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Bulletin of Geography. Socio-economic Series, No. 52 (2021): 85–94
http://doi.org/10.2478/bog-2021-0015

ISSN 1732–4254 quarterly

BULLETIN OF GEOGRAPHY. SOCIO–ECONOMIC SERIES

journal homepages:
https://content.sciendo.com/view/journals/bog/bog-overview.xml
http://apcz.umk.pl/czasopisma/index.php/BGSS/index

The modern concept of special economic zones in Ukraine

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How to cite:
Liashenki, V. Pidorycheva, I. Mytsenko, I. Chebotarova, N. (2021). The modern concept of special economic zones in Ukraine. *Bulletin of Geography. Socio-economic Series*, 52(52): 85-94. DOI: http://doi.org/10.2478/bog-2021-0015

Abstract. The article deals with special economic zones as a tool of state policy of countries seeking to attract foreign investment and ensure economic growth. The aim of the article is to substantiate the new concept of special economic zones of Ukraine as stimulating regulatory regimes aimed at attracting innovative investments and developing new industries based on the smart specialisation of regions and trends in the world economy. The regime is presented as a system of incentives and benefits, mandatory conditions and restrictions, and seeks to increase the investment attractiveness and technological diversification of the economy of the regions and the country as a whole. Each component of the regime has been classified, taking into account best practices of other countries and the strategic goals of Ukraine regarding the need to ensure sustainable and innovative development and to enter the world markets as a manufacturer of high-tech innovative products.

Article details:
Received: 7 February 2020
Revised: 26 November 2020
Accepted: 2 February 2021

Key words:
special economic zones,
regime,
innovative investments,
new industries,
smart specialisation of regions,
technological diversification

Contents:

1. Introduction

Today's world economy is undergoing transformations associated with the development of Industry 4.0 technology (World Economic Forum, 2018), increasing the intensity of international competition, and accelerating all processes, which are becoming more global and more open. In such circumstances, a country's ability to participate on an equal footing in the global economic relations system depends on its ability to consider new technological development trends.

At this stage, Ukraine is losing significantly in this regard. With considerable natural, human and material resources, Ukraine is inferior to all European countries in terms of social, economic and technological development. GDP per capita by PPP as of 2018 is USD 9,233.1, which is 4.7 times less than the European Union average (The World Bank, 2019a). Ukraine's position in the world market for high-tech products is rather modest: exports of high-tech Ukrainian products in 2018 amounted to 5.4% of total exports of manufactured goods. This is many times smaller than in the developed and even developing countries. For example, in China, this figure is 31%, in France 26%, in Israel 23%, in the Czech Republic 20%, in Australia, Estonia and Japan 17%; even in Bulgaria, a traditionally agrarian country it equals 10% (The World Bank, 2019b).

In order to change the current situation, public policy should focus on creating favourable conditions and introducing effective tools for attracting and directing investments in high value-added industries. One of the tools that has proven effective in many countries is Special Economic Zones (SEZs). In modern understanding and in the broad sense, special economic zones are geographically separate parts of the territory of one country, or border areas of a group of countries, and generally have a special administrative, regulatory and fiscal regime that is more liberal than in the country/countries as a whole and that are intended to create an attractive environment for managing and conducting entrepreneurial activity in priority activities; this is intended to solve the complex problems of a certain region, country or group of countries as a whole.

2. Literature review

Currently, there is a significant amount of theoretical and empirical literature devoted to various aspects of SEZ activities. However, despite a massive prevalence of economic zones in the world and their significant specific differentiation in terms of types, features, goals of establishment, size, eligible activities, markets and examples (Pidorycheva, 2017: 53), many important issues still remain unanswered. Specialists point to the lack of a precise understanding of economic zones due to the constant evolution of the original SEZ concept, the emergence of new zones or the modification of existing zones, and their plurality in certain countries and regions of the world. Thus, Aggarwal notes that in all developing countries there are more than one type of SEZ (Aggarwal, 2010: 8–9), which complicates the assessment of the number of economic zones (The World Bank Group, 2017) and analysis of their effectiveness (Farole, 2011).

Most studies are focused mainly on successful examples of economic zones, which calls into question the objectivity of conclusions about the regime and factors behind the success of SEZs. Along with successful attempts to create economic zones, it is necessary to take into account negative experiences and the reasons behind them. Each economic zone should be considered through the prism of established institutions in the country, taking into account the peculiarities of economic, political, social and cultural environments. In this regard, the development of studies on the profiles of Polish and Ukrainian managers in the context of the priority creation of free economic zones with the participation of Polish and Ukrainian businesses is quite productive (Glinkowska, Chebotarov, 2018).

The aim of the article is to substantiate the new concept of special economic zones of Ukraine as stimulating regulatory regimes aimed at attracting innovative investments and developing new industries based on the specialisation of regions and trends in the world economy.

3. Research methodology

The theoretical basis of the study is the guidelines of endogenous growth theory and the institutional economy. According to them, SEZs have a positive influence on the investment climate and can change the trends of the country's movement towards advanced innovative growth. But this requires effective institutions, including competent government and appropriate state policy.

Methods of analysis and synthesis, comparative analysis and systems approach have been used for this research. Scientific reports by international organisations, Ukrainian legislation acts, and foreign and Ukrainian scholarly research publications on this issue have been used as references.

4. Research results

The SEZ concept covers a wide range of economic zones that differ in purpose of creation, size and market orientation. In addition, economic zones often include specialised economic zones that are created to support certain activities (Table 1). Economic zones are constantly being modified – old types disappear or adapt to new regimes.

Sixty years of world experience in economic zones has allowed us to study the outcomes that are required to be considered whenever the feasibility of creating another SEZ is considered:

1. Economic zones, as a rule, go through an incubation period, which lasts from five to ten years, before they achieve their goals and bring benefits.
2. The current global economic environment is significantly different from that in which the first SEZs began to work. In order to attract investors to modern economic zones, significantly better regimes should be offered, in terms of costs and experience.
3. Excessive ambition and overestimation of opportunities are often found in the countries that try to use SEZs as a means to solve structural problems of the economy. This is usually the result of unrealistic assessments of the existing potential of the territory on which the economic zone is planned to be created.
4. Economic zones, as a rule, occupy large areas of land, which are provided to investors at below market cost, which creates risks of land not being used for its intended purpose. In order to prevent this situation, it is necessary to develop clear criteria that the investor of the economic zone must meet.
5. The practice of providing a wide range of tax benefits to SEZ investors is widespread in the world. However, not everything is so clear. Using exclusively fiscal preferences without respecting other mandatory control for creating zones, the authorities can certainly improve

Table 1. Examples of specialised economic zones*

Zone type	*Purpose of creation*	*Examples*
Scientific and technological parks	Promotion of high technology and science-intensive industries	*Singapore Science Park* (Singapore)
Software Zones	Development of software and IT services	*Dubai Internet City* (United Arab Emirates)
Finance Services Zones	Development of off-shore financial services	*Labuan Offshore Financial Centre* (Malaysia)
Tourism Zones	Integrated development of tourism	*Baru Island* (Columbia)
Logistics Parks	Support of quality logistics	*D1 Logistics Park* (Czech Republic)

* *Source:* Akinci, G., & Crittle, J., 2008, p. 11.

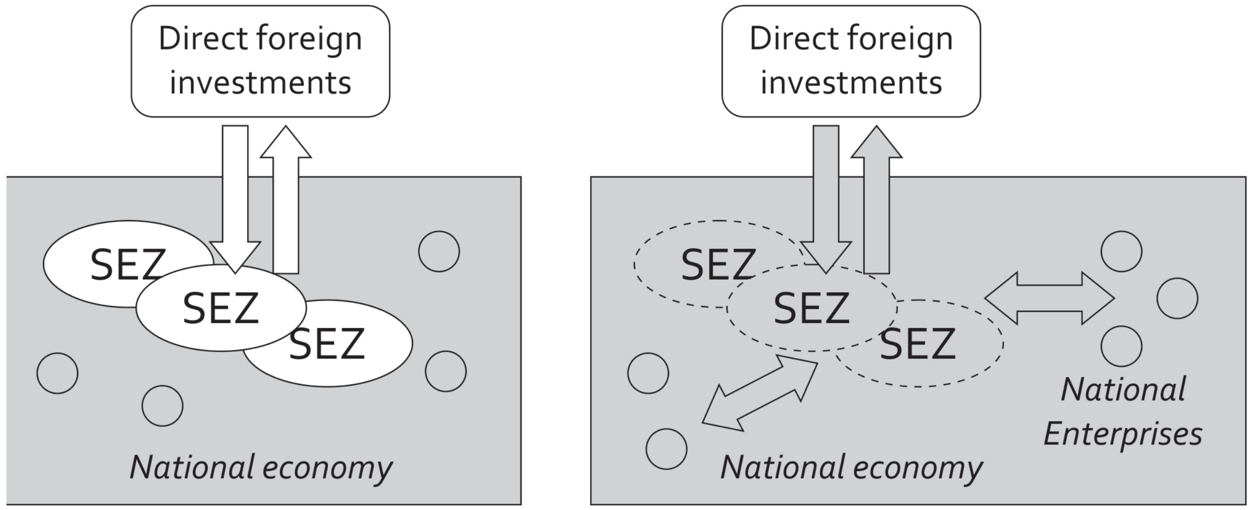

Fig. 1. Special economic zones as "islands" and "catalysts" of the national economy* (from left to right)
**Source: World Bank, 2010: 305*

the economic situation in the region, but it will hardly be possible to achieve a long-term effect. However, there are many examples of zones that remained isolated "islands" of the national economy, without playing a significant role in structural transformations (Fig. 1).

In this context, it is necessary to draw attention to the fact that most successful economic zones in the world are organically embedded in the national economy and closely integrated with global markets. For example, South Korean SEZs have strong ties to local suppliers. Savan-Seno SEZ in Laos operates as an economic border area that links Laos with the regional and global economy (Brown, 2018). In order to avoid such a scenario, it is necessary to develop infrastructure, and to invest in modernisation of roads, electricity and water supply systems, telecommunication systems, and transport. The lack of proper infrastructure, even in the presence of a favourable tax climate, could become a serious obstacle to the successful development of an SEZ, as happened in particular in Africa: the lack of reliable electricity and long distances from the port have caused the failure of many African economic zones. Thus, the role of location and proximity to land, air and sea transport is far from the least significant in contributing to the success of an SEZ.

Ukraine has a negative experience in creating special economic zones. The preferences provided by the state have not provided the expected results, leading to significant losses in the state budget, distortions in the economy and worsening of the competitive environment.

In accordance with the Basic Law of Ukraine (Verkhovna Rada of Ukraine, 1992) and special laws adopted for each specific zone, 11 SEZs were created in the period from the late 1990s to the early 2000s. Special laws on the territory of economic zones introduced privileged tax, customs and financial conditions of economic activity, among others. The following benefits were granted to investors in various combinations: special customs control, exemption from taxation of profits, exemption from taxation of investments, exemption from import duties and VAT, exemption from mandatory sale of foreign currency receipts, exemption from payment for land, and release from payment of fees to some budget funds. Provision of these benefits led to a reduction in tax revenues to the budget and a distortion of competition through the creation of economically unjustified preferences for certain producers and significant gaps in legislation.

In fact, the country operated a "manual" mode of creating SEZs. Decisions on their establishment were subjective and often were not related to the need to address the problems of a certain territory. Similarly, requirements (criteria) for enterprises that wanted to operate in economic zones were not defined. In fact, every enterprise, regardless of the sphere of activity (and this does not even refer to high-tech production as it is accepted by global practice), is justified in taking advantage of the special regime of activity.

The export strategy of Ukraine for 2017–21 aims to implement "the transition of Ukraine to the export of high-tech innovative products for sustainable development and successful entry into the world markets" (Cabinet of Ministers of Ukraine, 2017). The importance of achieving this goal is due to the high share of exports (41.1% as of 2019 [The World Bank, 2019c]) in the structure of the gross domestic product of Ukraine and its predominant commodity orientation (by the results of 2019, vegetal products and ferrous metals accounted for 43.3% of total Ukraine's commodity exports [State Statistic Service of Ukraine, p. 4–5]), which poses a threat to the social and economic stability of the Ukrainian state.

The entry of Ukraine into the new European markets depends to a large extent on the development of innovations, which are crucial for the diversification of production, productivity and added value. As the experts point out, the next wave of innovations will ensure the growth of the economies of those countries that will work in new industries, export information and knowledge-intensive services (Ross, 2017: 12, 18). Taking into account that specialised centres for the development of new industries have not yet been formed, each country (even developing countries) has every chance to become a centre of next-generation innovation and to make the "technological leap" as, for example, the newly industrialised countries. In this context, *special economic zones can be considered as tools for the liberation of the innovative potential of Ukrainian territories for the generation of ideas for new products and services, for the development of new knowledge-intensive types of activities that will facilitate technological (sectoral) diversification of the regional economy, their participation in the creation of global value chains (GVCs) of new industries and integration into existing GVCs on a more beneficial basis.*

In light of the above, it is proposed to create in the territory of Ukraine a modern type of SEZ as a stimulating regulatory regime that encourages innovative investment, combining a system of incentives and privileges, a mandatory regime and restrictions to maintain a balance between the interests of the population, business and the state.

The interests of the population are the provision of rights and freedoms, safety, the possibility of physical and intellectual development, ensuring a healthy lifestyle, and improving the quality of life.

The interests of the state (subject to the effectiveness of the state institution) are to promote sustainable development of regions (territories) and the country as a whole, improve living standards and ensure a decent standard of living for the population.

The investor's interests are maximisation of income per investment or minimisation of transaction costs per unit of received income.

The word "stimulating" means that in the regulatory regime, the system of incentives, privileges and permissions will dominate the system of prohibitions, responsibilities and restrictions on the interest of companies to invest in innovation. Taking into account lessons learned from negative previous experience, when ill-considered provision of a wide range of state preferences to residents of SEZ has led to extremely negative consequences (there have been cases of abuse of power, neglect of the requirements of the legislation for the purpose of illegal enrichment and obtaining of rent), this approach may seem utopian. But this is not about abandoning restrictions and prohibitions. They should be applied, but at the same time, they should not be the basis of the control, because in a market-oriented relationship the strategy of imposing behavioural models on private entities and prohibitive-enforcement tools of influence does not work. It is necessary to contribute in every way to the achievement of investors by their own goals, taking into account the interests of most Ukrainian citizens, rather than separate segments of society or people endowed with power.

In the economic zone, the rules and control of economic activity should be introduced and the investment climate should be of interest to business and investors as the main driver of economic growth.

In general, the term "regime" is a "set of rules, measures and norms for achieving any goal" (Lyashenko, 2012: 48). From the standpoint of cybernetic and synergistic approaches, the regulatory regime can be described in this way:

where G is the set of goals expected to be achieved by the introduction of the control; S is the set of subjects having access to the control; I is a set of rules and restrictions that are needed to achieve the goals; R is the set of resources required for the implementation of the regime; and P is a set of policies or strategies aimed at achieving and realising certain goals.

We shall use the concept of the regulatory regime as a balance of incentives, motives and re-strictions to the regime of special economic zones. The components of the regulatory regime of the special economic zone (RJSEZ) are as follows:

$$RJ = \{G; S; I; R; P\}$$

RJSEZ = {Goals of introduction of the regime; Subjects having access to the regime; Cri-teria for granting permits for conducting economic activity in the SEZ; Fiscal and non-fiscal preferences; Management structure of the zone; Operation period of the regime}.

1. Goals of the introduction of the regime are the attraction and support of investments in the development of competitive advantages (specialisation) of regions of Ukraine with the use of new technological tools, such as digitisation, virtualisation and automation of all processes, as well as new types of activities, including new industries in the field of high technologies in which busi-ness is interested, as perspective directions of future specialisation, for technological (sectoral) di-versification and enhancement of international competitiveness of the Ukrainian economy.

In order to grant the territory the status of a special economic zone, it should comply with cer-tain indicators. In this regard, it is necessary to follow the commitments undertaken by Ukraine by signing the Association Agreement between Ukraine and the EU, including maintaining free and fair competition, and ensuring equal conditions for all market participants. This, in particular, is men-tioned in Part 2 of Chapter 10 “Competition” of the Agreement (Verkhovna Rada of Ukraine, 2015):

But in some cases there are possible exceptions (clause 3 of Article 262 of the Agreement): the fol-lowing may be considered to be compatible with the proper functioning of this Agreement:

- aid to promote the economic development of areas where the standard of living is abnormal-ly low or where there is serious underemployment;
- aid to promote the execution of an important project in the common European interest or to remedy a serious disturbance in the economy of one of the Member States;
- aid to facilitate the development of certain economic activities or of certain economic areas where such aid does not adversely affect trading conditions contrary to the interests of the Parties;
- aid to promote culture and heritage conservation.

Fulfilling at least one of these conditions gives the state and local authorities the right to consider the possibility of introducing special legal control for economic activity on the territory in question.

2. **Subjects having access to the regime** are Ukrainian and foreign companies interested in innovation investment, activities in the field of high-tech product manufacturing and high-tech ser-vice provision and meeting the defined criteria of residence in the SEZ.

3. **The criteria** for granting permits for conducting economic activity in the SEZ are consid-ered as **restrictions** imposing **requirements, obligations** and **prohibitions** for investors wishing to operate in the economic zone.

3.1. *An obligatory condition of activity in the zone is legalisation of incomes and withdrawal from the shadow, waiving of shadow wages and shadow employment* to ensure social guarantees of the population, development of fair competition and reduction of corruption risks. According to var-ious estimates of experts, the share of the shadow economy of Ukraine ranges from 46% to 62% of GDP (Schneider, 2012; Harazishvili, 2017).

3.2. The criterion for creating jobs for existing enterprises is at least five new positions, for new ones it should be at least ten, including new types of activities. This criterion does not apply to small enterprises, to prevent their discrimination and promote the development of small innovative entrepreneurship in the zone.

3.3. The criterion of innovation is the key one and implies that the residents of the economic zone will: 1) carry out activities related to the development and/or introduction of new technologies in the specialisation areas of the region; 2) invest in the development of high-tech services; 3) devel-op new types of activities, based on available resources and local experience based on the principles of smart specialisation: the process of self-knowledge or the entrepreneurial process of discovery; types of activity, rather than the sectors of the economy as such, is the level for the establishment of priorities for development and investment; reasonable specialisation involves strategic and special-ised diversification; assessment and monitoring (OECD, 2013: 18-19).

3.4. The criterion of priority sectors is based on the comparative advantages of the region and promising areas in which entrepreneurs are interested in developing new activities. The priorities of sectors and promising directions of activity are not determined artificially by the government or local authorities via a "top-down" approach. Instead, these issues are solved by entrepreneurs on the basis of a reasonable specialisation approach.

3.5. The criterion of openness and transparency of activity is that the residents of the zone should be provided with free access to information according to their own interests, actual inquiries and needs for natural clustering with other manufacturers, suppliers and scientific organisations within the zone.

The list of proposed criteria is not claimed to be complete and may be supplemented by other restrictions, obligations and requirements of investors or adjusted depending on the purpose of cre-ating a zone, the specifics of the territory and other factors, but it cannot be contrary to the purposes of the regime.

4. Fiscal and non-fiscal preferences. As international experience has shown, the introduc-tion of considerable tax and other financial preferences in economic zones in the absence of quality infrastructure, access to electricity, water and other resources, links with local producers and suppli-ers and a favourable business climate is not the right approach. It is not perceived by civilised inves-tors aiming to obtain benefits by lawful means. The absence of the above-mentioned basic control cannot be offset by broad tax breaks, and in the best case it is able to provide short-term benefits, and often has negative consequences for the economy in the form of losses to the state budget, dis-tortions in the economy and distortion of the competitive environment, as happened in Ukraine. Therefore, *the special economic zone regime is proposed to be based on a reasonable combination of simplified regulatory and administrative non-fiscal incentives with the system of economic incentives in the form of temporary tax preferences.*

Issues relating to the stabilisation of the political situation and the reduction of corruption are certainly overwhelming, but are unlikely to be resolved within a region or territory. In the eco-nomic zone, it is necessary to focus, first of all, on simplifying the regulatory environment, providing informational and infrastructure (industrial, transport, social) support to investors, with some innova-tions in terms of tax and customs regulation. The latter can be implemented as an experiment in view of the unsuccessful previous experience with their application.

It is proposed to introduce such fiscal and non-fiscal preferences in the economic zone taking into account the best practices of other countries.

4.1. *Simplification of the regulatory environment:*

- introduction of a moratorium on inspections of residents of the zone by the fiscal authori-ties and state supervising bodies. Measures of state supervision may be carried out subject to their respective justification, with the consent of the Administration of the zone;
- transfer of all zone services into electronic format, introduction of an electronic document management system to simplify and reduce the registration procedure, reduce bureaucracy and avoid corruption in personal contact with fiscal and supervisory authorities.
- the introduction of complete automation of the reporting process and the payment of taxes and other mandatory payments in order to simplify tax administration.

4.2. *Improvement of information support for residents and potential investors of the zone* by creating a single information resource (site). The resource will, clearly and in an understandable form, present all necessary information on the regime and procedure for registration in the zone, the list of privileges and preferences, restrictions, requirements and obligations for potential investors in the zone in accordance with the current legislation. The administration of the site should be on a permanent basis, and all necessary information should be displayed promptly with the quick intro-duction of changes.

4.3. *Granting tax privileges*. It is proposed to introduce a separate bill into the "Amendments to the Tax Code of Ukraine (regarding the improvement of some norms of the Tax Code of Ukraine in terms of stimulating investment and innovation activity in the territory of Ukraine)", such changes to the Tax Code of Ukraine, as well as to the Customs Code of Ukraine:

- to release for five years from paying profit tax of resident enterprises of SEZ, for the next five years to set the tax rate half that in the country as a whole, at the level of 9%;

- to release from import duty for ten years modern equipment, equipment and components to them (in case they originate from states with which the relevant international agreements have not been concluded; for the states with which Ukraine has entered into corresponding agreements it is allowed to establish tariff exemptions in the form of dismissal from taxation of import duties – Arti-cle 281 of the Customs Code of Ukraine) in order for resident enterprises of the zone to use them in economic activity;

- to establish a zero rate of value added tax for a period of ten years for enterprises-residents of the SEZ that import new technologies and equipment for use in the territory of the zone;

- to provide the opportunity for local authorities and local councils to free investors from rent for the use of a land plot that has an economic zone, for a period of up to ten years.

Financial assistance in the form of tax benefits should be provided only after the com-mencement of economic activity and the receipt of income by investors of the zone that has a con-venient and safe form for the state budget and satisfies the principle of transparency of the provi-sion of state aid.

4.4. *Availability of ready-to-use industrial and transport infrastructure (road, electricity, wa-ter, communications, access to seaports and/or airports, etc.), residential premises and high-quality social infrastructure are important incentives.*

5. An integral part of the regime is the management structure of the zone, consisting of: *Administration of the zone*, which will carry out general zone management; *Public Council of the Zone* with the participation of experts and the public (professional and business organisations) to ensure a balance between the interests of business and the local population; *Advisory group of the zone* with the participation of profile experts to provide advice on the implementation of investment and innovation projects in various spheres.

6. Operation period of the regime. Taking into account the incubation period, which lasts from five to ten years before SEZs achieve their goals and bring benefits, it is proposed to set a ten-year regime and oblige the Zone Administration to provide the Ministry of Economic Development, Trade and Agriculture of Ukraine with an annual report on the work results.

5. Conclusions

Special economic zones are becoming increasingly popular as a tool for structural changes and eco-nomic development. The existence of the zones in international practice indicates the imperfection of the institutional and regulatory environment in many countries, which is difficult to overcome on a national scale. The creation of SEZs allows, at least point-wise, to create the necessary environ-ment for attracting investment and implementing structural changes in the economy based on inno-vations and new technologies.

Positive effects from the activities of the SEZ largely depend on the competence of the gov-ernment, the effectiveness of existing institutions (primarily the institution of state), and a correct understanding of the nature of economic zones as integral parts of the national economy, policies and strategies for the development of the state.

The idea of the study is to form a network of special economic zones on the territory of Ukraine as regulatory regimes to encourage innovative investments to generate ideas for new prod-ucts and services, and to develop new industries, taking into account the specialisation of the re-gions. The regime combines a system of incentives, benefits and limitations as the basis for maintain-ing a balance between the interests of business and the state in order to advance the innovative de-velopment of Ukraine. The introduction of the regime seeks to facilitate the release of the economic, industrial and innovative potential of the regions, technological diversification of the Ukrainian economy through the development of high- and medium-high-tech industries, high-tech services, and creative industries. This would address the strategic objectives of the structural and technologi-cal modernisation of the economy and its innovative, knowledge-based development.

The prospects for further research are to substantiate the feasibility of using the mechanism of franchising replication for the formation of the SEZ network in Ukraine at the following stages. *The first stage is pilot design. The second stage is duplication.* If the pilot project succeeds, organise the process of forming duplicate zones in other regions of the country. *The third stage is franchise replication.* Transmission of the mastered scheme for the creation and operation of pilot and dupli-cated zones for use in other regions of the country pilot design; duplication; franchise replication.

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