprises belonging to multinational firms and formally independent companies. The fragmentation of international production has led to significant changes in the division of labor, both at the corporation and country levels. Such network segmentation has led to the emergence of global value chains (GVCs) of multinational enterprises. Global value chains represent an organizational model of the fragmented value creation process that is managed and controlled by the MNEs.

The GVCs characterize the organizational structure of modern networks of international production. Fragmentation of international production gives rise to profound structural changes in contemporary world trade. More and more countries and firms are beginning to specialize in the individual stages, links, value creation functions within individual GVCs, which defines the new specialization of these economic units in the world economy [Baldwin, & Lopez-Gonzalez, 2015].

The flagship MNE's global value chains are often collaborate and combine to perform certain functions or tasks. This is clear evident in the existence of so-called "strategic alliances" [Dunning, 1995]. Such alliances of MNEs create global network production system.

Depending upon the MNEs organizational models and the technological features of industries and products, two types of international production fragmentation process can be distinguished. Vertically integrated multinationals typically fragment the process of final product manufacturing based on the stepwise processing of raw materials, semi-finished products, intermediate products. Such vertically integrated value chains cases are given by the petrochemical, electronic, and electrical industries. Multinational enterprises organize international production systems in these sectors based on sequential technological operations [Baldwin, & Okubo, 2019]. Horizontally integrated MNEs and international firms with widely diversified production lines tend to build another model for fragmentation architecture. These network systems have considerably higher role of participants' specialization in functions involved in value creation or their competencies and unique assets.

## **Literature review**

The concept of fragmentation was pioneered by Jones & Kezkowski [1990]. Although these authors have not developed a formal theory, they have analysed a fragmentation model in which the various "production units" have been linked to the services sector [especially in the fields of transport, communications and information technology]. Further useful theoretical analysis has been provided by the research of Grossman & Rossi-Hansberg [2008], Antras & Helpman [2004]. Grossman & Rossi-Hansberg [2012] proposed the term "trade in task" which characterizes the division of production functions into individual fragments. They developed a model of fragmented production where each country performs one function in the production and sale of goods. As Koe and Jeng point out, "organizationally fragmented and spatially distributed production networks constitute a new form of economic structure for the modern global economy and its uneven developmental consequences" [Coe, & Yeung, 2015: p.1].

The term value chain was first mentioned by Porter in his book *Competitive Advantage: Creating and Sustaining Superior Performance* [Porter, 1985]. Any firm is not just a set of equipment, people, resources. It is based on the sequence and systematicity of certain stages of activity. Each stage creates its value, which is included in the total value of the product [services]. Such systematic and consistent activity, as Porter says, allows the company to create products and services that are focused to consumers. The Porter's value chain is a set of activities that firm takes to create value for its customers. This scientist has proposed a general model of such a chain, which includes the basic elements of typical business activities and the relationship between them [Rogach, 2018].

Porter notes that value chains in the same industry have the same structure, but the main competitors tend to have different features. Such distinction cover product differentiation, different types of semi-finished products, geographical location of production operations and distribution channels. Porter calls such difference as a "key source of competitive advantage" and the activity of value creation firms is the "discrete building blocks" of their competitive power [Porter, 1985].

The concept of "chain" reflects the vertical sequence of events that led to the supply, consumption and maintenance of goods and services. The main accent here is on the product approach. Changes in the comparative advantages of countries move individual fragments of production to other countries [Pla-Barber, Linares, & Ghauri, 2018].

GVCs can also be complex and cover individual fragments of different systems of international production. For example, if several flagship MNEs form a strategic alliance, their global product chains intersect and have joint participants. This can occur when producing related products, or different classes of the same product [Buckley, 2016].

Gereffi, Humphrey & Sturgeon [2005], Lee & Gereffi [2015] and their followers developed an institutional and managerial stream of international production fragmentation research. At the center of their analysis, these scientists put not the development of trade models on tasks, but the structure analysis of fragmented international production, the role of its participants and management in global value chains [Mayer, Phillips, & Posthuma, 2017].

Some theoretical publications in political economy of international production considers both production and exchange of intermediate goods and services in the global networks of MNEs. It integrates new approaches to the international trade theory ["the trade in task" theory] and the latest concepts of FDI [the network concept of MNE, the concept of global value chains]. Based on this, it explains the evolution of the international division of labor and the modern features of venture capital movement, as well as the exchange of goods and services. Such research approach underlies the evolution of international trade and the geographic relocation of industries from one country to another. It generates a distribution of separate, ever smaller functions, tasks between countries. Such distribution is carried out in the global value chains, organized and controlled by MNEs [Johnson, & Noguera, 2012].

As Buckley [2009] showed, the development of operating fragmentation as a key feature of the global value chains was accelerated by two interrelated processes. The first one is a rapid progress of technology, allowing the industry to divide GVCs into small, 'compact' links. The second one is that technological innovation 'squeezed' the distance separating the countries and improved the speed, efficiency and effectiveness of coordination of geographically dispersed production process.

The new paradigm of international trade examines the impact of foreign production [GVCs fragmentation] on the expansion of export-import flows. As Baldwin [2006] argues, that such fragmentation leads to a significant increase in trade of intermediate goods, which represents only separate tasks or functions of global production and marketing.

In the framework of the international business theory [or theories of multinational enterprises] the microeconomic approach predominates in research agenda. In the definition of global value chain, the focus is made on the distribution of tasks between the parties and the control of MNEs over this process. FDI and exports are regarded as complementary but alternative operations of MNEs. Brainard [1997], Helpman, Melitz & Rubinstein [2008] restore the traditional

methodological approach to FDI as a substitute for trade. These views are reflected in the theory of exchange of concentration on proximity developed by them [also known as – “proximity-concentration trade-off theory”]. FDI will reduce the production concentration of the parent company in home, but in return the company will be in proximity to the market of the host country. In handling export instead of FDI, the firm will increase the concentration of production in the home country but will lose proximity of the plant to the market of a foreign country. Under these conditions, higher transport costs and trade barriers and lower investment barriers and the economy of scale at factory level in comparison to corporate level will encourage the firms to choose FDI, not export.

Later Helpman, Melitz & Yeaple [2004] introduced an important new factor in this theoretical model – the heterogeneity of companies in terms of their productive capacity. They proved that firms differ significantly in terms of productive capacity and by this indicator are divided into a group of companies with low, medium and high productivity. Foreign operations are usually carried out by firms with high productivity. The most productive firms will serve the foreign market through FDI, and the least productive – through export from the home country. The empirical studies confirm that in sectors with greater heterogeneity of firms the share of high-productivity firms relative to low-productivity firms is much higher than in other sectors. In such sectors the share of firms that choose FDI rather than export will be higher than in other industries [Castellacci, 2011].

Although the economic literature mainly refers to the global nature of value chains or global production networks of MNEs, some scholars believe that these companies are oriented on the regional market of its country of origin. They don't diversify GVCs on the global markets, because the costs of monitoring and coordination of global operations don't cover the benefits of their implementation [Rugman, 2005]. Rugman & Verbeke [2005], Verbeke & Kano [2012] state that the majority of the 500 largest MNEs have not global but regional structure of their value chains. Thus, regionalization may be a result of two strategies – either serving a starting solution in process of internationalization of the firm or being an intermediate process on the way toward globalization [Rugman, & Chang, 2010].

Political economy studies of global value chains have revealed the fragmented international production effects on the structure of the economy, employment levels, trade balance, and the country well-being [Baldwin, 2006]. Some of these studies proves that fragmentation has the positive impact for all participating countries. However, some studies distinguish short-term and long-term positive effects and highlight the greater benefits for multinational's home country or other industrialized countries from global value chains. Baldwin & Robert-Nicoud [2007] have also explored the theoretical aspects of offshore trade between countries with different factors of production. An important issue has also been the study of benefits from fragmentation, especially between industrialized and developing countries.

### **Research findings**

In the last two decades, significant structural changes have taken place in the organization of multinational enterprise's global value chains. This applies to the dynamics, territorial proportions, and the complexity of the goods and services flows in such value structures, as well as a reverse relocation tendency of some production segments in the context of outsourcing [Rogach, 2019].

GVCs are dynamic and flexible systems. They are mobile enough. Ever since the product fragmentation went beyond national borders and became international 30-40 years ago, there has been a constant adjustment or restructuring of production networks in response to changing comparative advantages of countries, increasing political risks or developing new corporate cost-minimization strategies.

Production networks mobility and flexibility is one of the essential features of modern globalization. None of the countries can be sure of the constant "loyalty" of the MNEs to maintain separate production units [as its own or subcontracted outsourcing] on its territory for a long time.

Moving individual links in global chains from one country to another has become a common trend that is accelerated or slowed by many economic and political factors.

At the present stage of the world economy internationalization, there are two trends in the localization of MNEs global chains. The first trend indicates a slowdown of such networks growth in the last seven years, and the related trend characterizes the increase in the backward movement of certain international production fragments to the MNEs home countries.

After three decades of international production networks rapid territorial and sectoral expansion, the pace of this process has slowdown. This is evidenced by the rather low growth rate of sales, value added and employment of multinational firm's foreign affiliates in 2012-2017. In 2005-2010 sales of foreign affiliates grew by an average of 9,7% per year and affiliate's value added grew by an average of 10,7% per year. In 2012-2017 the average growth of these indicators was much less – 1,5% for both [UNCTAD, 2018].

There are several explanations for this trend. The technological fragmentation in many industries is already sufficiently developed [or even exhausted] and further fragmentation of the value chain does not give additional profit. Some industries, such as electronic, electrical, which were the first to embark on the path of fragmentation, have already reached considerable "maturity" in this process. In the future, it is only possible to move individual segments of production from one country to another, and not to extend the range of supply chain member countries altogether.

However, technological factors obviously have different effects on the dynamics of GVCs in different industrial sectors. There are still many industries that are far from the "maturity threshold" of the production tasks distribution. Other economic sectors [e.g. services] have further potential for segmentation of operations. It is likely that the slowdown in the growth of "mature industries" networked production will be offset by the greater fragmentation dynamics of other industries that later embarked on this path (biotechnology, pharmaceuticals, creative industries, etc.). The modern industrial revolution continues to reduce the communications, transportation and logistics cost, which contributes to the geographical dispersion of all new types of production.

The general economic factors of the world economy post-crisis development in the last 5-7 years have had a significant impact on the GVCs modern economic dynamics.

Low economic dynamics of most EU countries (in recent years even the traditional European locomotive – Germany) as well as the BRICS countries (including Brazil, China, Russia), increasing volatility and economic problems of emerging markets (Turkey, Argentina) and developing countries, have become one of the main factors in slowing down the global chain's expansion.

Brexit adds even more negative expectations to the potential of European MNEs to further increase global value chains. For UK multinationals and international firms in EU countries, entirely new tax, customs, and supply chain constraints are emerging, constraining new investment or even forcing plans to change established production networks.

The second trend in the GVCs development in the last decade has been a marked process of international production networks restructuring. Although, as we have noted, the modification of production chains is ongoing and is not a new phenomenon of MNE's activity, in recent years it has been felt especially clearly and is increasingly gaining ground. The major impact on such restructuring has a reshoring, that is, the return by multinational firms some fragmented processes back home. The relocation of individual production units reduces the quantitative indicators of GVCs growth.

The process of outsourcing is influenced by many factors, such as robotization and automation of manufacturing processes, digitization of the economy, the introduction of 3D printers, the relative equalization of labor costs, the reduction of energy resources in the United States, as well as the result of special fiscal, trading actions.

All models of "trade in task" and fragmentation of international production studied the foreign outsourcing development with the focus on certain key factors – the difference in the wages of workers and the reduction of transport costs. If these conditions exist, as theoretical studies have shown, some of its segments are transferred to locations with cheap labor [Grossman, & Rossi-

Hansberg, 2006]. The MNEs practice fully proved these theoretical findings during last three decades of progress in communications, transportation, a reduction in international management costs, and the involvement of new regions with very cheap labor. The multinational firms' strategies were aimed at relocating production to Asia or other countries with cheap factors of production.

But the Fourth industrial revolution, the robotization of production and new technologies for shale oil and gas in the US are changing these traditional trends of fragmentation.

For example, the shale revolution has already led to a fall in gas and electricity prices in the United States, where the cost of such energy has become lower than in other industrialized countries. The reduction in energy costs in the United States has led to a major restructuring of GVCs in many industrial sectors. The more cheaper energy resources are in the United States [the current level of prices is still not the limit of decline], the more this factor begins to determine the restructuring of global value chains.

There are two aspects of this impact. First, US MNEs compare their economies against cheap labor in China and other developing countries and the benefits of using cheap energy in the US. For a growing number of industrial sectors, this comparison is not in favour of Asian countries. If the fixed costs of production closure in one location and opening it in another location are not crucial or could be offset by low gas and electricity prices, multinationals decide to disinvest abroad and return to the US. There is a fundamental change in logistics, delivery directions and participants in subcontracts, that is, the entire architecture of the GVCs.

The industrial sectors feel different impact of low energy prices. Therefore, it is still difficult to assess whether this factor can completely neutralize the motive for using cheap labor and deprive Asian countries [China, India and others] of their traditional comparative advantages. But cheap labor benefits "destruction" has already begun and is happening with increasing force. In this case, it is possible to predict the negative effects for the expansion of GVCs.

Another aspect of low energy prices impact is the attractiveness for European and Asian MNEs to set US subsidiaries. On the contrary, it has positive effects for the expansion of the GVCs, as energy-intensive manufacturing segments of non-US firms are shifted to the US. This situation, for example, is very clearly observed in the non-ferrous metallurgy [especially the aluminium industry], the petrochemical industry and even in the pharmaceutical sector. In the last ten years, almost all leading non-US multinationals in these industries have decided to open their US subsidiaries motivated by cheap electricity or gas. This is an important factor of their modern competitive strategy.

As already mentioned, robotization and automation also cause the return of assembly industries to post-industrialized countries, especially in the automotive and engineering industries. In recent years, a new industrial revolution has significantly reduced labor costs even in the apparel and footwear industries. US technology leadership in many industrial sectors encourages foreign firms to open branches in scientific and industrial agglomerations. Broetje-Automation (Germany) plans to open aerospace manufacturing robotics facility at Elk Grove Technopark in 2019, and Saab AB (Sweden) will set its military aircraft spare parts facility by 2021. These decisions were motivated by scientific cooperation with the US universities and the introduction of 3D printing into production [Lee, 2019]. In order to bring its production closer to R&D centers and consumers, Danish pharmaceutical MNE Novo Nordisk has decided to acquire an American manufacturer of diabetic drugs in North Carolina in August 2019 [Novo Nordisk, 2019].

Another important factor in the restructuring of the GVCs is the fiscal mechanisms implemented in the US by the Trump administration, including tax reform. But the short- and long-term effects of such measures differ significantly.

US tax reform has had a rather complex multi-vector effect on the dynamics of global FDI. This effect related to accumulated value of foreign direct investment as well as the volume of annual outflows and inflows. In anticipation of the tax reform multinational US firms have accumulated huge resources of retained earnings in their foreign accounts, including offshore jurisdictions [Curcuro, & Thomas, 2014]. According to the U.S. Bureau of Economic Analysis [U.S.BEA], since 2010 the annual repatriation of US MNEs income from abroad has not exceeded \$

150 billion a year. During the same period, their retained earnings rose rapidly from \$ 1.5 trillion to \$ 3.2 trillion in 2016, including \$ 2 trillion in cash on their foreign accounts [UNCTAD, 2018]. US tax law allowed it to do and receive tax deferrals.

The US Tax Cuts and Jobs Act (TCJA) 2017 also focuses to encourage companies to stay in the US in two ways: (1) by reducing the corporate tax rate from 35 to 21 percent and (2) by applying a territorial tax system.

One of the goals of US tax reform was to encourage US multinationals to bring their profits back home, while slowing down repatriation of profits from affiliates of non-US MNEs located here. Changing the US investment climate in corporate tax liberalization has started a new wave of tax competition between countries. The previous "foreign earnings liberalization" was used by the United States in 2005 when it generated a huge wave of inflow (US \$ 300 billion) in deferred US foreign earnings to this country.

According to the US Bureau of Economic Analysis, the 2017 Tax Cuts and Jobs Act [TCJA] resulted in the repatriation of \$ 142 billion profit from US foreign affiliate to their parent companies in 2018. Because US investment position statistics reflect such a negative revenue repatriation, even without hindering new US FDI to acquire \$ 83 billion in equity abroad, the country's net investment position this year was negative at \$ 58 billion [Nguyen, & Whitaker, 2019]. The decline in foreign assets of US firms in 2018 was due both to a decrease in the value of portfolio investment and to foreign direct investment. If at the end of 2017 the FDI of US firms at market value was \$ 8.9 trillion, then at the end of 2018 they decreased by \$ 1.4 billion to \$ 7.5 trillion. This decrease in FDI may also be related to the US MNEs disinvestment and repatriation of their capital to the US [Nguyen, & Whitaker, 2019].

Finally, another important factors in the dynamics and restructuring of the multinational enterprises network production are the geopolitical risks and political uncertainty. Political factors and risks have always been significantly correlated with FDI flows [Schneider, & Frey, 1985]. For example, the wave of MNE's assets nationalization in developing countries in the 1960s significantly changed the direction and volume of FDI.

A series of political developments in recent years, such as Brexit, economic sanctions against Russia, and the US government's rejection of several key international agreements have greatly increased the level of political uncertainty. Increasing economic nationalism, the threat of trade wars and the introduction of customs barriers have worsened the global investment climate. Surveys of multinational enterprise executives indicate that political uncertainty and geopolitical risks are one of the major obstacles to MNEs investment plans [Liu, 2019].

The trade war between the US and the China has had a particularly significant impact on the current global value chains rebuilding. The intensification of trade disputes has forced many firms to postpone investment decisions to expand export subsidiaries in China. This has led to uncertainty for MNEs about the profitability of their operations in the future and the benefits of geographical manufacturing fragmentation and outsourcing networks in low-cost countries. This was evidenced by the significant slowdown of new global value chains growth. Multinational firms that create supply chains to minimize costs are particularly vulnerable to such risks of uncertainty. For the first time in decades, there has been a fear of relocating some of their foreign units to avoid possible trading tariffs [Ayhan, 2019]. In such circumstances, an increase in foreign direct investment seems a very risky business.

If the most pessimistic trade war scenarios are deployed, one can expect an extremely strong effect of these events on the territorial and functional structure of the global MNEs chains. China declared in late August 2019 the introduction of a new 5-10% duty on \$ 75 billion of US goods, and in response, President Trump announced his intention to increase the already imposed duties on Chinese goods in the amount of \$ 250 billion from 10 to 15%, and additionally make a new round of increase in customs duties from 25% to 30% for another \$ 300 billion commodity group from October 1, 2019 [The Financial Times, 2019].

According to many experts, the initiation of 30% duty on exports to the US will make it impossible to have many logistics schemes for supplying multinational firms from China. In

combination with other factors of the technological revolution mentioned earlier, this will lead to the largest restructuring of the GVCs in 40 years.

Consequently, as a result of technological, economic and financial factors, US reshoring is gaining ground. According to the Reshoring Initiative, in 2015, for the first time in 45 years, the balance of relocation from the US (offshoring) and return to the US (reshoring) of enterprises in terms of created [lost] jobs was achieved, and the following year a positive balance of these processes was observed in the direction creating additional employment. According to this organization, if in the early 2010s, due to the transfer of multinational enterprises abroad, the US lost about 220 thousand jobs annually, then in 2016, for the first time, the overall result (offshoring + reshoring) was positive – 30 thousand new jobs. The next two years highlighted a unique situation for 50 years – such a net positive balance of new jobs reached at least 135 thousand a year. In 2018 1,389 companies announced their intention to return 145,000 jobs to the United States. [Reshoring Initiative, 2019 b].

It should be noted that these data include both plans for US MNEs headquarters to "bring production back home" and foreign direct investment by non-US firms that were accompanied by the transfer of their existing overseas production facilities to this country. In the latter case, such action by the MNEs is not a reshoring, since it means that a foreign firm is simply restructuring its GVCs. For example, Swiss pharmaceutical companies have manufactured components of their medicines in the UK or India, and now their production is being shifted to the United States, where energy costs or process automation make them more profitable. For the US this is inward FDI of Swiss MNE but not a reshoring.

GVCs transformation has led to decrease the share of foreign value added in world exports. In the previous twenty years the proportions of domestic and foreign value added in world exports have steadily changed in favour of the latter, then after the global financial crisis of 2008-2009 such a structural trend is no longer observed. The share of foreign value added in world exports stabilized at 30%. The coming years will show whether this is only a temporary stay, or a sign of more structural changes related to changes in the country's economic policies and new MNEs strategies.

An important political economy aspect of GVCs architecture is the territorial value creation proportions between groups of industrialized and developing countries. The data indicate a significant increase share of underdeveloped economies. However, there are discussions about the duration of this effect and the balance of benefits that countries get from international production fragmentation [Raei, Ignatenko, & Mircheva, 2019]. For example, Porter & Kramer [2019] argues that multinational enterprises should fundamentally revise their strategy of building GVCs in order to better address the needs of underdeveloped countries.

Most proponents of fragmentation theory believe that this process opens more opportunities niche specialization for countries that have advantages in producing individual segments but have not yet acquired competitiveness in the production of others. In this case, the total cost of performing individual tasks in different low-cost production units will be lower than the total cost of integrated [combined] production in one place. Some scholars argue that the benefits from participation in fragmented international production are approximately balanced between all participants. The high flexibility of GVCs and the mobility of production segments reinforce the trend of wage equalization for workers of the same skill level in different countries. This will facilitate the efficient allocation of resources and the equalization of social standards of rich and poor countries [Mankiw, & Swagel, 2006].

Buckley & Ghauri [2004] believe that MNEs are becoming a "global factories". Such global factories will allow to produce goods and services in any country where there is a demand for them, and to avoid long distances transportation of final products. In this context, as these authors emphasize, it is important to determine the determinants of global networks spatial dispersion. This is also important for shaping the economic policies of the host countries. The worst-case scenario for a global factory is to continue concentrating wealth in post-industrial countries and further lagging the poorer regions that will occupy the niche of low value industrial

floors. Fixing high-tech, knowledge-based, high-skilled workforce in developed countries and outsourcing standardized parts and semi-finished products in poor developing countries can capture the trends of the above scenario.

Starting with the early fragmentation models, their authors argue that the process will result in a regrouping of production models between countries. Structural shifts in industry and technological potential will occur in both the country with excess capital and the country with cheap labor. For the country of origin, MNEs fragmentation will lead to technological progress in the capital-intensive sector of the economy. Contrary to expectations, such a country does not experience a fall in the wages of unskilled workers [Strange, & Zucchella, 2017].

Another evidence of the GVCs transformation is the increasing emphasis on high-tech flows of goods and services, the creation of network knowledge and competences, the internationalization of the innovative activities of the branches. The creation of intangible assets is the primary goal of an increasing number of international MNEs production systems. The growth rate of royalties and license fee has averaged 5% over the past five years, three times higher than traditional GVCs dynamics – affiliates sales and value-added growth. [UNCTAD, 2018]. Given that the multinational firm's knowledge creation internationalization is rapidly growing, such a transformation of the GVCs will be observed more clearly in the coming years.

### **Conclusion**

The key feature of a new system of international production by MNEs is a dynamic development of global value chains. According to the degree of geographical coverage of the countries, the value chains can include several neighbouring countries, be regional or global. These value chains of MNEs are in permanent transformation, which covers not only the functional segments of the production structure, but also its geographic dispersion. This determines an important geographical configuration trend of the international production – the emergence of new factors and determinants of its localization.

Thus, the process of global value chains restructuring reflects the contradictory nature of many factors. After a long period of dynamic growth, such MNE's network production systems have slowed down their expansion significantly. The Fourth Industrial Revolution, on the one hand, will continue to reduce economic distance between countries, transport and communication costs of companies, and open new technological possibilities for fragmentation of production processes. This will stimulate further international production mobility and the emergence of new GVCs. On the other hand, a new industrial revolution generates factors that counteract the shifting of production from industrialized countries to low-cost countries or even cause return many manufacturing processes from offshore outsourcing areas. The correlation of such forces of "ejection" and "retraction" will obviously be different at certain stages of the world economy digitalization and the deployment of new robotic production platforms. It will determine the future dynamics of expansion [or possibly even contraction] and restructuring of MNEs global value chains.

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## **CURRENT STATE AND PROSPECTS FOR THE DEVELOPMENT OF THE NORTH AMERICAN FREE TRADE AREA**

## **СУЧАСНИЙ СТАН ТА ПЕРСПЕКТИВИ РОЗВИТКУ ПІВНІЧНОАМЕРИКАНСЬКОЇ ЗОНИ ВІЛЬНОЇ ТОРГІВЛІ**

## **СОВРЕМЕННОЕ СОСТОЯНИЕ И ПЕРСПЕКТИВЫ РАЗВИТИЯ СЕВЕРОАМЕРИКАНСКОЙ ЗОНЫ СВОБОДНОЙ ТОРГОВЛИ**

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**Abstract.** *This research aims to analyze current economic state of the North American Free Trade Area and to identify possible prospects for its development. The article explores the prerequisites for the formation of NAFTA, reasons for revising the agreement and compares the*

*differences between the previous and updated agreements, an impact of integration association on the socio-economic status, trade and investment activity of the participating countries, prospects for its development and analysis of its economic cooperation with Ukraine. The empirical analysis shows a significant relationship between the U.S. GDP and foreign trade with Mexico and Canada, unemployment and interest rates. Its results revealed that the U.S. trade with Canada had a positive impact on the U.S. GDP; at the same time the U.S. trade with Mexico had a negative impact on the U.S. GDP, which became the main argument for President Trump in his pressure on Mexico to revise the terms of the NAFTA agreement. The regression analysis also showed that there is an inverse relationship between GDP and interest rate in the United States from 1994 to 2018.*

*It was determined that the United States-Mexico-Canada Agreement (USMCA) is not fundamentally different from the previous one, but it can create new opportunities, for example, for workers and farmers in the United States, and new difficulties for Canada and Mexico. This agreement tightens labor standards and protection of intellectual property rights, especially in Mexico, thus, probably decreasing the attractiveness of Mexican economy to foreign investors, that is likely to reduce the U.S. investment in Mexico. Thus, Canada and Mexico are expected to receive less benefit from the USMCA for their economies than the United States.*

**Key words:** *NAFTA, USMCA, Free Trade Area, United States, Canada, Mexico, trade and investment flows*

**Анотація.** *Метою даного дослідження є аналіз сучасного економічного стану Північноамериканської зони вільної торгівлі та визначення можливих перспектив її розвитку. У статті досліджено передумови формування НАФТА, причини перегляду угоди та порівняння відмінностей між попередніми та оновленими угодами, вплив інтеграційної асоціації на соціально-економічний стан, торговельну та інвестиційну діяльність країн-учасниць, перспективи її розвитку та аналіз економічного співробітництва з Україною. Емпіричний аналіз показав значну залежність між ВВП США та зовнішньою торгівлею з Мексикою та Канадою, безробіттям та процентними ставками. Його результати показали, що торгівля США з Канадою позитивно вплинула на ВВП США; в той же час торгівля США з Мексикою негативно вплинула на ВВП США, що стало головним аргументом для президента Трампа в його тиску на Мексику щодо перегляду умов угоди НАФТА. Регресійний аналіз також показав, що існує зворотний зв'язок між ВВП та процентною ставкою в США з 1994 по 2018 рік. Було визначено, що Угода США - Мексика - Канада (ЮСМКА) принципово не відрізняється від попередньої, але вона може створити нові можливості, наприклад, для робітників і фермерів у США, а також нові труднощі для Канади та Мексики. Ця угода посилює стандарти праці та захист прав інтелектуальної власності, особливо в Мексиці, що, ймовірно, знижуватиме привабливість мексиканської економіки для іноземних інвесторів, що, скоріше за все, зменшить американські інвестиції в Мексику. Таким чином, для Канади та Мексики очікується, що вони отримають меншу вигоду від ЮСМКА для своєї економіки, ніж Сполучені Штати.*

**Ключові слова:** *НАФТА, ЮСМКА, зона вільної торгівлі, США, Канада, Мексика, торгівлі та інвестиційні потоки*

**Аннотация.** *Целью данного исследования является анализ текущего экономического состояния Североамериканской зоны свободной торговли и выявление возможных перспектив ее развития. В статье исследуется теория международной экономической интеграции, предпосылки для формирования НАФТА, причины пересмотра соглашения и сопоставления различий между предыдущими и обновленными соглашениями, влияние интеграционного объединения на социально-экономическое состояние, торговую и инвестиционную деятельность стран-участниц, перспективы его развития и анализ экономического сотрудничества с Украиной. Эмпирический анализ показал значительную зависимость между ВВП США и внешней торговлей с Мексикой и Канадой, безработицей и процентными ставками. Его результаты показали, что торговля США с Канадой*

*положительно повлияла на ВВП США; в то же время торговля США с Мексикой оказала негативное влияние на ВВП США, что стало главным аргументом для президента Трампа в его давления на Мексику по пересмотру условий соглашения НАФТА. Регрессионный анализ также показал, что существует обратная связь между ВВП и процентной ставке в США с 1994 по 2018 год. Было определено, что соглашение США - Мексика - Канада (ЮСМКА) принципиально не отличается от предыдущего, но оно может создать новые возможности, например, для рабочих и фермеров в США, а также новые трудности для Канады и Мексики. Это соглашение усиливает стандарты труда и защиты прав интеллектуальной собственности, особенно в Мексике, что, вероятно, будет снижать привлекательность мексиканской экономики для иностранных инвесторов, что, скорее всего, уменьшит американские инвестиции в Мексику. Таким образом, для Канады и Мексики ожидается, что они получат меньшую выгоду от ЮСМКА для своей экономики, чем Соединенные Штаты.*

**Ключевые слова:** *НАФТА, ЮСМКА, зона свободной торговли, США, Канада, Мексика, торговые и инвестиционные потоки.*

**Introduction.** The United States – Mexico – Canada Agreement (USMCA) is an updated comprehensive trade agreement between Canada, the United States and Mexico. The USMCA is the largest regional free trade area in the world, with a population of nearly 500 million people and an aggregate GDP of around \$24 trillion, equal to around 27% of world GDP. NAFTA – a preliminary agreement of the countries – became the first agreement in the world that linked through economic relations three countries of North America. It was also unusual in a global dimension because it was the first time that a free trade area linked two rich, developed countries with a low-income, developing country. The USMCA has high competitiveness, which has already been reached in the previous agreement, and also strengthens the positions of the participating countries individually, enabling them to produce goods and services that meet the needs of the world market, while increasing the incomes of their citizens, which is also indicative of ability to withstand competition in international trade. As the USMCA is one of the largest economic blocs in the world, there is a need to analyze the processes and changes that occur within it. Therefore, the topic of scientific work is relevant, because at this moment within this economic union historical change is taking place, which can affect not only economies of member countries, but also the state of the world economy as a whole.

**Recent literature review.** The free trade area (FTA) is the simplest stage of regional integration, which implies the elimination of tariffs and non-tariff barriers between member countries in order to increase mutual trade. Prerequisites are a similar level of economic development, the geographical proximity of countries, and a high level of interdependence. The benefits of an FTA are increased price competitiveness; productivity increase; increase in investment; promoting economic and political reform. Among the disadvantages should be highlighted: an increase in outsourcing; intellectual property theft; displacement of domestic industry; depletion of natural resources in developing countries.

It should be noted that for Mexico, the FTA with the United States became a way to capture the results of its market-opening reforms of the mid-1980s [M. Villarreal, 2017: 14]. The United States and Canada gained more access to the rapidly growing Mexican market. J. McBride and W. Tyner in their works paid special attention to the analysis of the influence of NAFTA on the economies of the participating countries [J. McBride, 2016: 3; W. Tyner, 2018: 16]. The authors noted overall GDP growth and job support, especially those that depend on trade. The theme of the difference between NAFTA and the updated agreement USMCA was revealed in work by R. Wolfe [R. Wolfe, 2018: 3]. The most significant differences are concentrated in the automotive sector.

In Ukraine the impact of regional integration on the development of national economies is studied in the scientific works of O. Rogach, T. Rodionova, O. Shnyrkov, S. Yakubovskiy [O. Rogach, 2019, 2020; T. Rodionova, 2019; O. Shnyrkov, 2019; S. Yakubovskiy, 2019]. Above

mentioned articles study the prospects for the development of integration unions as well as its member states in the context of globalized world. However, the new realities of changing global economic environment require further exploration of this issue.

**The purpose of research** is to conduct an economic analysis of the current state of the North American Free Trade Area and to identify possible prospects for its development.

**The main results of the research.** The dynamics of the main macroeconomic indicators of the NAFTA member countries is studied to identify the impact of their participation in the trading bloc on their economic development. The GDP of all USMCA countries is steadily increasing from 1998 to 2018. Analyzing the data, it should be noted that NAFTA gave a powerful impetus to the economic development of the countries. Over the past twenty years, GDP growth in the United States was U.S. – 102%, in Canada – 135%, in Mexico – 72%. According to the World Bank, in 2018, the United States ranked first in the world in GDP, Canada ranked 10th, Mexico ranked 15th [The World Bank, 2020]. As of 2019, in all three countries there was an increase in GDP: up to \$21.4 trillion in the United States, in Canada – up to \$1.73 trillion, in Mexico – up to \$1.22 trillion [IMF, 2020].

GDP per capita in the United States is also growing steadily. In 2018, it was \$ 62.8 thousand, which is almost twice as high as in 1998. Thus, the U.S. ranks among the high-income countries and ranks 12th in the world in GDP per capita. Canada has also seen a per capita GDP growth in the last twenty years. It can be noticed that in the period from 2008 to 2018 it was not as significant as in the previous ten years, but in 2018 it amounted to \$ 46.3 thousand, which is 2.2 times more than in 1998. Canada, like the United States, is ranked among the high-income countries and ranked 24th in the GDP per capita ranking. In Mexico, per capita GDP growth is around 86% over the period 1998-2008, but in the next decade the growth rate has not been so significant. In 2018, it was \$10.1 thousand. In 2019, per capita GDP growth occurred only in the U.S. and Mexico – up to \$65.1 thousand and \$10.1 thousand in accordance. In Canada, there was a slight decrease to \$46.21 [IMF, 2020].

The dynamics of the U.S. unemployment rate in 1998-2018 tended to fluctuate. In 2008, the figure rose to 5.8%, driven by the global financial crisis that led to the collapse of the labor market. In 2018, the U.S. unemployment rate has dropped to 3.7%, reflecting improved labor market conditions and an overall strengthening of the economy. Canada's unemployment rates have been steadily declining over the past twenty years and are generally quite low. In 2018, unemployment dropped to 6.11%, almost 2% less than in 1998. This indicates the effectiveness of the government's policy of increasing employment in the country. The unemployment rate in Mexico, as in the United States, has tended to fluctuate slightly over the past twenty years. In 2018, the figure was 3.49%, which is the natural unemployment rate in the country. As of 2019, unemployment has continued to decline: in the United States – up to 3.72%, in Canada – up to 5.7%, in Mexico – 3.44% [IMF, 2020].

Thus, the analysis of the data showed that NAFTA for 1998-2018 gave impetus for the sustainable economic development of all three countries, which continues in 2019, as evidenced by the improvement of the dynamics of the main macroeconomic indicators of the countries for the whole studied period.

The United States and Canada have the most comprehensive and closest trade links in the world, supporting millions of jobs in both countries. As the main exporter of Canadian goods and services is the U.S. market, foreign economic relations with the United States are essential for Canada. In turn, American trade with Canada and Mexico substantially supports jobs throughout the country, especially in California, Texas and most of the eastern states of America [Business Roundtable, 2020]. During its existence, NAFTA has stimulated significant productivity gains in the Canadian economy and facilitated its expansion and increased competitiveness.

Over the past 20 years, from 1998 to 2018, the U.S. exports to Canada have increased by \$95 billion. According to the World Integrated Trade Solution (WITS), in 1998 its structure was dominated by goods such as consumer goods, vehicles, manufacturing products, semi-finished products, electronics and wood [World Integrated Trade Solution (WITS), 2020]. In 2018, the

structure of exports changed, the top exported goods included consumer goods, fuel, semi-finished products, as well as vehicles.

The U.S. imports from Canada shrank by \$70 billion compared to 2008, but overall, over the past 20 years, the numbers increased. This situation could be caused by a significant increase in U.S. imports from Mexico in 2018. In 2018, the U.S. imports from Canada totaled nearly \$270 billion, up \$96 billion from 1998. In 1998, Canada exported to the United States production facilities, consumer goods, semi-finished products, raw materials, and livestock products [WITS, 2020]. In 2018, the structure of imports includes manufacturing products, consumer goods, vehicles, electronics, and semi-finished products. Two other important items of import are fuel and raw materials, as Canada is the largest energy supplier to the United States. Canada ranks third in the world behind oil reserves after Saudi Arabia and Venezuela and is the only member of the five non-OPEC leaders. And uranium produced in Canada is part of the fuel for the U.S. nuclear power plants. Overall, U.S. exports and imports from Canada have not undergone dramatic changes in 20 years.

The United States is Mexico's largest trading partner, and Mexico is the second largest export market of the United States (after Canada) and the third largest trading partner (after Canada and China). The U.S. trade with Mexico has increased at a faster rate than with Canada. Over the last 20 years, exports between the U.S. and Mexico have grown by \$143 billion and imports by more than \$195 billion. In 1998, U.S. exports were dominated by consumer goods, electronics, manufacturing, transportation, as well as raw materials and fuel, according to the World Integrated Trade Solution [WITS, 2020]. In 2018, the U.S. exported manufacturing, electronics, consumer goods, vehicles and semi-finished products to Mexico. The structure of U.S. imports from Mexico in 1998 included manufacturing, electronics, semi-finished products, transportation, as well as plastics and rubber. In 2018, the structure has changed a bit – raw materials, livestock products and chemicals have joined the semi-finished products and production facilities. The U.S.-Canada trade balance with Mexico remains negative, moreover, in 2018, compared to 2008, the deficit between the U.S. and Canada is decreasing, while between the U.S. and Mexico it is growing.

International transactions in services are a major component of the current account of the balance of international payments. The United States is the largest exporter of services in the world. According to the Bureau of Economic Analysis, from 1999 to 2018, exports and imports of services between the U.S. and its USMCA partners have increased. During this period, exports of the U.S. services to Canada increased 2.5 times and to Mexico – 2.4 times. Imports from both countries increased almost twice during the same period. Thus, it can be concluded that exports of services from the U.S. to Mexico grew at a higher rate than to Canada. The structure of U.S. exports in 1999 was dominated by travel related services, intellectual property costs, transportation, and business and financial services [Bureau of Economic Analysis (BEA), 2020]. In 2008, the structure remained almost unchanged: first place was occupied by tourist services, second place - costs for the use of intellectual property, then business and transport services. In 2018, the share of business services in the export structure increased.

There were also no changes in the structure of imported the U.S. services. The leading position in 1999 was occupied by tourist services. According to the Bureau of Economic Analysis, in 2018, the main imported services were travel services, business, transportation services, and fees for the use of intellectual property [BEA, 2020]. The balance of the U.S. services with the USMCA member countries from 1999 to 2018 is positive. Canada and Mexico's international trade in services has also become closer. Over the past 20 years, exports have increased by \$1.15 billion, and imports have increased by \$2.6 billion. However, over the last 20 years, the countries have a negative balance of services, which is growing and amounted to \$2.295 billion in 2018.

Since NAFTA was signed, bilateral investment volumes have grown significantly, both in terms of stocks and investment flows. The United States is Canada's largest foreign investor. Countries have some of the largest and most comprehensive investment relationships in the world. American investors are attracted to Canada's strong economic strengths, close to the U.S. market, highly skilled workforce and abundant resources. The United States accounts for more than 50

percent of Canada's total foreign direct investment. According to the U.S. Bureau of Economic Analysis, since 1998, the amount of direct investment in Canada has increased by \$303 billion. In 1998, the U.S. investors invested their capital in Canada mainly in the production of oil and chemicals, transportation equipment, food, as well as in the financial, insurance and real estate sectors. In 2018, the most invested areas in Canada were the extraction of minerals, in particular metals, the production of transport equipment, chemicals, food, as well as holding and financial companies. Over the past twenty years, the U.S. investment in Mexico has increased by \$88 billion. In 2018, Mexico has received \$114.8 billion from the United States. Mainly, the production of vehicles, food and chemicals, trade, financing and insurance was invested this year [BEA, 2020].

According to the Bureau of Economic Analysis, total foreign direct investment in the United States increased to \$4.34 trillion in 2018 compared to \$4.03 trillion in 2017 [BEA, 2020]. Canada ranked in the top three in terms of investment in the United States in 2018, after Europe, Asia and the Pacific. Over the past twenty years, Canadian direct investment to the United States has grown by more than \$380 billion. In 1998, Canadian invested in the production of computers and electronic products, real estate, financial sector and insurance. In 2018, Canada's direct investment was primarily focused on the financial sector and insurance, wholesale and retail, real estate, and chemical industry. Thus, it can be concluded that NAFTA has created a favorable investment climate in both countries over the years, which has increased investor confidence. In 2018, Mexico's direct investments in the U.S. totaled \$18.7 billion, almost eight times more than in 1998. According to the Bureau of Economic Analysis of the United States, in 1998, Mexico invested in the United States in food production, depository institutions, and wholesale. In 2018, it was invested in food production, chemicals and metalworking, trade and real estate.

The United States is one of Ukraine's major trading partners. In 2018, bilateral trade amounted to about \$ 4.07 billion, but the trade balance between countries remains negative. In 2018, Ukrainian exports to the U.S. totaled \$ 1.1 billion; up nearly \$ 283 million more than in the previous year. This was mainly due to the increase in exports of ferrous metal products, electric machines and some food products. Overall, U.S. exports tended to fluctuate between 2013 and 2018, but since 2017 they have increased nearly 1.4 times compared to 2018. In the structure of Ukrainian exports in 2018, ferrous metals occupy a significant share (mainly cast iron) - about 63%, ferrous metal products – 12.2%, electric machines – 4.2%, as well as sunflowers and soybeans [State Statistics Service of Ukraine, 2020].

Trade relations between Ukraine and Canada in 2018 received a positive trend towards an increase in bilateral trade. Exports to Canada from 2013 to 2018 also tended to fluctuate. Since 2017, Ukrainian exports began to increase, which is the result of the free trade agreement between Ukraine and Canada, which was signed over a year ago. In 2018, exports totaled \$ 74.1 million, 1.5 times more than the previous year. This was due to increased exports of ferrous metals, copper, some food and furniture. Exports in 2018 are dominated by ferrous metals – 27.5%, copper and copper products – 18.6%, as well as tannins, nuclear reactors and boilers and vegetable processing products [State Statistics Service of Ukraine, 2020].

Mexico is one of the main trading partners of Ukraine in Latin America. In 2018, exports grew to \$ 155.5 million, almost 20% more than in 2017, due to increased exports of seeds and fruits of oilseeds, ores, slag and ash, as well as tobacco. Ferrous metals account for the largest share in the export structure, 27%, cereals 21.7%, ores and slag 14.7%, as well as oilseeds and products of the flour and cereals industry [State Statistics Service of Ukraine, 2020].

In 2018, Ukrainian imports from the United States rose to \$2.96 billion, which is almost \$438 million more than in the previous year. Overall, in 2018, Ukraine imported from the United States such goods as mineral fuels, oil and its distillation products - 32.1%, vehicles and electric machinery - 18%, as well as nuclear reactors and auto parts. Imports from Canada have also been increasing since 2015. In 2018, it was \$333.1 billion, which is almost 60% more than in 2015. Imports in 2018 were dominated by mineral fuels, petroleum and distillation products – 49.2%, fish and crustaceans – 10%, pharmaceuticals – 7.4%, land vehicles – 6.6%, and nuclear reactors – 6.2%. Imports of goods from Mexico have been steadily increasing since 2016, but their volumes remain

small compared to Canada and the United States. In 2018, it was 169.7 million, up 32.6 million from the previous year. Imports in 2018 are dominated by goods such as vehicles – 29%, electric cars – 16.7%, nuclear reactors and boilers – 14.9%, alcoholic and non-alcoholic beverages and vinegar – 9.4%, and pharmaceuticals production – 4.9%. The amount of Ukrainian exports of services to the United States has been moderately increasing since 2016, reaching \$ 947.8 million in 2018, which is almost \$ 100 million more than in the previous year. Exports to the U.S. in 2018 are dominated by telecommunications services, computer and information services – 64.9%, transportation services – 17.4%, business and financial services – 12%. Exports to Canada in 2018 were down \$ 5.8 million from the previous year, but the balance of services is positive. This year the export structure was dominated by: telecommunications, computer and information services 66.5%, transport services – 17.9%, business services – 11.4% and tourist services – 2.4% . The amount of Ukrainian exports to Mexico has increased slightly to \$ 0.283 million in 2018. The structure of exports is as follows: tourist services – 31.7%, transport services – 13.6%, telecommunications services, computer and information services – 11.7%, business services – 10% [State Statistics Service of Ukraine, 2020].

The amount of Ukrainian imports from the U.S. in 2018 declined substantially to \$ 234.4 million, which is almost 3 times less than in the previous year. Imports from the United States are dominated by: business services – 28.4%, financial services – 24.4%, telecommunications services, computer and information services – 13.6%, royalties and other related services using intellectual property – 12.2% and transportation services – 11.2%. Services imports from Canada have fallen significantly in 2018, almost 5 times. The structure of imports is as follows: business services – 39.7%, transport services – 21.9%, royalties and other services related to the use of intellectual property – 11.1%, telecommunications, computer and information services – 8.7% and tourist services – 5.9%. Imports of services from Mexico in 2018 have almost tripled compared to the previous year and amount to \$ 2.1 million, mainly due to an increase in imports of tourist services. The structure of imports in 2018 includes: tourist services – 43.4%, business services – 28.2% and transport services – 3.2%.

The volume of direct investments from the U.S. into the Ukrainian economy in the period from 2013 to 2018 is steadily decreasing. In 2018, the volume was \$ 517.4 million; almost twice less than in 2013 and \$ 67.8 million less than in 2017. This tendency may be explained by the lack of real investment instruments and mechanisms for attracting investments in Ukraine, as well as by increasing competition for obtaining investments from other developing countries. On the contrary, the volume of direct investments from Canada to Ukraine has increased. In 2018, they totaled \$ 49.7 million, up \$ 8.6 million from the previous year. This situation is a consequence of the signing of the Free Trade Agreement between the countries and further deepening of relations. All this has led to increased activity of both large and small companies, and therefore increased investment inflows. In 2018 countries have invested in economic activities such as industry (mainly processing), wholesale and retail trade, financial and insurance activities, and real estate transactions in the Ukrainian economy [State Statistics Service of Ukraine, 2020].

Foreign direct investment from Ukraine to the United States from 2013 to 2017 tended to decline, but in 2018 it increased to \$ 0.6 million. In 2018, Ukraine invested mainly in professional, scientific and technical activities, which accounted for 94.7% of the total investment [State Statistics Service of Ukraine, 2020]. Thus, it can be concluded that the bilateral trade relations between Ukraine and the USMCA member states for the period 2013-2018 have improved and continue to deepen.

The revised Free Trade Agreement in North America is expected to have a major impact on the U.S. economy. In the industrial and energy sectors, it is expected that USMCA will have a particular impact on the automotive industry. According to the United States Commission on International Trade, provisions relating to other sectors of industrial goods, including chemicals and pharmaceuticals, electronic, energy products, textiles and clothing, will not have a significant impact on the economy as a whole [30]. Since the USMCA provides duty-free access for cars, 75% of the content of which comes from the three participating countries, this will lead to an increase in

the production of automotive parts in the United States. These changes will lead to an increase in the employment rate of people working in the automotive sector. At the same time, prices for passenger vehicles and cars will rise in the United States, which will lead to a decrease in their consumption. It is expected that the USMCA will have a positive impact on the U.S. agricultural sector. The combined impact of all USMCA provisions could increase U.S. annual total exports of agricultural and food products by \$ 2.2 billion. (1.1%) [United States International Trade Commission, 2019]. It can be noted that a large number of USMCA provisions on trade in services will not have a significant impact on the production and trade of services in the participating countries. Analyzing the impact of the USMCA on the investment activities of member countries, it can be noted that investment relations between the United States and Canada are not subject to significant changes. However, U.S. investment to Mexico is expected to decline in all areas except five economic sectors, which are allowed to use the rules of the dispute resolution process between investors and the state (oil and gas, electricity, telecommunications, transportation services and some infrastructures). The development of the American coal industry is estimated to increase due to the increase in capital released in Mexico. On the issue of labor, it is expected that the USMCA will lead to higher wages and better working conditions. The Commission suggests an increase in the salaries of Mexicans by 17.2%. This situation will have a moderate impact on the U.S. economy. Thus, the USMCA will stimulate economic growth and create more jobs for American workers. The U.S. GDP may increase by \$68.2 billion and will give about 176 thousand jobs. U.S. exports to Canada and Mexico will increase by 5.9% and 6.7%, respectively. U.S. imports from Canada and Mexico will increase by 4.8% and 3.8%, respectively [United States International Trade Commission, 2019].

**Empirical results.** In order to assess the importance of foreign trade for the United States in the framework of NAFTA the following linear regression model (OLS) is constructed.

Dependent variable: GDP (the U.S. GDP, billion U.S. dollars). The vector of independent variables: TrC – the United States-Canada trade balance, billion U.S. dollars; TrM – the United States-Mexico trade balance, billion U.S. dollars; Unemp – the U.S. unemployment rate, %; IntR – the U.S. interest rate, %.

The model of OLS regression is:

$$GDP = \beta_1 * TrC + \beta_2 * TrM + \beta_3 * Unemp + \beta_4 * IntR \quad (1)$$

The annual data ranges from 1994 to 2019. The model is testing the hypotheses if growth in the U.S. GDP (GDP ↑) is caused by an increase in the trade balance with Canada (TrC ↑) and Mexico (TrM ↑).

The result of the regression model is:

$$GDP = 0,268 * TrC - 0,765 * TrM - 0,188 * Unemp - 0,307 * IntR \quad (2)$$

(5,585\*\*\*)    (-11,510\*\*\*)    (-3,557\*\*\*)    (-4,357\*\*\*)

All standardized beta-coefficients are significant at 1% significance level;  $R^2 = 0.953$  (the factors selected for the analysis explain the dependent variable by 95.3%);  $F = 106.9$ .

The regression analysis shows a significant causality between the amount of the U.S. GDP and the country's trade balances with Canada and Mexico. For the period 1994-2018, an increase in the trade balance of the U.S. with Canada causes an increase in GDP, as the coefficient of the independent variable TrC is positive. An increase in the trade balance between the United States and Mexico causes a decrease in GDP.

Thus, an important result of the regression analysis is that during the existence of NAFTA, the U.S. trade with Mexico had a negative impact on the U.S. GDP. Negative impact of the US-Mexico trade on the U.S. economy is confirmed by a constantly negative trade balance between the USA and Mexico. While if the presence of a negative trade balance between the USA and Canada is fully compensated by a positive balance of services, the the positive balance in trade in services between the USA and Mexico is significantly less than the negative trade balance. And this

argument became the main one for the President Trump in his pressure on Mexico to revise the terms of the NAFTA agreement.

However, this argument is not indisputable. In particular, Mexico and Canada reported substantially larger U.S. goods surpluses in the same relationship. This reflects the large role of re-exported goods from other countries. The U.S. statistics calculate goods coming into the U.S. territory the third countries and being exported to trading partners, without substantial transformation, as exports from the United States. Canada and Mexico calculate these re-exported goods as imports from the country of origin. In the same way, export data from Canada and Mexico may include re-exported products originating in other countries as part of their exports to the United States, whereas U.S. data indicate these products as imports from the country of origin [Office of the United States Trade Representative, 2020].

The negative coefficient on the Unemp variable indicates that there is an inverse relationship between the U.S. unemployment rate and the country's GDP, that is, by increasing the unemployment rate by one standard deviation, GDP will decrease by -0.188 standard deviations. This result of the model is fully confirmed by recent positive dynamics of GDP and labor market in the United States.

The regression analysis also showed that there is an inverse relationship between GDP and interest rate in the United States from 1994 to 2018. Increasing the interest rate by one standard deviation, GDP will decrease by -0.307 standard deviations. The presence of the inverse relationship between the interest rate and the U.S. GDP, confirmed by the model, has also become an argument for the President Trump in his pressure on the Federal Reserve with a demand to lower the interest rate.

**Conclusions.** Analysis of the economic efficiency of the integration bloc showed that NAFTA gave incentive to sustainable economic development of the countries. Their GDP and per capita GDP have been growing steadily between 1998 and 2018, the unemployment rate in the three countries remains low, and the inflation rate in the United States and Canada has been quite low over the same period, while in Mexico it has decreased significantly. NAFTA has spurred substantial productivity gains in the Canadian economy. Between 1998 and 2018, trade between the United States and Canada increased. U.S. trade with Mexico increased at a faster pace than with Canada. The U.S. trade balance with Canada and Mexico remains negative. Analysis of trade in services showed that in 1999-2018, U.S. exports to Canada increased 2.5 times, and to Mexico increased 2.4 times. Imports from the two countries almost doubled over the same period. Relations between Canada and Mexico regarding trade in services have also become closer; in 20 years, trade volumes have almost quadrupled. Since 1998, direct investment from the United States to Canada has quadrupled, and to Mexico more than quadrupled. Foreign direct investment in the United States increased, with Canada joining the top three countries investing in the U.S.

Mexico benefited particularly from NAFTA, as its provisions on foreign investment helped consolidate the government's reforms, which contributed to improving the country's investment climate.

The regression analysis showed a significant relationship between the U.S. GDP and foreign trade with Mexico and Canada, unemployment and interest rates. Its results revealed that the U.S. trade with Canada had a positive impact on the U.S. GDP; in the same time the U.S. trade with Mexico had a negative impact on the U.S. GDP, which became the main argument for President Trump in his pressure on Mexico to revise the terms of the NAFTA agreement. The regression results have also proved the assumption, that there were an inverse relationship between GDP and interest rate in the United States from 1994 to 2018.

The volume of bilateral trade in goods and services of the USMCA member countries with Ukraine increased over the period 2013-2018. The relations of countries regarding foreign direct investment are developing less stable. If the flow of investment from Canada increased as a result of the Free Trade Agreement between the countries, the volume of investment from the United States decreased, reflecting the lack of mechanisms to attract investment in Ukraine, as well as increased competition for investment from other developing countries.

Research results suggest that the USMCA, which replaced the NAFTA, will probably spur economic growth and create more jobs in the United States. This agreement tightens labor standards and protection of intellectual property rights, especially in Mexico, thus, probably reducing the attractiveness of Mexican economy to foreign investors, which is likely to reduce the U.S. investment in Mexico. Thus, Canada and Mexico are expected to receive less benefit from the USMCA for their economies than the United States.

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**THE ROLE OF INNOVATION CLUSTERS IN BUILDING UP INVESTMENT AND INNOVATION STRATEGIES IN THE CROSS-BORDER COOPERATION CONTEXT**

**РОЛЬ ІННОВАЦІЙНИХ КЛАСТЕРІВ У РОЗРОБЦІ ІНВЕСТИЦІЙНИХ ТА ІННОВАЦІЙНИХ СТРАТЕГІЙ В КОНТЕКСТІ ТРАНСКОРДОННОГО СПІВРОБІТНИЦТВА**

**РОЛЬ ИННОВАЦИОННЫХ КЛАСТЕРОВ В РАЗРАБОТКЕ ИНВЕСТИЦИОННЫХ И ИННОВАЦИОННЫХ СТРАТЕГИЙ В КОНТЕКСТЕ ТРАНСГРАНИЧНОГО СОТРУДНИЧЕСТВА**

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**Abstract.** *Innovation clusters are analyzed in the article from the perspective of cross-border cooperation of regions. Types of clusters are highlighted, capable of adapting to cross -border cooperation, which enables to identify and outline the instruments of economic policy, capable to stimulate deepening of innovation processes in cross -border regions. Specialization and specifics of gaining competitiveness through promoting new comparative advantages are defined as the determining criteria for distinguishing the notions of “cross-border cluster in the conditions of cross -border cooperation” and “cross -border innovative cluster”. The innovative cluster’s role is analyzed in terms of its being a promoter of creating the innovation ecosystem as a highly coordinated system of dynamics interlinks between economic agents and institutes, resulting in the innovation activity, commercial success of projects and technological modernization of the structure of national economies, which effectiveness is conditional on the conformity of the institutional environment with the needs of R&D, education and business, and with the latter’s capability to build the closed loop innovation cycle. The determinants of gravity of regional entities, the dominant principles of cross -border cooperation, the determinants of effectiveness and ineffectiveness of cross -border cooperation of border regions are defined; the multi-category approach to assessment of the cross -border potential is given. The potential of customs tariff and fiscal regulation in stimulating the innovation activity in the conditions of cross -border cooperation is highlighted. The controversial character of “border” is identified from the perspective of opportunities and threats for innovation activities, generated by it. Cross-border cooperation is identified as a trigger for implementation of technological projects and innovation-driven productions.*

**Keywords:** cross-border cooperation, border region, innovation clusters, business innovation centers, innovation process.

**Анотація.** *В статті розглянуто інноваційні кластери з позиції транскордонного співробітництва регіонів. Виокремлено типи кластерних утворень, що можуть бути адаптивні при здійсненні транскордонного співробітництва, що дозволило ідентифікувати та виокремити інструменти економічної політики, здатні стимулювати поглиблення інтеграційних процесів в прикордонних регіонах. Спеціалізація та особливості досягнення конкурентоспроможності за рахунок просування нових порівняльних переваг визначено як детермінуючі критерії розмежування понять «інноваційний кластер в умовах транскордонного співробітництва» та «транскордонний інноваційний кластер». Розглянуто роль інноваційних кластерів у сприянні створенню інноваційної екосистеми як високо координованої системи динамічних взаємозв’язків, що виникають між економічними агентами й інститутами, результуючись в інноваційній активності, комерційній успішності проектів й технологічній модернізації економічної структури держави, ефективність якої залежить від ступеня відповідності інституційного середовища потребам науки, освіти й бізнесу і здатності останнього забезпечувати замкнутість інноваційного циклу. Визначено детермінанти тяжіння регіональних суб’єктів, домінантні принципи транскордонної діяльності, детермінанти ефективності та неефективності*

транскордонного співробітництва прикордонних регіонів, а також наведено багатокатегоріальний підхід до оцінки потенціалу транскордонного регіону. Виокремлено потенціал митно-тарифного та бюджетно-податкового регулювання в стимулюванні інноваційної активності в умовах транскордонного співробітництва. Ідентифіковано контроверсійний характер «кордону» з позицій продукованих ним як можливостей, так і загроз для інноваційної діяльності. Транскордонне співробітництво ідентифіковано як тригер реалізації технологічних проектів та інноваційного виробництва.

**Ключові слова:** транскордонне співробітництво, прикордонний регіон, інноваційні кластери, бізнес-інноваційні центри, інноваційний процес.

**Аннотація.** В статье рассмотрены инновационные кластеры с позиции трансграничного сотрудничества регионов. Выделены типы кластерных образований, которые могут быть адаптивными при осуществлении трансграничного сотрудничества, что позволило идентифицировать и определить инструменты экономической политики, способные стимулировать углубление интеграционных процессов в приграничных регионах. Специализация и особенности достижения конкурентоспособности за счет продвижения новых сравнительных преимуществ определены как детерминирующие критерии разграничения понятий «инновационный кластер в условиях трансграничного сотрудничества» и «трансграничный инновационный кластер». Рассмотрена роль инновационных кластеров в содействии созданию инновационной экосистемы как высоко координированной системы динамических взаимосвязей, возникающих между экономическими агентами и институтами, и имеющими своим следствием повышение инновационной активности, коммерческой успешности проектов и технологической модернизации экономической структуры государства, эффективность которой зависит от степени соответствия институциональной среды потребностям науки, образования и бизнеса и способности последнего обеспечивать замкнутость инновационного цикла. Определены детерминанты притяжения региональных субъектов, доминантные принципы трансграничной деятельности, детерминанты эффективности и неэффективности трансграничного сотрудничества приграничных регионов, а также приведен мультикатегориальный подход к оценке потенциала трансграничного региона. Проанализирован потенциал таможенно-тарифного и бюджетно-налогового регулирования в стимулировании инновационной активности в условиях трансграничного сотрудничества. Идентифицирован противоречивый характер «границ» с позиций как открываемых ими возможностей, так и угроз для инновационной деятельности. Трансграничное сотрудничество идентифицировано как триггер реализации технологических проектов и инновационного производства.

**Ключевые слова:** трансграничное сотрудничество, пограничный регион, инновационные кластеры, бизнес-инновационные центры, инновационный процесс.

**Introduction.** A viewpoint commonly expressed today is that the key criterion for assessment of the innovation activities at firm level is cluster formed by interlinked firms located on a rather small distance from each other within one region; they operate in one industry, being incorporated in one production chain, and combine their workforce and communication flows. In the latest decades innovation clusters have been created in various countries. Firms incorporated in these clusters operated in a variety of industries, from high tech ones, such as pharmaceuticals, computer technologies, manufacturing of research equipment and mobile phones, to more conventional manufacturing industries, such as car making, apparel or footwear. These firms tend to

interact with each other by exchanging workforce, providing information access, setting links between manufacturers and suppliers, getting access to venture capital or by combinations of these factors.

But not all the innovation companies operate in this way. There are essential differences in the internal structure of the innovation clusters, with some of them putting stronger emphasis on the production and others involved in the shared marketing. With more detailed analysis it becomes obvious that homogenous clusters actually demonstrate the essential degree of heterogeneity from the perspective of organization [17].

One of the quite recent assumptions is about the existence of various types of clusters, with some of them incorporating firms not linked with other innovation enterprises in the same region in spite of the relatively close location. It follows that they are located on the region's territory, but not involved in the regional innovation activities. Moreover, some of these firms are very small. In such microfirms the importance of an individual innovator or inventor working in a firm is reemphasized.

Compared with other forms of cooperation, the special role in the cluster's success is conditional on creating a well-structured chain for dissemination of technologies, new knowledge and innovations. The gradual adoption of the network principle of the global economy organization allows, to an essential degree, for integrating the advantages of hierarchical and market mechanism. The networking of entities in the conditions of horizontal integration enables them to have the supplementary synergetic effect manifested in the considerably higher competitiveness of these entities and the whole system than the one occurring if business entities operated independently. The effective combination of internal competition and cooperation inside a cluster in the process of product making creates "cluster mechanism" for competitiveness enhancement. The awareness of the clusters' role in the innovation-driven economic development was gradually spreading across domestic economies to reach the global level.

**The purpose of the article.** The assessment of cluster potentials in attracting investment and generating innovations at mesolevel of cross-country cooperation, namely in the conditions of cross-border cooperation, acquires significant importance (Cross-Border Cooperation (CBC)).

**Recent literature review.** The United Nations Economic Commission for Europe highlights the following basic characteristics of clusters[14]:

- proximity of companies, enabling them to have financial benefits from production cooperation, capital exchange and mutual learning processes;
- specialization of clusters, enabling companies to concentrate on specific activities with keeping intact the interests of all the project participants;
- cooperative involvement of large numbers of entities in a cluster;
- combination of cooperation-based and competitiveness-based components in networking of cluster participants;
- the importance of reaching certain "critical qualitative and quantitative" mass to achieve the effect of internal dynamics and development;
- reliance on the long-term operation of a cluster;
- involvement of cluster participants in the processes of organizational, marketing and technological innovations. Although clusters were designed as competitiveness enhancers of regional economies, they did not feature a clear focus on innovation. As a form of production concentration, an innovation cluster is created mainly due to the availability of required nature resources.

However, as shown by P. Maskell [10], with the material culture becoming more and more complex, production competencies acquire higher importance. Innovation clusters of our days differ from the earliest ones in terms of their stronger focus on exports of technologies and products compared with industrial clusters. Newly built clusters tend to be designed to develop cutting-edge production technologies or create new markets and new products. The closed chain that emerges (from creation of a product to its mass-scale manufacturing and introduction on the global market)

gives evidence that “intra-cluster” advantages have been recognized internationally. If a newly built cluster is to be competitive, its creators must be focused on the global market, because viable clusters with operation limited by regional level are an exception rather than a rule. The problem of creating an effective cluster is associated with its orientation on the manufacturing of goods that are best on the globe. This, in turn, will require building a reliable chain of engineers, suppliers, personnel. An important problem of a cluster may be absence of a well-established contact with customers on foreign markets and lack of guarantees for the stable product sales. Even successful clusters achieve the positive effect by concentrating resources and promoting goods through the cluster brand. However, even multisectoral clusters can often be exposed to pressures of unstable conjunctures of the global market. Also, clusters may face the problem of the relative closure of some large companies that often are unable to cooperate with new suppliers or absorb new products and technologies. The tendency to consider a cluster as a local phenomenon, with overlooking its focus on the global level, seems to be erroneous [8]. It will never do well without cooperation of its participants and expanding of horizontal links if even the necessary infrastructure is available. The development of horizontal links within a cluster is often substituted by creating infrastructure for the territories where clusters operate, which is often done at the expense of cluster participants. Another problem faced by the clusters created by a government initiative is the bureaucratic apparatus designed to supervise their development. Practices show that the cluster infrastructure, if created on the basis of greenfield project but without assessment of the territorial potentials, may be doomed to failure and will end up with financial losses for investors. For public officials it may often be difficult to assess the knowledge concentrated in small innovative firms forming the cluster core, to get awareness of the market capacities, and to use effectively the available resources. Cluster managers who receive investment from the government but not always meet its expectations are often engaged in active lobbying of their own interests irrespective of the cluster perspectives. The bureaucratic element in a cluster is exposed to significant pressures from “trendy” movements of science (informatics or biotechnology). It is, however, rather difficult to become a leader on such markets, whereas the chances to fail are almost guaranteed. On the other hand, a refusal to be involved in government-based clusters can have negative effects for their performance.

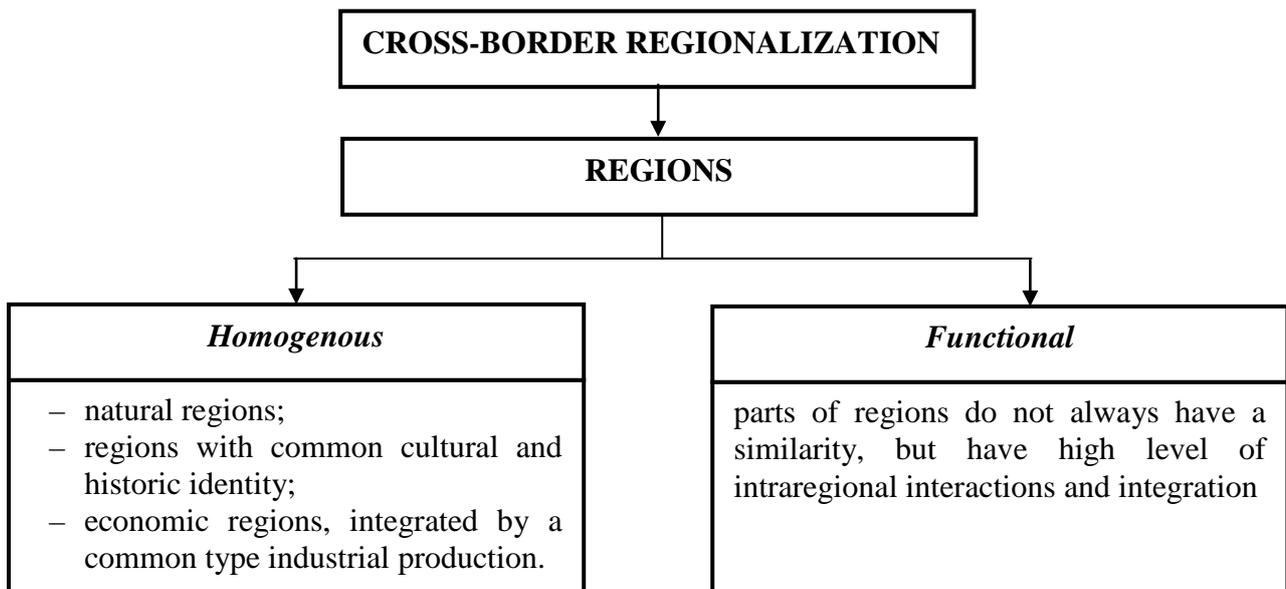
According to G. Popescu [12], in spite of the growing popularity of clusters worldwide and their increasing support, clusters are too risky as an instrument: because the initiatives on cluster creation tend to be time-consuming and expensive, the risks are also essential. Besides this, when such cluster initiative is implemented, more than the half of its budget will be coming from the public budget, and in most cases the cluster can hardly move to self-sufficiency. Bearing this in mind, it is commonly believed that supporting already created clusters would be more effective than creating new ones. A cluster can become low effective due to the improper quality of the organizational structure chosen for it. When enterprises are organized into clusters, their integration process has to rely on assessment of the company’s development potentials as part of the specifically created cluster rather than on successful industries or companies. This assessment should include analysis of the company’s financial and economic performance, its organization, its information and intellectual capital. Other problems can be caused by lack of companies required for the full-fledged development of innovation activities in a cluster. Besides that, a cluster may incorporate the companies that are ill-suited for the effective innovation activities [7].

Most part of the clusters in the last decades specialized only on manufacturing of consumer goods, and they were often created to enhance the economic competitiveness in selected territories or regions. At the beginning of this century industrial clusters were launched more and more often, engaged in logistics, ecology, information design, manufacturing of bio-medical drugs. The innovation focus of clusters was becoming increasingly stronger: now it had to be the core parameter of the competitiveness of clusters. With the cluster’s evolution the structure of its participants gradually transforms. As the cluster is a system that develops, it is difficult to predict its sustainability in the long run. The clusters that are successful nowadays (on account of science and technology progress or the current conjuncture of the global market) may lose their prospects and pace of development. Because a rapidly growing cluster often faces various kinds of limitations and

barriers, implementation of collaborative investment projects can be spread over a long period of time. As clusters existing in the global economy of our days differ by performance and development pace, this can provoke a number of new risks for the policy, because it can lose the effectiveness. Cross-Border Cooperation (CBC), a key priority of the European Neighbourhood Instrument, seeks to reinforce cooperation between EU Member States and Partner Countries along the external EU borders [6].

**Main research results.** From epistemological perspective, problems of cross -border economic cooperation have interdisciplinary background and two principle components: the set of theoretical, methodological and practical issues of the region’s economy development (with focus on the hierarchical vertical of power “center – regions”, historic, ethnic & demographic, religious, ecological, natural resource specifics of a region in the national labor division system), and issues of international economic cooperation and integration (which are related with issues of optimizing the specialization models, enhancing competitiveness of actors engaged in international economic relations at all the levels etc.).

Cross -border regionalization as the spatially integrated form for political cooperation is characterized by rise of new regions; its problems are solved by crossing national and administrative borders, with the awareness of interrelations, interdependence and mutual interests formed despite of these borders (Figure 1).



**Figure 1. Cross-border regionalization pattern**

*Source: developed by the author*

Determinants bringing regional entities together can be the following: political benefits from mutual cooperation; the need for integration to achieve the objectives; identity of values, laying the ground for the value-based integration; general history or its key points; geography, laying the basis for integrating the territorial entities into a region; economic complementarity of business or industrial entities operating within the boundaries of a territory [19].

Dominant principles of cross-border cooperation can be the following: basic institutional-legal principles (independence, sovereignty and territorial integrity; equality of participants; voluntariness; autonomy; legitimacy; administrative identity); basic economic-legal principles (solutions of common problems; coherence of interests; focus; systemic nature; comprehensiveness; hierarchy; spatial optimality) [18; 19].

Determinants for the effectiveness of cross-border cooperation between border regions can be the following: geopolitical factors (neighborhood with peaceful states or hostile states, with the threat of border removal resulting from warfare); geo-economic factors (capability to overcome technological asymmetries by integrating in global value added chains; capability to pursue expansionist trade and investment actions; capability to exploit the domestic market capacity and diversify the economic structure); institutional factor (the higher is the inclusiveness of institutions and the weaker is the extractive character of their operation, the easier the structural defects and infrastructural inadequacies of a domestic economy and can be mitigated, and the higher are the ability of economic entities to adapt to the challenges of cross-border cooperation); structural factors (in view of the resource potential, mineral and human one: the existing specialization of a region can be either a cooperation driver or a cooperation constraint).

Determinants of ineffectiveness of cross-border cooperation between border regions can be the following: poor social-economic development of cross-border regions; differences in administrative and territorial systems of bordering countries; national legal framework for cross-border cooperation, if incomplete or not harmonized with the existing standards; inadequate authorities of territorial communities in cross-border relations; immature system for government support to cross-border cooperation; limited financial resources of local budgets; inadequate participation of border regions in international development programs; poor awareness of essential business results of entities engaged in cross-border cooperation.

In view of the above, a cross-border region can act as: the locality concentrating economic resources and generating financial flows (resource-based competitive advantages); the institutional core for national economies (institutional competitive advantages); the epicenter generating knowledge and innovations (innovation-based competitive advantages) [15; 19; 20].

Cross-border regions at national, supranational or global level can demonstrate the “actor” capacities conditional on their legal, institutional and socio-economic structure:

- 1) the capacity to articulate own interests and future development strategies;
- 2) the capacity to have impact on economic processes;
- 3) the capacity to interact with other non-government entities from the countries engaged in cross-border interactions;
- 4) the capacity to hold negotiations (para-diplomacy);
- 5) the capacity for self-presentation.

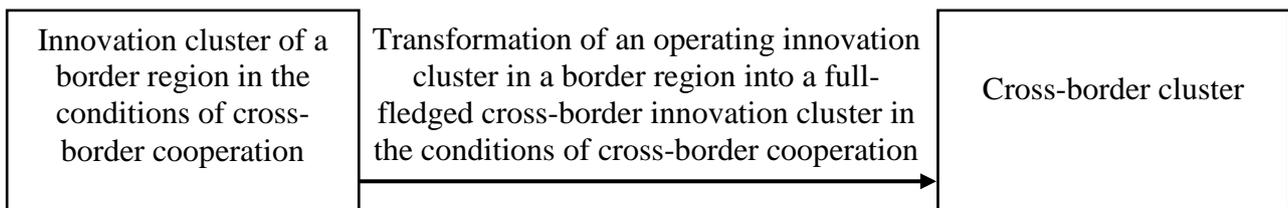
In the country-specific realities, investment and innovation strategies cannot be built by modeling “on blank space” on a given territory. Otherwise, the argument on the possibility of creating absolutely new (even very “advanced”) approaches by ignoring global practices that proved efficient by decades of the productive work of leading companies would be wrong. A vital problem, therefore, is finding out the common and the specific in the investment and innovation strategies of countries, in order to enhance the effectiveness of cross-regional projects.

Cross-border cooperation should be considered in the context of building the advanced institutional environment and creating the “high tech” model as the long-term development

framework of the Ukrainian economy. Proven mechanisms for practical utilization of its capacities can be found in global practices, which may involve a shared support, by two or more countries, of high tech investment and innovation projects, building of transnational cross-industry high tech clusters, networks of technoparks, business incubators, support to trial and design bureaus, advanced companies focused on innovation or cross-industry science and technology centers.

Cluster form of organization enables for creating a specific form of innovation, the aggregate innovation product. A. Markuzen distinguishes between five types of innovation clusters [9]: (i) new industrial systems, built now in form of industrial districts; (ii) systems of “center – network” type, built around several central corporations which operation is focused on the innovation-driven development; (iii) the industrial platform for daughter companies, built in all the countries irrespective of the innovation performance; (iv) the government oriented system, built as a supplier of new technologies, and (v) a mixed type, built on the basis of technoparks. However, we consider it appropriate to propose the author classification of innovation clusters.

Our analysis of innovation clusters from the cross-border perspective makes us believe that cluster formations need to be distinguished and classified into the following types: innovation clusters of border regions in the conditions of cross-border cooperation; cross-border innovation clusters; transformational flexible clusters of natural regions; because this classification enables to find out the specifics of relations between the participants of each cluster type and differentiate the tools designed to deepen integration processes in border regions. The typology of innovation clusters in the cross-border cooperation context is shown in Figure 2.



**Figure 2. Typology of innovation clusters from the cross-border perspective**

*Source: developed by the authors*

Building and operation of innovation clusters in border regions is essentially similar to regional innovation clusters as a whole. We believe that the phase “in the conditions” implies that innovation clusters in border regions can use some additional advantages for cross-order cooperation, such as a wider opportunity for Euroregions to promote innovation clustering of border regions through financing, participation in cross-border cooperation projects etc.

We suggest that in the conditions of cross-border cooperation an innovation cluster in a border region differs from a cross-border innovation cluster by several attributes. When it is assumed that a cross-border innovation cluster is a cluster integrating participants from a cross-border region (located on various sides of the border between two or more countries), the following differences need to be emphasized:

First, these types of clusters differ by specialization. When considering the background for building up an innovation cluster in a border region in the conditions of cross-border cooperation, we believe that it will be appropriate to define the specialization of Ukrainian border regions, and that the specialization of adjoining regions must not be identical to the specialization of the border regions of Ukraine [16; 17]. Once cross-border innovation clusters are considered, a cross-border area will have to be seen as the single area, with the single specialization of regions and equivalent selection of potential participants in such cluster.

Apart from specialization, there are other differences distinguishing the concept of “innovation cluster” in the conditions of cross-border cooperation from a cross-border innovation cluster. In particular, the competitiveness aspect needs to be considered. When a cluster is being built, including

an innovation one, we believe that it is supposed to enhance competitiveness in border regions. When cross-border innovation clusters are expected to be built in a country, this competitiveness will supposedly enhance the performance of two border regions: one is on the Ukraine's side and the other one is on the side of a country bordering Ukraine. However, when an innovation cluster in the conditions of cross-border cooperation is considered, this competitiveness will promote the development of economic potential in a Ukrainian border region. It should be noted that differences between the analyzed types of clusters will be caused by different legal frameworks regulating their operation, including taxation and custom one. Basically, innovation clusters in border regions in the conditions of cross-border cooperation are considered by us as the primary phase of cluster relations in a border area, because in future they may develop into the final phase, which is a cross-border innovation cluster.

A peculiarity of cross-border clusters is that the intensity of network interactions in a cluster is limited by the border erecting additional barriers for free movement of goods, workforce or capital. Other barriers for cooperation may be different mentalities, languages, cultures or historical backgrounds.

Strategies for promoting the innovation process at regional level in the context of cross-border cooperation objectives. The regional innovation policy can, therefore, constitute the first and important step in building up the national innovation system in Ukraine, with due consideration for not only domestic specifics of regional mosaics, but international experiences as well. The important factors to be born in mind in elaborating the national strategy are as follows:

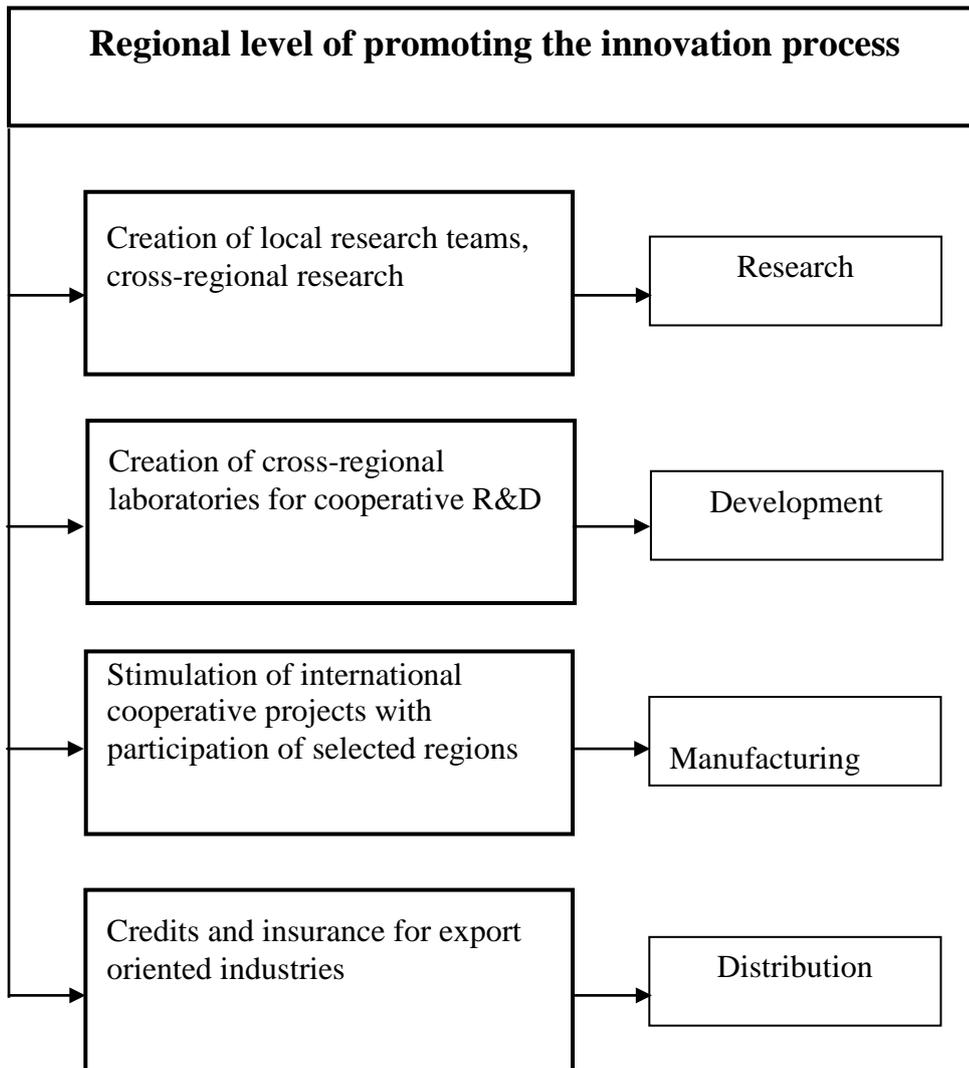
- potentials of the border regions where the innovation policy will be conditional on export orientation on neighboring external markets (orientation to export markets can be a strong innovation driver given the depressed domestic demand);
- potentials of the regions that are remote from the center and often have specific specialization;
- potentials of the depressive regions with urgent need to fight the crisis either through new technological decisions on cost reduction (given the preserved industry structure) or through creating radically new goods and establishing new companies manufacturing them (in parallel with liquidating the industries either provoking the crisis condition or failing to mitigate its negative effects; it should be added that in Japan the crisis regions are seen as drivers of the innovation process);
- the existence of cross-regional differences in economic specialization (there are regions with the well-established standardized production, and there are regions where the economy is based on large capital investment, which essential parameters are vast material assets, massive production output and turnover, huge social burden and high impact on budgets); the existence of structural differences between regions, in particular ones associated with opportunities for small and medium business (given the weaker pressure from "national champions") as the fundament for the whole regional economy.

Given the economic openness and global liberalization, an effective system for market relations cannot be built unless the hierarchy of the economic mechanism is cardinally changed: from companies to the overall economic system, from elaborating the development strategy at all the levels to the effective use of the array of advanced management methods.

Considering the realities of the investment and innovation process, it can be concluded that the modern innovation system cannot be limited by internal or domestic R&D. Hence, the potential opening up opportunities for sub-regional or cross-border cooperation can offer the singular or, in many cases, the sole way for implementing technological projects or developing industries with high information capacities.

However, change in the priorities needs to be accounted for, even in the innovation activities, because the innovations' quality and capacity to address strategic objectives of development rather than the innovation "output" parameters have the largest importance. Also, regulatory approaches

change, taking on the more explicit dynamic forms in response to the growing innovation and information component of the economic process in the countries pursuing cross-border cooperation policies. This distinguishes the new principles of regional and macroeconomic impact on the innovation process from the ones that were most common in the world quite recently, in the late industrial era, and were used as advanced means of impact on the real sector, to bring national economies up to highly competitive international orbit (the approaches regarded as advanced beginning with 70s of the past century, which can be referred to as the linear model of impact, are shown in Figure 3).



**Figure. 3. The system for promoting the innovation process at regional level in the late industrial era (linear model)**

*Source: constructed by the authors*

The regional dimension in promoting the innovation process constitutes only one organic “phase” in the regulatory mechanism of innovation; adapting the system logic of the total impact on the innovation process effectiveness, it permeates the economic practice at various phases of reproduction and innovation cycles. This logic of implementing the institutional authorities at meso level is shown in Figure 4.



jobs, projects on information society (RISI), rural area development (LEADER), agreements on territorial employment.

International organizations (associations, unions etc.) engaged in shared financing of innovations, providing stimuli to cross-country cooperation of companies in the information field, coordinating innovation management, thus pushing up local and regional development, constitute a “follow up” of national institutions for promotion. Their operation reflect intentions to optimize national economic systems in conformity with the sovereign interests of countries handing over the respective responsibilities to them, on the one hand, and mobilization of tools that cannot be freely accessed at country level.

An illustrative example of such international organizations is international non-profit organization “The European Business and Innovation Center Network” (EBN), created in Belgium and established in Brussels in 1984 by the General Directorate of the European Commission “Regional Policy” (DG REGIO); EBN success is based on the triad: SME, innovation and local development. According to official documents, the EBN’s objective is to develop and coordinate the network of associated members, business innovation centers (BIC), and to expand its operation in the EU regions and beyond (now EBN has nearly 150 full members and more than 50 associated members). Because BIC are designed as tools for local and regional economic development, their objective is to render assistance to the territories undergoing industrial restructuring and to lesser economically developed EU areas [2; 3; 4; 5]. The BIC purpose is to provide services for companies, with special emphasis on SME as a whole and the ones with “innovative image of operation” and good capacities for growth.

An important area in intensification of regions’ development using the potential of international cooperation is targeted effort of institutes (national and international ones) in setting up cross-regional cooperation. Launched in the framework of geopolitical organization ASEAN, such projects were subsequently regarded as mechanisms designed to stimulate economic and cultural cooperation between countries of South-East Asia. Foreign capital flowed to South-East Asia countries embodying economic and political stability in the region, such as Indonesia or Vietnam. It was due to regional and sub-regional projects that the two countries left far behind many developing countries by rates of economic growth.

A specific feature of “functional load” at meso level is emphasis on the development of transport and communication systems and transit status (whenever possible). It should be noted that international sub-regional level constitutes an implicit functional component of global transport communications, which adds to technological capacities of transport routs and communications and provides important organizational and institutional means of positive impact.

### **Conclusions.**

Building up investment and innovation strategies in the context of objectives related with cross-border cooperation requires, inter alia, utilization of the innovation cluster capacities. An innovation cluster in a border region in the conditions of cross-border cooperation is defined by us as the system for close relations, voluntary integration of research and education institutions, business sector, general public, power offices, supplementary institutes and foreign partners in a given sector (several sectors) of the regional economy, which covers the whole innovation chain from the birth of a scientific idea to its practical implementation (manufacturing of finished innovative product etc.), to enhance the competitiveness of a border region and increase living standards of the population due to the synergetic effect from the utilized opportunities of cross-border cooperation.

Considering the realities of the investment and innovation process, it can be concluded that the modern innovation system cannot be limited by internal or domestic R&D. Hence, the potential opening up opportunities for sub-regional or cross-border cooperation can offer the singular or, in many cases, the sole way for implementing technological projects or developing industries with high information capacities.

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## **THE INFLUENCE OF DEVELOPED COUNTRIES CENTRAL BANKS' UNCONVENTIONAL MONETARY POLICY ON THE ECONOMY OF UKRAINE**

### **ВПЛИВ НЕТРАДИЦІЙНОЇ МОНЕТАРНОЇ ПОЛІТИКИ ЦЕНТРАЛЬНИХ БАНКІВ РОЗВИНЕНИХ КРАЇН НА ЕКОНОМІКУ УКРАЇНИ.**

### **ВЛИЯНИЕ НЕТРАДИЦИОННОЙ МОНЕТАРНОЙ ПОЛИТИКИ ЦЕНТРАЛЬНЫХ БАНКОВ РАЗВИТЫХ СТРАН НА ЭКОНОМИКУ УКРАИНЫ.**

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**Abstract.** *In the period of globalization, the economic shocks that occurred in one country quickly spread to other countries. So the actions of the developed countries' Central banks have a significant impact on other countries, in particular emerging markets countries. The paper considers an example of the impact of the European Central Bank, the Federal Reserve and the Bank of Japan's unconventional monetary policy on the Ukrainian economy. The purpose of the study is to assess the impact of the ECB, the Fed and the Bank of Japan's unconventional monetary policy on the financial indicators of Ukraine. The analysis is based on the event study methodology and constructing econometric models using the one least-squares method. The event study method allows to evaluate whether the time series of the studied indicators moves around a certain date. As a result, it was determined that the ECB's unconventional measures had the greatest impact on Ukrainian financial indicators, and the Bank of Japan had the least impact. Non-traditional measures of banks under study affected exchange rates and the yield of two-year government bonds. ECB and Fed's Unconventional monetary policy had an impact on the MSCI stock index, and the ECB policy also affected the interbank three-month rate. On the whole, the first rounds of*

*unconventional monetary policy of the central banks under study have the main influence on the financial indicators of Ukraine.*

**Key words:** *unconventional monetary policy, the European Central Bank, the Federal Reserve, the Central Bank of Japan, financial indicators.*

**Анотація.** *У період глобалізації економічні шоки які відбуваються в одній країні досить швидко поширюються на інші країн. Так і дії центральних банків розвинених країн світу мають значний вплив на інші країни, зокрема країни з ринком, що розвивається. В роботі розглянуто приклад впливу нетрадиційної монетарної політики Європейського центрального банку, Федеральної резервної системи і банку Японії на економіку України. Метою дослідження є оцінка впливу нетрадиційної монетарної політики ЄЦБ, ФРС і банку Японії на фінансові показники України. Аналіз базується на методи дослідження подій і побудові економетричних моделей методом І МНК. Метод дослідження подій дозволяє оцінити, чи рухаються часові ряди досліджуваних показників навколо певної дати. В результаті було визначено, що найбільший вплив на українські фінансові показники мали нетрадиційні заходи ЄЦБ, найменший вплив чинили дії банку Японії. Нетрадиційні заходи обраних банків впливають на зміну обмінних курсів і прибутковість дворічних державних облігацій. Нетрадиційна монетарна політика ЄЦБ і ФРС також впливала на фондовий індекс MSCI, і політика ЄЦБ ще впливає на міжбанківську тримісячну ставку. В цілому основний вплив на фінансові показники України мали перші раунди нетрадиційної монетарної політики досліджуваних центральних банків.*

**Ключові слова:** *нетрадиційна монетарна політика, європейський центральний банк, федеральна резервна система, центральний банк Японії, фінансові показники.*

**Аннотация.** *В период глобализации экономические шоки происходящие в одной стране достаточно быстро распространяются на другие стран. Так и действия Центральных банков развитых стран мира оказывают значительное влияние на другие страны, в частности страны с развивающимся рынком. В работе рассмотрен пример влияние нетрадиционной монетарной политики Европейского центрального банка, Федеральной резервной системы и банка Японии на экономику Украины. Целью исследования является оценка влияния нетрадиционной монетарной политики ЕЦБ, ФРС и банка Японии на финансовые показатели Украины. Анализ базируется на методе исследования событий и построении эконометрических моделей методом І МНК. Метод исследования событий позволяет оценить, движутся ли временные ряды исследуемых показателей вокруг определенной даты. В результате было определено, что наибольшее влияние на украинские финансовые показатели имели нетрадиционные меры ЕЦБ, наименьшее влияние оказывали действия банка Японии. Нетрадиционные меры выбранных банков влияют на изменение обменных курсов и доходность двухлетних государственных облигаций. Нетрадиционная монетарная политика ЕЦБ и ФРС также оказывала влияние на фондовый индекс MSCI, и политика ЕЦБ еще влияет на межбанковскую трехмесячную ставку. В целом основное влияние на финансовые показатели Украины имели первые раунды нетрадиционной монетарной политики исследуемых центральные банков.*

**Ключевые слова:** *нетрадиционная монетарная политика, европейский центральний банк, федеральная резервная система, центральний банк Японии, финансовые показатели.*

**Introduction.** In recent decades, the integration of countries into the global economy has accelerated. International shocks affect all countries without exception. But the strength of the impact depends on how vulnerable each individual country or region is to environmental changes. [Kireyev, A., & Leonidov, A.: 2015]

The implementation of unconventional monetary policy by the developed countries' central banks was a necessary measure in economically unfavorable conditions. Such actions by central banks of developed countries have various positive domestic effects. At the same time, the other

side of these unconventional measures is the cross-border effects and reaction of the developing countries' economies. Since, during the period of non-traditional measures, developed countries made huge injections of liquidity into financial markets, which significantly increased their balance sheets.

Large-scale operations by the ECB, the Fed and the Bank of Japan (BOJ) were selected to analyze the impact of unconventional monetary policy on emerging markets. These banks today still use these methods. Ukraine was chosen as an example of a country with an emerging market.

It is assumed that the unconventional monetary policy of the ECB, the Fed and the Bank of Japan have had a significant impact on emerging markets, including Ukraine. Ukraine is a small open economy, which means that exports and imports account for most of the GDP.

**The purpose of research** is to assess the impact of the unconventional monetary policy of the ECB, the Fed and the Bank of Japan on the financial indicators of Ukraine.

**Recent literature review.** In the world scientific and economic community at the moment, there is no unambiguous position about which exactly cross-border consequences has unconventional monetary policy. In particular, the issue of the nature of the impact of quantitative easing and other non-standard measures that were used central banks of developed countries on emerging markets is considerable debate. Sayuri Shirai [*Shirai S.:2019*], Ben Charoenwong, Randall Morck, and Yupana Wiwat [*Charoenwong B., Morck R., and Wiwat Y.:2019*] studied the influence of the unconventional monetary policy of the Central Bank of Japan. Koichiro Kamada, Tetsuo Kurosaki, Ko Miura, and Tetsuya Yamada examine how public information causes shocks and how much it affects the financial market [*Kamada K., Kurosaki T., Miura K., and Yamada T.:2018*]. Jai Won Ryoua, Saang Joon Baakb, Won Joong Kima analyze QE and QQE shocks based on their announcements on the economies of Japan and Korea using the vector autoregressive model [*Ryoua J. W., Baakb S.J., Kima W. J.:2019*].

Atsushi Inoue and Barbara Rossi study how unconventional monetary policy affects the exchange rate [*Inoue A., Rossi B.:2019*]. Tatjana Dahlhaus Garima Vasishtha examine the impact of US monetary policy news on portfolio flows to emerging markets The results show that the impact of unconventional shock on portfolio flows is generally economically small, but varies significantly across countries [*Dahlhaus T., Vasishtha G.:2019*].

Ana Paula Serra and Eurico Ferreira study the impact of the unconventional monetary policy of the Fed, the ECB and the Bank of England on the financial markets of developing countries. Using the event study methodology, the author comes to such conclusions that the announcement of unconventional monetary policy measures is significant for European stock markets [*Serra A. P. Ferreira E.:2019*].

David Bowman Juan M. Londono Horacio Sapriza examines the actions of US unconventional monetary policy and its impact on government bond yields, exchange rates, and stock prices in emerging economies [*Bowman D, Londono J.M., Sapriza H.:2014*]. Daniel J. Lewis proposes a new method for identifying announcement-specific decompositions of asset price changes into monetary policy shocks using intraday time-varying volatility [*Daniel J. Lewis: 2019*].

Yakubovkyi S.O, Alekseevska H.S. [*Якубовський С.О. Алексеевська Г.С.: 2017*] and Kyfak A., Rodionova T [*Alekseevska H., Kyfak A., Rodionova T., Yakubovskiy S: 2019*] studied examples of applying unconventional monetary policy in the EU and the USA.

Falagiarda M., McQuade P., Tirpak M studied the impact of ECB unconventional policies on the economies of countries such as the Czech Republic, Hungary, Poland and Romania, and also explored various transmission channels of the secondary effects this policy. The authors conclude that the ECB's policy has a significant impact on emerging markets [*Falagiarda M., McQuade P., Tirpak M.:2015*].

Stann Carsten and Theocharis N. Grigoriadis in their study argue that the ECB's unconventional monetary policy had a significant impact on the economies of Eastern Europe and Russia [*Stann Carsten M., Grigoriadis Theocharis N.:2019*].

**Data and methodology.** In order to assess the impact of unconventional monetary policy measures by the ECB, the Fed and the Bank of Japan on the Ukrainian economy was using press

releases from these banks. Based on these data and use event study methodology was created database of unconventional monetary policy announcements for selected central banks for the period from January 1, 2008 to December 31, 2019. They are independent variables that take the values 1 on the day of the announcement of unconventional monetary policy and 0 on other days. The dependent variables are the exchange rate national currency to the euro, yen and US dollars., the stock market index, measured by the MSCI index of the Ukraine, a three-month interbank lending rate, a yield of 2 years sovereign bonds from 26 August 2011., due to the availability of data, and spreads on credit default swaps for 3, 5 and 10 years for the US dollar, euro and Japanese yen. The control variables included: the marginal lending rate of the ECB, the federal funds rate of the Fed and the Bank of Japan political rate; the European benchmark volatility index VSTOXX, for the United States - S&P 500 Low Volatility index, for Japan the NIKKEI Stock average volatility index and the Central Bank rate of Ukraine. All financial data was obtained from Thomson Reuters DataStream.

The effects of statements by the ECB, the Fed, and the Bank of Japan about non-standard monetary policy on financial variables are measured by ordinary least squares (OLS) regression. Metrology is based on an article by Stann Carsten M., Grigoriadis Theocharis N. (2019) [*Stann Carsten M., Grigoriadis Theocharis N.:2019*], their article focuses on the impact of ECB's unconventional monetary policy on emerging markets and the sampling period included 2009-2017. In this article was added next two years of observation 2018 and 2019. Our study focuses only on Ukraine and examine the influence of two more banks that used unconventional monetary policy.

General view of the regression:

$$Y_t = c + \beta_1 UMP_{j,t} + Y_{t-1} + \beta_2 IR\_NBU_t + \beta_3 IR\_CB_{j,t} + \beta_4 Vol\ Index_{j,t} + \varepsilon_t \quad (1)$$

Where  $Y_t$  is a dependent variable (exchange rate, stock market index, three-month interbank lending rate, yield on 2-year sovereign bonds, spreads on credit default swaps for 3, 5 and 10 years).  $UMP$  - announcements of unconventional monetary policy,  $Y(t-1)$  - a lagged dependent variable, which was included due to the fact that investors are considering changes in the past for decision-making.  $IR\_NBU$  is the rate of the national bank of Ukraine,  $IR\_CB$  is the rate of the central bank whose monetary policy was studied,  $Vol\ Index$  is the volatility index.  $j$  - the central bank that applied unconventional measures. Also  $\mathcal{E}$  is error term;  $c$  is a constant term;  $\beta$  - coefficients. This model was built separately for each bank and for each instrument of unconventional monetary policy.

**Main research results.** One of the factors determining the impact on the Ukrainian economy of unconventional monetary policy is the presence of economic relationships between countries. One such indicator is the level of trade relationships. Main part Ukrainy's exports fall to the countries of the European Union, the smallest to Japan.

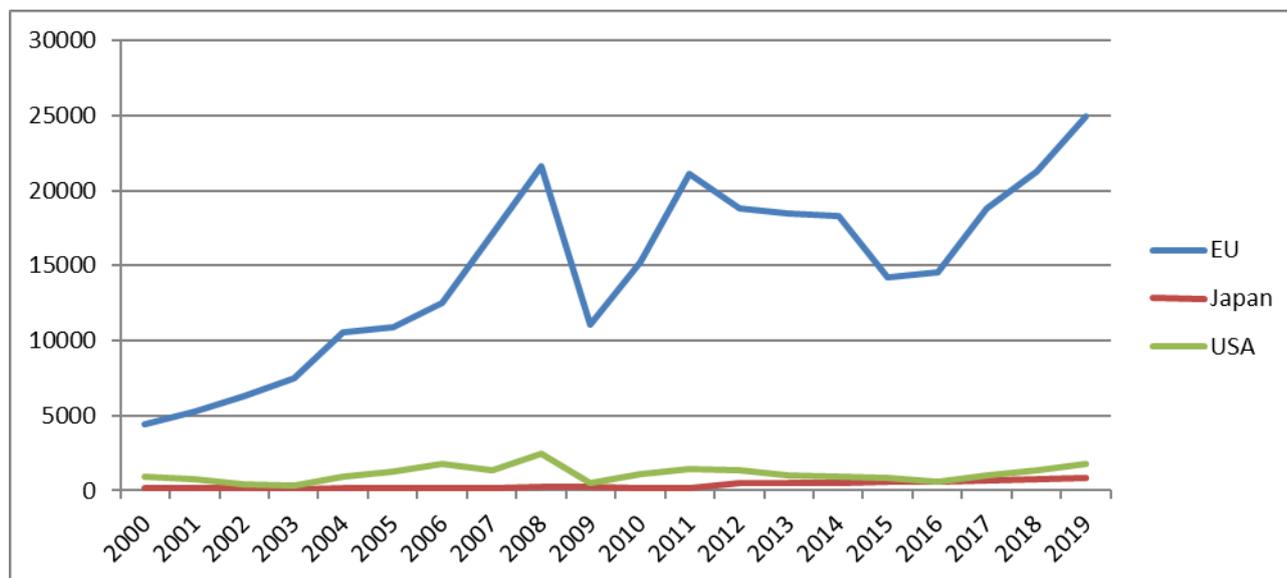


Fig.1 Ukraine's exports to the EU, USA and Japan 2000-2019 (mil.USD)  
Source: [IMF]

In export and import trends, an increase was observed until 2009. That says the growth of hornly relationships between countries. In 2009, when the effects of the crisis affected the whole world, both indicators were reduced. There was also a decrease in 2015 due to lower prices for the main Ukrainian export items (metals, grain) and a significant devaluation of the national currency.

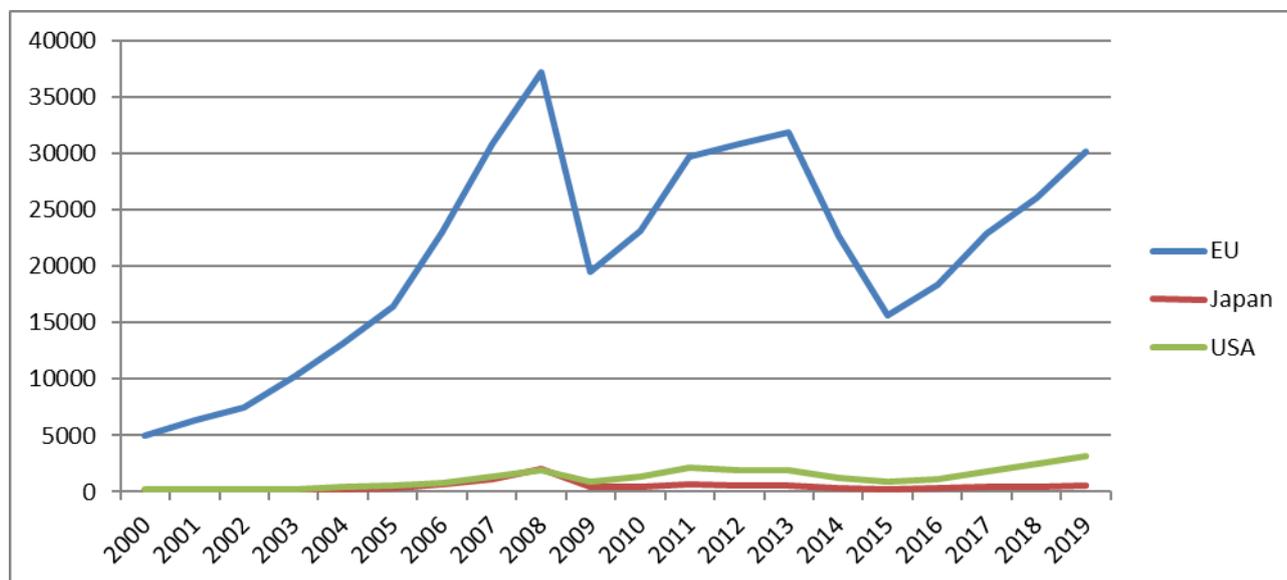


Fig.2 Imports of Ukraine from the EU, USA and Japan 2000 -2019 (mil.USD)  
Source: [IMF]

The highest level of interconnection is observed between Ukraine and the EU countries, in trade in these countries in 2019 accounted for more than 35%, in the USA up to 10% and Japan a little more than 3%. Accordingly, it is assumed that the ECB's unconventional actions will have a stronger impact on the Ukrainian economy.

The results of assessing the impact of the ECB's unconventional monetary policy on Ukraine's financial indicators are presented in Appendix 1.

ECB unconventional measures such as FRFA, LTRO, FOR, CBPP2, CBPP3, ABSPP, PSPP, OMT, CSPP did not affect the financial variables of Ukraine.

The exchange rate was influenced by the Long-Term Refinancing Operations Program (TLTRO). As a result of this program, the exchange rate strengthened during the days the program was announced.

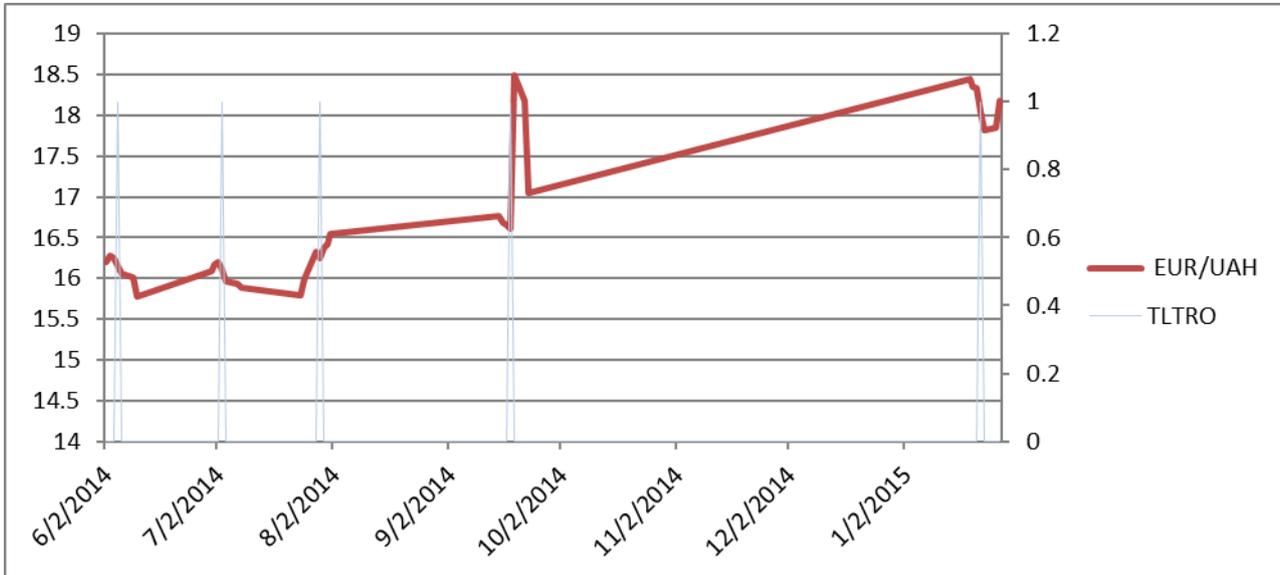


Fig3. Days of TLTRO policy announcement (05.06.2014, 03.07.2014, 29.07.2014, 18.09.2014, 22.01.2015, 07.03.2015) and exchange rate.

Source: [Reuters' Datastream]

Figure 3 shows the tendency to revalue the exchange rate on the days when the program was announced. On the days before the announcement of the program, the devaluation of the exchange rate was visible, on the day of announcement the revaluation was observed, and in the next few days the tendency to revaluation continued, except for the announcement on September 18, 2014, the rate rose by 2 hryvnias from 16 to 18 UAH on the next day. According to the result of the model, the level of influence of this program is low because the coefficient is 0.23.

Asset purchase programs CBPP1 and SMP influenced on financial market indicator MSCI. In response to SMP announcements, stock indices in Ukraine grew by 12 percent, and during the implementation of CBPP1 policy fell by 10 percent (see appendix 1).

The first bond purchase program (CBPP1) influenced the interbank interest rate, as a result of which the rate decreased by 1%. This can be explained by the fact that one of the channels of unconventional monetary policy is the liquidity channel. Large banks in Ukraine are mainly owned by banks in the eurozone. These banks can receive liquidity from their parent bank and use it to replace liquidity available in the local money market. This may lead to lower demand for funds in the local money market and lower rates in the money market. As was observed in the Ukrainian market during the announcement of CBPP1 policy

The following were investigated Fed unconventional monetary measures. The results are presented in table 1

Table 1

**The Impact of Fed Unconventional Monetary Policy**

Dependent variable	Unconventional methods of monetary policy				
	LSAP1	LSAP2	LSAP3	FG	MEP
USD/UAH	-0,100 (0,090)*	0,009 (0,933)	-0,004 (0,949)	-0,013 (-0,183)	-0,006 (0,960)
MSCI	-0,741 (0,724)	1,084 (0,650)	0,657 (0,660)	0,481 (0,767)	7,824 (0,0056)***
INTERBANK 3M	0,017 (0,925)	0,050 (0,816)	-0,051 (0,708)	0,175 (0,234)	-0,011 (0,962)
2Y - ZERO YIELD	-	-	-0,503 (0,0247)*	-0,070 (0,899)	-0,462 (0,661)
CDS 3Y (USD)	34,387 (0,727)	-1,92 (0,986)	-28,4004 (0,683)	19,111 (0,801)	-26,008 (0,843)
CDS 5Y (USD)	34,232 (0,716)	-0,098 (0,999)	-20,600 (0,756)	19,523 (0,788)	-21,929 (0,862)
CDS 10Y (USD)	33,975 (0,708)	-2,013 (0,984)	-24,173 (0,707)	19,295 (0,783)	-18,780 (0,877)

Note: The numbers in the parentheses beside the Wald statistics are the P-values: \*\*\*, \*\*, \* represent the 1%, 5%, and 10% significance levels, respectively.

Source: author’s calculations [Reuters’ Datastream; Fed policy announcements]

The unconventional monetary policy of the United States affected the exchange rate, in particular, this is the first round of asset purchases conducted in 2008-2009. The exchange rate has responded to this policy by revaluing the national currency; this is also seen in Fig4.

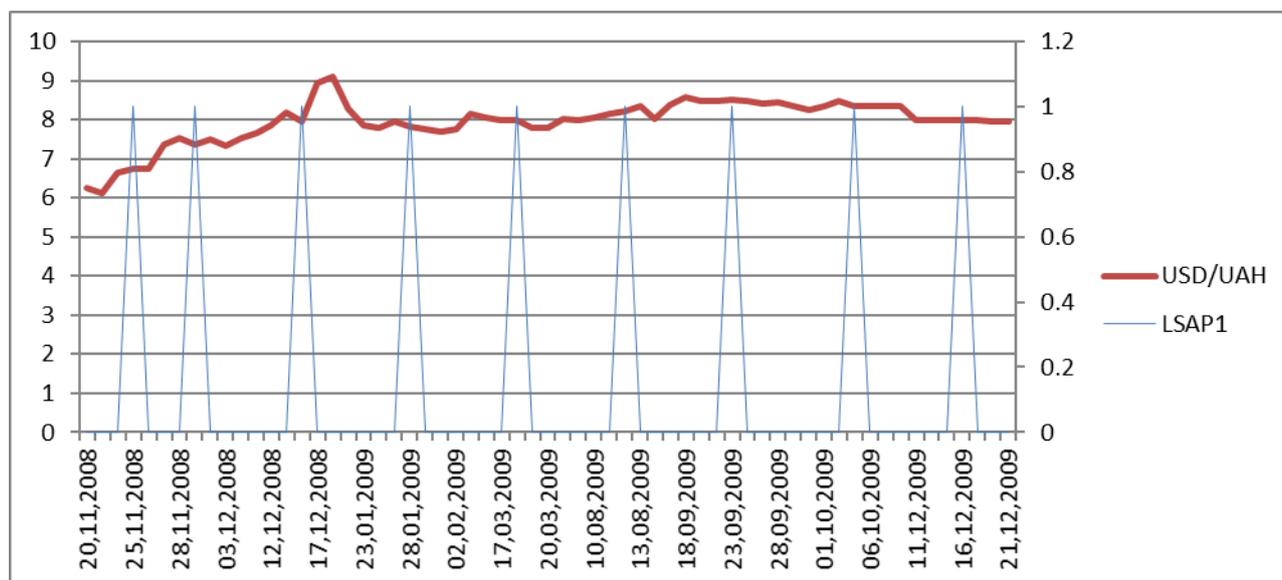


Fig4. LSAP1 Policy Announcement Days and Exchange Rate USD / UAH

Source: [Reuters’ Datastream]

The level of influence of this independent variable is not high, and is 0.1 UAH. And also the MEP policy, the twist operation that started in August 2011, was influential on the stock market index, measured by the MSCI index, which according to the results shows an increase

of 7%. Operation Twist is a tool aimed at changing the shape of the yield curve by simultaneously buying and selling long-term and short-term government bonds.

The results of the impact of non-traditional monetary policy programs of the Bank of Japan on the financial variables of Ukraine are presented in table 2

Table 2

**The Impact of BOJ Unconventional Monetary Policy**

Dependent variable	Unconventional methods of monetary policy			
	CME	QQ1	QQ2	NIR
JPY/UAH	-0.133 (0.0432)**	-0.051 (0.596)	-0.013 (0.702)	-0.029 (-0.212)
MSCI	2,805 (0,110)	0,874 (0,735)	0,055 (0,953)	0,177 (0,961)
INTERBANK 3M	10,052 (0,821)	-33,196 (0,440)	-51,81 (0,321)	-49,489 (0,991)
2Y - ZERO YIELD	0.27168 (0.0004)***	-0,157 (0,833)	-0,139 (0,6134)	0,163 (0,876)
CDS 3Y (JPY)	-0,889 (0,945)	-0,637 (0,937)	-1,132 (0,8732)	-0,991 (0,970)
CDS 5Y (JPY)	-0,933 (0,942)	-0,889 (0,963)	-0,9879 (0,888)	-0,947 (0,972)
CDS 10Y (JPY)	-0,976 (0,940)	-1,170 (0,9512)	-0,815 (0,907)	-0,891 (0,973)

Note: The numbers in the parentheses beside the Wald statistics are the P-values: \*\*\*, \*\*, \* represent the 1%, 5%, and 10% significance levels, respectively.

Source: author's calculations [Reuters' Datastream; BOJ policy announcements]

As well as the unconventional policy of the ECB and the USA, the measures of the Bank of Japan influence the exchange rate of the Ukrainian hryvnia and the Japanese yen. The national currency in the days of the announcement of the policy is strengthened by 0.1 UAH. This influence is not very significant.

Also, all the studied central banks have an impact on the yield of two-year government bonds. According to the analysis, as a result of the ECB's quantitative easing policy, in particular purchases of government bonds (PSPP 2014-2018), and the Fed's third round of purchases assets (LSAP3 2012-2014), government bond yields was reduced by 0.5%. And as a result of the Japan's comprehensive monetary easing policy (2010-2013) the yield on government bonds decreased by 0.2%. This influence probably passed through the liquidity risk premium channel. The fall in yields in the United States and the countries of the euro zone implies a relatively higher return on comparable assets of developing countries, including Ukraine. In this regard, investor interest in these countries is increasing, which may cause an increase in the volume of purchases of their government bonds. But the impact of the banks under study is not obvious, because Ukraine has huge economic instability due to the war in the eastern part of the country, the political crisis and the restructuring of external debt.

**Conclusion.** Ukraine has the closest relationship with the countries of the European Union. And this research confirms the hypothesis that the actions of the ECB are the most influential on the financial indicators of Ukraine.

The analysis shows that the exchange rates of the Ukrainian hryvnia to the euro, US dollar and Japanese yen were isolated from the influence of Central Bank announcements. This is confirmed by a minor influence. This is because the monetary policy in Ukraine only in 2015 actually switched from a fixed exchange rate regime to inflation control. The change of regime included the transition to a floating exchange rate.

Unconventional monetary policy announcements also had an impact on government bond yields and stock indices, but the Ukrainian stock market is underdeveloped, and this effect is small.

On the whole, the results confirm the hypothesis of the secondary effects exerted by the unconventional monetary policy of developed countries on emerging markets. The main influence was on the first programs of unconventional monetary policy of the ECB, the USA and the Bank of Japan. In those periods when unconventional measures were only introduced and it was difficult to regulate them and predict their consequences.

## APPENDICES

### Appendix I. The Impact of ECB Unconventional Monetary Policy

	FRFA	COLL	LTRO	TLTRO	FOR	CBPP1	CBPP2	CBPP3	SMP	PSPP	OMT	ABSPP	CSPP
EUR_UAH	0,002 (0,977)	0,004 (0,951)	0,011 (0,886)	-0,230 (0,077) *	0,027 (0,705)	0,117 (0,555)	-0,004 (0,983)	0,061 (0,593)	-0,006 (0,973)	0,106 (0,286)	-0,0064 (0,675)	-0,056 (0,567)	0,075 (0,623)
MSCI	2,376 (0,193)	0,453 (0,761)	0,864 (0,552)	-2,196 (0,357)	2,012 (0,128)	-10,564 (0,0037) ***	2,940 (0,420)	-1,227 (0,560)	12,427 (0,0007) ***	0,026 (0,988)	-0,227 (0,935)	-0,935 (0,608)	-0,104 (0,975)
INTERBANK 3M	0,049 (0,766)	-0,166 (0,216)	-0,144 (0,2697)	0,216 (0,314)	-0,182 (0,126)	-1,066 (0,001)* **	-0,143 (0,663)	0,021 (0,908)	-0,075 (0,817)	-0,151 (0,359)	-0,022 (0,928)	0,087 (0,593)	0,081 (0,965)
2Y - ZERO YIELD	0,211 (0,817)	0,276 (0,560)	0,425 (0,511)	-0,181 (0,808)	-0,051 (0,932)	-	0,094 (0,928)	-0,395 (0,517)	0,259 (0,887)	-0,574 (0,072) *	0,028 (0,972)	-0,325 (0,538)	0,025 (0,975)
CDS 3Y	0,634 (0,994)	-8,773 (0,909)	18,380 (0,806)	48,144 (0,696)	3,322 (0,9612)	91,354 (0,627)	3,787 (0,984)	33,725 (0,757)	-3,428 (0,985)	13,90 (0,883)	4,175 (0,977)	28,772 (0,760)	4,224 (0,976)
CDS 5Y	0,397 (0,996)	-9,507 (0,899)	17,801 (0,808)	34,238 (0,776)	3,202 (0,961)	91,641 (0,617)	2,199 (0,990)	28,27 (0,791)	-2,586 (0,988)	11,653 (0,899)	4,062 (0,977)	24,799 (0,787)	4,51 (0,974)
CDS 10Y	0,382 (0,996)	-9,232 (0,891)	13,885 (0,843)	24,44 (0,832)	2,193 (0,972)	66,39 (0,706)	1,465 (0,993)	21,427 (0,833)	-1,41 (0,993)	7,067 (0,946)	4,080 (0,976)	24,551 (0,815)	4,860 (0,971)

Note: The numbers in the parentheses beside the Wald statistics are the P-values: \*\*\*, \*\*, \* represent the 1%, 5%, and 10% significance levels, respectively.

Source: author's calculations [Reuters' Datastream; ECB policy announcements]

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УДК 332.7: 336.7

## **CREDIT RISKS MITIGATION AND BANKING COLLATERAL VALUATION IN UKRAINE**

### **КРЕДИТНІ РИЗИКИ ТА БАНКІВСЬКА ОЦІНКА ЗАСТАВНОГО МАЙНА В УКРАЇНІ**

### **КРЕДИТНЫЕ РИСКИ И БАНКОВСКАЯ ОЦЕНКА ЗАЛОГОВОГО ИМУЩЕСТВА В УКРАИНЕ**

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**Abstracts.** *Contemporary international requirements and mechanisms which are oriented to credit risks abatement and assurance of financial sector functioning are reviewed with particulars of their implementation in national banking sector.*

*As is demonstrated general reasons for the new generation of regulatory measures of crisis resilience in financial sector are grown up from the last global economy crisis which demonstrated vulnerability of the main credit institutions and their failure to absorb considerable financial market fluctuations.*

*To improve financial systems stability is the main goal of measures and instruments proposed by the international Basel Committee on Banking Supervision as well as Directives and Regulations of the European Union, which should be implemented at the national level.*

*One of the underlining aspect in this new international regulatory documents is recognition of the assets valuation key role in the whole methodology of risks mitigation. Main approaches to consider time effect on assets valuation results are analyzed in this context.*

*Based on these last international regulatory documents in this direction special Resolution No. 351 of the National Bank of Ukraine has been issued for banks credit risks assessment. Much less attention in this Resolution is given to assets valuation which is linked to some extent with outdated national valuation standards. This situation requires active measures to be provided for updating basic national documents in this area as is underlined.*

**Key words:** *credit risks, credit institutions, banking collateral, assets valuation, risks mitigation, international regulations, valuation approaches, time effect, valuation methodology.*

**Анотація.** *Розглянуті сучасні міжнародні регуляторні документи, які визначають вимоги до зменшення кредитних ризиків та забезпечення стійкого функціонування банківського сектору в контексті їх застосування у вітчизняній банківській системі.*

*Продемонстровано, що головна причина появи нового покоління регуляторних документів цього напрямку полягає в негативних наслідках останньої глобальної економічної*

кризи, яка висвітлила слабкості діючої фінансової системи в цілому, неспроможність її ключових інституцій протидіяти негативному впливу ринкових флуктуацій.

Підвищення стійкості функціонування всієї фінансової системи як раз і стало головною метою прийнятої Міжнародним Базельським Комітетом з Банківського Нагляду низки документів, які є основою відповідних Директив та Регламентів Європейського Союзу.

Одним з ключових аспектів цих міжнародних документів регуляторного характеру є визнання значного місця в забезпеченні стійкого функціонування банківського сектору вартісної оцінки заставного майна. В цьому відношенні в роботі розглянуті та проаналізовані існуючі підходи до урахування часового фактору при визначенні вартості різних активів.

Спираючись на ці міжнародно прийняті документи, національний банк України прийняв спеціальну постанову за № 351, яка встановлює детальний порядок визначення рівня кредитного ризику по активним банківським операціям. В той же час питанням методології вартісної оцінки залогового майна в даному документі приділено недостатньо уваги. Багато в чому це пов'язано з загальним відставанням національної регуляторної бази вартісної оцінки матеріальних та нематеріальних активів, що визначає необхідність подолання цієї прогалини та актуалізації національних стандартів оцінки.

**Ключові слова:** кредитні ризики, інститути кредитування, кредитне забезпечення, оцінка активів, зниження ризиків, міжнародне регулювання, підходи оцінки, методологія оцінки, часовий ефект.

**Аннотація.** Рассмотрены современные международные регуляторные документы, определяющие требования к снижению кредитных рисков и обеспечению устойчивого функционирования банковского сектора в контексте их применения в отечественной банковской системе.

Показано, что основная причина появления нового поколения регуляторных документов данного направления вызвана негативными последствиями последнего глобального экономического кризиса, выявившего слабости действующей финансовой системы в целом, неспособность ее ключевых элементов противодействовать негативному влиянию рыночных флуктуаций.

Повышение устойчивости функционирования всей финансовой системы как раз и явилось основной целью принятого Международным Базельским Комитетом Банковского Надзора ряда документов, которые стали основой соответствующих Директив и Регламентов.

Одним з ключевых аспектов этих международных документов регуляторного характера является признание существенной роли в обеспечении устойчивого функционирования банковского сектора стоимостной оценки залогового имущества. В этих рамках рассмотрены различные подходы к учету временного фактора при определении стоимости активов различных видов.

Опираясь на эти международно принятые документы, национальный банк Украины принял специальное Постановление № 351, устанавливающее порядок оценки кредитных рисков по активным операциям украинских банков. Значительно меньшего внимания в этом базовом национальном документе уделено вопросам методологии стоимостной оценки залогового имущества. Во многом это связано с общим заметным отставанием национальной нормативной базы стоимостной оценки материальных и нематериальных активов, что определяет необходимость принятия соответствующих мер по устранению все возрастающего пробела и актуализации национальных стандартов оценки.

**Ключевые слова:** кредитные риски, институты кредитования, кредитное обеспечение, оценка активов, снижение рисков, международное регулирование, подходы оценки, методология оценки, временной фактор.

**Introduction.** The general statement that the stable functioning of the banking sector is one of the dominant features of the efficient functioning of the entire economy has been clearly confirmed by the last global economic crisis of 2007-2009. Significant liberalization of mortgage lending of residential real estate, initiated by the White House in the 1970s, including the simplification of procedures and requirements of insurance, securing loans and the valuation of collateral assets, gradually led to a significant increase in the number of unsecured or so called “toxic” loans.

According to the Harvard University Joint Center for Housing Studies, at the beginning of the century their share reached almost 20% of total mortgage loans. In absolute terms the number of high-risk loans exceeded 13 million with a total value of more than USD 2 trillion [10, p. 43]. It quickly transformed this "bubble" into a large-scale financial crisis that directly engulfed 165 major international and national banking institutions.

As is well known the overall effects of the crisis have been spectacular. The Dow Jones Index has fall down more than a half with unsecured loans loss totaling around USD 2.8 trillion by 2011 in Europe and America only. The most vulnerable to the global crisis with its sharp decline in commodity turnover were countries with export-oriented and transitional economies including Ukraine. By the level of devaluation, which amounted to 42% in the second half of 2008, the Ukrainian hryvnia ranked second in the world after the Icelandic krona with industrial production in the country falling over 34%.

A meticulous analysis of the main causes and effects of the crisis, carried out by a specially established reputable National Commissions of the United States and the International Monetary Fund, have revealed the list of the most important ones. Among them [8, 9]:

- systematic disruption of financial regulation and control, which has had a material adverse effect on the stability of the functioning of financial markets;
- significant weaknesses in corporate and credit risk management in many influential financial institutions;
- the combined negative effect of excess borrowing, risky investing and lack of transparency that were inherent for the entire financial system;
- inconsistency and low standards of mortgage lending and mortgage derivatives;

In this respect a reliable valuation of mortgaged property is recognized as being essential for the overall reliability of financial sector.

Given the magnitude of the global financial crisis which reached a global level, and based on its root causes revealed, international and national institutions have developed and implemented a number of regulative solutions to mitigate the adverse negative effects and prevent recurrences of such drastic events in the future.

Based on this, the **purpose** of the article is to analyze the measures provided by the relevant international and national regulatory documents and the instruments based on them, aimed at reducing credit risks and strengthening as a result the stability of financial systems as a whole, as well as the peculiarities of their implementation at the national Ukrainian level with respect to the collateral valuation.

**Recent researches and publications analysis.** Based on the mandate received from the G20 Summits of 2008-2012, the International Basel Committee on Banking Supervision has developed and adopted in a post-crisis period a set of documents, commonly known as Basel III in the development of the previous Basel I and Basel II documents.

The Basel III documents provide for a gradual transition to a new level of regulatory requirements for credit institutions. First of all it concerns the requirements for equity and the provision of high quality and liquidity of credit security or collateral [2, 3].

In its latest document, which came out at the end of 2017 and is considered to be a transition from Basel III to Basel IV, the Basel Committee finalized the regulatory changes, limiting to a large extent the permissible risk weighted assets. These restrictions are structured according to the type of credit institution and its rating level.

Fundamental measures proposed by the Basel III documents are oriented to:

- improve the ability of the banking institutions to absorb stresses;
- increase the level of risk management and corporate governance standards;
- increase transparency and openness of banking activities.

In addition to a significant increase in banking system-wide operational standards, Basel III envisages a gradual transition to a new level of specific requirements for credit institutions. First and foremost, they relate to equity requirements and the provision of high level of credit collateral liquidity.

At its core, the documents of the Basel Committee on Banking Supervision are internationally agreed standards, developed and adopted by consensus with the participation of representatives of the central banks and supervisory authorities of the most economically developed countries in the world.

Therefore, their status is not legally binding, being mainly of advisory type. Hence in this sense, it seems appropriate to investigate the implementation of these main provisions both at international and national levels.

**Main results description.** The implementation of the Basel III recommendations in the EU countries has been primarily done through the adoption of Directive 2013/36 / EC (CRD) and Regulation 575/2013 / EC (CRR) on the capital requirements of credit institutions [5,6]. These documents are already mandatory for implementation in all EU countries and should be considered as a single package. If Directive 2013/36/EC on capital requirements establishes general provisions on access to capital and a set of preventative management actions that financial institutions should support, then Regulation 575/2013/EC details the requirements themselves in a structured manner.

The main objective of the new package of European regulatory requirements for credit institutions is to establish a uniform, standard-based approach to responsible lending to reduce solvency, liquidity and excessive leverage risks, as well as to increase their resilience in the face of financial crises as a whole. Fully based on fundamental provisions, including main indicators of the Basel III international agreement, these documents set minimum requirements for banking and investment institutions which are involved in credit operations.

Another important European regulatory document oriented at reducing credit risk is Directive 2014/17/EC [7]. This document, commonly known as the Mortgage Lending Directive, aims to provide the borrowers with greater transparency and awareness of lending conditions and to set higher standards for the provision of support services. In particular, the Directive points to the need to use the most reliable and recognized mortgage valuation standards, which include the International Valuation Standards IVS, the European Valuation Standards EVS and the Royal Institute of Chartered Surveyors RICS standards.

These European regulatory documents stipulate that the value of the collateral assets must not be higher of their market value. In order to apply the most prudent approach, the concept of mortgage value is introduced. This concept was first accepted as a valuation basis in the previous Directive 2006/48/EC and afterwards it was transposed into Regulation 575/2013/EC.

In explaining the notion of mortgage value, both International and European Valuation Standards indicate that when used as a valuation base, mortgage value should be considered for a longer term than the market value which should be determined for a fixed point of time (Fig.). It follows that the collateral value of the property, as a rule, cannot exceed its market value and it should exclude the influence of any speculative elements.

In the most concentrated and detailed form, the requirements for assets valuation are set out in a special Regulation of the European Union 2018/345/EC, which was issued in November 2018. This extended document, which is primarily intended to value assets in resolution procedures and to regulate credit institutions insolvency, sets out the full scope of requirements for assets valuation methodology.

In particular, in addition to the market value, mortgage value and fair value, the following new basis of value are introduced:

- hold value;
- disposal value;

- franchise value.

It is emphasized also that, overall, the valuation methodology should be preferably based on income approach through cash flow discounting. In this context it is probably for the first time when possibility of value range determination is indicated in addition to its point value.

To its full extent, the methodological basis of banking valuation of property and liabilities are described today by two European documents:

- Consolidated Document of the Association of Mortgage Banks of Germany HypZert / VDP- "Mortgage Lending Value"[*Grimman, 2016: 245* ],

- European Banking Authority Guide - "EBA Handbook on Valuation for the Purpose of Resolution" [11].

These two documents are most detailed and therefore significant in content. As is stated in particular separate attention should be given to the time effect in collateral assets value. The fact is that, as is well known, under the influence of external (economic cycles, inflation, demand, etc.) and internal (wear, aging, damage, etc.) factors, the market value of mortgage property changes over time. This creates significant problems in determining the level of collateral value, since the terms of the loan agreements are often several years, especially when lending is related to real estate.

Being addressed to this issue, the most common today are 3 approaches based on the following concepts:

- *Mortgage Lending Value*, MLV, most widely used in Germany;
- *Investment Value*, IV with more global implementation;
- *Adjusted Market Value*, AVM, mainly used in UK and Spain.

Comparative testing of these three approaches, carried out by the *Property Industry Alliance Working Group*, has favored the latter, i.e. the AVM approach [12].

In addition to these three, a more structured approach has been proposed recently which is based on the Long-Term Sustainable Value or L-TSV concept. This concept is grounded on an income approach and introduces such new parameters as:

- *sustainable cap-rate*;
- *sustainable rent-rate*,

Both these parameters take into account long-term changes in the market value of assets. Accordingly, well known and widely used Williams-Gordon-Shapiro modified formula has a modified form that also takes into account inflation impact and assets physical deterioration:

$$V_0 = Y_1 / (i_{rf} + i_{rp} (g + \pi) + d)$$

$V_0$  – Long-Term Sustainable Value;

$Y_1$  – Net Operating Income for the next Year;

$i_{rf}$  – Risk-free Yield;

$i_{rp}$  – Property Risk Premium;

$g$  – Yearly Income Growth Rate;

$\pi$  – Inflation Rate;

$d$  – Depreciation Rate.

An example of the application of this approach to German residential real estate valuation using historical data for the period 1991-2017 and projected statistical estimates for the near future demonstrated the feasibility of its further wider testing and utilization [*Fischer, 2019: 12*].

International experience and practical activity in strengthening the financial system has not been overlooked by the domestic banking sector. The basic document of the national level in this respect is, of course, the widely known Resolution of the National Bank of Ukraine No. 351 dated of June 30, 2016 [1].

The main content of this Resolution, including a number of amendments to it, is the provision on determination of the credit risk level on active banking operations. This Resolution describes in details the methods and procedures for determination of this criterion and sets the level of its compliance.

In general, this Resolution is entirely based on the principles and recommendations of the Basel Committee on Banking Supervision and takes into account requirements of the relevant European Union policy documents in this area.

At the same time, much less attention has been given to the issues of assets valuation trustworthy. The content of the Resolution in this respect is limited to:

- basic principles for accepting assets in loan collateral;
- determination of the asset types to be accepted as a collateral and their liquidity ratios;
- requirements for monitoring the availability and conditions of such collateral;
- general requirements for the valuation bodies.

Methodologically, the content of these domestic regulatory document, with all the editorial changes, is limited to the provision of "the implementation by banks of collateral valuation at a value that does not exceed market (fair) value and ensures its sale to a third-party buyer." It also points to the need to "re-evaluate the value of collateral ... on a regular basis, in particular, real estates, businesses, land and machinery equipment - at least once a year ...".

There is, evidently, a significant gap between existing international practices and the national valuation requirements for property, property rights and obligations, which are described above. In doing so, we should take into account that, in practice, the valuation of mortgaged property is performed with the reference to the market value.

This certainly casts doubt on the validity and reliability of the results obtained in assessing both the quality of banks' assets and their stress testing results, as the market value is usually higher than the mortgage one or similar type of valuation basis which reflect long-term effect. Accordingly, the value of assets, when the market value is used as a basis for valuation, exceeds its level in comparison with the case of the utilization of mortgage or similar value basis. It means that final results of assets value assessment will be shifted to a non-conservative side.

At the same time, the overall sustainability problems of Ukrainian banking sector remain significant. According to the recent data from The World Bank Group, the share of non-performing or "toxic" loans in the banking sector in Ukraine is the highest among the major post-Soviet countries being equal in 2017 to 54.5 % or more than a half of a total loans number [13]. All this also necessitates the continued adoption of sound regulatory measures.

At the same time, it should be emphasized that the problems of a significant lag in the methodology of valuation are of general type. A simple acknowledgment of this is the fact that, as of today, the national valuation standards which were issued initially in 2003 -2006, and still remain unchanged to this day. Even the very concept of mortgage value is not defined in these standards being classified among other types of valuation basis apart of the market value. Coming from this, regulatory measures necessary should cover not only national banking sector but all assets valuation activity in a country.

**Concluding remarks.** The recent global economic crisis has revealed significant deficiencies in the functioning of the financial system, its low ability to dampen crisis phenomena. Based on the joint decision of G-20 Summits 2008-2012 a number of international regulatory instruments aimed at strengthening the banking sector were introduced. They include first of all documents of the International Basel Committee on Banking Supervision - Basel III and European Union policy documents, which set out new principles and approaches, as well as criteria for ensuring a more stable functioning of banking institutions including their ability to counteract crisis events.

One of the main outcome from this documents is recognition of core importance of collateral assets valuation. At the same time from a methodological point of view it's important to consider time effect on assets valuation results with respect to the loan agreement duration. Different existing approaches to take into account this effect are reviewed which gave a priority to adjusted market value (AMV) and long-term sustainable value (L-TSV) concepts.

Relying on international documents issued, the National Bank of Ukraine in its Resolution No. 351 also presented regulations for assessments of credit risks in financial institutions. At the same time methodological guidance for collateral assets valuation are covered in this Resolution in

sufficiently. Partly it is caused by outdated general national valuation standards published in 2003-2006. From this it became evident necessity to provide sufficient measures for filling in enlarging gap in valuation guidance documents at national level.

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