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**Nataliia Marynenko**

Doctor of Sciences (Economics), Full Professor  
Professor of the Department of Economics and Finance  
Ternopil Ivan Puluj National Technical University, Ternopil, Ukraine

**Iryna Kramar**

Doctor of Sciences (Economics), Associate Professor  
Professor of the Department of Economics and Finance  
Ternopil Ivan Puluj National Technical University, Ternopil, Ukraine

**Halyna Tsikh**

PhD (Economics), Associate Professor  
Dean of the Faculty of Economics and Management  
Ternopil Ivan Puluj National Technical University, Ternopil, Ukraine

## IT OUTSOURCING CONTRIBUTION TO THE UKRAINE'S ECONOMY

*“In order to build an innovation-driven nation we need to educate our people well, and to provide them enough resources and incentives to chase their dreams”*

*Chandrajit Banerjee (The Global Innovation Index, 2014)*

The drastic labour migration makes an impact on the country's economy in terms of the Gross Domestic Product (GDP) losses etc. The importance of the IT industry development and necessity for talented IT professionals to stay and work in the country in particular, are proven by the significant impact of this sphere on the domestic economy.

According to the survey carried out by the largest Ukrainian developer community DOU.ua [1] for finding out the reasons for “relocation” of Ukrainian IT-professionals, only 11% respondents said they were traveling for career prospects. The main reasons for relocating are the possibility of calm and safe life for myself and my family (32%) and there are no prospects to stay (25%). Thus, the quality of institutions within the country and perspectives of the company development are key reasons to leave. Among the possible reasons for return, the first place belongs to the significant improvement in the country (63%), and second – to the family circumstances (39%), followed by the end of the anti-terroristic operation in the East of Ukraine and an interesting proposal from a professional point of view.

Reasons for working in tech are as follows: interest in technologies (78 %), high salaries (63 %), professional growth prospects (54 %), flexible work schedule (42 %), possibility to move abroad (29 %), open-minded colleagues (25%) and it happened accidentally (11 %) [2].

IT outsourcing enables companies-outsourcers to quickly set up smooth running of IT systems, determine the required quality of service, involve highly skilled professionals in solving problems, significantly reduce the risk of losing important data, optimize costs and make them more predictable, focus the company's resources on its core business.

As to the world arena for outsourcing services, Asia continues to dominate the 2019 annual Global Services Location Index at a regional level [3]. The US and also perform well. Latin America remains a strong contender, with Brazil, Mexico, and Colombia taking 9<sup>th</sup>, 11<sup>th</sup>, and 13<sup>th</sup> place, respectively. Central and Eastern Europe countries, however, have shifted in their Index performance. While less established locations such as the Baltic States, Ukraine (20<sup>th</sup> position) and Russia are pulling ahead, the more prominent Czech Republic, Poland, and Hungary show large declines in the ranking due, in part, to rising costs. It should be also noted that Ukraine holds 43<sup>rd</sup> position in Education [4] among 148 nations and one Special Administrative Region of China, Hong Kong – ahead of India, China, Indonesia, Mexico, Brazil, Chile as popular outsourcing destinations.

The US remains Ukraine's largest partner for joint R&D activities (around 45 % of the companies involved), followed by Great Britain, Canada, Cyprus, Germany, the Netherlands, Ireland, Israel, Norway, Sweden, Switzerland [5; 6].

Ukrainian software development companies are primarily serving such industries as data management (26 %), telecom (19 %), cloud (18 %), gaming and e-commerce (16 % each), media (12 %), finance (12 %), healthcare (8.0 %), travel (6 %), retail (6 %), security (5 %) [7].

A. Pavliv, the CEO of N-iX and chairman of the Lviv IT cluster supervisory board, considers that the growing presence of Ukraine in the Global Outsourcing 100 list is explained by the fact that more and more foreign IT companies are opening their centers here [8]. Microsoft, Samsung, ABBY, Huawei, Aricent, Boeing, Ericsson, Huawei, Oracle, Siemens and Teleperformance etc. have chosen Ukraine as one of their R&D facilities location [9; 10].

The share of the information and communications technology (ICT) industry in the Ukrainian economy is 3.9% of GDP as of 2018 (Table 1).

Table 1

Ukraine's GDP and ICT

Year	2010	2011	2012	2013	2014	2015	2016	2017	2018
GDP, mln. UAH	1079346	1299991	1404669	1465198	1586915	1988544	2385367	2983882	3560596
ICT, mln. UAH	33011	38390	43379	48372	52724	72596	89268	110296	138828

Source: [11]

Dynamics of the Ukraine's total exports of goods and services, service exports, ICT service exports (3<sup>rd</sup> place in total exports) in 2010-2017 according to the World Bank data is presented in Figure 1.

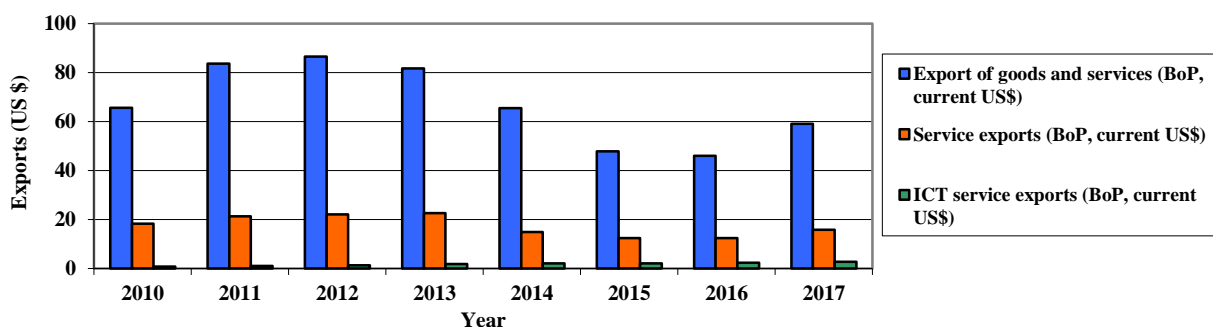


Figure 1. Total exports of goods and services, Service exports, Information and communications technology service exports in Ukraine in 2010-2017\* (Balance of Payments, current US dollars)

\*Most recent data for ICT service exports are available for 2017 as of March, 2020

Source: [13; 14; 15]

The IT ecosystem in Ukraine is multifaceted and dynamic and is composed of IT clusters (currently 17), business associations and innovation centres [6]. The talent pool in Ukraine was 185 thous. IT specialists in 2018 [12] and in 2019 it accounts for 200 thous. ones.

In the Ukraine, 27 % of IT professionals are 1 or 2 years experienced, 14% – less than a year. Another 29 % have been working in the industry for 3-5 years, 17 % – for 6-10 years. The amount of those who are more than 10 years experienced accounts for 14 %. Men account for 76 %, and women – for 24 %. The age of IT professionals is distributed as follows: less than 20 years old – 8 %, 21-25 years – 32 %, 26-30 years – as well, 31-35 years – 18 %, 36-40 years – 7 %, above 40 years – only 3 % of total amount. The average age of programmers (women and men) almost doesn't differ: juniors are 23, middles – 26, seniors – 30 years old. Architects are the oldest being averagly 32 years old [2].

Given the high salaries of programmers, the vast majority of companies are forced to use a scheme with PEs, otherwise they simply will not be able to hire and retain good (expensive)

specialists taking into account the tax burden arising when hiring employees compared to simplified tax regime.

The model of contracting with private entrepreneurs (PEs) is very advantageous because it significantly reduces the tax burden on companies and enables them to be competitive in the international market, provides rapid growth of the industry as a whole. This simplified income tax rate is in contrast to a very high tax burden of more than 40% when working as a salaried employee (split between the employer and employee: 22% as USC, 18% as personal income tax (PIT), 1.5 % as a Military fee (MF)). Such taxation option is very favorable as foreign companies are reducing their tax burden by contracting with PEs and also save costs associated with incorporating and maintaining a local company [16; 17].

The importance of payroll tax issues for the IT industry is demonstrated by the structure of taxes paid by companies, where the largest share, which increases each year, belongs to the PIT (Table 2).

*Table 2*

Structure of taxes paid by IT companies in total tax payments, in percentage

Tax type Year	Personal income tax, PIT (standard tax rate is 18%)	Corporate income tax, CIT (standard tax rate is 18%)	Value added tax, VAT (standard tax rate is 20%)	Other taxes, %
2013	29	21	45	5
2014	36	21	36	7
2015	41	22	32	5
2016	42	22	30	6
2017	47	16	32	5

Source: [6]

The amount of revenues to the state budget from PIT per IT worker was almost 4 times higher than the national average. Because the practice of contracting with PEs in the industry is widely used, the amount of a single tax paid by one active entrepreneur was also taken into account. However, its volume also turned out to be 3.4 times higher than the volume of PIT per 1 employee. Salary accounts for 80-85 % of business expenses, up to 7 % of them are for office rentals and up to 5 % – for taxes. Given this structure, the stability and predictability of payroll taxes is of great importance for the IT companies [6; 7; 18; 19; 20; 21].

The single tax paid by PEs belongs in full to local budgets at the place of registration, while only 75 % of PITs are distributed among local budgets of different levels and as to the CIT, 90 % of it is distributed to the state budget. Therefore, IT workers contribute to local budgets and regional development.

In September of 2019 the former Prime Minister of Ukraine O. Honcharuk proposed to establish a Human Capital Development Fund – IT Creative, the funds from which were planned to be spent on scholarships for talented students, grants for young scientists and the creation of educational infrastructure. However, the generation of revenues for it had to be due to the introduction of a new tax (1% in 2020, 2 % – in 2021, 3 % – in 2022, 4 % – in 2023, 5 % – in 2024) to be paid not by companies, but by PEs working in the industry. Additionally such PEs were to pay doubled USC and 1.5 % of MF [17].

Another survey has been conducted by the DOU.ua a bit earlier than the idea with IT Creative arose for finding out the reaction of IT professionals to the possible tax increase. According to [22] 48 % of those who do not support the tax increase or have not decided on their opinion (or 37% of all respondents) would look for opportunities to relocate if the tax does increase; 14 % of those who do not support the tax increase or have not decided on their opinion (11 % of all respondents) would definitely move to another country. Kyiv (which hosts almost 40 % of all Ukrainian IT professionals) is ranked at the end of The Economist Liveability Index [23], so why should a programmer live in Kyiv if he/she may be paid almost the same salary while working in Krakow or Berlin, but having much more comfortable living conditions?

M. Ishchenko, the founder of the Ukrainian community of developers DOU.ua, commenting on this, pointed out that instead of solving these problems, we are offered to leave everything as it is for another 10 years by raising the single tax rate. He continues by saying that for the growth of the IT industry, the most effective way is to reform the whole country, not it [24].

A survey on the quality of IT education in Ukrainian HEIs, conducted by DOU.ua among IT graduates [25] testified that, despite the fact that the training program (curriculum) is still the weakest aspect of Ukrainian higher education, most IT professionals (69 %) recommend getting high school degree in Ukraine, while emphasizing on the need and importance of self-education.

Relatively low costs and high quality of jobs performed, high level of Ukraine's IT specialists professionalism, the highest among neighboring countries share of technical and mathematical specialties are the determinants of Ukrainian IT industry success and popularity.

One of the key issues remaining for the further IT industry's successful development are fiscal policy and the possibility to have preferential conditions for the IT industry development in particular. The largest companies-developers operating in Ukraine aim to get rid of the Ukraine's image of purely outsourcing country, the main competitive advantage of which is cheap labor. Reorientation of Ukrainian IT companies to product development is one of perspectives for industry to grow and to take leading positions in the world market for IT services as well as to positively impact Ukraine's image at international arena as an innovative country.

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