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Ukraine, the European Union and the International Community: Current Challenges and the Agenda for Overcoming the Stalemate

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Peter Havlik

Ukraine, the European Union and the international community: current challenges and the agenda for overcoming the stalemate

Introduction

Ukraine was confronted with an unprecedented economic and financial crisis during 2008-2009. That crisis has until recently been compounded by a highly unstable political situation. The European Union, Ukraine's neighbours and the international community have been concerned about possible repercussions of these developments on the stability of the whole region. The recent (February 2010) presidential elections brought more political stability and Ukraine's economic situation markedly improved as well. Simultaneously, discussions about the further development of EU external policies after the entry into force of the Lisbon Treaty and in the context of negotiations regarding the next EU financial framework after 2013 open a window of opportunity for new international initiatives. These should go beyond present efforts regarding Ukraine as well.

In this context, the Austrian Ministry of Finance and the Vienna Institute for International Economic Studies (wiiw) jointly organized a high-level international expert seminar in Vienna, on 21 June 2010.[1] The seminar focused on selected issues related to current political, institutional, economic and social developments in Ukraine and scenarios of future developments. Relations with Ukraine's neighbours, in particular the European Union and Russia, the role of international financial institutions (IMF, EBRD, The World Bank) in overcoming the current economic crisis were addressed as well. In addition to the current situation, likely scenarios of the future medium- and long-term developments and related challenges were also discussed. The first part of the seminar was reserved for an invited audience; the closing afternoon panel was open to the public. Apart from representatives of the Austrian Ministry of Finance and wiiw, the speakers came from Ukraine, Russia, Poland, the United Kingdom, Canada and the EU Commission (see attached programme).

Summary of deliberations[2]

The seminar opened with two presentations on the current economic situation and challenges in Ukraine based on the respective studies included in this report. Igor Burakovsky, Director of the Institute for Economic Research and Policy Consulting in Kiev, outlined in his contribution two scenarios of future economic development, the associated

1 Accidentally, on the same day, the IMF resumed negotiations with the new Ukrainian government about the new stand-by arrangement – see http://www.imf.org/external/np/sec/pr/2010/pr10281.htm.

2 Summarized by Peter Havlik, wiiw. The individual seminar participants have not authorized their summary contributions and the text below thus represents the interpretation of the present author.

assumptions and economic policies. The author was modestly optimistic that the newly consolidated political power (President Yanukovych and Prime Minister Azarov belonging to the same political party) will finally launch the necessary institutional and structural reforms. Vasily Astrov, researcher at wiiw, prepared for the seminar a comprehensive background study describing the political stalemate before the elections and analysing the economic situation in Ukraine before, during and after the recent economic crisis. The author argued that Ukraine's short-term economic prospects are likely to be helped by the relatively favourable external environment and the competitive exchange rate, while the conditionalities put forward by the IMF in the negotiations over a new loan package were critically assessed. Last but not least, the overreaching topic of the conference, namely the difficult policy balancing between Ukraine's key partners EU and Russia, was briefly addressed as well.

The discussion in the first section focused on the new government's willingness to reform, the role of the IMF in the new economic situation, and the pros and cons of rebalanced external policies with respect to both the EU and Russia. The reform of the gas sector was identified as the most challenging and pressing economic issue.

The second section dealt with economic and political scenarios for Ukraine's medium and long-run development. Vasil Yurchyshyn, Director of Economic Programmes at the Razumkov Centre in Kiev, outlined in his presentation (also included in this report) the recent economic and political developments. His assessment regarding the short-term economic prospects was slightly more upbeat than the outlook for consistent economic reform policies of the new government in the medium run. His 'realistic' development scenario reckons with slow and cautious improvements and a GDP growth not exceeding 4% while he sees cooperation with the IMF as crucial for anchoring the necessary reforms.

The political analysis of Ukraine after the elections was provided by Tomas Valasek, Director of foreign policy and defence research at the Centre for European Reform, London. According to his assessment, the new Ukrainian president V. Yanukovych is sending signals neither to the EU nor to Russia; his policy steps have so far been directed largely at the domestic audience. Indeed, most domestic problems have been more pressing than foreign ones: issues related to the domestic economy, the judicial system, the business environment and corruption are of key importance and call for urgent remedies. Even the controversial natural gas and Black Sea Fleet deals with Russia were done mostly for the domestic audience. At the same time, negotiations of the Deep Free Trade Agreement with the EU have virtually stuck, the situation with human rights and the rule of law in general even deteriorated. In Valasek's view, Yanukovych is 'more Putin than Merkel and more Soviet than Western'. At the same time, 'oligarchs' have maintained or even increased their influence, while lobbying against the EU or NATO accession was scrapped from the agenda.

Finally, the last section of the seminar dealt in more detail with Ukraine–EU economic and political relations. Olga Shumylo-Tapiola, Member of the Supervisory Board at the International Centre for Policy Studies in Kiev (and currently on the move to the Centre for Economic and Political Studies in Brussels) outlined the EU's policy instruments with respect to Ukraine: Eastern Partnership, Deep Free Trade Agreement, modernization of the gas network grid, Association Agreement. The latter in particular was a purely political declaration which did not satisfy Ukraine's aspirations for more: the prospect of EU membership. But in Shumylo's view, the previous (Tymoshenko) government had not been ready for real negotiations, not least because this would mean to comply with the EU's 'acquis communautaire' which the oligarchs did not like. The new (Azarov) government has missed the opportunity to pursue more active EU policies and is not really interested in EU membership either (perhaps with the exception of potential cash transfers). At the same time, Russia has been more active with respect to Ukraine than the EU. On the key issues, first and foremost the visa-free regime, the EU remains split (not to speak about membership, which is not on the EU agenda at all).

The position of the EU Commission was presented by Reinhold Brender, Deputy Head of Unit for Ukraine, Moldova, Belarus and Southern Caucasus at the European Commission, Brussels. Reacting to some earlier comments, Mr. Brender stressed in his brief statement that the EU was a community of values and not a donor organization. The conclusion of a Deep Free Trade Agreement implies that Ukraine takes over parts of the 'acquis'. His impression was that Ukraine is now even less interested in this than before. In this sense, 'the agenda for overcoming the current stalemate' (a part of the seminar's disputed title) is well known. But, Mr. Brender also clearly stated that relations between the EU and Ukraine depend very much on the EU's relations with Russia and that Ukraine's EU membership is not in the cards in the foreseeable future.

The deliberations on EU–Ukraine political and economic relations were complemented by comments from representatives of two neighbouring countries: Russia and Poland. Grzegorz Gromadzki, independent expert from Warsaw, started with reservations regarding the use of the term 'stalemate' in describing either present or past EU–Ukraine relations (his deliberations are also included in this report). In the past, the EU has recognized Ukraine as a European country, initiating the Eastern Partnership, Deep Free Trade Agreement, etc. Ukraine is an established (albeit imperfect) democracy with regular free and fair elections, and this is an achievement in the post-Soviet space. However, the preservation of democracy is not yet assured and Mr. Yanukovych represents a typical post-Soviet authoritarian politician. Unfortunately, Ukraine is of just secondary importance for the EU, yet the practical steps for overcoming the stalemate are well known: Association Agreement, Deep Free Trade Agreement and visa-free regime to name just a few. The forthcoming Polish EU presidency in 2011 should bring a new dynamism – provided democracy in Ukraine is maintained.

Last but not least, a view from Russia was presented by Alexander Dynkin, Director of the Institute for International Relations and International Economy, Russian Academy of Sciences, Moscow (IMEMO). His opening remarks referred to the recent natural gas discount and Black Sea Fleet deals and illustrated the Russian feelings about Ukraine: 'Yanukovych will be more expensive for Russia than Tymoshenko'. However, a 'reset' in Russia–Ukraine relations is just as important as the previous Russia–USA reset. As far as Ukraine is concerned, the country is facing many challenges, such as establishing balanced relations with both Russia and the EU and overcoming the economic crisis. This will be even more difficult as Ukraine's de facto monopoly on gas transit will soon disappear (South Stream, Nabucco, etc.), but new (or resuscitated) areas of cooperation between Russia and Ukraine open up in the aviation industry, in nuclear energy or shipbuilding, to name just a few.

The closing panel brought a wrap-up of the seminar with moderately optimistic conclusions. The economic situation has been improving recently and Yanukovych has not been as 'bad' as some may have feared. There is no 'stalemate' in EU–Ukraine relations according to Ulrike Hauer, Head of the Trade and Economics Section of the EU in Kiev. However, Ukraine's EU membership is not on offer by the EU and it is also not a priority for Ukraine. The visa-free regime with the EU (unilaterally implemented by Ukraine for EU citizens already since 2005) will be difficult to endorse within the EU. The EU offers assistance in reforms (e.g. within the Eastern Partnership and Deep Free Trade Agreement), but otherwise has few instruments, be it sticks or carrots – especially compared to the IMF (which provides loans attached to conditionalities)[3] or Russia (which has been providing loans and subsidies without apparent conditionality).

In sum, the seminar offered a number of highly interesting insights for all participants, yet the complex issue whether there is a 'stalemate' in EU–Ukraine relations remained unresolved.

[3] The IMF Executive Board approved the stand-by agreement with Ukraine amounting to USD 15.15 billion on 28 July 2010. The loan is conditioned on the implementation of fiscal, energy and financial sector reforms which will be reviewed on a quarterly basis – see http://www.imf.org/external/np/sec/pr/2010/pr10305.htm.

Seminar programme

Ukraine, the European Union and the International Community: Current Challenges and the Agenda for Overcoming the Stalemate

International Expert Seminar

21 June 2010

Austrian Ministry of Finance, Peter Quantschnigg Saal,

Hintere Zollamstr. 2b, 1030 Vienna

Introduction

Ukraine is confronted with an unprecedented economic and financial crisis which has been compounded by a highly unstable political situation. The European Union, Ukraine's neighbours and the international community are concerned about possible repercussions of these developments on the stability of the whole region. The recent presidential elections in the Ukraine, discussions in the EU about the further development of external policies after the entry into force of the Lisbon Treaty and in the context of the new financial framework open a window of opportunity for new international initiatives which would (and should) go beyond present efforts.

The Austrian Ministry of Finance and the Vienna Institute for International Economic Studies (wiiw) are jointly organizing a high-level expert seminar that will focus on selected issues related to current political, institutional, economic and social developments in the Ukraine and scenarios of future developments. Relations with Ukraine's neighbours, in particular the European Union and Russia, the role of international financial institutions (IMF, EBRD, The World Bank) in overcoming the current economic crisis will be addressed as well. Apart from the current situation likely scenarios of the future medium- and long-term developments and related challenges will be also discussed.

The first part of the seminar will be reserved for an invited audience. The closing panel will be open to the public.

Working language will be English (without translation). The written statements, summary of sections prepared by rapporteurs, summary of the closing panel discussion including policy recommendations, as well as the background paper prepared by wiiw will be published.

PROGRAMME

9.30 **Introduction:** *Thomas Wieser*, Ministry of Finance, Austria

9.40 **Section 1: Ukraine: Current political, social and economic challenges**

Igor Burakovsky, Director of the Institute for Economic Research and Policy Consulting, Kiev

Vasily Astrov, Researcher, The Vienna Institute for International Economic Studies (wiiw)

Rapporteur: *Peter Havlik*, Deputy Director, The Vienna Institute for International Economic Studies (wiiw)

11.00 **Coffee break**

11.30 **Section 2: Scenarios for economic and political developments in the medium and long run**

Vasyl Yurchyshyn, Director of Economic Programmes, Razumkov Centre, Kiev

Tomas Valasek, Centre for European Reform, London

Rapporteur: *Oleh Havrylyshyn*, Munk Centre, University of Toronto (formerly IMF and deputy finance minister, Kiev)

13.00 **Lunch break**

14.00 **Section 3: Ukraine–EU political and economic relations; the role of international organizations and agenda for overcoming the current stalemate**

Olga Shumylo-Tapiola, Member of Supervisory Board, International Centre for Policy Studies (ICPS), Kiev

Reinhold Brender, Deputy Head of Unit for Ukraine, Moldova, Belarus and Southern Caucasus, European Commission

Grzegorz Gromadzki, Independent expert, Warsaw

Alexander Dynkin, Director, IMEMO RAN, Moscow

Rapporteur: *Ulrike Hauer*, Head of the Trade and Economics Section of EU Kiev Delegation, European Commission, Brussels

15.30 **Coffee break**

16.00 **Panel discussion**

Chair: *Thomas Wieser*, Head of Department, Ministry of Finance, Vienna

Rapporteurs: *Peter Havlik*, *Oleh Havrylyshyn*, *Ulrike Hauer*
Reinhold Brender
Vasyl Yurchyshyn
Igor Burakovsky
Alexander Dynkin

18.00 **End of seminar**

Vasily Astrov

Ukraine after the elections: economic challenges and prospects[4]

Political background

The current political landscape of Ukraine dates back to the events of late 2004 when presidential elections in the country, which had been governed by President Leonid Kuchma since 1994, culminated in the so-called Orange Revolution. The outcome of the second round of elections in November 2004, declaring the incumbent prime minister Viktor Yanukovych the winner, was widely believed to be rigged and led to large-scale popular protests. Under the pressure, Ukraine's Supreme Court cancelled the election result and ordered a repeated vote, which was won by Mr. Yanukovych's contender, the right-of-the-centre pro-European opposition leader Viktor Yushchenko. Although there were certain doubts as to the legal aspects of the 'third round' of elections, it probably represented the best possible way out of the political crisis, avoiding both violence and possibly even a territorial break-up of the country. However, the perceived pro-western and anti-Russian stance of the new president and particularly of the new prime minister Yuliya Tymoshenko – Mr. Yushchenko's key ally during the Orange Revolution – depressed their support in the mostly Russian-speaking and generally wealthier eastern and southern regions of Ukraine.[5] The new authorities would have needed much political skill to bridge these regional divisions, as well as to balance the country's external policies between Russia and the EU.

Subsequently, integration into the EU was re-instated as the priority into Ukraine's foreign policy doctrine, reflecting the dominating public opinion: the majority of Ukrainians were in favour of joining the EU (though not NATO). The mass media became subject to less censorship, and society in general got more freedom. The parliamentary elections in March 2006 – the first elections after the Orange Revolution – were widely considered to be the first fully free and fair elections ever held in the country. However, the non-binding declarations of the EU parliament apart, the EU was persistently reluctant to acknowledge the country's membership perspective, although the European and American leaders hailed the Orange Revolution as a significant step towards democracy.[6] Also, while fighting corruption, which had become pervasive under former President Kuchma, was one of the key declared priorities of the new authorities, the actual progress on this front proved very limited. Simultaneously, the country's relations with Russia deteriorated, while the

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[4] Peter Havlik, wiiw, provided valuable comments on an earlier draft of this study.

[5] The southern and especially eastern regions of Ukraine are home to the country's heavy industrial base. The latter was largely installed in Soviet times, but has been the motor of recent economic growth in the country and accounts for the bulk of its export revenues.

[6] Some new EU member states, in particular Poland and Lithuania, were more supportive of Ukraine's prospective EU membership.

economy fell victim to serious policy mistakes such as the pre-announced re-privatization campaign, the abolition of Special Economic Zones, and administrative price interventions for gasoline, meat and sugar.

On 8 September 2005, President Yushchenko dismissed the government of Yuliya Tymoshenko. The move followed a protracted period of infighting within the ruling elite, reflecting partly personal ambitions, but also the divergence of views on some key policy issues, particularly in the area of the economy (the liberal-minded Yushchenko versus the largely populist Tymoshenko). Simultaneously, it marked a switch in the country's political landscape, as Mr. Yushchenko resorted to co-operating with his former rival in the presidential elections, Viktor Yanukovych, in order to secure the appointment of a moderate 'orange' politician Yuri Yekhanurov as the new prime minister. This new alliance could also be interpreted as an attempt to bridge the rift between the West and the East of the country, which emerged anew after Mr. Yushchenko's victory in the presidential elections. The immediate task of the Yekhanurov government was to repair the damage inflicted to the economy by the previous government, including abortion of the large-scale re-privatization campaign initiated by Ms. Tymoshenko.

The March 2006 parliamentary elections resulted in a triumph of the opposition parties, notably the Party of Regions of Mr. Yanukovych, which came first, and the Block of Yuliya Tymoshenko (BYuT), which came second. This weakened the position of the pro-Yushchenko 'Our Ukraine' party and forced it to accept difficult compromises. After several months of protracted negotiations and the eventual failure of a renewed 'orange' coalition, August 2006 witnessed the formation of the so-called 'anti-crisis' coalition with the right-of-the-centre pro-Russian Party of Regions at its core (the two minor coalition partners being the Socialists and the Communists) and with Mr. Yanukovych becoming Ukraine's prime minister once again. 'Our Ukraine' was left with little choice but to join de facto the new coalition by signing the so-called 'Universal Declaration'. The new government returned to the 'multi-vector' foreign policy pursued by former president Kuchma, thereby putting more emphasis on relations with Russia, although integration into the EU was still on the agenda. In contrast, the prospects of NATO membership were put on hold. In the area of economic policy, the Yanukovych government was focusing on improving the business environment (especially for the big business) by further tax cuts, a more protectionist stance in trade policy, and maintaining a competitive exchange rate.

Over subsequent months, Prime Minister Yanukovych was increasingly successful in consolidating his power grip, while President Yushchenko looked increasingly weak and isolated. He had been outmanoeuvred by both Mr. Yanukovych and Ms. Tymoshenko and largely lost control even over his own party. Also, he was often facing a constitutional (two-thirds) parliamentary majority against him, as the faction of Ms. Tymoshenko – though formally in opposition – opted to cooperate with Mr. Yanukovych on several occasions.

Most notably, the beginning of 2007 witnessed a continuous expansion of the ruling parliamentary coalition controlled by Mr. Yanukovych, which was gradually approaching a two-thirds majority – enough to enact constitutional amendments shifting still further powers from the president to the parliament. In response, president Yushchenko dissolved the parliament on 2 April 2007, triggering a new political crisis which resulted in a compromise on early parliamentary elections held on 30 September 2007.

The September 2007 elections yielded a surprisingly good result for Ms. Tymoshenko's BYuT. Its trailing behind the Mr. Yanukovych's Party of Regions turned out to be smaller than widely expected, providing a slim majority for the two 'orange' parties – BYuT and Our Ukraine-People's Self-Defence (OUPS) of President Viktor Yushchenko – in the newly elected parliament. A new 'orange' coalition government was formed in December 2007, with economic policy-making assigned almost exclusively to BYuT, and Ms. Tymoshenko herself becoming prime-minister for the second time. In economic policy terms, the second premiership of Ms. Tymoshenko proved less controversial than the first one,[7] while in the area of foreign policy, the new 'orange' government was predictably drifting away from Russia, and the efforts to bring the country closer to NATO received a new impetus. However, the authorities agreed to the opposition's demands of a popular referendum on this issue (which in reality never took place, given the generally sceptical public attitude towards NATO membership).

Over subsequent months, the tensions within the 'orange' camp were mounting and manifested themselves inter alia in the lengthy struggle over the control of the State Property Fund, with pro-presidential forces successfully undermining the government's privatization plans. Also, the government revoked a major oil production-sharing agreement with the US-based Vanco signed by the previous Yanukovych government and with the approval of the president. The latter move was aimed at confirming Ms. Tymoshenko's image as a fighter against 'oligarchs' and corruption who safeguards the country's 'national interests' (the insufficient transparency of the Vanco deal and its alleged ties to Russia's Gazprom were the official reasons for the PSA revocation). The 'orange coalition' finally collapsed in September 2008, after BYuT joined votes with the Party of Regions to undermine the presidential powers and after Ms. Tymoshenko adopted a more Russia-friendly stance on a number of issues.[8] However, the parliament refused to provide funding for early parliamentary elections under the crisis conditions, implying a political victory for Ms. Tymoshenko who managed to secure her position as prime-minister for the meantime. Nevertheless, subsequent protracted efforts to create a coalition between BYuT and the Party of Regions – which would have involved major constitutional amendments turning

[7] For instance, she abandoned her earlier idea of large-scale re-privatizations.

[8] These included Ms. Tymoshenko's reluctance to adopt an anti-Russian parliament resolution on the Russian-Georgian war, her resistance to reverse the Odessa-Brody oil pipeline (which is currently pumping Russian oil towards the Black Sea) in order for it to ship Caspian oil to Poland, and her party's support of the bill de facto providing the Russian language official status.

Ukraine into a parliamentary republic – failed, opening the door to presidential elections at the beginning of 2010. Needless to say, the persistent political instability played a significant role in the way the global economic crisis has affected Ukraine's economy. The infighting between president Yushchenko and prime-minister Tymoshenko hampered a consolidated policy response, most visibly manifested in the lack of coordination between the government and the National Bank, which is subordinated to the president. Also, privatization and other crucial reforms, including the liberalization of the gas sector, were repeatedly delayed, although accession to the WTO was finally completed.

The second round of presidential elections on 7 February 2010 resulted in a narrow victory of Mr. Yanukovych followed by the formation of a new parliamentary coalition centred around Mr. Yanukovych's Party of Regions (and including two smaller parties: the Communist Party and the centrist Lytvyn Block, as well as a number of defectors from the two 'orange' factions) and a new government headed by Mykola Azarov, a close ally of Mr. Yanukovych. Although the legal aspects of coalition build-up appear questionable,[9] a speedy government formation was seen to be crucial in bringing the badly needed political stability. Indeed, the fact that the president and the prime-minister represent now the same political force has put an end to the stalemate which persisted in Ukraine over the years of the 'orange' rule, and the policy efficiency of the authorities will potentially increase. However, the newly gained stability seems to have come at the expense of reductions in political freedoms, including a tougher scrutiny of mass media.

One priority for the new Ukraine's authorities has been to mend relations with Russia (which had suffered dramatically under the presidency of former president Yushchenko), manifested most visibly in the new contract granting a 30% price discount for the imported Russian gas starting from April 2010 in exchange for extending the lease of the Russian naval base in Sevastopol at least until 2042. This is an encouraging development, which also reduces drastically the probability of future 'gas wars' between the two countries (a major concern for Europe, which receives the bulk of its gas imports from Russia via Ukraine). However, the scope of Ukraine's advances towards Russia is potentially constrained by domestic politics and the powerful Tymoshenko-led 'orange' opposition, which is eager to earn political points in the run-up to the next parliamentary elections scheduled for autumn 2011. Therefore, it is unlikely that the most radical Russian advances – such as merging Ukraine's energy monopolist Naftogaz with Russia's Gazprom or Ukraine acceding the Russia-Belarus-Kazakhstan customs union[10] – will materialize in the near future, although increased cooperation in a number of areas including aviation and nuclear energy is almost certain. Also, the recent wave of acquisitions of some of Ukraine's biggest steel mills (Zaporyzhstal, Ilyich Steelworks and

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9 Ukraine's constitution envisages that the parliamentary coalition is formed by factions rather than individual MPs, although the constitutional court has confirmed the legitimacy of the new coalition.

10 Unlike the latter three countries, Ukraine is a WTO member.

Industrial Union of Donbass) by unnamed Russian investors via intermediation of Russia's Vneshekonombank as well as the possible acquisition of Raiffeisen Aval by Russia's Sberbank appear to be related to the political rapprochement between the two countries.

The new – more pragmatic and more Russia-friendly – foreign policy course means that the new Ukrainian administration might adopt a less forthcoming stance in negotiations with the EU, e.g. in the ongoing negotiations over a deep free trade agreement. On the other hand, it is favouring the creation of a Ukraine-EU-Russia gas consortium, which should jointly operate the country's gas pipeline network and could further enhance the security of energy transit across Ukraine, not least through the upgrade and the modernization of the country's gas pipeline network.

Economic performance prior to the crisis

Between 2000 and 2007, the Ukraine's economy was generally rapidly growing. As illustrated by Table A1, economic growth exceeded 5% in 2000 and 2002, 7% in 2006 and 2007, 9% in 2001 and 2003, and reached as much as 12.1% in 2004. Only in 2005 did real GDP growth slow down to 2.7%, reflecting largely the adverse impact on investments of policies of the first Tymoshenko government[11] and the negative foreign trade developments.[12] This dynamic development is to be viewed however against the background of a very low base resulting from the dramatic decline in the course of the 1990s. Even in 2008 – after almost a decade of high growth – the country's GDP still stood at just 74% of the 1990 level.

The major factors behind the impressive performance were:

- the devaluation of the Ukrainian hryvnia in 1999 in the aftermath of the Russian financial crisis, which created a window of competitive advantage for the country's producers, particularly in the food processing industry, which was increasingly substituting imports;

[11] In particular, tax and customs benefits enjoyed by certain industries (including the automotive, aircraft and space industries) as well as by the 'special economic zones' (SEZs) and the 'territories of priority development' (TPDs) were scrapped with a retroactive effect. The latter move was aimed at closing the 'loopholes' for smuggling, but it also hurt the investment projects already implemented there. Even more importantly, the new authorities launched a re-privatization campaign, revising some of the most controversial privatization deals concluded under the former president Kuchma. To make things worse, the government added to investors' worries by a series of contradicting statements regarding both the scope and the particulars of the upcoming re-privatization scheme. Several privatization deals were indeed annulled in court, including the country's biggest steel producer Kryvorizhstal' and the Nikopol Ferroalloy Plant. Subsequently, Kryvorizhstal' was re-sold to Mittal Steel for some EUR 4 billion, or six times the price paid by the previous owners.

[12] On the export side, the world steel prices plunged by some 30% in the first half of 2005 following an upgrade of steel production capacities in China, and Ukraine's steel exports suffered accordingly. Simultaneously, imports were fostered by increased social spending and the currency revaluation undertaken in April 2005.

- rapid economic growth in Russia and the other CIS countries, resulting inter alia in rising demand for Ukrainian machinery and transport equipment on these markets;
- the rising world prices of steel (see Figure 1) and strong external demand for metals – Ukraine's major export commodity; and,
- starting from 2005-2006, a strong expansion of domestic consumer demand due to the social-oriented policies of the Tymoshenko government, on the one hand, and the credit boom, not least due to the increasing presence of foreign banks, on the other.

Thus, while in the early 2000s, the economic growth was largely driven by exports (and the related investment demand from the export-oriented industries), starting from 2005, domestic consumption became an increasingly important growth engine. Also, fixed investments which had suffered during the first 'orange' government recovered markedly, not least thanks to the surge in energy-saving investments following the 'gas price shock' in January 2006 (as Russia started bringing its gas export prices charged to the CIS countries closer to EU levels). On the production side, it was industry that was leading the growth, whereas the performance of agriculture was traditionally much more volatile – largely due to the changing weather conditions for harvests.

The gradual shift from external to domestic sources of demand led to the widening of the external imbalances, as imports were rising ahead of exports. Starting from 2006, Ukraine's current account was negative and deteriorating: the current account deficit grew from 1.5% of GDP in 2006 to 7.1% in 2008 – partly as a result of the negative trade developments, but also due to the interest payments on foreign loans and FDI-related profits. However, these current account deficits were (almost) fully covered by the inflows of FDI and thus per se did not apparently provide a reason for concern, given the similar patterns observed earlier in the Central European new EU member states.[13]

In 2005-2006, consumption was fuelled to a large degree by the hikes in pensions and wages in the public sector by 'orange' governments (more on that, see below), which benefited particularly the poor segments of the population. However, the role of rising wages behind consumption growth has been generally diminishing, as the government of Mr. Yanukovych (in 2006-2007) allowed only a modest wage growth in the public sector. Thus, rising consumption was increasingly driven by expanding consumer credit. The lending boom was not least due to the growing presence of foreign banks which had easy access to external funds. The strong demand for consumer goods was partly spilling over into imports (in particular those of durables), but was also benefiting consumer-oriented branches of the economy such as retail trade and food-processing. Besides, the rapid expansion of consumer credit also boosted housing construction. Finally, the consumption

[13] The current account deficits of the latter had been typically offset by inflows of FDI and resulted largely from large-scale imports of FDI-related investment goods needed for modernization.

boom under the second Tymoshenko government (throughout most of 2008) was underpinned by the government compensation of private deposits in the former Soviet Sberbank (which had been eaten away by hyperinflation during the early 1990s),[14] as well as the generous social payments, as pensions were raised to the subsistence minimum level.

Impact of the global crisis

Until September 2008, Ukraine's economy had proven generally resilient to the emerging global financial crisis. Overall, economic growth proved robust (6.9% in January-September 2008), helped by the record grain harvest and a continued boom in private consumption: the retail trade turnover was up by 25.1% in real terms. However, the investment activity started decelerating already at the beginning of the year, and the construction sector was stagnating. The stock market fell sharply reflecting the increased risk aversion of foreign portfolio investors (between mid-March and October 2008, the PFTS index plunged by nearly 80%), although given the very small size of the stock market, the repercussions on the real economy were negligible. Also, the domestic credit expansion slowed down from +78% year-on-year in January 2008 to still formidable +54% in September, mainly at the expense of household lending. At the same time, some of the country's biggest banks which were foreign-owned continued to enjoy access to the funds of their parent companies, although many of the domestically owned smaller banks started facing difficulties to re-finance themselves.

However, in October 2008, following the collapse of Lehman Brothers, the situation changed rapidly for the worse, representing a combined effect of the global liquidity crunch, the steeply falling steel prices, and renewed political crisis following the break-up of the ruling 'orange' coalition. The impact of the liquidity crunch was not surprising given that Ukraine had been heavily borrowing in international capital markets to finance its increasingly domestically-driven growth – and relied heavily on access to new credit in order to finance existing debts. By mid-2008, the gross external debt – largely within the private corporate and banking sectors – reached USD 100.1 billion (corresponding to 66% of the 2007 GDP), of which some USD 9 billion was due to be repaid in the fourth quarter of 2008 and another USD 20 billion in the course of 2009. In international comparison, Ukraine's ratio of foreign debt to GDP did not appear to be particularly high.[15] However, unlike in many other countries in Eastern Europe, the bulk of the private sector in Ukraine was largely domestically owned and thus lacked privileged access to the funds of parent companies headquartered abroad. Furthermore, the prospects for external borrowing worsened dramatically as global commodity prices plummeted, Ukraine's terms of trade worsened and credit ratings were revised accordingly.

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[14] These compensations took place with a generally flat fee of USD 200 per depositor.

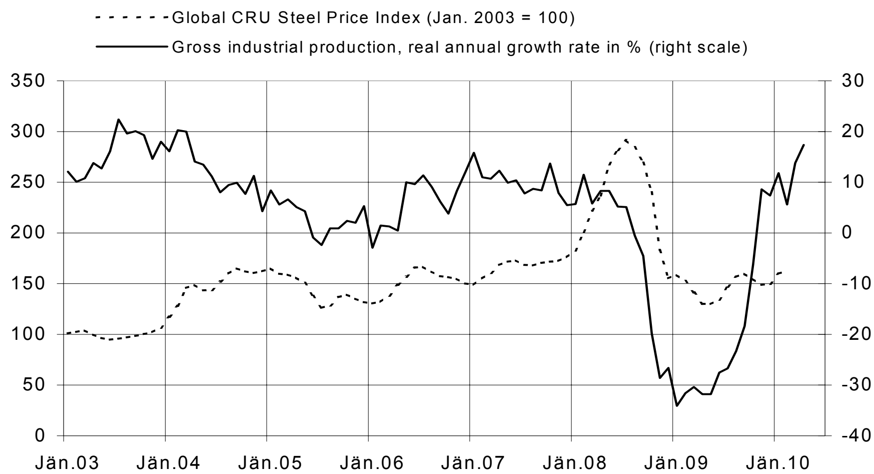
[15] Some East European countries, such as Hungary, Bulgaria, Croatia, Latvia or Estonia, had a much higher foreign debt (close to, or even exceeding, 100% of GDP).

Restricted access to new external finance put the country's corporate and banking sector under severe pressure and contributed – along with the shareholder dispute over Prominvestbank, one of the country's top ten banks – to a run on the banks in October-November 2008.[16] In the first two weeks of October 2008, households withdrew some UAH 6.2 billion of private deposits before the National Bank reacted with a set of measures, including providing extra liquidity to banks, lowering minimum reserve requirements, imposing a moratorium on the premature withdrawal of term deposits, and forbidding banks to extend further loans. In another move, the National Bank imposed a maximum 5% deviation between the buy and sell rates for foreign currency trading, while the regulation of the interbank foreign exchange market was tightened as well.

As households started converting part of their hryvnia withdrawals into foreign currency while export revenues were drying up, the exchange rate came under severe pressure as well. The official corridor (re-aligned from 4.85 to 4.95 UAH/USD and widened from ± 4% to ± 8% around the central parity in response to the first signs of turmoil) became increasingly meaningless, as the National Bank was initially reluctant to intervene. Although subsequently it spent USD 4.1 billion of its foreign exchange reserves in October 2008, USD 3.4 billion in November and USD 2.8 billion in December, in an endeavour to bolster the faltering hryvnia, the latter depreciated by some 60% against the US dollar, to some 8 UAH/USD, putting the holders of foreign-currency-denominated liabilities (58% of total outstanding loans at that time) under severe pressure. Ironically, the National Bank spent some of the reserves on sterilizing the hryvnia liquidity which it had injected in order to ease the credit crunch, only to have some of it channelled into the foreign exchange market instead.

Figure 1

Steel price and gross industrial production, 2003-2010



Source: wiiw Monthly Database incorporating national statistics and CRU steel price index

16 In January 2009, 75% of the insolvent Prominvestbank was acquired by the Russian state-owned Vneshekonombank.

In addition, Ukraine's problems were aggravated by the 70-80% drop in the global price of steel – the country's main export commodity – in the second half of 2008 (see Figure 1). Steel prices were plunging amidst fears of a global recession and also due to the fact that both the construction and the car industries – the two important consumers of steel – were hit particularly hard by the global crisis. To improve the financial situation of steel producers, the government granted a 9-10% discount on the railway transportation tariffs for coke and iron ore, but the measure was not substantial enough to make a major impact.

Due to repercussions from the global crisis, in the fourth quarter of 2008, Ukraine's GDP contracted by 8% (year-on-year), thus bringing the cumulative growth for the year as a whole to just 2.1% (see Figure 2). Agriculture proved the only sector performing exceptionally well (+17.5% in gross output terms) on the back of a record grain harvest, whereas construction (-16%) declined throughout most of the year, and industry (-3.1%) was invariably contracting starting from August 2008. On average, the production of metals fell by 10.6%, while two other major industries – chemicals and oil processing – reduced their output by 6.2% and 15%, respectively, in response to plummeting world prices. Fixed investments recorded only a marginal 2% growth, as many investment projects (including foreign, such as the construction of a steel mill by Austria's Voestalpine) were put on hold in the fourth quarter of 2008. Against this background, private consumption proved the main pillar of economic growth in 2008. The retail trade turnover was still up by 18.6% in real terms, boosted by the generous wage policy of the Tymoshenko government and the credit boom – at least until the global liquidity crunch spilled over into Ukraine in September 2008. In addition, at the initial stage of the crisis, household spending was fuelled by the shattered trust in banks and expectations of a rise in inflation following the massive hryvnia devaluation. However, as the crisis deepened, the decline in real wages, blocked access to credit, and – last but not least – rising unemployment ineluctably dampened private consumption as well.

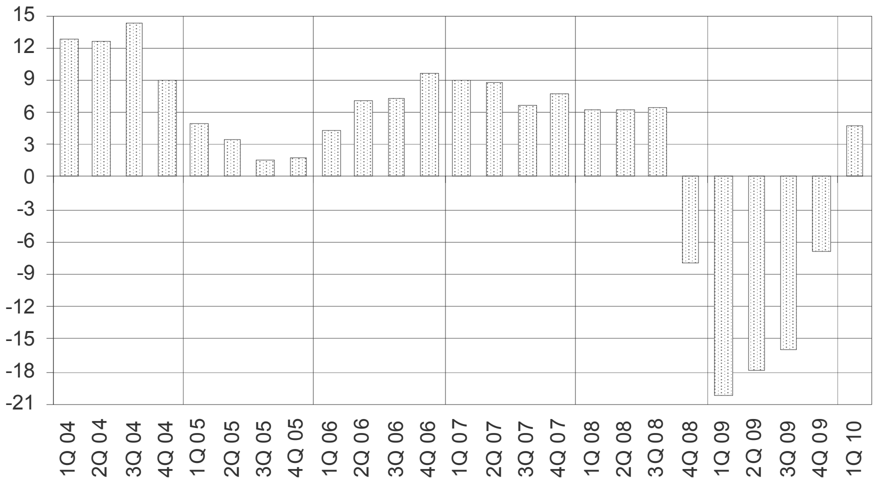
It was not until 2009 that the impact of the crisis was fully felt. In 2009, the GDP contracted by horrendous 15%, industrial production fell by 22%, and construction output by 48%. Across sectors only agriculture – whose output was flat – proved resilient to the crisis, owing to a very high (46 million tons) grain harvest for the second year in a row. Within industry, manufacturing suffered the most (-45% year-on-year in gross output terms), not least due to the collapse in investment demand at home (-46%) and in Russia, where the bulk of the otherwise uncompetitive Ukrainian machinery is exported. The collapse in investments reflected reduced profits, the credit crunch and government budget cuts, which fell primarily on capital expenditures. At the same time, the metals and chemicals industries, which had recorded huge output losses at the early stages of the crisis, started recovering in the last quarter of 2009 in response to the favourable world market trends. Private consumption declined by 14% against the background of rising unemployment (by

2.5 percentage points against 2008),[17] falling real wages (by 9%), and the virtual lack of access to household credit. Government consumption fell too, albeit not as strongly, while the dynamics of net exports was highly positive.

Figure 2

Real GDP growth, 2004-2010

quarterly, year-on-year change in %



Source: wiiw Database incorporating national statistics.

At the same time, the combined effect of a pronounced devaluation and the deep domestic recession made imports increasingly unaffordable. The latter plunged faster than exports, and the external equilibrium was nearly restored: in 2009, the current account deficit stood at a mere 1.5% of GDP – down from 7.1% in 2008. Initially, the radical improvement in the current account and the National Bank's policy of targeted auctions resulted in a strengthening of the hryvnia, to around 7.6 UAH per USD at the beginning of summer 2009. However, the peak in external debt repayments scheduled for summer and autumn of 2009 – and the related depreciation expectations – reversed the earlier trend as of July. In particular, households resumed converting their hryvnia-denominated bank deposits into foreign currency, resulting in the hryvnia falling back to nearly 9 UAH per USD by September 2009, although the exchange rate recovered since then to levels around 8 UAH per USD.

The latest (early 2010) economic trends are generally encouraging and give evidence of an export-led recovery underway. Real GDP was up by 4.8% in the first quarter of 2010 (year-on-year), while industrial production increased by 12.6% in January-April. The metals industry and machine building have been leading this growth (+22% and +28% in gross output terms, respectively) and are strongly export-oriented. Steel exports soared over the

[17] Still, the surge in unemployment appears to be relatively small compared to what the dramatic contraction in output might suggest, which is partly due to the substantial wage flexibility but also to the reluctance to undertake large-scale layoffs in big industrial enterprises, such as steel mills, forming the backbone of the local economy.

same period by 37% and those of machinery by 39% (in US dollar terms). Overall, exports of goods and services increased by 25%, while imports by only 20%. As a result, the trade deficit in goods and services in January-April 2010 halved compared to the same period of last year. This was entirely due to trade in services, whereas the trade deficit in goods actually widened. However, the latter reflected the abnormally high growth in energy imports in January-April 2010 (particularly in the value of oil imports), given the very low oil price in the first months of 2009 and hence the very low statistical base. In the coming months, the imports growth will almost certainly fall short of the growth in exports, partly due to the subsiding statistical effect, but also thanks to the 30% discount on Russian gas starting from the second quarter of 2010 onwards.

The observed improvement in external competitiveness is hardly surprising given the 60% nominal depreciation of the hryvnia during the crisis which brought the real exchange rate back to levels observed in 2005-2006, when Ukraine's external accounts were largely balanced. At the same time, domestic market-oriented sectors continue to be a drag on growth. The performance of the food-processing industry was anaemic (+1.2% in January-April 2010), while retail trade turnover – a proxy for private consumption – fell by 1.2%, albeit picking up gradually on a monthly basis. Investment activity proved to be an even bigger disappointment: in the first quarter 2010, investments in fixed assets plunged by 12.5% and construction output by 21% year-on-year – and that starting from an already very low base (already in the first quarter of 2009, they fell by 40% and 57%, respectively). The weakness of domestic demand reflects the combination of risen unemployment, fallen wages, cautious spending behaviour, still under-utilized capacities and the on-going credit crunch in both corporate and consumer segments. Interest rates charged on loans (16-17% p.a. in hryvnia terms) remain prohibitively high and reflect the high risk perceptions of banks.

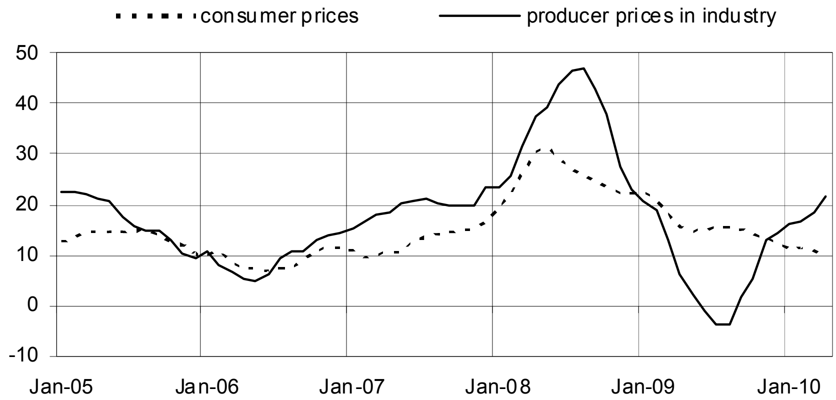
Monetary sector

The unpleasant side of the fast economic growth in the years prior to the crisis was a pick-up in inflation. After reaching a low of 0.8% on annual average in 2002, consumer price inflation was generally on the rise in the subsequent years and amounted to as much as 25.2% in 2008 on annual average. Also industrial producer price inflation accelerated markedly and invariably remained above consumer price inflation (see Figure 3). Up until 2005, the 'demand-pull' inflation was driven by the persistent current account surpluses and the resulting inflows of foreign exchange, whereas in subsequent years it was increasingly fuelled by the expanding consumer credit. On the other hand, the increase in the price of oil starting from 2003 and the price hikes for the Russian gas starting from 2006 (as Gazprom was bringing its export prices charged to the CIS countries closer to West European levels) contributed to cost-push inflation, given the extremely high energy intensity and energy import dependence of Ukraine's economy. Another 'cost-push' factor were the growing bottlenecks in some segments of the labour market in 2007-2008, as nominal wages were rising far ahead of the labour productivity, implying an increase in unit labour costs. Finally, the dramatic surge in inflation in 2008 reflected primarily the booming prices for food, which account for over half of Ukraine's consumer basket. The soaring food prices reflected, on the one hand, market speculation, but also increased use of crops for the biofuels production in response to the surging oil price.[18] In particular, the rising world prices of sunflower seeds – a commodity where Ukraine's export positions in the world market have been traditionally strong – created a strong upward price pressure in the domestic market, while the government was hesitant to impose any new export restrictions.

Figure 3

Inflation, 2005-2010

monthly, year-on-year change in %



Source: wiiw Database incorporating national statistics.

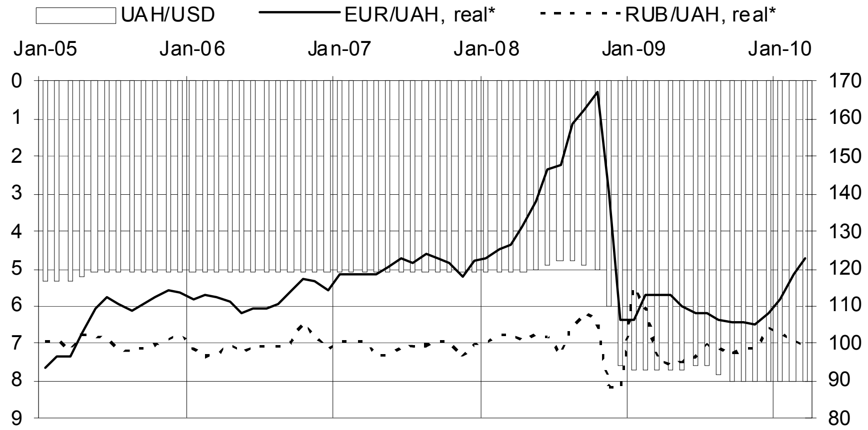
While the fiscal policy used to be generally fairly restrictive, inflation in Ukraine in the years prior to the crisis was fuelled by the lax monetary policy. Given the country's economic openness and the virtual lack of domestic monetary policy instruments, the latter essentially boiled down to exchange rate policy – in particular, to maintaining a de facto exchange rate peg to the US dollar at the level of UAH 5.33 per USD, which was in 2005 re-aligned to UAH 5.05 per USD (see Figure 4). In view of the persistent appreciation pressure – initially stemming from net export proceeds and after the Orange revolution increasingly replaced by capital inflows – the National Bank was systematically buying foreign exchange in order to maintain the exchange rate peg, resulting in the expansion of monetary base and typically negative real interest rates. Rising capital inflows from 2005 onwards represented a combination of factors, including the conversion of households' dollar savings into hryvnia in response to the currency revaluation in 2005, a surge in FDI

[18] The poor grain harvest in Ukraine in 2007 played a role as well.

inflows related to the re-privatization of the biggest steel mill Kryvorizhstal' and the wave of takeovers in the banking sector, as well as increasing portfolio inflows and foreign credits.

Figure 4

Exchange rate, 2005-2010



* Right scale: Jan 2002 = 100, deflated with PPI

Source: wiiw Database incorporating national statistics.

Even at double-digit levels occasionally, the country's inflation never posed any real danger to economic growth. However, the IMF consistently named taming inflation a key priority for the Ukrainian authorities – particularly as the inflationary pressure was mounting after the Orange Revolution. The prescribed instruments were of standard IMF-variety and included a more restrictive monetary and fiscal policy – although fiscal policy options were heavily constrained by the new spending commitments. In the area of monetary policy, the IMF was advocating a switch from the de facto exchange rate peg to inflation targeting, thereby letting the hryvnia float and almost inevitably appreciate – given the strong capital-related foreign exchange inflows. However, the wisdom of such a switch appeared questionable, since attempts to contain inflation, which was increasingly driven by supply-side factors, could have harmed the real economy.

The tightening of liquidity in the wake of the global financial crisis led inter alia to increased risk aversion and to a rapid turnaround of capital flows to numerous emerging markets, including Ukraine. In response, in November 2008, Ukraine secured an IMF 'stand-by' stabilization package worth USD 16.4 billion (of which USD 10.5 billion was actually disbursed before the end of 2009). Initially, the package was aimed at facilitating the repayment of external debts; however, as macroeconomic policy concerns were increasingly shifting to the fiscal side in the course of 2009, the arriving IMF funds were increasingly used for fiscal purposes (more on that, see below). In line with the IMF bank recapitalization demands, a total of UAH 44 billion was envisaged for this purpose in the 2009 budget (although the actual recapitalization-related expenditures proved to be smaller). The government drafted a list of five big domestically-owned banks in need of recapitalization, including Rodovid Bank, Ukrgazbank, Bank Kyiv, Nadra and Ukrprombank. At the same time, the foreign-owned banks (accounting for some 40% of the sector's assets) started receiving parent funding for the purpose of recapitalization. According to the IMF, the share of non-performing loans surged from 18% at the beginning of 2009 to over 30% by the end of the year. The latter is hardly surprising against the background of the severe output slump and the pronounced currency devaluation given that more than half of all loans were denominated in foreign exchange. Particularly in the retail lending segment, insolvencies and the resulting debt restructurings were widely reported.

The combined effect of a pronounced devaluation (by 60-70% against the US dollar and the euro) and the deep domestic recession has made imports increasingly unaffordable. The latter plunged faster than exports, and the current account deficit fell dramatically, to EUR 1.4 billion in 2009 (from EUR 8.7 billion the year before). This small deficit was comfortably financed by the (net) inflows of foreign direct investment worth EUR 3.2 billion, representing largely the funding of Ukrainian subsidiaries of foreign banks by parent structures. However, FDI apart, the capital balance proved highly negative: net capital outflows, representing notably external debt repayments by banks and the flight to foreign cash by households, summed up to EUR 11.7 billion. The resulting external financing gap of EUR 9.8 billion was partly covered from the existing foreign exchange reserves and partly from the arriving IMF funds. As a result, the share of public debt in Ukraine's gross external debt increased (at the expense of private debt), although the overall level of indebtedness remained nearly unchanged at above EUR 70 billion. In November 2009, however, the IMF programme was suspended in response to the government's reluctance to implement the agreed hikes in domestic gas tariffs and following the 20% increase in the minimum wages and pensions.[19]

As of mid-2010, the need for IMF funding appears less acute given the recent marked turnaround in external balances. Since March 2010, Ukraine – for the first time since the crisis began – has become a net importer of capital, helped by increased political stability and the reversal of depreciation expectations, which resulted in flight from foreign cash by households. Overall, in January-April 2010, Ukraine recorded net capital inflows of USD 500 million – compared to outflows of USD 5.3 billion in the same period of last year. In addition, the current account improved further, to a surplus of around USD 100 million in January-April 2010 (from a deficit of USD 900 million in the same period of 2009), and is expected to be close to zero for the year as a whole. To contain the appreciation pressure, the National Bank has been replenishing its foreign exchange reserves, so that the hryvnia

[19] Still, in January 2010 the IMF allowed the government to draw on the National Bank's foreign exchange reserves (originally received from the IMF) in order to provide Naftohaz with enough funds to pay its monthly bill to the Russian Gazprom for the imported natural gas.

has appreciated against the US dollar only slightly, to around 7.9 UAH/USD (the appreciation against the euro which fell against the US dollar in April-May 2010 was of course more pronounced.)

Despite the collapse in domestic demand in the wake of the crisis, inflationary pressures initially stayed high due to the 60% hryvnia depreciation (making imports more expensive – to the extent that the latter were affordable) and the administrative hikes such as those of excise taxes on tobacco. In 2009, consumer price inflation stood at 12.3% on the end-year basis, corresponding to 15.9% in average annual terms. At the same time, the monetary policy could be hardly blamed for the inflationary pressures: if anything, it was very tight, as the National Bank raised its reserve requirements and lowered the discount rate only marginally. Also, repeated foreign exchange interventions to defend the exchange rate and the resulting losses of forex reserves constrained the growth of the monetary base. In 2009, the latter grew by only 1.4% in nominal terms, corresponding to an 11% decline in real (CPI-adjusted) terms. The contraction of broad money balances (M3) was even more pronounced (by 17.1% in real terms), indicating that the lending activity was virtually frozen.

Fiscal policy

The impressive economic upswing prior to the crisis took place without any major boost from the fiscal side. If anything, the fiscal policy remained fairly restrictive: while the economic upswing and improved tax collection were inflating budget revenues, expenditure items were often under-financed. Also, the government accumulated huge arrears of VAT refunds to exporters, which were later partially converted into bonds.[20] With the exception of 2004 (when the deficit reached 3% of GDP), the country's general government budget was largely balanced (see Table A1), and the role of the state remained fairly modest. Government expenditures as a share of GDP stayed consistently below 30%, making Ukraine on this account a very liberal state not only by European, but even e.g. by US standards – at least judging by this indicator. Another manifestation of the liberal economic policy course was a series of tax reforms initiated by the 'first' Yanukovych government as of 2004, including a cut of the profit tax from 30% to 25% and, most importantly, the introduction of a 13% flat personal income tax following Russia's example. The latter measure was intended to broaden the tax base by raising tax compliance,[21] although this target was never achieved. Unsurprisingly, the backbone of the country's public finances had invariably been the collection of the value-added tax (VAT), which is typical of countries with a level of development comparable to that of Ukraine.

[20] The latter was a consequence of the wide proliferation of 'tax optimizing' schemes involving fake export contracts aimed at evading VAT.

[21] The scale of the shadow economy in Ukraine stands, according to the estimates of the Ministry of Ecnomy, at 35% of GDP.

The Orange Revolution and, in fact, already the 2004 presidential election campaign marked a switch to a more active role of the state in the economy. It was the ‘first’ Yanukovych government which doubled the minimum pension on the eve of the 2004 elections in order to improve the prospects for Mr. Yanukovych to be elected. Largely as a result of this measure, the consolidated budget in 2004 recorded a 3.2% deficit. The new (risen) budget spending commitments were further re-enforced by the amendments to the 2005 budget enacted by the first ‘orange’ government. In line with those, the minimum pension was raised by another 17%, and wages in the public sector by 57% in nominal terms. This policy of increased social spending probably reflected the growing awareness within the ruling elite that Ukraine should have more of a welfare state than it used to have before. As a result, since 2005, the share of consolidated budget expenditures in GDP has been invariably above 30% (Table A1). Unsurprisingly, the higher social spending and the resulting gains in disposable money incomes of households, particularly of the poorer ones, led to a boom in private consumption (aided additionally by expanding consumer credit). Between 2005-2007, the latter was growing by some 16-17% p.a. – more than double the growth rate in GDP, and was increasingly spilling over into imports.

Under the first Tymoshenko government (in 2005), the rising expenditure commitments were backed by increased revenues resulting from higher excise taxes on tobacco and fuels, the imposition of VAT on energy imports, a harder stance on smuggling, and the already mentioned abolition of preferences to SEZs. The combined effect of these measures was an impressive rise in government revenues, although some of the measures had unpleasant side-effects, which spilled over into other areas of economic policy (e.g. the imposition of VAT and of higher excise taxes on fuels imported from Russia resulted in a dramatic surge in the price of oil products, prompting the Tymoshenko government to resort to administrative price controls, which resulted in widespread shortages of gasoline.)

Under the second Tymoshenko government (in 2008), the minimum monthly wage (affecting wages in the public sector) was raised again. Pensions were raised as well, as were childbirth grants in an attempt to counteract the dramatic demographic decline (simultaneously, they were differentiated according to the number of children in the family). Also, the government started the reimbursement of household savings in the state-owned Oschadbank, which lost their value in the wake of hyperinflation in the early 1990s after the collapse of the Soviet Union, with a generally flat compensation of USD 200 per depositor. For these purposes, the government initially earmarked 2.2% of GDP in 2008, although this was only a fraction of the officially acknowledged UAH 125 billion worth deposits to be repaid. Also, the re-imbursement campaign was never actually completed, not least due to the financial crisis which took full swing by the end of 2008. The social generosity was benefiting Ms. Tymoshenko who owed her political support to a large extent to anti-oligarchic rhetoric and her image as the chief advocate of the interests of simple people.

However, from the macroeconomic point of view, the fiscal expansion in 2008 worked rather pro-cyclically, as it fuelled the already booming private consumption, adding to both rising imports and inflationary pressures.

Given the limited own fiscal resources and the blocked access to international capital markets, Ukraine – unlike e.g. advanced OECD countries or Russia – was not in a position to implement a fiscal stimulus programme to mitigate the impact of the global crisis on its economy.[22] On the contrary, one of the key conditionalities attached to the USD 16.5 billion worth IMF 'stand-by' package which Ukraine received in November 2008, was a deficit-free budget for 2010 and a freeze in public wages and pensions. This approach appeared completely ill-conceived given that the public finances were the least of Ukraine's problems. In previous years, the country had invariably had nearly balanced budgets, and public debt as a share of GDP (12.3% at the end of 2007) and public foreign debt as a share of total foreign debt (14.9% in mid-2008) were both very modest by international standards. Also, the service of public external debt (USD 2.5 billion due before the end of 2009) was only a fraction of total payments on debt service due (some USD 30 billion).

In violation of the IMF conditionality, the 2009 budget law envisaged a deficit of 3% of GDP – justified at a time of a steep economic decline, since a balanced budget would have undermined domestic demand still further. The higher (than demanded by the IMF) budget deficit was also hardly surprising, as prime-minister Tymoshenko was seeking to soften the painful social blow of recession and maintain her popularity in view of the upcoming presidential elections. The government strategy in the fiscal area was to focus on social expenditures; budget cuts fell mostly on investment programmes (which were cut by half) and partly explain the above-mentioned collapse in investment activity last year.

However, as the actual economic performance in 2009 proved disastrous (GDP fell by 15.1% instead of growing by 0.4%, as envisaged in the budget law), the budget deficit turned much higher.[23] Financing a deficit of this size was a challenge under Ukraine's circumstances, given the high (though declining) CDS spreads, the blocked access to international capital markets, and the nearly absent privatization revenues (a mere EUR 70 million for the year as a whole). Therefore, the government had to resort to domestic borrowing – typically at high interest rates, reaching up to 30% p.a. in hryvnia terms in October 2009 (although the bulk of newly issued government bonds reportedly ended up in the hands of the National Bank). In addition, the arriving IMF funds were increasingly used

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22 Still, a number of measures were enacted, including setting a price cap for natural gas consumed by the 'key' industries (metals, chemicals and mining), assistance to the agricultural sector with the attached conditionality that the money be used to purchase domestically-manufactured goods, and the governmental purchases of flats in houses where at least 50% of construction works has been completed.

23 According to official statistics, the general budget deficit in 2009 stood at just 4.1% of GDP. However, including the deficits of the state-owned energy company Naftohaz and of the Pension Fund, the actual deficit was in the tune of 8-9% of GDP.

for fiscal purposes, as the IMF was busy revising its conditionalities attached to the stabilization package – most notably by softening its stance on the maximum allowed budget deficit (from zero at the beginning of 2009 to 6% of GDP by October). As a result, public domestic debt in 2009 more than doubled, bringing the total public (including publicly-guaranteed) debt to 33% of GDP, up from 12% before the start of the crisis.

One of the declared priorities of the new (Azarov) government is to resume cooperation with the IMF. Currently, the government is hoping for a new 2.5-year IMF package of up to USD 19 billion. However, for that, the fiscal deficit will have to be cut to 6% of GDP in 2010 (the 2010 budget law adopted by the new government envisages a deficit of 5.3% of GDP). On the one hand, the fiscal situation should be helped by the ongoing economic recovery. Also, the newly granted price discount for the Russian gas should reduce the losses of the state-owned Naftogaz and ultimately the burden on the state budget. However, the targeted surge in budget revenues by 28% (in nominal terms) underlying the current budget is highly questionable and relies partly on tax hikes (excise tax) and improved tax administration (e.g. of banks), which have not been legislatively enacted yet. In the first five months of 2010, the tax revenue collection fell 8% short of the target, and the situation is unlikely to change dramatically, implying that the budget deficit for the year as a whole will likely reach at least 7% of GDP.

Meanwhile, the prospects for the government to raise funding elsewhere rather than from the IMF have improved. Following the speedy government formation, the yields on government (hryvnia-denominated) bonds plunged markedly: from over 20% p.a. at the end of 2009 to 10-13% p.a. currently. Given the current (CPI) inflation rate of 10-11%, this corresponds to real yields close to zero. [24] The CDS spreads also declined from around 10% at the start of the year to a mere 5% in mid-April, although they increased subsequently to around 7% due to the turbulence in the eurozone and the related increase in risk aversion. The 2010 budget law envisages domestic borrowings of UAH 36 billion (excluding bonds issue for the purposes of bank recapitalization) and foreign borrowings of USD 4.1 billion, including the anticipated USD 2 billion from the IMF to be used for fiscal purposes. In addition, privatization – which almost stalled in the past few years due to the persistent political stalemate – is likely to receive a boost, with stakes in Ukrtelecom and Odessa Port plant (the second-biggest fertilizer producer) featuring on the privatization list. The 2010 budget law reckons with privatization revenues of UAH 10 billion.

The relatively high fiscal deficits also imply that it will not be easy for the new authorities to implement their ambitious tax reforms promised during the presidential election campaign, but seemingly postponed at least until 2011. These include inter alia a reduction of profit tax from 25 to 20-22% and of VAT from 20 to 17%, whereas excise taxes are to be raised

[24] Of course, the latter applies only to domestic investors; for foreign investors, the yields are very high given the stable exchange rate outlook.

further (bringing them closer to EU levels), and a 'luxury' tax is on the agenda. In addition, export subsidies of up to 3% of GDP are envisaged for next year. In the longer term, the deficit of the Pension Fund (also financed from the state budget) is to be cut via a profound reform of the pension system, including the abolition of a number of early retirement schemes, the increase of the general retirement age to 65 years and its unification between men and women.

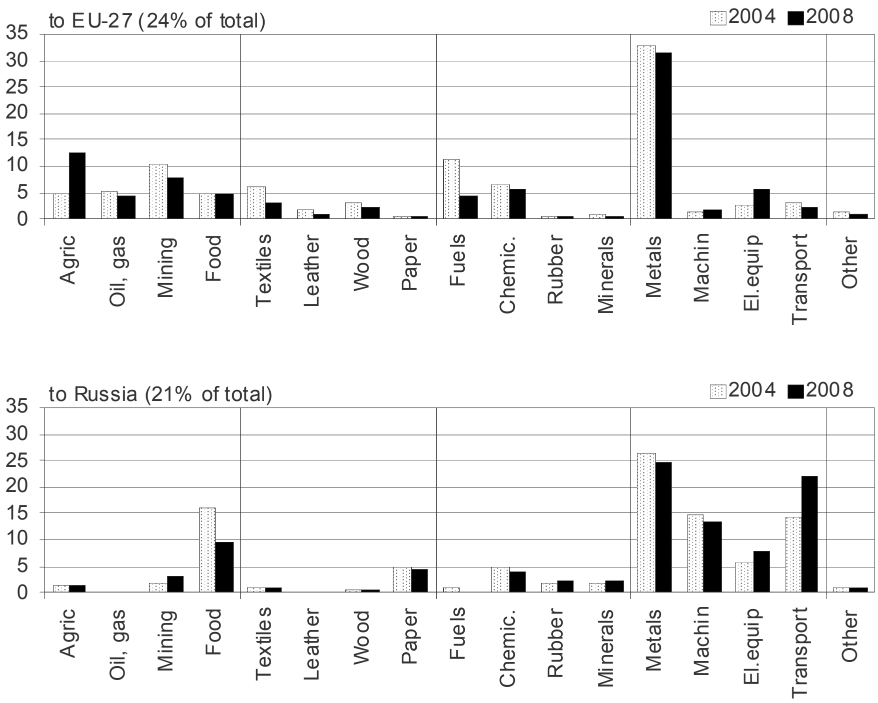
Foreign trade and investment

Ukraine's foreign trade developments since the country's independence have been generally characterized by a re-orientation of trade flows away from Russia and the CIS – reflecting the trend characteristic of most countries of the former Soviet Union. In Ukraine, this had been particularly the case with exports, although this trend reversed starting from 2002 onwards because of the high economic growth in Russia and the resulting market potential. Besides, more recently this was also due to the stagnation of Ukraine's exports of metals, the bulk of which was destined for 'third countries' (such as China, Saudi Arabia or Algeria) given the high level of protection of the steel industry in both Russia and the EU.

Figure 5

Commodity structure of exports to the EU-27 and Russia, in 2004 and 2008

in % of total



Source: wiiw Database incorporating national statistics.

Currently, Russia accounts for 21% of Ukraine's total exports – somewhat below the enlarged EU with 24%. However, the commodity patterns of Ukraine's trade with Russia and with the EU are strikingly different (see Figure 5). In trade with the EU, Ukraine is largely occupying the niche of a less developed country, as it is specializing in a relatively narrow range of not very sophisticated products, notably metals, while imports are dominated by machinery and equipment. However, in its trade with Russia, Ukraine has a strong position in a number of more sophisticated items such as transport vehicles and machinery and equipment, including military production – although this is partly explained by the existence of production links dating back to Soviet times. For a number of machinery and equipment items, the share of Russia as an export destination stands at over 50%, and the recent agreements may boost Ukrainian machinery exports to Russia still further. At the same time, some of Ukraine's main export items continue facing high tariff and particularly non-tariff barriers to entering the Russian market (the latter is also true for Ukraine's imports from Russia). Although the two countries have had a formal free trade agreement since June 1993, a number of essential products – including sugar, tobacco, spirits, confectionery, and metals – are exempted.

Unlike in the case of exports, re-orientation of imports away from Russia has been less pronounced due to the country's high dependence on energy deliveries, and Russia has been consistently ranking as Ukraine's biggest source of imports, with a share of some 25-30% in the last few years. Energy dependence on Russia also explains Ukraine's persistently high trade deficit with Russia which is however partly counterbalanced by a surplus in services – largely due to the transit fees charged by Ukraine for the Russian oil and gas exports to Europe.

Despite high expectations after the Orange Revolution, Ukraine's trade relations with the EU have not advanced very much, although the country was granted the 'market economy' status in December 2005, and in May 2008, Ukraine joined the WTO, opening the door to negotiations over 'deep free trade' with the EU. According to the terms of the WTO accession, the binding import tariffs[25] on agricultural products were lowered by about 3.5 percentage points to 10.66% on (unweighted) average, and for industrial goods, the average binding import tariff was set at 4.95%, although the WTO-conform tariff regime for industrial goods had been implemented already in 2005. On the export side, export duties for metals scrap, oilseeds and grain were reduced, and export quotas eliminated. The import quota for Ukrainian steel in the EU was scrapped, and the import tariffs in WTO member countries applied to Ukrainian goods were reduced to the 'most-favoured-nation' regime levels.[26] Also, the incidence of anti-dumping measures against imports from

25 According to the WTO regulations, the actually applied import tariffs may not exceed the so-called 'binding' tariffs agreed upon accession.

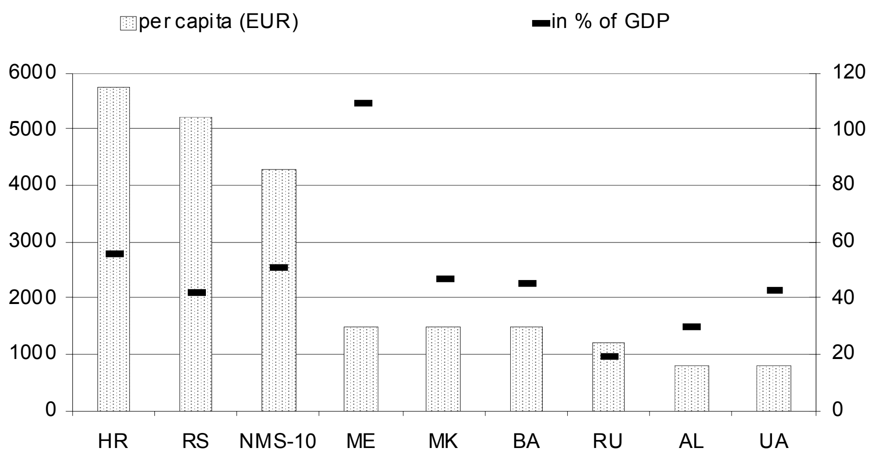
26 In the case of the EU, however, no automatic tariff reduction has taken place, since 'most-favoured-nation' tariffs had been applied within the framework of the Partnership and Cooperation Agreement (PCA) already since 1998.

Ukraine such as chemicals went down, as the country gained access to the WTO trade dispute facilities. Probably most importantly, the WTO accession was expected to improve the climate for FDI, although the full impact will not be seen before the legacy of the financial crisis has been overcome.

Generally, the current structure of Ukraine's exports does not provide much room for long-term growth and, as the recent economic crisis has demonstrated, makes the country highly vulnerable to volatile commodity (particularly steel) prices. In a number of neighbouring Central European countries, a substantial upgrade in their export structure has taken place thanks to the sizeable inflows of FDI. The experience of these countries has shown that capital per se, though important, is just one, and not the most important, benefit reaped by a country-recipient of FDI. Much more important has been the related transfer of technology and managerial know-how, which generally gave rise to remarkable productivity improvements and successful marketing strategies abroad. Therefore, it is not only the volume of FDI inflows that matters, but also their source and the sectors targeted, with FDI originating from advanced economies such as the EU-15 and targeting the more sophisticated industrial branches bringing the most benefits.

Figure 6

Stocks of inward FDI in Ukraine and selected CEECs, end of 2009



Source: wiiw Database incorporating national statistics.

On this account, the performance of FDI into Ukraine has been so far fairly disappointing – see Figure 6. By the end of 2009, the cumulated inward stock of FDI per capita – arguably most appropriate indicator of FDI penetration – amounted in Ukraine to just EUR 800. This is far below the levels observed not only in the relatively advanced new EU member states (NMS-10) but also e.g. Croatia, Serbia or even Russia. Apart from the EU, another important investor into Ukraine is Russia, although the bulk of Russian FDI is flowing via the 'offshore' countries such as Cyprus. The high importance of Russian capital in Ukraine reflects not only the cultural, geographical, etc. proximity, but is also a manifestation of the country's economic dependence on Russia. In fact, a substantial part of Russian investment in Ukraine in the end 1990s-early 2000s was driven by Ukraine's failure to honour its energy-related debt to Russia (particularly that for gas) on time, resulting in a series of debt-for-equity swaps.

Relations with Austria

Although Ukraine is not a very important trading partner for Austria, Austria is a relatively important trading partner for Ukraine. This is not only due to the geographical, but partly also to the cultural proximity: western regions of Ukraine used to be part of the Austro-Hungarian Empire. Starting from 2000, the trade turnover between Ukraine and Austria was constantly on the rise, reaching according to the Eurostat Comext data some EUR 1.4 billion by 2008 (although it plunged to EUR 800 million in 2009 due to the global crisis).[27] The expanding trade volume reflected first of all Ukraine's economic upswing, as Austrian exports to this country nearly doubled between 2005 and 2008 alone (the dynamics of Austrian imports from Ukraine has been generally less impressive). As a result, Austria has been running a growing surplus in its trade with Ukraine, which stood at EUR 200 million in 2009. Around 40% of Ukraine's exports to Austria is represented by basic metals and fabricated metal products – largely in line with the country's overall pattern of export specialization (Table 1). In turn, the structure of imports from Austria is more diversified and more advanced, with chemical products and various types of machinery and equipment featuring high on the list (Table 2).

Since the 'orange revolution', Ukraine has become an important investment target for Austria – by far exceeding its relatively modest role as a trading partner. At the end of 2009, the stock of Austrian FDI stood according to Ukraine's statistics at EUR 1.8 billion, accounting for 6.5% of total inward FDI stock and making Austria the fifth-biggest investor in the country (behind Cyprus, Germany, the Netherlands, and Russia). In particular, Austria established itself as a leading investor in Ukraine's banking sector after the EUR 860 million worth acquisition of a 93.5% stake in Ukraine's second biggest bank Aval by Raiffeisen International in 2005 (prior to the deal, Austria had ranked only ninth in the list of foreign investors in Ukraine).

[27] There are however relatively large discrepancies in the data provided by Eurostat and Statistik Austria. Thus, according to Eurostat, Ukraine's exports to Austria in 2008 totalled EUR 478 million (EUR 519 million according to Statistics Austria) and imports from Austria EUR 942 million (EUR 903 million according to Statistics Austria).

Table 1

Ukraine's exports to Austria in 2005-2009, in EUR million

according to NACE 2-digit classification

	Product	2005	2006	2007	2008	2009
AA	Agriculture, hunting and forestry	7.2	9.9	4.5	4.6	6.1
BA	Fishing	0.0	0.0	0.0	0.0	0.0
CA	Mining and quarrying of energy producing materials	1.3	0.0	8.0	12.1	6.6
CB	Mining and quarrying, except energy producing materials	1.9	3.6	12.0	3.5	1.7
DA	Food products, beverages and tobacco	24.8	25.6	35.2	16.3	10.9
DB	Textiles and textile products	3.9	4.6	7.3	6.6	6.0
DC	Leather and leather products	0.3	0.0	0.4	0.3	0.0
DD	Wood and wood products	13.3	16.1	17.3	16.3	11.7
DE	Pulp, paper and paper products	0.5	0.6	0.7	0.7	0.5
DF	Coke, refined petroleum products and nuclear fuel	0.2	0.1	0.1	0.1	0.2
DG	Chemicals, chemical products and man-made fibres	5.0	6.4	7.1	9.5	5.6
DH	Rubber and plastic products	2.3	4.5	3.8	3.9	1.9
DI	Other non-metallic mineral products	0.5	0.6	1.1	2.3	1.3
DJ	Basic metals and fabricated metal products	29.3	22.6	40.5	44.5	36.8
DK	Machinery and equipment n.e.c.	2.7	3.1	4.2	4.7	3.7
DL	Electrical and optical equipment	25.2	36.0	45.4	48.8	17.5
DM	Transport equipment	5.3	1.0	5.7	8.9	6.5
DN	Manufacturing n.e.c.	28.9	35.1	26.6	28.8	28.7
	n/a	0.0	0.0	0.0	0.1	0.4
	TOTAL	**341.5**	**316.2**	**380.3**	**478.2**	**314.9**

Source: Eurostat Comext database

Table 2

Ukraine's imports from Austria in 2005-2009, in EUR million

according to NACE 2-digit classification

	Product	2005	2006	2007	2008	2009
AA	Agriculture, hunting and forestry	4.1	5.7	12.3	24.8	10.7
BA	Fishing	0.0	0.0	0.0	0.0	0.0
CA	Mining and quarrying of energy producing materials	0.0	0.0	0.0	0.0	0.0
CB	Mining and quarrying, except energy producing materials	0.6	0.7	0.5	0.5	0.3
DA	Food products, beverages and tobacco	23.6	30.4	39.2	50.6	32.8
DB	Textiles and textile products	10.3	14.6	15.8	18.5	12.2
DC	Leather and leather products	3.3	6.0	7.8	7.0	4.0
DD	Wood and wood products	7.5	10.7	13.6	16.6	6.3
DE	Pulp, paper and paper products	31.2	40.8	46.7	50.4	37.3
DF	Coke, refined petroleum products and nuclear fuel	4.6	6.8	8.9	10.7	7.0
DG	Chemicals, chemical products and man-made fibres	80.0	108.4	142.5	176.8	140.1
DH	Rubber and plastic products	25.7	28.3	25.1	25.2	17.8
DI	Other non-metallic mineral products	5.4	4.5	9.0	12.6	6.5
DJ	Basic metals and fabricated metal products	36.6	73.3	88.6	92.0	44.2
DK	Machinery and equipment n.e.c.	126.9	190.2	177.3	159.7	81.7
DL	Electrical and optical equipment	83.6	116.8	107.2	119.9	66.4
DM	Transport equipment	25.5	34.6	41.8	86.4	26.2
DN	Manufacturing n.e.c.	16.2	15.8	30.9	56.7	11.9
	n/a	17.3	20.9	17.3	19.9	3.6
	TOTAL	**511.8**	**717.4**	**807.3**	**942.4**	**516.6**

Source: Eurostat Comext database

The main motivation behind the deal have been Raiffeisen's plans to expand its retail banking activities in Ukraine, given Aval's extensive network all over the country numbering over 1300 branches.[28] Although Raiffeisen had been present in Ukraine already since 1998 (under the name Raiffeisenbank Ukraine), its activities had been targeting primarily corporate banking. Following the takeover of Aval, the new owner was considering merging the two assets, but ultimately opted for selling Raiffeisenbank Ukraine to OTP bank of Hungary (this deal was finalized in summer 2006). In the aftermath of the Aval deal, two other Austrian banks – Erste and Bank Austria – followed suit, taking over Ukraine's Prestige Bank and Ukrsotsbank, respectively. Also, the past few years have witnessed a number of acquisitions by Austrian companies in the Ukrainian financial sector on a smaller scale, e.g. the takeover of the Ukrainian insurer Garanta (ranking second in property insurance and third in life insurance) by the Austrian branch of Italy's Generali.[29] Overall, some 400 Austrian enterprises are currently operating in Ukraine, including Baumit and Stahlbau Unger (construction), Wiener Städtische and Uniqa (insurance), Steirerobst (agriculture), Austrian Airlines (transport services), and Cargo Partner (logistics). The construction of a steel mill near Odessa by Austria's Voestalpine was however put on hold in autumn 2008 because of the financial crisis, which hit hard the global metals industry.

At the same time, the Ukrainian FDI stock in Austria is negligible: EUR 3.6 million at the end of 2009, according to Ukraine's statistics.[30] A EUR 155 million worth deal which could have become the biggest Ukrainian investment in Austria – a takeover of Bank Burgenland in 2006 by a Ukrainian consortium consisting of Ilyich Iron and Steel Works, Ukrpodshipnik and Active Bank – was blocked largely for political reasons. (Eventually, the troubled bank was sold to Grazer Wechselseitige of Austria for a mere EUR 100 million.)

Given Austria's geographical location, it is little surprise that the country has been an active supporter of the eastern dimension of the European Neighbourhood Policy (ENP), notably with respect to Ukraine, Belarus and Moldova. It was back in 1998 that the Austrian EU presidency developed the 'Partnership Europe' concept, which was initially targeted at the three above-mentioned countries. The key instruments of ENP implementation have been the country-specific 'Action Plans' focusing on a range of political and economic reforms and extensive cooperation in a number of areas, including political dialogue, trade and integration, internal affairs, energy, transport, etc. The Action Plan targeting Ukraine was largely based on the strategy paper drafted by Austria (together with Hungary) in autumn 2003 and incorporated many important provisions from this document such as the support in establishing a functioning market economy and WTO accession, and the elaboration of

[28] According to the most recent media reports, Raiffeisen Aval could be soon purchased by Russia's Sberbank for USD 2 billion.

[29] Raiffeisen Investment's daughter company Centragas Holding has also been acting as a partner in the controversial Rosukrenergo deal with Russian Gazprom and Ukrainian businessmen D. Firtash and I. Fursin.

[30] Ukraine's statistics suggest that 93% of the country's outward FDI stock is accounted for by Cyprus.

a feasibility study for the EU-Ukraine free trade area as a next step. The subsequent Austrian EU presidency in the first half of 2006 proposed the building of an EU common energy policy, the centrepiece of which was supposed to be dialogue with Ukraine and Belarus – the two important transit countries for the shipment of Russian oil and gas to Europe.

More recently, Austria welcomed the Eastern Partnership initiative, which was put forward in early 2008 by Poland and Sweden and inaugurated at the Prague summit on 7 May 2009. (The Eastern Partnership covers six post-Soviet republics of Eastern Europe and the Southern Caucasus: Armenia, Azerbaijan, Belarus, Georgia, Moldova and Ukraine.) Austria perceives the Eastern Partnership as a tool for implementing ENP in times of the financial crisis, which serves well the ENP's stated goal to form a 'circle of friends' around the European Union. In particular, the Eastern Partnership initiative would allow to strengthen individual partnerships with the countries involved, which could foster the implementation of necessary reforms in these countries and contribute to the badly needed stability in times of the economic crisis. Also, Austria has supported the earmarking of additional funds for the Eastern Partnership (EUR 350 million proposed by the European Commission, drawing on unused funds from the 2007 budget). The country puts emphasis first of all on the bilateral dimension of the Eastern Partnership initiative, concentrating on small projects such as integrated border management (IBM). Another important aspect of the Austrian approach towards the Eastern Partnership is that it is perceived to be in synergy with the so-called Danube Process, initiated in 2002 by Austria and Romania to stimulate the economic, social and cultural cooperation in the Danube region, including Ukraine. However, Austria is firmly opposed to treating the Eastern Partnership initiative – and ENP more generally – as an EU enlargement vehicle, and its attitude towards Ukraine's EU membership is generally cool. This is partly due to the focus of Austrian pro-enlargement diplomacy lying elsewhere (primarily in the Western Balkans), but also due to the possible repercussions on its relations with Russia.

Outlook

The recovery of global commodity prices and the gains in external competitiveness following the massive currency depreciation are the key drivers behind the current economic growth in Ukraine. For 2010, we expect GDP growth of close to 4%, with gradual acceleration in the years to come. This growth will be driven largely by recovering exports, particularly those of metals and chemicals, but also machinery (first of all to Russia). Producer prices in industry have picked up markedly – an indicator to be interpreted favourably in Ukrainian circumstances, since they largely reflect favourable developments in the country's terms of trade. For 2010, exports are projected to grow faster than imports, resulting in the already modest current account deficit (1.5% of GDP in 2009) probably disappearing altogether.

However, even with this relatively high growth, Ukraine's GDP will still be nearly 12% below the pre-crisis level. Also, the domestic demand, though picking up somewhat, is likely to remain subdued at least until the end of the year. Unemployment is unlikely to recede fast, while bank lending is unlikely to recover before the re-capitalization of the banking sector has been completed. One positive consequence of the weak domestic demand is however further disinflation. In annual average terms, consumer price inflation this year should not exceed 11%, particularly if the government opts not to raise gas tariffs for households and heating companies. A lower inflation should lead to lower nominal interest rates and reduce incentives for speculative capital inflows, thus preventing excessive currency appreciation and safeguarding external competitiveness.

The tax reforms planned by the new government should ease somewhat the pressure on businesses and also be helpful in reducing the scope of the shadow economy by providing incentives to comply, whereas the initially resulting shortfall in the government revenues could be potentially offset by extra privatization receipts. However, it is important that the government remains impartial and creates a level playing field for businesses: in particular, the big business should not be treated preferentially.

In the medium and long run, the country's economic policy challenges include the need for modernization and diversification away from the narrow specialization on metals and chemicals, raising the energy efficiency, and economic integration with its important neighbouring export markets. For that, Ukraine needs to attract substantial amounts of investment. The likely formation of a 'deep' free trade area with the EU will be certainly instrumental to reaching that goal, but the latter has to be accompanied by a parallel co-operation and further trade liberalization with Russia in order to avoid painful trade diversion effects. The 'first-best' solution in this respect would be the formation of a free trade area encompassing Ukraine, Russia and the European Union, which could be later advanced to the stage of a customs union.

Overall, Ukraine is offering a lucrative combination of a highly qualified and cheap workforce, proximity to EU markets and good market prospects both at home and in Russia. However, a broad range of institutional reforms in the areas of privatization, liberalization, competition policy and the rule of law, which have nearly stalled over the years due to the persistent political stalemate and vested interests, need to be advanced. The lack of these reforms might become an increasing constraint for the country's development. One of the most problematic sectors is agriculture, where market mechanisms have not been set in motion yet due to the existing moratorium on the sale of agricultural land and the enormous potential remains largely idle. Unfortunately, any progress in structural reforms will be more difficult without the 'carrot' of future EU membership, which is not on the agenda.

Igor Burakovsky

Ukraine's economy: from crisis to recovery, from recovery to … ?

From crisis to recovery

Ukraine's economy entered recession in the fourth quarter of 2008 as the world financial crisis unfolded and shook up the weak economic foundations of the country. Real GDP growth decelerated from 7.1% year-on-year in the first eight months to 2.1% year-on-year in twelve months because of a sharp decline in real exports and slowed household consumption due to the credit crunch. From the end of August 2008 the economic conditions already started getting worse as external demand and prices for metals went down and a credit crunch paralyzed domestic consumption and investment demand. The main sectors of the economy – manufacturing and trade – responded with a rapid decrease in value-added.

The global economic and financial crisis has hit Ukraine particularly hard. But at the same time this shock did not disrupt economic activities in a way as had been expected. Thus it is justified to say that the Ukrainian economy did surprisingly well in the times of crisis.

The crisis did not change the basic economic proportions. For instance, the structure of foreign trade has remained practically the same.

Ukraine is still oriented more towards the CIS rather than the EU. In other words, geographic trade reorientation has not yet occurred and the question remains whether this situation will stay the same in the future or will undergo some change. As data show, the geographic pattern of Ukrainian trade is quite stable, with the CIS region dominating.

It should be mentioned that Ukraine is a rather open economy, that is why the crisis affected exports and imports, the current account and external debt dynamics. It is necessary to stress that the current economic recovery is mostly export-driven, but an analysis of the external dimensions of Ukraine's economy would require special attention.

It may be argued that the current crisis has not represented a real shock, at least in the short run, and in a certain sense has not performed its traditional role in terms of selecting viable entities and making non-viable business entities leave the market.

To a certain extent, the same refers to politics. In public discussions the new government (as well as the president) have repeatedly stated that the current economic problems have resulted from the non-professional activities of the Yuliya Tymoshenko government and have been exacerbated by the global crisis. Though in many instances this critique cannot be denied, that approach is not justified as a lot of problems have been accumulating over a long period and the current government should also take on a certain responsibility for the absence of reforms before the crisis.

Recovery prospects

Today there is a wide consensus that the Ukrainian economy is recovering after the crisis and will grow in terms of GDP in 2010 and 2011 (see Table 1). The speed and specific features of the economic recovery will depend on external economic developments (performance of external markets for traditional Ukrainian export goods and financial markets as the source of investments) as well as internal factors (appropriate economic policies first of all).

Our estimates of GDP growth are rather modest and take into account a number of risks that can be downgraded. In principle, we expect good time ahead, but the pessimistic scenario cannot be completely ruled out either.

Table 1

Ukraine's economy: Past results and current expectations

	2006	2007	2008	2009	2010*	2011*
Real GDP (%)	7.3	7.9	2.3	-15.1	3.8	4.8
Consolidated budget balance (%, GDP)	-0.7	-1.1	-1.5	-2.4	-4.6	-2.9
Current account balance (%, GDP)	-1.5	-4.1	-7.2	-1.5	0.9	0.0
Net FDI inflow USD bn	5.7	9.2	9.7	4.7	5.0	8.5
Money supply (M2) UAH bn	259	391	513	485	572	751
CPI (%), yoy, ave.	8.0	12.8	25.2	15.9	11.4	11.5

*) Estimate.

Source: Calculations by IER (Institute for Economic Research and Policy Consulting, Kiev).

This scenario considers the following risks:

– the world economy suffers a new wave of economic and financial crisis;
– no cooperation with the IMF;
– the Ukrainian government fails to finance its internal commitments;
– world oil prices (Brent) will be 65-70 USD/barrel in 2010 and 70-80 USD/ barrel in 2011;
– external demand for Ukrainian metals remain low until the end of 2011;
– world metals prices (fob Black Sea) remain low until the end of 2011;
– unfavourable weather conditions for agriculture;
– VAT refund arrears accumulate in 2010-2011;
– tax arrears accumulate in 2010-2011;
– the economy encounters massive credit defaults in the real sector in 2010-2011;

– the financial sector suffers substantial losses, a number of systemic (big) banks go bankrupt.

This list of negative assumptions includes potential external and domestic threats. In principle, a second recession cannot be ruled out because the probability of a number of ‘negative’ events seems to be growing, but currently it is difficult to say how a new crisis would hit Ukraine if it should happen.

Economic policies: starting points and realities

Sustainable economic recovery and future economic growth require well-defined and efficient economic policies.

– The first objective should be to identify the causes of the crisis so that Ukraine becomes more resilient to any new financial crisis. In other words, what lessons should be drawn from the recent crisis?

Despite its obvious nature this question is not easy to answer adequately and comprehensively. Though there is a more or less broad consensus about the fundamental causes of the crisis and its after-effect, there is number of questions about the peculiarities of individual countries’ reaction to the external shocks.

– Second, the crisis has caused substantial problems, most notably the deterioration of public finances, which must now be addressed.

The current crisis represented a severe stress on Ukraine’s system of public finances. It revealed systemic problems (systemic is a key characteristic) which have been known for a long period. But in the years of economic growth these issues (though admitted) were not properly addressed.

– Third, the speed and scale of the economic decline has been exacerbated by the continuing lack of structural and institutional reforms in previous years.

The discussion about reforms and their role as crisis prevention tools is very complex but the current experience shows that many countries (including post-communist ones such as Poland or emerging economies) have demonstrated positive (and in some case quite spectacular as compared with less lucky peers) GDP growth rates. But one thing is clear – *ceteris paribus,* lack of proper institutional and structural reforms makes a country less resilient and more vulnerable to external economic shocks.

Generally speaking, Ukrainian economic policies should include two main components (goals).

(1) The first one can be called the anti-crisis component. It includes measures dealing with problems in the field of monetary and exchange rate policies, fiscal policy, government debt and various distortions stemming from the crisis and state intervention.

For example, the rehabilitation of recapitalized banks has so far not been as successful (in terms of results achieved) as was expected earlier.

(2) The second component is a strategic one – it consists of the necessary structural and institutional reforms to secure stable economic growth in the long run. The list of these reforms is well known as are the methods to address specific problems.

Taking into account the current state of Ukraine's economy, public finance and state governance, combining those two components in a balanced way is an extremely challenging task for the government.

The analysis of the current economic situation and the economic policies of the new government leads to the following conclusions:

– The current state of public finance represents a real danger to the ongoing economic recovery and stability. Radical and comprehensive reforms in this field are to be on top of the economic policy agenda.
– The reform programme contains in principle correct intentions (though some priorities, measures and their timing can be disputed) and in a way reflects many of the proposals presented earlier while the way of implementation and the 'roadmaps' of changes have yet to be properly defined.
– The new government has been constantly repeating that it has to deal with numerous problems caused by non-professional actions and wrong decisions of its predecessors and, before launching any reforms, the new authorities have to restore elementary order in various fields, ranging from discipline within the government – restoring 'controllability' ('dirigibility') of the national economic system – to public finance.
– Certainly, it cannot be denied that the efficiency of state governance (state institutions) in Ukraine has been traditionally low. And in the times of crisis and large-scale political confrontation the state has weakened while many problems have accumulated. Thus, the authorities must avoid a conflict between 'ensuring order' regulatory policies and the development of entrepreneurial initiative.
– The state desperately needs money to meet its obligations so it borrows money both internally and externally. That is why debt accumulation can be described as both a temptation and a danger.
– Though many important decisions have already been taken (and a number of them can be positively evaluated), these decisions require subsequent steps to yield the full-scale positive results. At the same time it is clear that without radical structural and

institutional changes all steps lead to nowhere in the medium- and long-term perspective.

– It is obvious that Ukraine as an open economy should make use of the benefits of international economic cooperation, but external opportunities should be viewed as an instrument of reform and not a way to preserve the status quo. Moreover, efforts to intensify cooperation in one field/geographic direction should not be undertaken at the expense of cooperation in other fields/geographic directions.

Key challenges for Ukrainian policy-makers

In our opinion, the fiscal deficit remains a key challenge for macroeconomic stability. The Law on the State Budget for 2010 provides for a nominal increase in spending by 33%, a significant increase in revenues and a deficit of 5.3% of GDP. However, the deficit is probably underestimated particularly considering the risks on the revenue side. The funding needs of the public sector remain significant, thus measures to review expenditures and their approximation to a more realistic revenue forecasts are urgently needed.

The stability of banking sector is another issue of concern. Assisting banks in restructuring their loan debts, the National Bank, in the first quarter of 2010, prolonged the refinance loans worth UAH 37.9 billion previously granted to banks. The measures taken by the National Bank have benefited the active restructuring of loans by banks and also positively influenced the dynamics of quantitative indicators for the credit portfolio. In particular, the growth of loans classified as negative went down to 2.4% as compared with 49.9% in the respective period of 2009.[31] But the problem with non-performing loans is far from being solved while the banks experience difficulties in finding solvent clients to provide credits.

It should be specifically mentioned that economic recovery at the micro-level will depend upon the ability of banks and companies to solve the external debt problem: Ukraine's gross external debt is dominated by the corporate sector while state debt accounts for a relatively small share (see Annex B, Table B1).

Ukraine, just as many other countries in the region, inherited social security programmes from the central planning era both in terms of ideology (paternalistic approach) and institutional design (multiplicity of social benefits and privileges along with a large number of targeted social and professional groups, domination of the 'pay-as-you-go system') leaving much room for rationalization and more precise targeting. The system is extremely expensive (taking into account the current economic and demographic trends), difficult to manage and inefficient in terms of delivering services.

[31] National Bank of Ukraine data.

This makes it necessary, first of all, to rethink the very fundamentals of the social security programmes in accordance with the current market and demographic realities and then reform its design and eligibility criteria, consolidate social programmes, eliminate most untargeted privileges, etc.

The situation in the medium- and long-term perspective will depend upon the resumption of investment activity, which has been severely hit by the crisis (see Annex B, Table B2).

Ukraine–IMF: resuming cooperation

From the first days in office, President Victor Yanukovych and Prime-Minister Mykola Azarov declared the necessity to resume the cooperation with the IMF that had been suspended before the presidential elections.

In fact, cooperation with the IMF had been suspended twice in 2009 after Ukraine had failed to keep its pledges to cut budget expenditures during the battle of the political leaders ahead of the elections. The government also refused to raise natural gas prices for households and failed to adopt the laws necessary to stabilize the financial system.

The parliamentary opposition managed to push through parliament laws on higher spending on social benefits, including an increase in the minimum wage. The political turmoil in the country prevented the adoption of the state budget for 2010. This failure illustrated the inability of the authorities (the parliament, president, government and the National Bank) to agree on economic policy priorities and to ensure the proper implementation of Ukraine's commitments.

Upon completion of a two-week visit of the IMF mission to Kiev in June 2010, the IMF issued a press release announcing that 'the mission has reached a staff-level agreement with the authorities of Ukraine on an economic policy programme that can be supported by a two-year stand-by arrangement in the amount equivalent to SDR 10 billion (USD 14.9 billion).

The agreement reached with the authorities is subject to approval by the IMF Management and the Executive Board. Consideration by the Executive Board is expected in late July, following approval of legislative changes relating to the budget and financial sector.

The new Ukraine–IMF programme is set to replace the USD 16.4 billion two-year stand-by arrangement concluded in November 2008, which went off track in November 2009 amid repeated non-compliance by the Ukrainian authorities with the programme conditions. Under the previous programme, Ukraine drew down USD 10.6 billion (of which USD 4.8 billion were used for budget deficit financing).

According to the IMF press release, 'the goal of the authorities' economic programme is to entrench fiscal and financial stability, advance structural reforms, and put Ukraine on a path of sustainable and balanced growth'. Specifically, the programme envisages the implementation of fiscal adjustment measures (i.e. expenditure cuts combined with efforts to improve tax administration) aimed at containing the general government deficit at 5.5% of GDP in 2010 and 3.5% in 2011, and setting public debt firmly on a declining path.

Another important element of the programme is the energy sector reform, focused on 'strengthening the gas sector and improving Naftogaz's financial position, limiting its deficit to 1% of GDP in 2010 and balancing its finances in 2011'. At the same time, measures are to be taken to compensate the most vulnerable people.

Fiscal adjustment is to be achieved by tax and social security structural reforms. Additional resources are allocated in the budget to protect the poorest segment of the population. No further details of the programme have been disclosed yet as loan parameters (i.e. tranches schedule and volumes, prior actions, performance criteria and structural benchmarks) are probably to be revealed after the IMF Board meeting.

Financial sector reforms are focused on restoring the health of the banking system, including by ensuring an adequate level of capitalization and strengthening the independence of the National Bank of Ukraine.

In general, reforms will be aimed at modernizing the economy and improving the business environment, in order to restore robust economic growth over the coming years.

Reforms and integration of transition countries into the global economy: lessons for Ukraine

In principle, the global financial crisis once more drew attention to the question of the relationship between reforms and the integration of transition countries into the global economy, with subsequent implications for their economic growth. In this context we can quote the World Bank Report 'Turmoil at Twenty: Recession, Recovery, and Reform in Central and Eastern Europe and the former Soviet Union', which addresses three fundamental questions that relate to recession, recovery and reform, respectively, in Europe and Central Asia:

(1) Did the transition from a command to a market economy and the period when it took place, plant the seeds of vulnerability that made transition countries (the region excluding Turkey) more prone to crisis than developing countries generally?

(2) Did choices made on the road from plan to market shape the ability of affected countries to recover from the crisis?

(3) What structural reforms do transition countries need to undertake to address the most binding constraints to growth in a world where financial markets have become more discriminating and where capital flows to transition and developing countries are likely to be considerably lower than before the crisis?[32]

These questions are of fundamental importance for policy-makers but are rarely discussed in Ukraine. The answers to them are of a practical nature.

In general, the authors of the report provide the following answers and these considerations represent a quite useful analytical tool to address a number of Ukraine's problems.[33]

First, the transition shaped the nature of vulnerability but was not its sole determinant. In particular, in some financially integrated countries that were latecomers to the transition, excessive credit growth was fed on the demand side by households attempting to catch up to Western European living standards. In that sense, the transition shaped the nature of vulnerability and made transition countries more prone to being hit by the global economic crisis as compared to developing countries. But that is only part of the story. Turning to the supply side, the transition countries were integrating into the world economy at a time of historically high global liquidity, when fierce competition in international banking provided an abundant supply of credit to emerging market economies. However, the countries could have done more to manage risks: in particular, fiscal policy could have played a greater role in limiting the vulnerability to a sudden change in market sentiment.

This statement is true for Ukraine where credit growth led to a construction bubble, for example. It should be mentioned that the banks were eager to lend money and the lending procedures were rather lax. The Ukrainian economy is characterized by a high level of dollarization, and foreign currency is in fact widely used as a quasi-legal tender in the country (see Table 2). The existence of a de facto fixed exchange rate regime (for a long period) stimulated the development of hard currency lending to households. This practice was a risky one because in the majority of cases borrowers did not have income denominated in hard currency and the sharp devaluation of the hryvnia in 2008 became another factor of the financial crisis in the country.

Second, crisis-hit countries that had decided in the course of the transition to privatize banks to foreign investors (in order to harden budget constraints and attain macroeconomic stability) have generally navigated the crisis more successfully over the past year. Foreign banks – and other foreign lenders – exposed countries to greater risk.

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[32] Pradeep Mitra, Marcelo Selowsky and Juan Zalduendo (2010), 'Turmoil at Twenty: Recession, Recovery, and Reform in Central and Eastern Europe and the former Soviet Union', The World Bank, Washington DC, pp. 3-4.

[33] Mitra, Selowsky and Zalduendo, op. cit., pp. 21-22.

But crisis-hit countries with majority foreign-owned banking sectors have so far been able to roll over maturing external debt to parent banks more easily than those with majority domestic-owned banking sectors, which relied more heavily on wholesale funding. Indeed, the rollover of wholesale funding has been and continues to be difficult across the region.

Table 2

Deposits by households, breakdown by currencies

(outstanding amounts at end of period, hryvnia million)

Period	Total	including by currencies				
		hryvnia	US dollar	euro	Russian rouble	other
1	2	3	4	5	6	7
2005	74,778	43,688	26,372	4,615	20	83
2006	108,860	59,889	40,848	7,909	27	186
2007	167,239	102,379	48,808	15,514	57	480
2008	217,860	110,016	75,461	31,134	81	1,169
2009						
May	195,980	101,298	66,639	26,947	80	1,015
June	201,358	103,474	68,974	27,852	88	970
July	203,576	101,852	72,061	28,626	91	946
August	206,368	97,785	77,072	30,479	99	933
September	204,963	96,640	76,248	30,935	106	1,034
October	207,006	96,434	76,899	32,449	120	1,105
November	210,072	97,444	77,632	33,654	127	1,215
December	214,098	101,081	78,627	33,126	133	1,131
2010						
January	214,597	101,756	78,890	32,687	129	1,134
February	217,259	104,223	79,770	31,970	140	1,156
March	222,197	106,485	81,501	32,916	158	1,137
April	233,627	114,716	84,068	33,494	178	1,171
May	236,895	118,719	85,531	31,260	200	1,185

Source: National Bank of Ukraine.

It should be mentioned that foreign-owned banks did not close down their operations in Ukraine though the scale of their activities was reduced and business strategies reconsidered. This favourable (for Ukraine) development may be directly attributed to the so-called Vienna Initiative, a forum that was created in early 2009 to coordinate the responses of major public and private stakeholders to the financial crisis in the European transition countries. This forum brings together home- and host-country authorities of the major EU-based bank groups, the bank groups themselves, the International Monetary Fund (IMF), the EBRD, the European Investment Bank (EIB), the World Bank Group, and the European Commission (EC).

The Initiative’s objectives were to determine the respective responsibilities of the national home- and host-country authorities in crisis management; avoid uncoordinated national crisis responses; and keep key international bank groups engaged – all under the auspices of, and with financial backing from, international financial institutions (IFIs).

Three points in this respect should be highlighted:

- EU-based parent banks pledged to recapitalize and refinance their subsidiaries in transition countries. In countries with IMF-supported programmes (co-financed, in the case of EU members, by the EC), this has taken the form of letters by the major banks which commit to maintaining exposures as long as IMF-backed programmes remain on track.
- The 1 March 2009 Emergency Summit of EU leaders confirmed that national government support packages for parent banks would not contain restrictions affecting the activities of subsidiaries in EU host countries.
- IFIs announced financing packages within the mandate of their respective institutions. In late February 2009 the EBRD, EIB, IFC (International Financial Corporation) and MIGA (Multilateral Investment Guarantee Agency) launched the Joint IFI Action Plan to support banking sector stability and lending in the real economy with a budget of EUR 25 billion for 2009-2010.[34]

These steps definitely contributed to the national stabilization efforts in the region and had a positive impact upon Ukraine.

Third, high growth in the years preceding the crisis caused firms in transition economies to encounter capacity constraints in infrastructure and labour skills – the positive legacy of socialism – for the first time since transition began. At the same time, progress in transition caused firms and economies to outgrow the capacity of institutions to provide public goods to support market economies, as is evident from concerns about the legal and judicial system, labour regulation, and corruption.

This point is particularly true for Ukraine where structural and institutional reforms practically stopped in 2003-2004. It should also be mentioned that the technical level of Ukraine's industry has remained rather low: Ukraine needs new technologies and investment goods for virtually all sectors. Thus, at the moment, Ukraine faces a real challenge to pursue reforms in order to modernize the country as such. To my mind, modernization is the key word, and this task has three interrelated dimensions: modernization of industrial capacities (including infrastructure), modernization of the institutional framework, and modernization of economic policy making.

Crisis and reforms: general approach

According to EBRD the crisis led to a major slowdown in reforms in the year 2009; in most countries the absence of discernible progress – as measured by the EBRD transition

[34] EBRD Transition Report 2009, p. 18.

indicators – has been evident. This raises the questions, what about next year and beyond? Will the reform process gain fresh momentum once the global economy starts to recover, or will the legacy of the crisis be an 'anti-market' bias that will see authorities undoing the good work of the past?[35]

The key conclusion of the EBRD experts is that the current crisis is unlikely to either trigger a major reform reversal or significantly re-invigorate the reform process with a few years' lag, as occurred, for example, after the 1998 Russian crisis.[36]

As far as Ukraine is concerned, the new government has been stressing not only the necessity of reforms but also its readiness to launch large-scale reforms. As mentioned earlier, the reform programme contains the appropriate goals and intentions, but a number of major steps are scheduled for 2011-2012 only. The government's readiness for reform will be tested by the ability to comply with IMF demands as the IMF-supported programme can be considered as the one and only real set of steps addressing the burning economic issues.

Again, in the case of Ukraine, it is difficult to say at present whether the EU anchor (in the framework of the Eastern Partnership) will be important for the country as a reform factor. In a certain sense Ukraine has again found itself at a crossroads where difficult and quick choices are to be made.

The fundamental issue about the nature and extent of economic reforms boils down to a civilized choice based on values: whether the country continues to function in a post-Soviet environment with monopolized markets, dominated by corruption schemes and excessive bureaucratic interference in production and commercial activities of economic agents, or whether the country chooses to establish the principles of real competition and economic rationale rather than the bureaucratic one, with adequate market functions of the state. In fact it boils down to making a choice between the creation of an efficient economic system that opens up a practically unlimited growth potential, or the partial improvement of the current economic model that has no prospects.

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35 *EBRD Transition Report 2009*, p. 19. As earlier, we make use of the EBRD experts' approach to draw some conclusions for Ukraine.

36 This statement is supported by the following reasoning: Major reform reversals remain unlikely based on the fact that the reform orientation of most governments has not changed since the intensification of the crisis in the second half of 2008. Indeed, several pro-reform governments have come to office in the meantime. The lack of a generalized anti-reform backlash may be attributable to the fact that economic institutions and political systems are generally more mature in this crisis than in 1998; that the region is better integrated into regional and global institutions; and that the response to the crisis was more successful, preventing high inflation and banking system collapses, notwithstanding large declines in output. However, a major burst in new reforms, as happened during the early years of this decade, is also unlikely. This is true both for EU member countries where the distance from the transition frontier is moderate at this point, and where the reform effort needed to make further advances in transition is typically higher; and for countries further east, where reforms have been less consistent in recent years and support for market institutions is weaker. In addition, the political systems in this part of the region have not yet developed mature institutions of interest intermediation and accountability, suggesting that incumbent governments and conservative policies are likely to remain in place despite pressures for changes. Source: *EBRD Transition Report 2009*.

Vasyl Yurchyshyn

Scenarios for Ukraine's economic and political development in the medium and long run

In the following we present a brief analysis of the key economic challenges facing Ukraine and the main prospects for an acceleration of the economic dynamics and improving the business environment. The disproportionately huge impact of the world economic and financial crisis on Ukraine, as compared to other economies, requires a careful assessment of the pre-crisis economic situation. Understanding these issues is necessary to evaluate the current macroeconomic conditions and mid-term policies, in order to achieve sustainable economic recovery and growth.

The severe economic decline in Ukraine was mainly caused by the strong politicization of economic decisions, rendering impossible the approval of a coordinated anti-crisis programme by the relevant authorities. Today Ukraine is confronted with large budget deficits, inflation, high foreign debt, a distrusted banking system and loss of confidence in public policy.

Some characteristics of the Ukrainian economy in the crisis period and its current situation are presented in the next tow sections. Then we discuss the importance of the collaboration with the IMF, which can be considered the basis of economic recovery. We subsequently present two potential economic development scenarios – an optimistic and a realistic one – analysing the advantages and risks of each. Finally we draw some conclusions concerning the chances of realization of the two scenarios.

Losses of Ukraine's economy in the crisis period

From the beginning of the millennium until the autumn of 2008, Ukraine witnessed quite positive economic dynamics, with average growth reaching 7.5%. Thereafter, the global economic and financial crisis caused a huge negative pressure on Ukraine. How can we measure the losses of the recession? Several observations would be reasonable.

Table 1

GDP per capita in Ukraine

2001		**2005**		**2007**		**2009 (e)**	
USD	*USD PPP*	*USD*	*USD PPP*	*USD*	*USD PPP*	*USD*	*USD PPP*
766	4350	1761	6848	3035	6914	*2500*	*6400*

Source: IMF.

(1) In 2009 GDP per capita dropped to USD 2500 (in current USD terms); Ukraine was ranked 110th in the world according to IMF assessments (Table 1).

(2) Wages and incomes of the population declined by 27% in USD term[37] (Table 2).

Table 2

Average wages in Ukraine

(end of the period)

	2007	**2008**	**2009**
Monthly average wage, UAH	1475	1917	1950
… in USD	292	333	244

Source: State Committee of Statistics of Ukraine. Estimation: author.

(3) Real GDP declined by 15.1% in 2009 (industrial production by 22.0%, construction by 45.9%, transport by 48.0%; fixed investments dropped by 46.2%). That decline was mainly the result of the collapse of exports, the credit crunch and reduced domestic savings along with a shortage of own resources of the corporate sector. These negative developments destroyed the sources needed and the stimulus for the transformation of infrastructure and for modernization.

At the same time, the vulnerability of the Ukrainian economy was proven by the following additional components:

Internal:

- Consumer-oriented domestic demand with low income:
  - share of final consumption: 84.6% of GDP (private consumption: 65.4%, public consumption: 19.2%);
  - investments had a share of 17.1% of GDP.[38]
- Ukraine mainly produces goods with a low processing degree or semi-finished goods, which are largely dependent on energy (imports). The vast consumption of imported materials and energy resources, whose cost will only grow in the long run, points to the low efficiency of the national economy.

External

- Rather high openness of the economy: in 2009 exports amounted to 46.3% and imports to 48.0% of GDP;
- The lack of diversification of this open economy: more than 50% of total exports are accounted for by just a few products of low value-added, such as metals, grains and agricultural products.

[37] National currency – hryvnia (UAH). Average exchange rate: 2007 – 5.05, 2008 – 5.8, 2009 – 8.0 UAH/USD.

[38] Year 2009. Compare with an investment share of 22-26% of GDP in the previous five years.

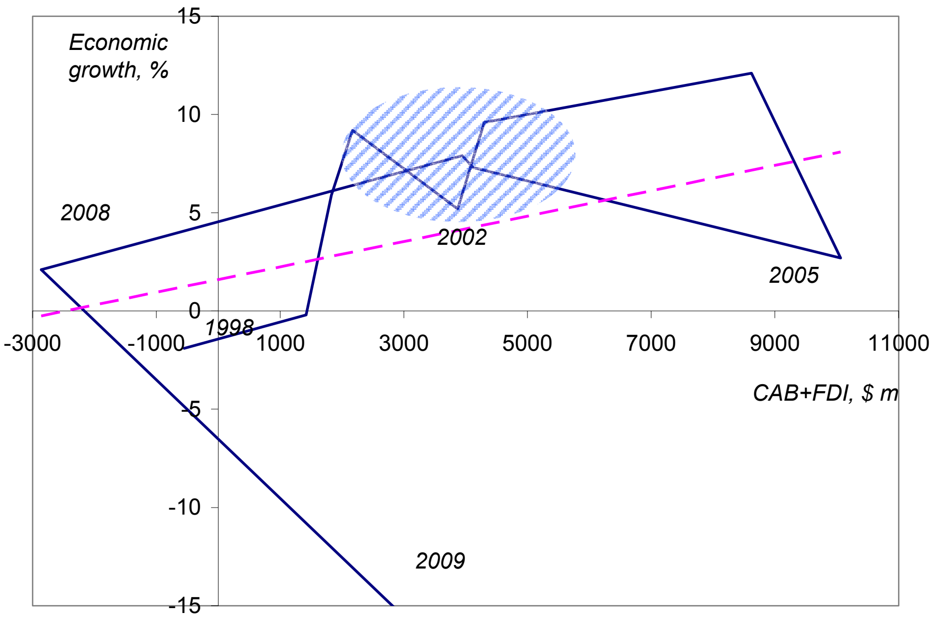
- Narrow geographic diversification of exports: Ukraine's key trading partners – Russia, Turkey, Italy, Poland, Belarus, and Germany – account for half of total exports.
- The high volatility of demand for Ukrainian exports: as global demand for exports, in particular for low value-added goods, tends to fluctuate significantly due to business cycles, export revenues for Ukraine remain unstable and unpredictable.

(4) Public finances deteriorated in 2008-2009, with a high general government deficit (at about UAH 70 billion or 7.5% of GDP in 2009).[39] For reasons of stability, the National Bank of Ukraine (NBU) attempted to restrict the money supply but, due to poor policy coordination, the fiscal policy remained lax in 2009. Thus, the NBU monetized the fiscal deficit by repurchasing T-bills (amounting to 8.4% of GDP in 2009), in parallel with the sterilization of USD 4 billion liquidity (6% of M3) of the banking sector.

(5) The resultant crowding-out effect (fall of domestic credit to the private sector) increased liquidity risks and the growth of the non-performance loans (NPL) share in bank portfolios to 34% (Fitch). Moreover, with more than half of all outstanding loans in the Ukrainian banking system denominated in foreign currencies, both borrowers and commercial banks were exposed to currency risks, which resulted in the loss of public confidence in the banking system.

Figure 1

External resources (CAB+FDI) and economic growth



Source: State Committee of Statistics of Ukraine (Derzhcomstst). Estimation: author.

[39] The consolidated budget deficit was reported at about 4% of GDP in 2009. However, if including the public funds used to recapitalize commercial banks and the state-run natural gas company Naftogaz (about 5% of GDP) and the extra expenditures to cover the pension fund deficit, the overall fiscal deficit in 2009 totalled about 11.5% of GDP.

(6) In 2009 merchandise imports declined by 44%, exports by 37%, as compared to 2008. As a result, the current account deficit narrowed to 1.9% of GDP in 2009, as against 7% of GDP or USD 13 billion in 2008.

(7) The huge current account deficit in 2008 and the drop in FDI in 2009 due to the escalating economic crisis in Ukraine were among the critical factors of the economic decline in H2'2008-2009. Highly concentrated and uncompetitive exports and a worsening investment climate significantly reduced external resources for economic growth[40] (Figure 1).

(8) Total external debt increased to USD 104 billion (as of the beginning 2010) – about 85% of GDP, with sovereign debt rising by 49% (to USD 18 billion) during 2009 (Table 3). At the same time, the banking system visibly improved its debt position. Over the past several years, Ukraine had borrowed excessively from abroad to finance the sharply increasing domestic consumption and investments. The international liquidity crisis led to a reversal of capital flows, which drained liquidity in the banking sector and depressed credit, investment and consumption. All of this took a heavy toll on economic activities in the country.[41]

Table 3

Ukraine's external debt

USD billion (as of the beginning of the year)

	2008	2009	2010
Government	11.9	12.0	17.8
NBU (Central Bank)	0.5	4.7	6.2
Banking system	30.9	39.5	30.8
Corporate	33.6	41.3	44.1
Total	**80.0**	**101.7**	**104.0**

Source: NBU.

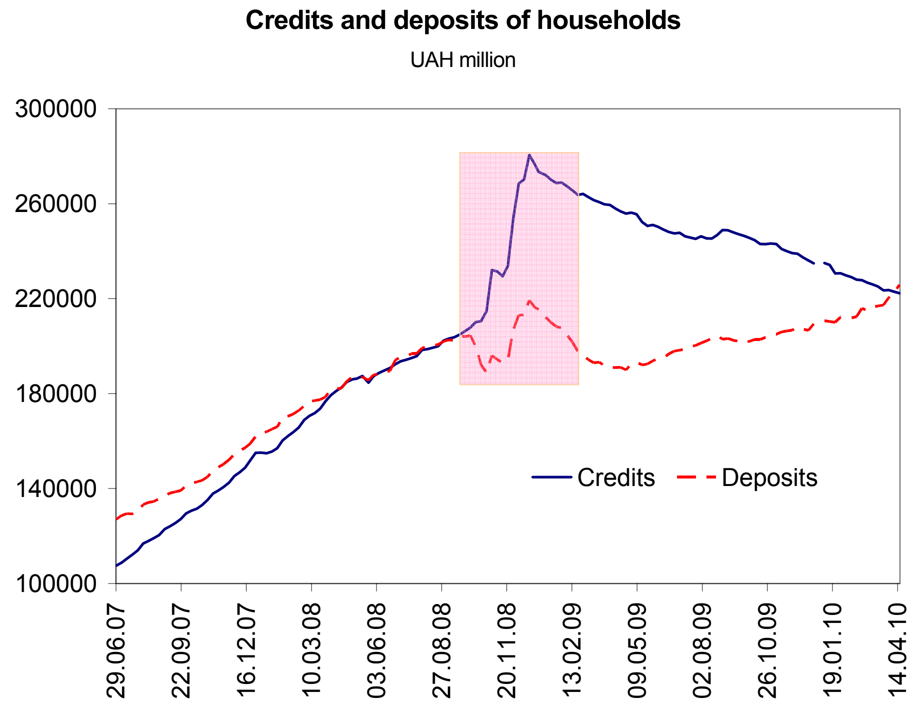
(9) The banking sector is underdeveloped and unstable, although the loans-to-GDP ratio (total loans to non-financial customers) rose from 48.5% at the end of 2008 to 52.7% in 2009, but mainly due to the GDP decline. Credits to households fell from 54.9% of total credit portfolios in 2008 to 48.8% in 2009. This represented a real shock for businesses and households, after several years of rapid growth of crediting (Figure 2).[42]

40 Disbursements of IMF stand-by tranches of USD 6.1 billion and financial support from other IFIs (such as WB, EBRD) helped to cover Ukraine's external financing gap in 2009.

41 See also: 'The Impact of the Global Liquidity Crisis on Ukraine and the Road to Economic Recovery. The Bleyzer Foundation Position Paper', Forum on the Economic Development of Ukraine, Washington DC, October 2009.

42 In the period 2005 to first half of 2008, Ukrainians obtained access to new (for them) sources of enhancement of their wellbeing. Over these years, the banking sector had been experiencing an extraordinary, unsustainable expansion: bank lending grew by over 70% per year. Relative macroeconomic stability (not seen by the country before the

Figure 2



Source: NBU.

In the coming two to three years, the prospects for an at least partial restoration of the positive growth dynamics of private deposits in the banking system are poor, due to serious mistakes of the country's central bank during the crisis developments in the autumn of 2008, and the persisting strong mistrust in the NBU policy.[43]

(10) Over several years (from 2001) Ukraine followed a de facto fixed exchange rate regime. During that period inflation remains high. Sooner or later, this loss of competitiveness should have been restored through corresponding exchange rate adjustments. The crisis in the autumn of 2008 caused a crash for UAH purchasing power and the NBU was obliged to spend a huge amount of reserves to prevent further losses (Figure 3).

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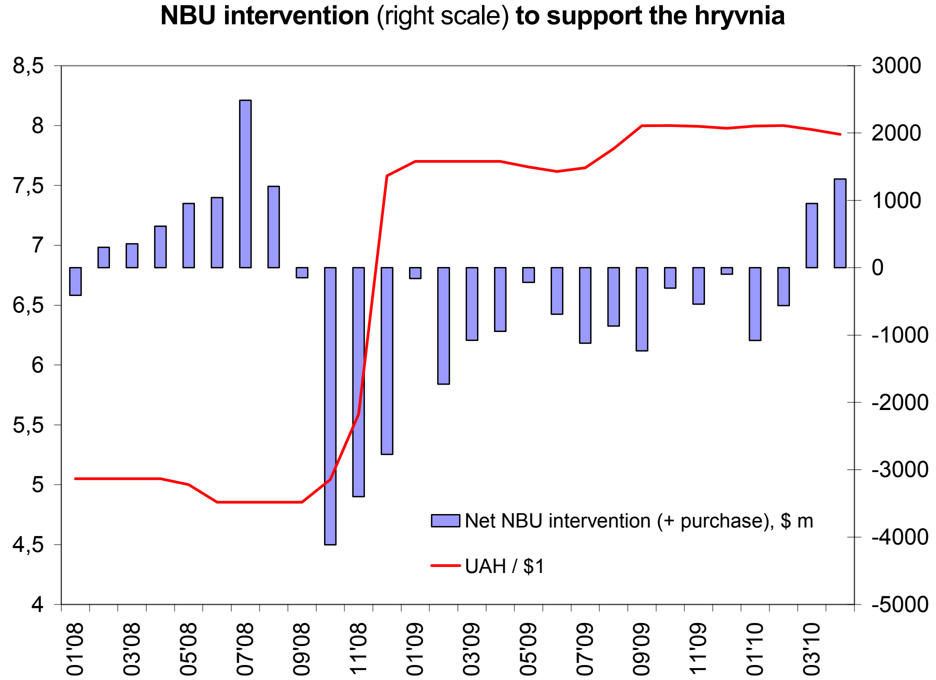
beginning of the 2000s), the entry of many foreign-owned banks, the inflow of foreign currency facilitating support for the national currency and the involvement of domestic banks in international financial flows, promoted, *first*, substantial growth of individual deposits (which, in turn, provided resources for the banking system) and *second,* access of the national banking system to cheap resources of international banking structures (which also made possible the build-up of the internal borrowing base).

43 The authorities failed to control the use of the liquidity support that was initially provided to a number of banks in the crisis period. It appears that these funds were used not to revive domestic lending as initially expected, but to buy foreign exchange to transfer it abroad. That contributed to high depreciation pressure on the hryvnia. See, e.g., 'Specificity of the Swedish monetary policy', National Security & Defence, No. 1, 2009, pp. 51-56.

Figure 3



Source: NBU.

Ukraine: back to recovery in early 2010 and further growth?

Following the sharp decline in GDP in 2009, Ukraine now has made some steps towards recovery. There is supportive external demand that has a positive impact on the exporting sectors and helps to sustain economic recovery. However, the chances that the former major sources of economic growth (domestic consumption based on wider access to credit resources, and exports resting on a favourable pricing situation) will further ensure GDP growth are very low.

One important factor for the recent positive developments and an optimistic outlook for the coming months is the consolidation of the political power under the leadership of the president, which should help Ukraine's economic environment to become more predictable and transparent, and make national businesses and international investors more optimistic about Ukraine's prospects.

Political consolidation. After the presidential elections a quick consolidation of power by the winner occurred:

- a new parliamentary coalition led by the party of the president – the Party of Regions (PR) – was formed;
- a new government was formed primarily from representatives of PR, implying the consolidation of the executive branch of power as well;

- rotation on the regional level provided the possibility for the government and president to pursue a new consolidated policy on the regional level;
- the permanent conflicts of the past five years between the president and the government are over;
- the president and the government are now able to realize their initiatives under the support of the 'friendly' coalition.

The political consolidation should create more certainty for businesses and investors concerning Ukraine's future prospects. However, the endurance test of the governmental power will come in late October 2010, when the elections for local Ukrainian authorities will be held. Clearly, before that date the government will avoid harsh stabilization steps, by conducting financial and commodity interventions to balance the domestic demand. The maintenance of economic control in the interim period will result in an increase in the influence of political power.

Economic improvement. Against the low comparative base of the previous year (industrial output declined by 31.8% in the first quarter of 2009), industrial output grew by 12.6% in January-April 2010, with double-digit growth in the main industries: metallurgy +22.2% year-on-year, oil-chemical industry +23.8%, machine building +28.0%.

In April to May, a further reduction of inflationary pressure was observed, with 0.3% and 0.6% deflation in those two months. The balance of payments continued to improve: both current account and capital account ran surpluses. The surplus on the current account is estimated at USD 109 million, international reserves grew by USD 600 million. The national currency appreciated slightly (see Figure 3 above).

Public finances remained under significant strain during the first months of 2010. Despite a stronger recovery, the budget revenues performance was quite weak. The consolidated budget deficit amounted to 2% of GDP in the first quarter of 2010. However, the official deficit did not include pension fund and Naftogaz imbalances as well as bank recapitalization spending; hence, the broad fiscal deficit can be estimated at about 7-8% of GDP. The deficit was primarily financed by new domestic borrowing. The lion's share of government T-bills was purchased by the NBU, implying indirect monetization of the budget deficit.[44]

Is there hope for recovery in the short run? There are some doubts in terms of the GDP structure:

- **final consumption** expenditures of households will not grow significantly in the near future. Despite GDP growth, the retail trade turnover continued to decline (by 3%

[44] For more details see: O. Pogarska, E. Segura, 'Ukraine. Macroeconomic Situation', SigmaBleyzer, April 2010.

year-on-year in January-April 2010), indicating a further cooling of domestic demand and household consumption;

- **investments** – the current economic policy does not create incentives and preconditions for increasing capital investment, neither from the state budget nor local budgets, nor from enterprises' own funds;
- **net exports** remain volatile and dependent on the pace of recovery in the world economy, in particular the demand for key Ukrainian exports.

Under conditions of decreasing world demand for Ukrainian exports, the main trade and investment flows have been reoriented towards Russia and the CIS. Since the dynamics of the Ukrainian economy seriously depend on the dynamics of the Russian economy, the problems experienced by the latter may complicate Ukraine's prospects of economic recovery in the short or even medium run.

Meanwhile, in the short run (in 2010) it is reasonable to expect:

- further improvement of the current account balance, reflecting price cuts for imported gas;
- lower inflation (less than 10% year-on-year) in the event of a postponed rise in gas tariffs for households and industries;
- the discount for imported gas supports price competitiveness of basic exporting industries which will expand resources for macroeconomic stabilization;
- further price stabilization due to hryvnia appreciation (declining pressure from the current account).

At the same time it should be mentioned that the state measures to support the economy inevitably mean a substantial increase in the government's role in business. This may result in politicization, de-institutionalization and monopolization of the economy and curtailment of private initiatives.

Institutional outlook. Recently Ukraine has continued to lose competitiveness, first of all due to weak institutions, public management and politicization of economic decisions, which is confirmed by international ratings. In particular, general observations from *Doing Business 2010*[45] summarize the following aspects (see Figure 4):

- the quality of the business environment in Ukraine remains unsatisfactory – the country is ranked 145th out of 183 countries in terms of 'Ease of Doing Business';
- domestic and foreign businesses still face an onerous burden of excessive and costly regulatory, licensing and taxation procedures;

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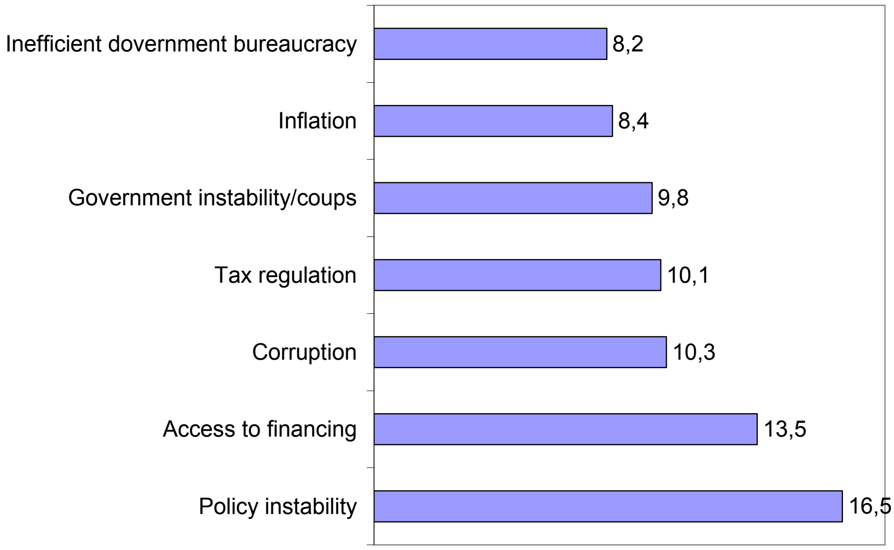
[45] Source: *Doing Business 2010* (http://www.doingbusiness.org/). *Doing Business* is produced by the World Bank Group and presents quantitative indicators on business regulations and the protection of property rights that can be compared across 183 economies.

- the weak investment climate continues to hold back the development of the Ukrainian private sector, restraining the growth of investment, employment, output and welfare.

As for economic growth, as mentioned earlier, the past sources (that is, major increases in domestic consumption and exports) are unlikely to be the main drivers for Ukraine's GDP growth in the future.[46] Therefore, in order to accelerate economic development, the authorities will have to find new ways to increase domestic and foreign direct investments, which will encourage output and productivity growth. This means that the authorities will need to demonstrate that Ukraine's investment climate is rapidly changing for the better.

Figure 4

The most problematic factors for doing business in Ukraine



Source: Doing Business 2010.

Collaboration with the IMF as the basis for economic recovery

The discussed trends for a certain improvement of the political and macroeconomic situation in Ukraine caused the spread of a general belief in political circles that Ukraine has already reached a steady state of growth. Nevertheless, as was the case during the previous years, these trends are neither stable nor irreversible. Risk trends may contain both external factors (e.g. possible dissemination of the 'second wave' of the European economic and financial crisis followed by its negative impact on Ukrainian exports and capital inflows into Ukraine) and internal processes (e.g. deterioration of the financial

[46] See also: 'The Impact of the Global Liquidity Crisis on Ukraine and the Road to Economic Recovery. The Bleyzer Foundation Position Paper', Forum on the Economic Development of Ukraine, Washington DC, October 2009. In Ukraine, many problems are also associated with the politicization of the economic environment, inefficient governance, administration etc. See also: 'Ukraine: International Experience in Resolving Financial Crises', The Bleyzer Foundation, 2008.

stability of the banking system and increasing fiscal problems as the result of the suspension of economic recovery).

To stimulate economic development, a new government programme was prepared and presented to the public, businesses and investors at the beginning of June 2010 (see Box 1).

The programme is very ambitious and seemingly too optimistic, taking into account available resources and current governmental practices. Moreover, previous attempts at reforms have shown that the Ukrainian government has no particular experiences and incentives for the independent introduction of systemic transformation. These factors might lead to two basic scenarios for the development of Ukraine in the medium and long run (see below). A successful implementation of the new programme will mean fruitful cooperation with the IMF and other IFIs, as well as rapid economic growth and social development. Postponement or delay of the reforms will push Ukraine into slow and poor economic activities, at least in the medium term.

Box 1

Main priorities of the new programme for economic reforms

The Committee for Economic Reforms has been established under the new president to create and deliver an economic reform programme for 2010-2014. Among the main priorities of the programme are: (i) setting a framework for ensuring long-term macroeconomic stability; (ii) keeping inflation low; (iii) stabilizing public finances; and (iv) developing a more sustainable financial sector. In the pursuit of these, the major directions of the reform plan are as follows:

- introducing mid-term budgetary planning and fiscal rules, in order to stabilize the budget throughout the economic cycle;
- balancing the pension fund: measures aimed at enhancing systematic solidarity in the pension granting and indexation mechanism, as well as introducing mandatory state pension insurance by 2014;
- As for monetary policy, its main goal will be to bring core CPI inflation to single digits from 2010;
- consolidating the banking sector and improving banking supervision, in order to make the financial sector more sustainable in the future.

The government is focussing its attempts on reducing the budget deficit and expanding revenue sources (via such means as introducing taxes on luxury products, and hiking excise rates and royalties for natural resources extraction). Aiming to bring public finances back to a sustainable position without choking off the nascent economic recovery, the government announced that the overall deficit would not exceed 6% of GDP (including the state monopoly Naftogaz), A significant reduction is expected for the quasi-fiscal deficit of Naftogaz: from USD 4.2 billion in 2009 to USD 0.3 billion in 2010. The necessary measures include also a 100% increase in gas tariffs for regional district heating companies and the population.

Source: Committee for economic reforms;
http://www.kmu.gov.ua/control/uk/publish/article?art_id=243337174&cat_id=243337165.

It is, however, obvious that, for returning to the path of sustainable economic growth, it is not enough to solve the problems caused by the global economic crisis. It is clear that overcoming the effects of the fall in the medium and long term can only be achieved by having dealt with a number of internal and external negative factors:[47]

- decreasing working-age population;
- outdated production capacities;
- increased international competition and protectionism, which is intensifying due to the losses caused by the crisis and the need to protect domestic markets and producers.

At the same time, it is necessary to identify and recognize the risks concerning the **deinstitutionalization of the economy.** Governmental measures designed to support certain sectors of the economy will inevitably lead to a significant increase in the state's role in economic life (including growth of the share of state ownership in enterprises and banks). This may result in growing politization and monopolization of markets, reduced efficiency in the use of resources and restriction of private initiative, etc.

The required reforms must bring a meaningful and long-lasting transformation and should include:[48]

- a fundamental transformation ensuring the stability and predictability of the legislature and the judiciary;
- a set of measures aiming to deregulate and liberalize business activities through a radical reduction of red tape, as well as streamlining and simplification of the regulatory environment;
- complex measures to promote and diversify exports. This axis is particularly important since the traditional sources of export growth (metals and chemical products) are unlikely to maintain their growth at such high rates as was characteristic in the past;
- a broad revision of the national energy policy, which should improve energy infrastructure, increase efficiency of energy consumption, diversify energy supply (including incentives for the broad adoption of alternative energy sources) and strengthen competition in the energy sector;
- measures aiming to encourage entrepreneurship and the development of small businesses, by supporting a competitive and growing private sector, reducing the costs of doing business, de-regulating and strengthening corporate governance;
- entry into free trade agreements with other countries. The proposed Deep Free Trade Agreement with the European Union would bring Ukraine into the supply chain of Europe and promote exports.

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[47] See: *Recovery of economic growth in Ukraine*, K., 2009 (in Russian).

[48] See also: 'The Ukraine Competitiveness Report 2008'; http://www.weforum.org/pdf/Global_Competitiveness_Reports/Reports/Ukraine.pdf.

Under these conditions, a crucially important role will be played by the programme of cooperation between Ukraine and the IMF, designed to support the process of economic recovery in Ukraine which, although started, is yet extremely fragile. Restoring cooperation with the IMF means also improving collaboration with the World Bank and the EU, which would give investors a positive signal concerning the reduction of macroeconomic risks. *Vice versa*, the failure to adopt the programme for cooperation between Ukraine and the IMF would mean increasing economic imbalances, capital outflow, and social losses.[49] This becomes particularly important in the wake of a new wave of financial turmoil in the eurozone that might impose some additional constraints on financing to Ukraine.

At the same time there exists a significant internal risk to further Ukraine-IMF cooperation: the relevant agreement can be postponed until after the local elections in the autumn of 2010. Despite this risk we expect the agreement with the IMF to be reached within the next months.

Economic development scenarios for Ukraine

In the meantime, the current modest progress in economic recovery and financial improvement creates a false impression concerning the possibility of further delays in profound economic reforms that are aimed at overcoming the chronic imbalances of the financial system. The 'relaxation' of the urgency of the current need for funds may push the IMF to postpone actions to be taken to open a credit application, which might be seen as unpopular in Ukraine.[50] As a result, the reforms may be generally postponed for an indefinite period. Very quickly, this will lead to frustrated businesses and investors and, consequently, to new socio-economic losses.

It is important to distinguish the risks and caveats associated with a non-renewal of continued cooperation and of sustainable crediting of Ukraine according to the old IMF stand-by programme, or with the absence of a new programme of cooperation:[51]

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[49] Experts expressed high confidence that in late May 2010 the IMF mission would take a positive decision on the Ukraine-IMF programme and would provide a loan tranche of USD 3-5 billion. However, until mid-June (when this publication was prepared), Ukraine has not demonstrated real willingness as concerns fiscal consolidation and transparency, as opposed to most European countries that have expanded measures to strengthen fiscal and financial stability. In these circumstances, the visit of the IMF mission to Ukraine, as well as the prospects of restoring full cooperation between Ukraine and the IMF, have been postponed.

[50] On 9 June the president of Ukraine had talks with IMF representatives in Kiev. During the meetings, discussions were focused on fiscal policies to achieve the 2010 fiscal target, public debt decline and structural reforms, in particular in the financial and energy sectors, to set Ukraine on a path towards stability and growth. The meetings restarted on 21 June when a full IMF mission came to Kiev.

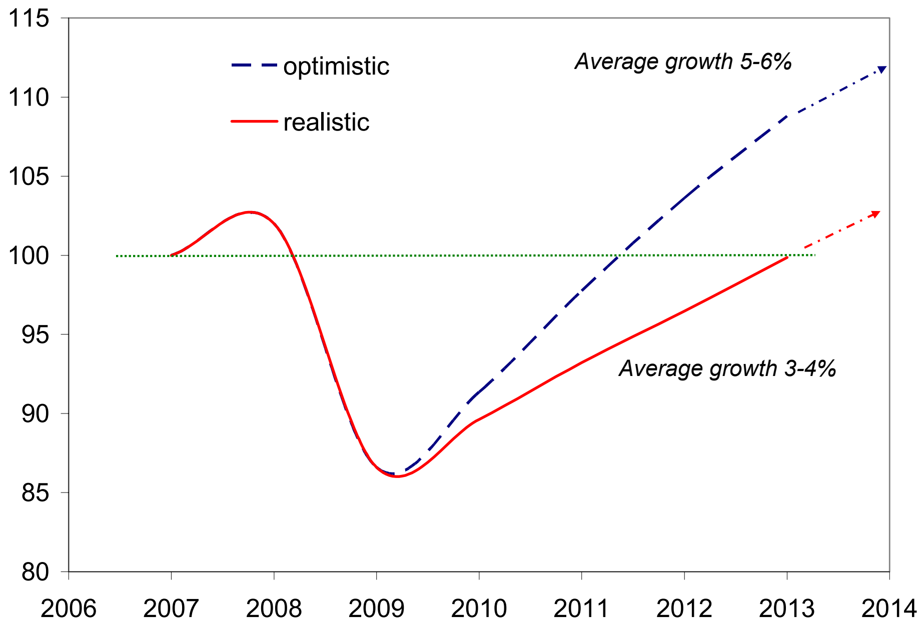
[51] Ukraine's budget for 2010 has a USD 4.3 billion allowance for FX borrowing, including USD 2 billion from the IMF. As the IMF appears reluctant to lend to the government for budget financing purposes, the government is now able to substitute IMF budget funding with Russian loans. Note that for other IFI financing to materialize (USD 1.1 billion), a resumption of cooperation with the IMF is still seen as a prerequisite. In the absence of such a cooperation programme, the country would have adequate alternative financing sources, such as domestic market and bilateral loans, including from Russia. (At the beginning of June Ukraine in fact borrowed USD 2 billion from Russia to bridge the budget deficit.)

- failures in fully balancing public finances;
- automatic blocking or high cost of alternative external financing (including the adopted EUR 500 million from the EU);
- impossibility to cut tax rates; to optimize the tax burden (which taxes are required by the economy for its acceleration);
- growing role of issues related to exporting VAT refund, increasing both business debts to the budget and budget debts to business;
- continuation of the policy of active domestic debts. This will lead to the growth of the pyramid of domestic T-bills as an alternative to crediting the economy with bank credits;
- strengthening of the ‘investment famine’ and worsening of the conditions for sustainable macroeconomic growth;
- significant decrease/collapse of confidence in the national currency, devaluation expectations as a result of predicted net capital outflows.

Figure 5

Economic development scenarios for Ukraine: optimistic / realistic

Index GDP, end-2007 = 100



Source: Derzhcomstst. Forecast: author.

However, if Ukraine were indeed to opt for bilateral or private placement-type financing instead of securing a new IMF programme, market participants would very likely be sceptical, partly because of the lack of a solid foundation for tighter policies and reform. Furthermore, no bilateral loan would be able to match the USD 12-18 billion IMF financing that may become available under a new programme. Source: Credit Suisse Economics Research, http://www.credit-suisse.com/researchandanalytics.

Information about a refusal of the IMF to grant credit to Ukraine or on terminating cooperation with Ukraine may create negative informational perceptions. It will consequently have negative secondary effects, which are themselves able to provoke a deterioration of economic conditions:

- phasing-out of funding by other international financial institutions (e.g. World Bank, EBRD);
- reducing the sovereign ratings of Ukraine, rising cost of foreign borrowing;
- complications in restructuring sovereign and corporate debts;
- outflow of short-term capital;
- reorientation of the population towards purchasing (foreign) currencies as a result of rising devaluation expectations.

In fact the cooperation between Ukraine and the IMF, followed by the confident implementation of reforms, or the delay to them, defines the two main scenarios of the medium- and long-term development of Ukraine (Figure 5). As Ukraine is a small, open economy, foreign capital flows are extremely sensitive toward changes in investors' sentiments, precipitating a highly deteriorating effect on the economy. Besides, the Ukrainian banking system remains very vulnerable to solvency risks that restrict resources for growth and development.[52] Thus, the fruitfulness of the Ukraine-IMF relationship is crucial for the implementation of these scenarios.[53]

The **optimistic scenario** is associated with the establishment and consistent implementation of a system transformation that during five to seven years should radically improve the economic and investment environment of Ukraine and set it on a path of sustainable long-term development. Unfortunately, experience from previous years indicates a low likelihood of this scenario. Therefore, a second scenario seems to be more realistic. The **realistic scenario** is characterized by slow and cautious improvements which are not too risky for the government, mainly supporting the current structure of the economy but not providing significant incentives for improving productivity and incomes of the population. The macroeconomic outlook for both scenarios is presented in Table 4.

Realistic scenario. This scenario is the more likely one, with 3-4% growth of GDP in the years to come. Our realistic scenario assumes that the global economy remains weak, but the process of recovery continues to strengthen in 2010-2012. This means that external

52 See also: E. Segura, O. Ustenko et al., 'Ukraine: Currency and Economic Outlook 2009', SigmaBleyzer, February 2009.

53 Here we do not consider the more pessimistic scenario, where Ukraine faces a combination of deep global slowdown (due to expanding crisis in the eurozone) and imbalanced domestic macroeconomic policies. In such a case the demand for Ukrainian export goods would decline sharply, capital outflow would speed up, the budget would run a sizeable deficit, and a weaker currency and sharp reduction in household incomes would push the economy into a new wave of deep recession.

demand for Ukrainian products (of the metal and chemical industries) remains weak and unpredictable. At the same time, weak domestic demand, relatively stable world crude oil prices (we assume that in the medium term the price for oil will stabilize at about the current level) and a 30% discount for imported gas, help to curb imports of goods, which will lead to a significant narrowing of the current account deficit (in fact, to a balanced current account) (see also Annex C1, Energy pricing).

Table 4

Macroeconomic outlook for Ukraine: realistic / optimistic scenario

	2008	**2009**		**Realistic**			**Optimistic**	
			2010	*2011*	*2012*	*2010*	*2011*	*2012*
GDP,%	2.1	-15.1	3.5	4.0	3.5	5.0	6.0	5.5
Nominal GDP, UAH bn	950.5	914.7	1046	1220	1400	1070	1300	1550
Nominal GDP, USD bn	181.0	113.9	129.1	151.6	175.0	133.9	164.6	198.7
GDP per capita, USD	3927	2482	2826	3331	3863	2930	3617	4387
CPI, % yoy, eop	22.3	12.3	12.0	10.8	9.8	12.0	10.8	9.8
UAH/USD, average	5.25	8.03	8.10	8.05	8.0	7.99	7.9	7.8
Budget balance, UAH bn	-25.8	-68.1	-69.0	-65.0	-63.0	-58.0	-52.0	-51.0
Budget balance, % GDP	-2.7	-7.4	-6.6	-5.3	-4.5	-5.4	-4.1	-3.3
Current account balance, USD bn	-12.8	-1.8	-1.5	-1.0	-1.0	-1.0	-1.7	-1.5
Current account balance, % GDP	-7.1	-1.6	-1.1	-0.7	-0.6	-0.7	-1.0	-0.8
FDI, USD bn	9.9	4.7	4.2	5.0	4.8	5.5	7.5	6.5
Current account balance+FDI, USD mn	-2.9	2.9	2.7	4.0	3.8	4.5	5.8	5.0
FX reserves, USD bn, eop	31.5	26.5	24.0	22.0	22.0	25.0	28.0	32.0
Population, mn	46.1	45.9	45.7	45.5	45.3	45.7	45.5	45.3

Ukraine's public finances will be in high deficit in the short term. According to some estimates, Ukraine's total hidden consolidated deficit in 2010 is projected to exceed 10% of GDP. This figure includes 5.3% primary revenue deficit, about 3% for the gas monopoly Naftogaz (if there is no increase in utility tariffs), 1.5% for the pension fund deficit and more than 2% for bank recapitalization[54].

Under these conditions the depreciation pressure will remain quite strong but the NBU will continue to support the hryvnia. However, tight international liquidity conditions and global risk aversion imply that the inflow of foreign capital (both in the form of FDI and loans) will remain modest. In particular, FDI inflows are projected at USD 4-5 billion yearly. This means that Ukraine's attractiveness for investors remains depressed and that productivity and efficiency of the economy are frozen at the current insufficient level.

[54] Source: 'IMF may not restart lending unless politicians tame deficit', *Kyiv Post*, May 2010.

Meanwhile external debt repayments, including sovereign debt, seem quite manageable for 2010-2012[55] (Table 5). In particular, in 2010, there is only one sizeable FX debt repayment (of about USD 400 million, on a yen-denominated Eurobond) that falls due at the end of the year. Total FX debt repayments start to rise in 2012 and peak in 2013 (at USD 7.9 billion, of which USD 2.6 billion will be due to the IMF).[56]

Table 5

External debt redemption

USD million

	2010	2011	2012
Eurobond market*, total	1765	3011	3258
… including			
Sovereign	642	816	680
Quasi-sovereign	245	973	718
Syndicated loan market	1755	2228	2267

* Including interest and principal.

Source: 'Investment Capital Ukraine LLC', March 2010.

Optimistic scenario. According to this scenario the global economy enters a soft but relatively stable recovery path and the eurozone economy diminishes its imbalances. As for Ukraine, the key precondition for this scenario is that the government stabilization packages are implemented, first of all in the budgetary sphere (see Box 2).

Box 2

Tax reform are expected in Ukraine

Ukraine's authorities are planning to finish off and approve the Tax Code in 2010. This is provided for in the Economic Reform Programme for 2010-2014.

The implementation of tax reform will take place in three stages: First, bringing together the tax accounting and general accounting (by the end of 2010); reimbursing the debts for the value-added tax (VAT) by the state funds; and (starting from 1 August) reimbursing the VAT in time.

In the second stage, the reduction of inefficient taxes and fees (including a simplified taxation system for small businesses) and the introduction of a single social contribution are planned (until late 2012). In addition, the introduction of a property tax is envisaged, as well as reforming the tax administration – first of all, VAT – and introducing a mechanism for environmental taxation.

The third stage of reforming the tax system (until late 2014) requires a phased reduction of profits tax and the transition to a system of payments for mineral extraction with the application of rental income.

Among the steps necessary in the process of reforming the tax system are also gradual increases in the rate of unified social contributions for wage earners.

Source: 'Tax reform in Ukraine: three stages', http://mignews.com.ua/en/articles/27679.html.

55 For more details see 'Investment Capital Ukraine LLC', March 2010.

56 Source: 'EMEA: A (relative) paragon of fiscal stabilization', Credit Suisse, February 2010.

In this scenario, foreign exchange requirements will be balanced (due to the IMF and World Bank financing) and the exchange rate will even appreciate. Moreover, the continuation of the IMF programme will help to maintain investors' confidence at a comfortable level, which facilitates the refinancing of maturing external liabilities of the private sector. The current account may even worsen but will still run a rather small deficit, reflecting the expansion of domestic demand and modest improvements in the economic environment[57], with additional benefits from cheaper energy imports[58]. Thus, in the medium term, the current account deficit will stabilize at about USD 1.5-2 billion or about 1.0% of GDP in 2011-2012. FDI inflows, particularly due to an expansion of privatization processes that peak in 2011, will stimulate economic growth (see Figure 1 above) and support the private sector in rolling over maturing external debts (see Table 5 above).

Conclusions

Both scenarios may materialize and both are challenging. At the same time, restructuring the management system, eradicating corruption, increasing responsibility and new governance require significantly more time. It is important to note that the realization of the optimistic scenario is much more complicated, since a variety of macroeconomic tasks to be resolved in the post-crisis period will be added to the problems of structural and institutional transformation, which are principally new for Ukraine. Thus, in order to jumpstart the economic recovery under the conditions of the problems of post-crisis stabilization, Ukraine should develop those sectors that are characterized by a significant growth potential, as well as the efficient use of labour resources. Even if some 'traditional' sectors (i.e. the metallurgical or chemical industries) remain an important component of the economy, they will not continue to be a driving force for the development of the whole economy unless the companies change their production or recycling processes for those with a high level of value-added. This is, however, quite difficult, as such a demand should be created by the rather inflexible large domestic customers. Partially, this may be achieved by the planned projects associated with the Euro 2012 football championship.

In fact, the situation in industry depends to a large extent on the success in implementing the Euro 2012 programme. If Ukraine can establish positive collaboration and give economic guarantees to investors, significant improvements in infrastructure can be expected. This involves in particular the construction sector, including the construction of roads. Even in the metallurgical sector, external demand may be partially substituted by domestic consumption. Otherwise, if the Euro 2012 programme does not work properly,

57 Ukraine can even benefit from euro depreciation in so far as technology imports from the EU becomes cheaper.

58 In April 2010 Ukraine and Russia agreed on a 30% discount on the price of imported gas to Ukraine. Thus, the average price for imported gas is now estimated at about USD 230-245 per 1000m^3 in 2010 compared to the previous USD 335 per 1000 m^3. Lower gas prices will particularly benefit the natural gas-intensive chemical industry and metallurgy, thus giving stronger impetus to the recovery of the Ukrainian economy. See, for example: O. Pogarska, E. Segura, 'Ukraine. Macroeconomic Situation', SigmaBleyzer, April 2010.

Ukraine will remain hostage to the external business cycle. There will be no demand for the country's export-oriented products and services, thus any rapid recovery is unlikely.

At the same time, there is a high potential in some sectors of the economy that might materialize either thanks to positive economic dynamics of the whole economy or to Ukraine's geographical position. In the medium and long term, these sectors are logistics, tourism, construction, and the automobile industry (including their services). The most significant potential is in logistics, where coherent development requires the harmonization of customs procedures with neighbouring countries and a significant increase in the quality of roads, transport services and infrastructure.

Finally, good governance is particularly important for Ukraine, since in the conditions of the ongoing decline of living standards, public trust in the state has been almost entirely lost (see also Annex C2, People's expectations). The restoration of that trust – a prerequisite for ending the crisis – will depend on sustainable growth of the income of the population, abidance by the principles of social fairness on the part of the state, and protection of human rights.

Grzegorz Gromadzki

Ukraine–EU political and economic relations, the role of international organizations and agenda for overcoming the current stalemate

The years from 2005 to 2009, after the Orange Revolution, were decisive in shaping the current relations between the EU and Ukraine. What term could be used for describing EU-Ukraine relations in those five years? It seems that 'stalemate' would be too pessimistic an evaluation, while 'steadily developing relations' would be a too optimistic statement. Thus, something in-between those two options would be the right assessment of the state of relations between Brussels and Kiev.

EU approach

There was no radical change in the EU's approach towards Ukraine after the Orange Revolution. Brussels proposed almost the same Action Plan to the then new President Victor Yushchenko and the new Ukrainian government as had been negotiated with President Leonid Kuchma before the Orange Revolution. A lack of consensus within the EU about Ukraine's membership perspective was the most important problem. The majority of member states was against it, but a quite strong minority – the new member states – was in favour. The newcomers to the EU envisaged for Ukraine the same path as they had followed after the collapse of the communist bloc and a repetition, on their part, of the policy of Germany in the 1990s towards the Visegrad-4 countries (the Czech Republic, Hungary, Poland and Slovakia).

Nevertheless the EU as a whole has partially changed its position towards Ukraine and, in a way, recognized Ukraine as a European country with a European society. This was one of the main results of the Orange Revolution. A package of proposals for Ukraine was delivered, but this initiative was not officially announced. The package included an Association Agreement with a Deep and Comprehensive Free Trade Area, a gradual integration in energy matters (first of all, membership in the Energy Community, created by the EU for the integration of the Western Balkan countries with the energy market of the Union) and, last but not least, the visa issue with visa-free travel as the long-term goal. All those proposals were then included in the Eastern Partnership (EaP) announced by the EU in May 2009 and were extended (at least partially) to other countries of the EaP, first of all Moldova.

In sum, the EU's approach was ambiguous. The Union was open for closer cooperation and even partial integration of Ukraine, but only as a long-term project (visa-free movement is a good example), without a clear final goal, namely membership. Ukraine was perceived by the EU as a whole as a good neighbour rather than a future family member. There were at least three reasons for this approach: first, enlargement fatigue after the big bang enlargement in 2004 and 2007; second, internal EU problems with the new treaty; and third, a 'Russia first' policy supported by many member states

Ukraine's approach

The strong pro-Western (the EU and NATO including) rhetoric of President Yushchenko and the pro-European rhetoric of Yuliya Tymoshenko were typical of the period between 2005 and 2009. But this rhetoric was not followed by corresponding actions and concrete steps. The lack of reforms indispensable for closer cooperation and partial integration with the EU was one of the results provoked by the permanent political crisis in Ukraine. Ukraine's political elites were almost entirely focused on domestic affairs and internal struggles and were not able to build a national consensus on European integration. In this respect, they differed from the political elites of Central European countries who were strongly engaged, in the 1990s, in pro-European reforms. The Orange leaders were not capable of reforming Ukraine and building well-working institutions of constitutional democracy.

Some achievements

Nevertheless, there were some important achievements. Ukraine became a WTO member in 2008 after 14 years of negotiations. WTO membership was the condition sine qua non for opening negotiations on a Deep and Comprehensive Free Trade Agreement (DCFTA) between Ukraine and the EU in 2008. A visa facilitation agreement between the EU and Ukraine was signed in 2007 with a visa-free regime (unilaterally declared by Ukraine) promise as a long-term goal. Both sides agreed in spring 2009 to modernize the Ukrainian transit gas pipeline system (but the agreement was not fulfilled by the Tymoshenko government).

The most important achievement is that Ukraine became a well-established electoral democracy during the Orange period of 2005-2009. Ukrainians could choose their leader and could change the ruling elite. There has been a quite long list of democratic elections after the Orange revolution – two presidential elections in 2005 and 2010 and two parliamentary elections in 2006 and 2007. Ukraine's current status as an electoral democracy is a real achievement of the Ukrainian society and the political elite.

This represents a rare example in Eastern Europe; in many post-Soviet countries autocratic tendencies have intensified in the past five years, with Russia being the prime example (but also Belarus, Azerbaijan and Armenia). In this respect Ukraine, along with Moldova and Georgia (in both with some doubts), represents one of the exceptions on the post-Soviet space. But Ukraine still stands in sharp contrast to its Western neighbours which became EU member states during the big bang enlargement in 2004 and 2007. The ‘newcomers' are constitutional democracies despite their internal problems. Ukraine has failed to make up ground on this latter group of countries over the past five years and thus remains unambiguously categorized as a post-Soviet state. Therefore the gap between Ukraine and its Western neighbours is even larger now than five years ago. The crucial question is how long Ukraine can exist as a non-consolidated democracy, situated between the liberal democracies of the EU and the semi-authoritarian and authoritarian regimes on the CIS space – two groups which are on completely different trajectories. This question concerns not only the political system of the Ukrainian state but also Ukrainian society as a whole.

Behaviour of the new ruling elite in the context of EU–Ukraine relations

Perhaps it is too early to judge the behaviour of the new president and government – but several negative signals and tendencies are already visible, both in domestic affairs and foreign policy.

‘Within the first weeks after Viktor Yanukovych's victory in the presidential elections, a small group close to the president and the new Prime Minister Mykola Azarov has swiftly taken extensive control of the country. The parliament plays only a minor role. The opposition and the free media are under pressure... Within just a few weeks a noticeable backslide into the old authoritarian patterns of the Kuchma era has taken place. Courts and public authorities are clearly making decisions in accordance with the new government's policy. The public prosecutor's office lets itself be exploited for the slandering of the opposition... The ratification of the Black Sea Fleet deal and the passing of the national budget in the parliament took only eight minutes. There were no government declarations, no discussions and no debates neither about the international agreement and its extensive implications for the country's long-term geopolitical orientation, nor about the national budget – the classic privilege of the parliament. President Yanukovych and Prime Minister Azarov thus have revealed the role they assign to the parliament. They have clearly shifted the country's political balance in favour of the president and expect the Verkhovna Rada to just sign-off their politics...

Another surprising development since Yanukovych's assumption of office has been the decreasing influence of the formerly dominant group of the Donetsk-based tycoon Rinat Akhmetov within the Party of Regions. The winner of the internal power struggle is the gas lobby of Dmitry Firtash, former boss of RosUkrEnergo, Serhii Lovochkin and Yurii Boiko, the minister of energy. On the whole, the conservative and more Russia-oriented wing of *the Party of Regions has become stronger, while the more progressive, reform-oriented and more Europe-friendly politicians under Akhmetov are kept out of important decisions... It remains uncertain whether the necessary reforms will follow... The gas lobby, which now has strong control over Ukraine and the Party of Regions, is closely connected to companies that nourish on market distortion, government manipulation, monopolies and administrative resources. Incentives for reform have been lowered by the new gas deal... [In sum,] The Yanukovych-Azarov tandem represents a more authoritarian and typically post-Soviet, administrative style of politics.'*

This assessment of the situation in Ukraine is an extensive quotation from the paper 'The first 100 Days after the Change of Power in Ukraine: Authoritarian Tendencies and Rapprochement with Russia', written by German expert Nico Lange, director of the Konrad Adenauer Foundation office in Kiev.[59] Unfortunately, one can agree with this opinion 100 per cent.

EU perception of the new ruling elite

The EU showed friendly openness towards President Yanukovych immediately after the presidential elections held at the beginning of 2010. High-rank representatives of the EU – Catherine Ashton and Jerzy Buzek – were present in Kiev during the inauguration of the newly elected president. The European Parliament adopted a strongly pro-Ukrainian resolution. And President Yanukovych was warmly welcomed during his visit to Brussels (it was his first visit abroad as president). The Ukraine-Russia rapprochement has been assessed very positively by many in the EU. Also the expected political stability in Ukraine under President Yanukovych, after the period of turbulence, has been perceived as a desired phenomenon. Nevertheless the EU's position can be described as a 'wait and see' approach. Ukraine is a secondary issue for the EU because there are too many other hot issues – first of all the economic crisis but also the Afghanistan or Middle East conflicts, for instance. However, Ukraine should be treated as an important secondary issue. How could the state of affairs between Ukraine and the EU be called today? It is anything but a 'stalemate', but it is a 'difficult challenge' for both sides. It is certainly time to start a real political dialogue with the new Ukrainian authorities based on the first activities taken by Yanukovych and Azarov. Probably an early warning is needed.

A fundamental dilemma

One should ask, what is the priority for the EU regarding Ukraine? Stabilization and modernization in which democracy plays a secondary role – to say it diplomatically (a model already proposed for EU-Russia relations – Partnership for Modernization) or further

59 See http://www.kas.de/wf/doc/kas_19723-544-2-30.pdf.

democratization which leads to the modernization and consolidation of the Ukrainian state, economy and society? Stabilization and modernization without democracy could even mean a better investment climate and better possibilities for doing business by investors from the EU. But this would be a short-term, not a long-term solution. The better option therefore would be further democratization that would make Ukraine a more predictable partner for the EU in long-term perspective. The most important question today is whether the Ukrainian electoral democracy may be in danger under President Yanukovych. The answer is that this may happen. Therefore the preservation of the electoral democracy can be considered the main challenge for Ukrainians in the next months and years.

EU actions

Democracy in Ukraine can only be preserved and developed by Ukrainians of course. External actors can only assist in that process, but that assistance can play an important role in helping Ukrainians in their efforts. EU assistance should be provided at the national but also at the regional level in Ukraine. The EU as a whole should be involved but bilateral relations – between individual member states and Ukraine – are also important and should be well coordinated. Further, EU assistance should be developed not only at the state and government levels, but the EU should also support relations between non-governmental actors from Ukraine and the EU. In sum, a good combination of all these elements is needed.

Representatives of EU institutions and politicians from member states should build close relations with the new Ukrainian authorities and with the opposition at the same time. Both sides of the Ukrainian political scene should know that they are supported by the EU if they preserve democratic rules. Close relations between political parties from Ukraine and EU member states and common actions of local authorities from both sides of the border are needed. But also a frank assessment of the situation in Ukraine should be made by EU politicians and experts, and the EU as a whole as well as its individual member states should deliver assistance (including financial) for watchdog organizations in Ukraine and support the Ukrainian civil society in general. EU actions and efforts should not be perceived as a kind of interference in internal Ukrainian affairs because democracy as a political system is accepted by all main political forces in Ukraine (officially at least).

The fulfilment of the EaP package could revive EU-Ukraine relations. The negotiation of the Association Agreement with DCFTA is the main challenge. Probably the agreement could be signed in 2011 but it depends first of all on the position of the new Ukrainian president and government. The liberalization of the visa regime and the introduction of a visa-free regime for Ukrainians travelling to the EU (EU citizens can already travel to Ukraine without visas) is also one of the crucial issues, particularly important for ordinary citizens of Ukraine and their perception of the EU. But the issue is very sensitive in many

EU member states. Nevertheless, the EU should decide as soon as possible on visa-free travel to the EU for Ukrainians. The Polish government has already announced that the issue will be raised during Poland's EU presidency in the second half of 2011. The gradual integration of Ukraine with EU energy market (the gas sector in particular) would be the next crucial issue for closer cooperation and partial integration of Ukraine with the EU. However, it seems that the new Ukrainian authorities are not interested in bilateral cooperation with the EU on energy and prefer closer relations with Russia. The EU could eventually become a kind of 'third partner' in energy cooperation between Kiev and Moscow.

It should be stressed that, after a fruitful implementation of the EaP package, EU-Ukraine relations would be at a substantially higher level than today. But the EU faces up a serious political dilemma because fulfilment of the current package could be a gift to Yanukovych. The question is: Can the EU sign the Association Agreement with a less and less democratic Ukraine? Conditionality from the EU side is therefore indispensable – electoral democracy has to be maintained as a minimal condition. But Ukrainians and friends of Ukraine from the EU still have to think about a more ambitious goal, namely the establishment of constitutional democracy in Ukraine; electoral democracy is only a first stage (non-consolidated democracy) in the democratization process.

Ukraine's interests in democracy and EU interests in a democratic Ukraine

One may ask, why is the existence of this type of democracy so important for Ukraine and Ukrainians? The answer is simple: only a country with a well-established constitutional, consolidated democracy can integrate with the EU. If Ukraine is interested in integration with the EU it should make serious efforts towards constitutional democracy. It is a kind of test for the new authorities – their real goals in their policy towards the EU. Unfortunately Yanukovych's presidency will probably be a break in the building of a consolidated democracy in Ukraine.

The EU's interests for democracy in Ukraine should not be perceived as a geopolitical game with Russia and a discussion about zones of influence. The issue should be seen in a much broader context than the regional one: as a kind of competition between two models of governance in the 21st century – liberal democracy on the one hand and modern autocracy on the other. In this context Ukraine will be an important piece of the puzzle.

Conclusions

In sum, the months and years ahead will represent a very important period for EU-Ukraine relations. Many problems can be expected. Changes within Ukraine will play crucial role. The situation inside the ruling group, the position of R. Akhmetov for instance, and the relations between the authorities and the opposition – which may be either weak and divided or united and strong – will have an impact on EU-Ukraine relations. On the part of the EU, a clear answer to the question whether it supports (i) a stabilization and modernization of Ukraine in which democracy plays a secondary role or (ii) further democratization which leads to modernization, will decide on the character of future relations between the EU and Ukraine. There are two major goals and challenges for Ukraine and for the EU as well: minimum – preservation of electoral democracy (short-term goal) and maximum – the building of a constitutional, consolidated democracy (medium- and long-term goal).

Annex A

Table A1

Ukraine: Selected economic indicators

	2006	2007	2008	2009 [1]	2009	2010	2010	2011	2012
					1st quarter			Forecast	
Population, th pers., average	46788	46509	46258	46053	46112	45934	45800	45600	45400
Gross domestic product, UAH mn, nom.	544153	720731	948056	914720	188037	218125	1049200	1195100	1368200
annual change in % (real)	7.3	7.9	2.3	-15.1	-20.2	4.9	3.8	4.5	6
GDP/capita (EUR at exchange rate)	1800	2200	2700	1800	.	.	.	.	.
GDP/capita (EUR at PPP - wiiw)	5200	5800	6000	5100	.	.	.	.	.
Consumption of households, UAH mn, nom.	319383	423174	582482	590196	131905	148068	.	.	.
annual change in % (real)	15.9	17.2	11.8	-14.2	-15.1	0.5	2	4	6
Gross fixed capital form., UAH mn, nom.	133874	198348	250158	164522	32189	33631	.	.	.
annual change in % (real)	21.2	23.9	1.9	-46.2	-53.9	-2.2	5	10	10
Gross industrial production									
annual change in % (real)	6.2	7.6	-5.2	-21.9	-31.8	10.8	6.5	7	8
Gross agricultural production									
annual change in % (real)	2.5	-6.5	17.1	-1.8	1.7	5.3	.	.	.
Construction industry									
annual change in % (real)	9.9	15.6	-15.8	-48.2	-56.5	-21.4	.	.	.
Employed persons - LFS, th, average	20730.4	20904.7	20972.3	20191.5	20005.1	20088.4	20200	20250	20300
annual change in %	0.2	0.8	0.3	-3.7	-3.4	0.4	0	0.2	0.2
Unemployed persons - LFS, th, average	1515.0	1417.6	1425.1	1958.8	2096.9	1983.8	.	.	.
Unemployment rate - LFS, in %, average	6.8	6.4	6.4	8.8	9.5	9.0	8.7	8.2	7.8
Reg. unemployment rate, in %, end of period	2.7	2.3	3.0	1.9	3.1	1.8	.	.	.
Average gross monthly wages, UAH [2]	1041.4	1351.0	1806.0	1906.0	1736.0	1993.0	.	.	.
annual change in % (real, gross)	18.4	15.0	6.8	-8.9	-11.0	3.3	.	.	.
Consumer prices, % p.a.	9.1	12.8	25.2	15.9	20.4	11.2	10.5	9	8
Producer prices in industry, % p.a. [3]	9.6	19.5	35.5	6.5	17.4	17.2	.	.	.
General governm.budget, nat.def., % GDP									
Revenues	31.6	30.5	31.4	29.8	34.9	.	.	.	.
Expenditures	32.3	31.6	32.8	33.9	35.0	.	.	.	.
Deficit (-) / surplus (+)	-0.7	-1.1	-1.5	-4.1	-0.04	.	-7	-4.5	-3
Public debt, nat.def., in % of GDP	14.8	12.3	20.0	33.0	19.1	.	37	37	35
Discount rate of NB, % p.a., end of period	8.5	8.0	12.0	10.3	12.0	10.3	.	.	.
Current account, EUR mn [4]	-1289	-3849	-8721	-1291	-500	-50	500	0	-500
Current account in % of GDP	-1.5	-3.7	-7.1	-1.5	-2.7	-0.3	0.5	0.0	-0.4
Exports of goods, BOP, EUR mn [4]	31048	36383	46274	28958	6468	7577	33300	36600	40300
annual growth rate in %	10.5	17.2	27.2	-37.4	-30.7	17.2	15	10	10
Imports of goods, BOP, EUR mn [4]	35188	44100	57270	32296	7200	8565	35500	39100	43000
annual growth rate in %	21.3	25.3	29.9	-43.6	-41.6	19.0	10	10	10
Exports of services, BOP, EUR mn [4]	9000	10337	12228	9936	2176	2371	10900	12000	13200
annual growth rate in %	19.9	14.9	18.3	-18.8	-8.7	9.0	10	10	10
Imports of services, BOP, EUR mn [4]	7305	8571	11039	8048	2040	1764	8000	8800	9700
annual growth rate in %	20.7	17.3	28.8	-27.1	-12.5	-13.6	0	10	10
FDI inflow, EUR mn [4]	4467	7220	7457	3453	697	705 [5]	4000	.	.
FDI outflow, EUR mn [4]	-106	491	690	116	21	.	.	.	.
Gross reserves of NB excl. gold, EUR mn	16587	21634	21847	17824	18647	17934	.	.	.
Gross external debt, EUR mn	41391	54421	72109	72516	75437	76275	.	.	.
Gross external debt in % of GDP	50.6	56.0	82.6	90.8	94.4	72.7	.	.	.
Average exchange rate UAH/EUR	6.335	6.918	7.708	10.868	10.065	11.068	10	10.5	10
Purchasing power parity UAH/EUR, wiiw [6]	2.227	2.656	3.402	3.921	.	.	.	.	.

1) Preliminary. - 2) Excluding small enterprises. - 3) Domestic output prices. - 4) Converted from USD with the average exchange rate. - 5) FDI net.
6) wiiw estimates based on the 2005 International Comparison Project benchmark.

Source: wiiw Database incorporating national statistics. Forecasts by wiiw.

Table A2

Ukraine: Selected monthly data on the economic situation 2009 to 2010

(updated end of Jul 2010)

		2009									2010					
		Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec	Jan	Feb	Mar	Apr	May	Jun
PRODUCTION																
Industry, total	real, CPPY	-31.8	-31.8	-27.5	-26.7	-23.3	-18.4	-6.2	8.6	7.4	11.8	5.6	13.8	17.4	12.7	8.9
Industry, total	real, CCPPY	-31.9	-31.9	-31.1	-30.4	-29.6	-28.4	-26.4	-24.0	-21.9	11.8	8.8	10.8	12.6	12.6	12.0
Industry, total	real, 3MMA	-31.3	-30.4	-28.7	-25.8	-22.8	-16.0	-5.3	3.3	9.3	8.3	10.4	12.3	14.6	13.0	
Construction, total	real, CCPPY	-55.6	-55.8	-54.9	-54.3	-53.6	-52.4	-51.5	-49.7	-48.2	-24.1	-20.9	-21.4	-21.2	-20.0	-19.3
LABOUR																
Employees total, registered [1]	th. persons, avg	10748	10683	10651	10611	10567	10534	10506	10451	10374	10740	10723	10738	10724	10693	.
Employees in industry, registered [1]	th. persons, avg	2888	2858	2838	2822	2809	2792	2788	2779	2761	2850	2846	2847	2834	2825	.
Unemployment, registered	th. persons, eop	809	736	659	607	570	543	508	512	532	527	530	505	455	419	399
Unemployment rate, registered	%, eop	2.9	2.6	2.4	2.2	2.0	1.9	1.8	1.8	1.9	1.9	1.9	1.8	1.6	1.5	1.4
Labour productivity, industry [1]	CCPPY	-24.7	-24.4	-23.3	-22.4	-21.3	-19.8	-17.5	-14.8	-12.6	16.5	13.0	14.7	16.1	15.6	.
Unit labour costs, exch.r. adj.(EUR) [1]	CCPPY	5.6	4.0	1.2	-1.4	-4.7	-8.7	-13.0	-15.5	-15.3	-8.8	-6.7	-5.7	-5.1	-1.9	.
WAGES, SALARIES [1]																
Total economy, gross	UAH	1845	1851	1980	2008	1919	1964	1950	1955	2233	1916	1955	2109	2107	2201	.
Total economy, gross	real, CPPY	-8.0	-9.0	-8.6	-9.9	-11.1	-10.9	-10.9	-5.6	-0.6	3.6	1.7	4.5	4.1	9.6	.
Total economy, gross	EUR	181	178	186	186	172	169	165	164	191	168	178	195	198	220	.
Industry, gross	EUR	201	195	198	202	194	189	187	188	192	193	203	232	234	250	.
PRICES																
Consumer	PP	0.9	0.5	1.1	-0.1	-0.2	0.8	0.9	1.1	0.9	1.8	1.9	0.9	-0.3	-0.6	-0.4
Consumer	CPPY	15.6	14.7	15.0	15.5	15.3	15.0	14.1	13.6	12.3	11.1	11.5	11.0	9.7	8.5	6.9
Consumer	CCPPY	19.1	18.2	17.6	17.3	17.1	16.8	16.5	16.3	15.9	11.1	11.3	11.2	10.8	10.3	9.8
Producer, in industry	PP	0.4	-0.7	1.4	0.7	1.8	3.6	1.9	0.4	1.0	1.9	1.9	3.0	3.0	4.4	-0.5
Producer, in industry	CPPY	6.4	1.9	-0.9	-3.6	-3.6	1.7	5.1	12.8	14.4	16.3	16.5	18.6	21.7	28.0	25.6
Producer, in industry	CCPPY	14.4	11.6	9.3	7.2	5.7	5.2	5.2	5.9	6.6	16.3	16.4	17.2	18.3	20.2	21.1
FOREIGN TRADE																
Exports total (fob), cumulated	EUR mn	8749	10895	13009	15294	17546	20131	22992	25668	28496	2110	4576	7467	10604	13903	.
Imports total (cif), cumulated	EUR mn	10233	12571	14843	17625	20323	23129	26084	29139	32611	2330	5045	8522	11974	15459	.
Trade balance, cumulated	EUR mn	-1484	-1676	-1834	-2332	-2776	-2998	-3092	-3471	-4115	-220	-469	-1055	-1370	-1556	.
FOREIGN FINANCE																
Current account, cumulated	EUR mn	.	.	-626	.	.	-661	.	.	-1291	.	.	-133	40	235	.
EXCHANGE RATE																
UAH/EUR, monthly average	nominal	10.175	10.391	10.669	10.777	11.127	11.644	11.843	11.917	11.676	11.430	10.953	10.822	10.634	10.000	9.668
UAH/USD, monthly average	nominal	7.700	7.653	7.616	7.648	7.807	7.999	8.000	7.994	7.978	7.997	8.000	7.967	7.926	7.926	7.916
EUR/UAH, calculated with CPI [2]	real, Jan07=100	92.0	90.4	88.8	88.2	85.1	81.9	81.1	81.3	83.5	87.2	92.4	93.7	94.6	99.9	102.8
EUR/UAH, calculated with PPI [2]	real, Jan07=100	95.6	92.9	91.5	91.8	90.1	89.4	89.2	88.8	91.5	94.4	100.1	103.6	107.7	119.1	.
USD/UAH, calculated with CPI [2]	real, Jan07=100	94.2	94.9	95.7	95.3	93.0	91.4	92.1	93.1	94.3	95.4	97.2	98.1	98.1	97.4	.
USD/UAH, calculated with PPI [2]	real, Jan07=100	97.7	96.7	96.7	97.8	96.1	97.7	98.9	98.1	98.9	98.5	100.9	102.9	105.9	110.0	.
DOMESTIC FINANCE																
Currency outside banks	UAH bn, eop	150.7	153.0	153.2	151.8	149.2	148.9	148.8	147.9	157.0	153.1	154.0	155.1	159.9	162.1	168.3
M1	UAH bn, eop	213.7	217.8	226.9	225.7	221.7	221.5	218.1	220.7	233.7	227.0	227.6	235.5	242.8	249.2	259.5
Broad money	UAH bn, eop	465.1	468.2	472.7	471.9	471.1	469.5	468.4	470.4	487.3	479.9	480.4	494.2	510.8	521.4	533.5
Broad money	CPPY, eop	8.3	9.0	4.9	1.0	-0.8	-1.7	-2.6	-2.8	-5.5	-2.6	2.0	6.6	9.8	11.3	12.9
Refinancing rate (p.a.)	%, eop	12.0	12.0	11.0	11.0	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	10.3	9.5
Refinancing rate (p.a.) [3]	real, %, eop	5.3	9.9	12.0	15.2	14.4	8.5	4.9	-2.3	-3.6	-5.2	-5.3	-7.1	-9.4	-13.8	-12.8
BUDGET																
General gov.budget balance, cum.	UAH mn	-3494	-3162	-13254	-17837	-16696	-24550	-28414	-15742	-37258	423	-4778	-4363	-1820	-11505	.

1) Excluding small firms. - 2) Adjusted for domestic and foreign (US resp. EU) inflation. Values more than 100 mean real appreciation. - 3) Deflated with annual PPI.

Source: wiiw Database incorporating national statistics.

Table A3

Ukraine: Foreign trade

HS commodity groups, current prices, per cent of total

	1996	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009
Exports											
Total exports, fob, USD mn	14400.8	14572.6	16264.7	17957.1	23066.8	32666.1	34228.4	38368.0	49296.1	66954.4	39695.7
Total exports, fob, EUR (ECU) mn 1)	11357.4	15778.0	18160.7	18990.2	20391.5	26261.1	27512.6	30557.5	35969.4	45522.5	28491.0
	(% of total)										
Live animals, animal products	4.1	2.5	2.8	2.1	2.3	2.0	2.1	1.0	1.5	1.2	1.5
Vegetable products	6.0	2.5	4.3	6.2	3.2	3.5	5.0	5.1	3.5	8.3	12.7
Oils, fats and waxes	1.3	1.6	1.4	1.9	2.4	1.7	1.7	2.5	3.5	2.9	4.5
Prep. foodstuffs, beverages, tobacco	1.0	2.8	2.8	3.0	3.9	3.5	3.8	3.6	4.3	3.8	5.3
Mineral products	8.6	9.6	10.8	12.5	15.2	13.2	13.7	10.1	8.7	10.5	9.8
Chemicals and related products	11.6	10.6	9.1	7.8	8.4	8.5	8.7	8.8	8.2	7.5	6.3
Plastics, rubber and rubber products	2.8	1.7	1.6	1.5	1.6	1.3	1.7	2.1	2.0	1.5	1.4
Raw hides and skins, leather, furs	0.8	0.8	0.8	0.9	0.8	0.6	0.6	0.8	0.8	0.5	0.4
Wood & products, charcoal, cork	0.4	1.5	1.4	1.6	1.7	1.6	1.6	1.6	1.7	1.2	1.7
Paper and paper products	1.0	1.4	1.8	1.6	1.4	1.2	1.3	1.6	1.6	1.3	2.0
Textiles and textile products	2.7	3.7	3.8	3.6	3.3	2.7	2.7	2.4	2.0	1.5	1.8
Footwear, headgear, etc.	0.5	0.5	0.5	0.4	0.4	0.4	0.3	0.3	0.3	0.3	0.4
Stone, cement, ceramic, glass, etc.	1.2	0.8	0.9	0.8	1.0	0.9	0.6	0.7	0.7	0.7	0.7
Pearls, prec. stones & metals, etc.	.	.	.	.	.	.	0.3	0.3	0.3	0.2	0.2
Base metals and products	33.1	44.4	41.3	39.7	36.8	39.9	40.9	42.8	42.1	41.3	32.3
Machinery and electrical equipment, etc.	9.8	9.3	10.5	9.8	10.1	9.3	8.3	8.7	10.1	9.5	12.6
Means of transport	4.4	3.0	3.4	3.8	4.3	6.2	4.8	5.4	6.7	6.5	4.0
Optical, med. instruments, clocks, etc.	0.4	0.4	0.5	1.0	1.4	1.8	0.4	0.4	0.4	0.4	0.7
Arms and ammunition	.	.	.	.	.	.	.	.	.	.	.
Miscellaneous manufactured prod.	0.4	0.5	0.6	0.5	0.5	0.5	0.6	0.7	0.7	0.7	0.8
Works of art, antiques etc.	.	.	.	.	.	.	.	.	.	.	.
Other non-mentioned groups	9.9	2.4	1.9	1.1	1.3	1.1	0.8	1.0	0.9	0.4	0.8
Imports											
Total imports, cif, USD mn	17603	13956	15775	16977	23020	28997	36136	45039	60618	85535	45433
Total imports, cif, EUR (ECU) mn 1)	13883	15110	17614	17954	20350	23311	29046	35870	44231	58156	32609
	(% of total)										
Live animals, animal products	1.8	0.7	1.2	0.8	0.8	1.1	1.4	1.4	1.3	2.0	2.8
Vegetable products	1.4	2.2	1.7	1.3	3.4	1.5	1.5	1.5	1.4	1.7	2.8
Oils, fats and waxes	0.2	0.4	0.5	0.7	0.5	0.5	0.6	0.4	0.6	0.7	0.8
Prep. foodstuffs, beverages, tobacco	4.8	3.2	3.7	3.8	4.8	3.5	4.0	3.7	3.5	3.1	4.5
Mineral products	49.9	46.9	42.6	41.5	36.8	37.4	32.0	30.0	28.4	29.7	34.5
Chemicals and related products	5.8	6.4	7.1	8.1	7.7	7.8	8.6	8.6	8.8	8.1	11.7
Plastics, rubber and rubber products	4.4	4.5	4.4	4.3	4.5	4.9	5.4	5.6	5.6	5.2	5.9
Raw hides and skins, leather, furs	0.3	0.3	0.4	0.3	0.3	0.3	0.3	0.3	0.3	0.3	0.3
Wood & products, charcoal, cork	0.7	0.4	0.5	0.5	0.5	0.5	0.6	0.6	0.6	0.6	0.6
Paper and paper products	2.2	2.8	3.4	4.0	3.6	2.7	2.8	2.6	2.5	2.1	3.0
Textiles and textile products	2.8	4.0	4.1	4.0	3.7	3.4	3.9	3.0	2.5	2.5	3.1
Footwear, headgear, etc.	0.4	0.2	0.3	0.3	0.4	0.1	0.8	0.6	0.4	0.6	0.6
Stone, cement, ceramic, glass, etc.	0.9	1.1	1.2	1.2	1.2	1.3	1.4	1.6	1.6	1.5	1.4
Pearls, prec. stones & metals, etc.	.	.	.	.	.	.	0.6	0.4	0.4	1.2	0.4
Base metals and products	4.5	4.9	5.2	4.8	5.2	6.0	6.8	7.4	7.8	7.5	5.9
Machinery and electrical equipment	13.7	13.9	15.1	14.7	15.1	16.3	17.5	17.5	17.5	15.6	13.8
Means of transport	3.2	3.6	4.7	6.0	8.1	8.6	8.9	11.4	13.6	14.1	4.8
Optical, med. instruments, clocks, etc.	1.2	1.3	1.6	1.6	1.6	1.9	1.4	1.5	1.7	1.4	1.5
Arms and ammunition	.	.	.	.	.	.	.	.	.	.	.
Miscellaneous manufactured prod.	0.9	0.6	0.7	0.8	0.8	0.8	0.9	1.0	1.0	1.2	1.1
Works of art, antiques etc.	.	.	.	.	.	.	.	.	.	.	.
Other non-mentioned groups	0.9	2.6	1.4	1.3	1.0	1.2	0.7	0.7	0.6	0.6	0.6

1) USD converted to EUR using the ECB EUR/USD reference rate. - 2) Including beverages and tobacco.

Source: wiiw Database incorporating national statistics.

Table A4

Ukraine: Inward FDI stock by economic activities

	2006	2007	2008	2009	2005	2006	2007	2008	2009
NACE Rev. 1 classification:									
A Agriculture, hunting and forestry	307.0	379.3	576.9	607.8	1.8	1.9	1.9	2.3	2.2
B Fishing	0.4	0.3	3.8	3.6	0.0	0.0	0.0	0.0	0.0
C Mining and quarrying	327.7	716.5	759.2	786.8	2.0	2.0	3.6	3.0	2.8
D Manufacturing	4212.2	4637.2	4862.9	5398.8	28.2	25.7	23.1	19.2	19.3
E Electricity, gas and water supply	100.2	94.2	89.8	106.7	0.4	0.6	0.5	0.4	0.4
F Construction	637.7	1110.7	1373.7	1543.4	3.0	3.9	5.5	5.4	5.5
G Wholesale, retail trade, repair of veh.etc.	1993.7	2091.0	2615.3	2946.4	11.6	12.2	10.4	10.4	10.6
H Hotels and restaurants	284.0	291.5	293.0	298.9	1.6	1.7	1.4	1.2	1.1
I Transport, storage and communication	744.3	867.4	1000.9	1050.6	4.8	4.5	4.3	4.0	3.8
J Financial intermediation	1910.5	3314.1	5075.0	6255.0	6.8	11.6	16.5	20.1	22.4
K Real estate, renting & business activities	1342.9	1816.8	2563.3	2835.1	6.3	8.2	9.0	10.1	10.2
L Public administr., defence, comp.soc.sec.	.	0.1	0.4	0.4	.	.	0.0	0.0	0.0
M Education	27.9	12.3	9.5	9.6	0.2	0.2	0.1	0.0	0.0
N Health and social work	135.8	129.6	87.6	84.3	1.0	0.8	0.6	0.3	0.3
O Other community, social & pers.services	159.4	194.5	322.2	367.1	1.2	1.0	1.0	1.3	1.3
Other not elsewhere classified activities	4222.8	4452.3	5630.1	5622.2	31.2	25.7	22.1	22.3	20.1
Total by activities	**16406.5**	**20108.0**	**25263.4**	**27916.6**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**
D Manufacturing industry									
DA Food products, beverages and tobacco	965.8	1062.6	1195.8	1281.4	24.6	22.9	22.9	24.6	23.7
DB_DC Textiles & prod.; leather & prod.	95.9	98.1	100.4	101.5	2.2	2.3	2.1	2.1	1.9
DD Wood and wood products	149.9	164.4	182.4	195.6	3.3	3.6	3.5	3.8	3.6
DE Pulp, paper & prod.; publish.& printing	122.1	127.8	141.2	165.5	2.9	2.9	2.8	2.9	3.1
DF Coke, ref.petroleum prod. & nuclear fuel	152.0	217.5	234.2	314.8	4.4	3.6	4.7	4.8	5.8
DG_DH Chemicals & prod.; rubber & plastic	498.8	572.3	673.8	840.8	12.5	11.8	12.3	13.9	15.6
DI Other non-metallic mineral products	266.7	479.3	488.9	581.8	4.8	6.3	10.3	10.1	10.8
DJ Basic metals & fabricated metal prod.	1093.8	1086.8	962.2	977.3	26.1	26.0	23.4	19.8	18.1
DK_DM Machinery; elec.equip.; transp.equip.	733.4	689.6	721.3	763.1	15.9	17.4	14.9	14.8	14.1
DN Manufacturing n.e.c.	133.8	138.9	162.7	177.0	3.3	3.2	3.0	3.3	3.3
D Manufacturing industry total	**4212.2**	**4637.2**	**4862.9**	**5398.8**	**100.0**	**100.0**	**100.0**	**100.0**	**100.0**

Remark: Inward FDI stock refers to equity capital, reinvested earnings. From 2007, data exclude market valuation of shares of big enterprises.

Source: State Statistics Committee of Ukraine, National Bank of Ukraine.

Table A5

Ukraine: Inward FDI stock by home countries

	2006	2007	2008	2009	2006	2007	2008	2009
		EUR mn				in % of total		
1 Cyprus	2420.3	4047.4	5449.6	5993.3	14.8	20.1	21.6	21.5
2 Germany	4235.5	4028.3	4535.2	4612.2	25.8	20.0	18.0	16.5
3 Netherlands	1164.6	1707.6	2256.2	2791.2	7.1	8.5	8.9	10.0
4 Russia	744.8	995.2	1313.4	1865.4	4.5	4.9	5.2	6.7
5 Austria	1240.6	1407.2	1734.7	1816.2	7.6	7.0	6.9	6.5
6 United Kingdom	1187.1	1344.6	1612.6	1657.1	7.2	6.7	6.4	5.9
7 France	630.5	711.1	869.7	1143.9	3.8	3.5	3.4	4.1
8 United States	1076.7	978.0	1043.8	967.4	6.6	4.9	4.1	3.5
9 Virgin Islands, British	613.7	711.8	933.5	956.2	3.7	3.5	3.7	3.4
10 Sweden	104.3	671.6	895.9	887.2	0.6	3.3	3.5	3.2
11 Italy	100.9	102.4	648.5	692.0	0.6	0.5	2.6	2.5
12 Poland	299.6	457.5	492.8	603.2	1.8	2.3	2.0	2.2
13 Switzerland	383.4	397.4	507.6	561.8	2.3	2.0	2.0	2.0
14 Hungary	281.6	279.9	422.4	470.9	1.7	1.4	1.7	1.7
15 Greece	54.7	103.2	219.9	230.8	0.3	0.5	0.9	0.8
16 Luxembourg	70.9	143.4	152.2	176.1	0.4	0.7	0.6	0.6
17 Denmark	108.3	106.0	125.5	131.1	0.7	0.5	0.5	0.5
18 Ireland	54.8	79.7	94.8	100.4	0.3	0.4	0.4	0.4
19 Estonia	40.3	47.6	76.8	85.4	0.2	0.2	0.3	0.3
20 Slovakia	76.0	70.0	75.5	74.4	0.5	0.3	0.3	0.3
21 Latvia	51.8	50.6	45.4	61.4	0.3	0.3	0.2	0.2
22 Lithuania	47.5	50.3	60.0	60.4	0.3	0.3	0.2	0.2
23 Czech Republic	49.4	53.2	57.0	55.7	0.3	0.3	0.2	0.2
24 Spain	44.3	43.2	41.3	49.5	0.3	0.2	0.2	0.2
25 Belgium	27.5	26.6	30.8	44.9	0.2	0.1	0.1	0.2
Other	1297.7	1494.4	1568.4	1828.5	7.9	7.4	6.2	6.5
Total by countries	**16406.5**	**20108.0**	**25263.4**	**27916.6**	**100.0**	**100.0**	**100.0**	**100.0**
of which EU-15	9037.1	10492.2	13229.7	14382.5	55.1	52.2	52.4	51.5
of which EU-27	12345.3	15595.2	19951.5	21865.3	75.2	77.6	79.0	78.3

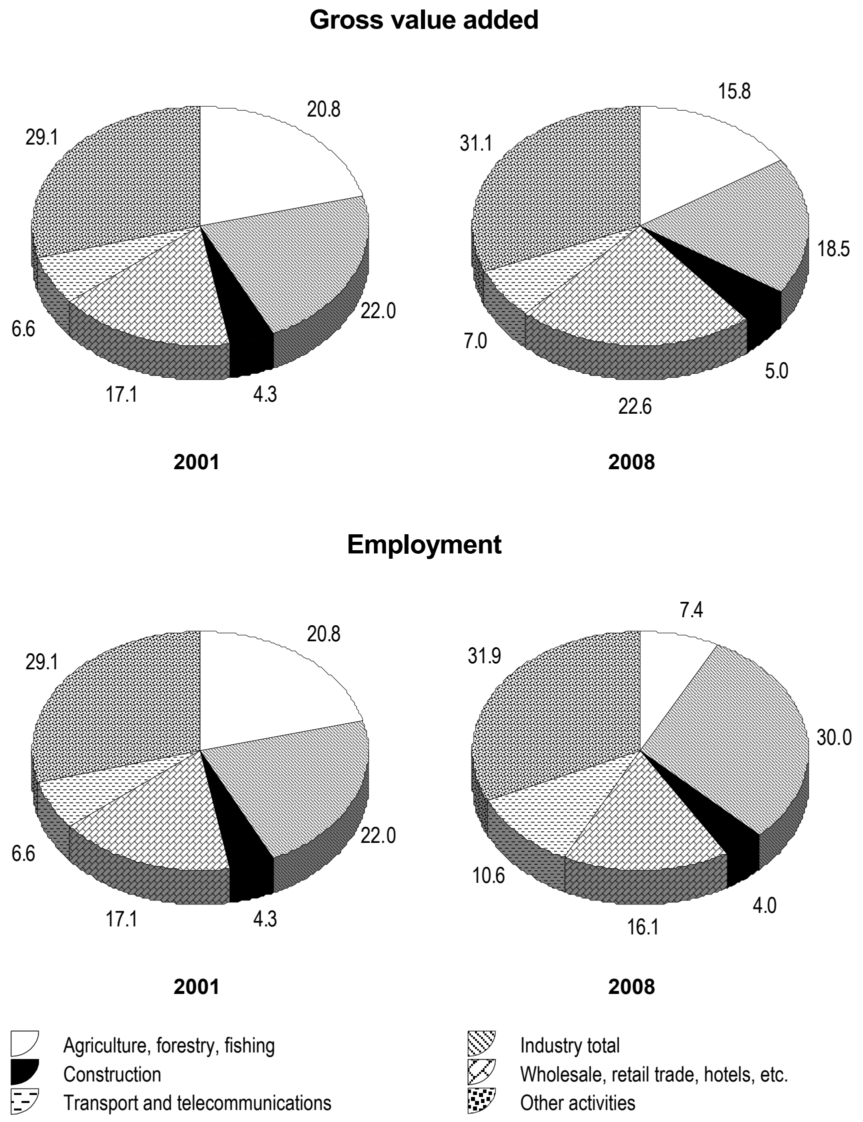
Remark: Inward FDI stock refers to equity capital, reinvested earnings. From 2007, data exclude market valuation of shares of big enterprises.

Source: State Statistics Committee of Ukraine, National Bank of Ukraine.

Figure A1

Ukraine: Gross value added and employment by activities

in % of total



Source: wiiw Handbook of Statistics

Table A6

Ukraine: GDP and gross value added by activites

	2000	2005	2006	2007	2008	2009
At current prices, UAH mn						
Agriculture, hunting and forestry	24433	40542	41006	47417	65148	65517
Fishing	158	165	151	161	.	.
Mining and quarrying	7405	17939	22064	31695	54337	35409
Manufacturing	31051	86863	109416	143428	164735	144943
Electricity, gas and water supply	10819	15169	18610	23245	28800	31640
Construction	5677	16370	21168	30456	29185	22110
Wholesale, retail trade, repair motor veh.	14640	56041	68573	95220	131261	123115
Hotels and restaurants	841	2370	5388	6827	.	.
Transport, storage and communications	19756	47435	56053	70063	87078	103527
Financial intermediation	3060	19777	25387	42394	68983	71872
Real estate, renting & business activities	8283	30543	38851	63702	85345	99943
Public admin., defence, compuls.soc.sec.	6522	20490	26209	33500	45005	45099
Education	7221	20882	26243	32905	43520	47750
Health and social work	4256	13965	17722	22542	29209	31584
Oth. community, social & personal serv.	1885	7452	10291	13337	.	.
Gross value added at basic prices	146007	396003	487132	656892	860714	847852
FISIM	-1745	-7402	-13009	-22098	-36538	-50849
Net taxes on products	25808	52851	70030	85937	123880	117717
Gross domestic product	170070	441452	544153	720731	948056	914720
Real growth in %						
Agriculture, hunting and forestry	.	0.4	2.0	-6.0	17.2	-0.3
Fishing	.	19.3	-12.1	-8.6	.	.
Mining and quarrying	.	3.9	9.9	2.0	-1.5	-10.5
Manufacturing	.	2.1	9.2	10.1	-2.3	-26.6
Electricity, gas and water supply	.	0.6	0.1	1.3	-4.8	-11.7
Construction	.	-8.8	0.3	14.1	-17.5	-45.9
Wholesale, retail trade, repair motor veh.	.	-9.8	17.7	15.8	1.8	-15.7
Hotels and restaurants	.	-0.4	69.0	5.7	.	.
Transport, storage and communications	.	5.7	7.6	9.3	7.1	-9.1
Financial intermediation	.	7.7	15.8	22.5	-18.7	-16.2
Real estate, renting & business activities	.	26.3	3.6	20.0	13.2	-6.1
Public admin., defence, compuls.soc.sec.	.	0.1	-10.3	3.6	3.1	-2.0
Education	.	0.8	2.1	-2.2	-0.6	-1.2
Health and social work	.	1.6	2.4	0.0	-0.6	-1.5
Oth. community, social & personal serv.	.	22.1	9.9	11.4	.	.
Gross value added at basic prices [1)]	5.0	0.5	6.4	8.4	1.2	-14.9
Gross domestic product	5.9	2.7	7.3	7.9	2.3	-15.1

1) Including FISIM deduction.

Source: wiiw Database incorporating national statistics.

Table A7

Ukraine: Employment by activities

	2002	2003	2004	2005	2006	2007	2008
Thousand persons, annual average [1]							
Agriculture, forestry, fishing	4136	4106	3998	4006	3653	3485	3322
Industry, total	4220	4123	4077	4072	4037	3973	3871
Construction	839	834	908	942	987	1030	1043
Wholesale, retail trade& hotels and restaurants	3657	3752	3971	4175	4404	4564	4744
Transport, storage and communications	1354	1361	1375	1401	1428	1452	1466
Financial intermediation	178	190	216	248	286	344	395
Real estate, renting & business activities	848	915	920	967	1042	1135	1150
Public admin., defence, compuls.soc.sec.	1183	1171	1050	1029	1034	1036	1068
Education	1630	1637	1649	1668	1691	1694	1702
Health and social work	1359.8	1366.5	1348.9	1356.6	1356.7	1359.0	1369.9
Oth. community, social & personal serv.	685.8	707.7	782.9	816.7	812.8	832.5	840.1
Employment total	20091	20163	20296	20680	20730	20905	20972
Annual growth in % [1]							
Agriculture, forestry, fishing	-0.3	-0.7	-2.6	0.2	-8.8	-4.6	-4.7
Industry, total	-3.9	-2.3	-1.1	-0.1	-0.9	-1.6	-2.6
Construction	-3.1	-0.6	8.9	3.7	4.8	4.4	1.3
Wholesale, retail trade& hotels and restaurants	6.9	2.6	5.8	5.1	5.5	3.6	3.9
Transport, storage and communications	2.1	0.6	1.0	1.9	2.0	1.7	1.0
Financial intermediation	3.5	6.9	13.6	14.7	15.4	20.4	14.7
Real estate, renting & business activities	1.7	7.9	0.6	5.1	7.8	8.9	1.4
Public admin., defence, compuls.soc.sec.	1.8	-1.1	-10.3	-2.0	0.5	0.3	3.0
Education	0.6	0.4	0.7	1.2	1.3	0.2	0.5
Health and social work	-0.1	0.5	-1.3	0.6	0.0	0.2	0.8
Oth. community, social & personal serv.	2.8	3.2	10.6	4.3	-0.5	2.4	0.9
Employment total	0.6	0.4	0.7	1.9	0.2	0.8	0.3

1) LFS based on population 15-70. Excluding conscripts.

Source: wiiw Database incorporating national statistics.

Table A8

Ukraine: GDP by expenditure

	1990	1995	2000	2005	2006	2007	2008	2009
At current prices, UAH mn								
Final consumption expenditure	1.230	41651	127982	337879	424906	558581	758902	774075
Household final consumption	0.910	27094	92406	252624	319383	423174	582482	590196
Government final consumption	0.280	11595	31667	80528	100350	128962	169163	175377
Final consumption of NPISHs	0.040	2961	3909	4727	5173	6445	7257	8502
Gross capital formation	0.460	14547	33531	99876	134740	203318	264883	156480
Gross fixed capital formation	0.380	12692	33427	96965	133874	198348	250158	164522
Change in inventories	0.080	1855	104	2911	866	4970	14725	-8042
Balance of goods and NFS	-0.020	-1681	8557	3697	-15493	-41168	-75729	-15835
Exports of goods and NFS	0.460	25663	106200	227252	253707	323205	444859	423565
Imports of goods and NFS	0.480	27344	97643	223555	269200	364373	520588	439400
Gross domestic product	1.671	54516	170070	441452	544153	720731	948056	914720
Real growth in %								
Final consumption expenditure	.	-3.6	2.0	10.0	12.4	13.6	9.0	-12.1
Household final consumption	.	-1.6	2.5	16.6	15.9	17.2	11.8	-14.2
Government final consumption	.	-7.9	1.0	2.7	2.7	2.5	0.4	-5.6
Final consumption of NPISHs	.	-5.0	-1.2	0.0	-8.3	5.6	-4.5	5.2
Gross capital formation	.	-46.4	24.6	14.0	18.5	25.8	4.2	-52.2
Gross fixed capital formation	.	-30.8	12.4	3.9	21.2	23.9	1.9	-46.2
Change in inventories	.	.	.	.	.	.	.	.
Balance of goods and NFS	.	.	.	.	.	.	.	.
Exports of goods and NFS	.	1.1	21.5	-11.2	-5.6	3.3	6.7	-25.6
Imports of goods and NFS	.	-4.6	23.8	6.4	6.8	21.5	17.5	-38.6
Gross domestic product	-4.0	-12.2	5.9	2.7	7.3	7.9	2.3	-15.1
Shares in GDP, in %								
Final consumption expenditure	73.6	76.4	75.3	76.5	78.1	77.5	80.0	84.6
Household final consumption	54.5	49.7	54.3	57.2	58.7	58.7	61.4	64.5
Government final consumption	16.8	21.3	18.6	18.2	18.4	17.9	17.8	19.2
Final consumption of NPISHs	2.4	5.4	2.3	1.1	1.0	0.9	0.8	0.9
Gross capital formation	27.5	26.7	19.7	22.6	24.8	28.2	27.9	17.1
Gross fixed capital formation	22.7	23.3	19.7	22.0	24.6	27.5	26.4	18.0
Change in inventories	4.8	3.4	0.1	0.7	0.2	0.7	1.6	-0.9
Balance of goods and NFS	-1.2	-3.1	5.0	0.8	-2.8	-5.7	-8.0	-1.7
Exports of goods and NFS	27.5	47.1	62.4	51.5	46.6	44.8	46.9	46.3
Imports of goods and NFS	28.7	50.2	57.4	50.6	49.5	50.6	54.9	48.0
Gross domestic product	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: wiiw Database incorporating national statistics.

Table A9

Ukraine: Gross fixed investment by type and activities

	2005	2006	2007	2008	2009
At current prices, UAH mn					
Construction	50552	71518	109694	134655	.
Machinery and equipment	42544	53736	78792	98426	.
Others	.	.	.	.	.
Agriculture, hunting and forestry	5016	7309	9519	16890	9382
Fishing	27	55	36	62	22
Mining and quarrying	8107	8594	12142	16767	13914
Manufacturing	22399	30113	44823	48976	35322
Electricity, gas and water supply	4525	6096	7376	10875	8421
Construction	4929	6300	9107	12469	5325
Wholesale, retail trade, repair motor veh.	7614	11655	17779	24695	14091
Hotels and restaurants	1508	1483	2614	3222	2589
Transport, storage and communications	16887	20329	31709	32558	24555
Financial intermediation	1964	2386	4165	4636	3359
Real estate, renting & business activities	15334	24026	39415	48840	25678
Public admin., defence, compuls.soc.sec.	793	1054	1572	1819	894
Education	870	1163	1651	2322	1484
Health and social work	1297	1835	2518	3531	1932
Oth. community, social & personal serv.	1826	2854	4061	5421	4809
Gross investment total	93096	125254	188486	233081	151777
Real growth in %					
Construction	.	.	.	.	.
Machinery and equipment	.	.	.	.	.
Others	.	.	.	.	.
Agriculture, hunting and forestry	25.8	33.9	18.4	42.3	-50.2
Fishing	-38.8	85.8	-42.1	5.8	-65.7
Mining and quarrying	4.0	-6.3	25.1	9.0	-25.1
Manufacturing	14.1	22.7	32.0	-11.9	-35.3
Electricity, gas and water supply	-27.3	14.8	3.2	15.4	-30.2
Construction	-15.1	15.5	28.6	6.0	-62.2
Wholesale, retail trade, repair motor veh.	18.0	34.9	30.8	9.0	-48.3
Hotels and restaurants	13.7	-16.9	45.3	-3.9	-27.9
Transport, storage and communications	-5.6	7.2	33.5	-17.6	-33.3
Financial intermediation	35.5	12.5	59.5	-11.8	-35.4
Real estate, renting & business activities	10.2	30.7	33.4	-5.8	-52.8
Public admin., defence, compuls.soc.sec.	-42.1	19.6	28.9	-5.9	-55.6
Education	-24.3	14.7	17.8	10.3	-43.1
Health and social work	-26.7	24.3	17.5	13.0	-50.7
Oth. community, social & personal serv.	-30.9	38.3	25.9	2.5	-18.4
Gross investment total	1.9	19.0	29.8	-2.6	-41.5

Source: wiiw Database incorporating national statistics.

Table A10

Ukraine: Labour productivity and wages by activities

	1995	2000	2005	2006	2007	2008	2009
Labour productivity [1)]							
Real growth rates in %							
Agriculture, hunting and forestry	.	.	0.2	11.8	-1.5	22.9	.
Fishing	.	.	.	.	.	.	.
Industry total	.	.	2.2	8.8	9.5	0.0	.
Mining and quarrying	.	.	.	.	.	.	.
Manufacturing	.	.	.	.	.	.	.
Electricity, gas and water supply	.	.	.	.	.	.	.
Construction	.	.	-12.1	-4.3	9.3	-18.5	.
Wholesale, retail trade, repair motor veh.	.	.	.	.	.	.	.
Hotels and restaurants	.	.	.	.	.	.	.
Transport, storage and communications	.	.	3.8	5.5	7.5	6.1	.
Financial intermediation	.	.	-6.1	0.4	1.7	-29.1	.
Real estate, renting & business activities	.	.	20.2	-3.9	10.2	11.7	.
Public admin., defence, compuls.soc.sec.	.	.	2.2	-10.7	3.3	0.1	.
Education	.	.	-0.4	0.7	-2.4	-1.1	.
Health and social work	.	.	1.0	2.4	-0.2	-1.4	.
Oth. community, social & personal serv.	.	.	17.0	10.4	8.8	.	.
Gross domestic product	.	4.7	0.8	7.0	7.0	2.0	-11.8
Average gross monthly wages [2)3)]							
Current prices, UAH							
Agriculture, hunting and forestry	38.0	114.0	437.0	581.0	771.0	1101.0	1206.0
Fishing	58.0	145.0	499.0	606.7	721.0	913.0	1029.0
Mining and quarrying	131.0	394.0	1245.8	1535.1	1970.0	2681.0	2894.0
Manufacturing	77.0	271.0	905.0	1137.3	1456.0	1849.0	1856.0
Electricity, gas and water supply	118.0	370.0	969.0	1228.1	1577.0	2111.0	2394.0
Construction	103.0	260.0	894.0	1139.8	1486.0	1833.0	1511.0
Wholesale, retail trade, repair motor veh.	66.0	225.0	713.2	897.9	1145.0	1514.0	1565.0
Hotels and restaurants	51.0	178.0	566.5	735.2	944.0	1221.0	1267.0
Transport, storage and communications	90.0	335.0	1057.5	1328.2	1670.0	2207.0	2409.0
Financial intermediation	172.0	559.0	1553.4	2049.7	2704.0	3747.0	4038.0
Real estate, renting & business activities	75.0	277.0	900.0	1193.3	1485.0	2086.0	2231.0
Public admin., defence, compuls.soc.sec.	81.0	337.0	1086.7	1578.6	1852.0	2582.0	2513.0
Education	71.0	156.0	640.6	806.3	1060.0	1448.0	1611.0
Health and social work	75.0	139.0	517.1	657.9	871.0	1177.0	1307.0
Oth. community, social & personal serv.	63.0	163.0	619.6	828.1	1090.0	1511.0	1783.0
Total economy	73.0	230.1	806.2	1041.4	1351.0	1806.0	1906.0
Real growth rate in %	-0.1	1.1	20.4	18.4	15.0	6.8	-8.9

1) Gross value added at real terms divided by employment based on LFS. Partly estimated by wiiw. - 2) Based on Monthly Statistical Survey. - 3) Excluding small enterprises.

Source: wiiw Database incorporating national statistics.

Table A11

Ukraine: Trade with the EU, by individual countries

(exports, imports and trade balances, current prices)

	1993	1995	2000	2005	2006	2007	2008	2009
				(EUR mn)				
European Union (27)								
Exports [1)]	.	.	5203.1	8225.7	9627.2	10154.2	12326.3	6818.1
Imports [1)]	.	.	4373.5	9799.8	12897.8	16212.1	19627.8	11047.9
Trade balance	.	.	829.6	-1574.2	-3270.6	-6057.9	-7301.5	-4229.8
European Union (25)								
Exports [1)]	.	.	4610.8	7396.3	8654.3	9291.4	11118.3	6304.9
Imports [1)]	.	.	4255.9	9542.2	12438.7	15520.1	18668.8	10588.7
Trade balance	.	.	354.9	-2145.9	-3784.3	-6228.7	-7550.5	-4283.8
European Union (15)								
Exports [1)]	788.2	1074.3	2814.0	4587.7	5333.2	5617.3	6559.4	3911.3
Imports [1)]	937.5	1768.1	3119.5	6770.0	8484.0	10371.1	12551.5	7233.4
Trade balance	-149.3	-693.7	-305.6	-2182.3	-3150.8	-4753.8	-5992.1	-3322.1
Austria								
Exports	171.5	59.1	177.2	255.1	262.1	313.3	403.5	235.9
Imports	103.2	101.4	200.5	368.5	435.8	584.0	701.1	439.4
Trade balance	68.2	-42.3	-23.3	-113.4	-173.7	-270.7	-297.6	-203.5
Belgium, Luxemburg								
Exports	17.9	55.7	116.8	.	.	.	.	.
Imports	124.5	85.9	155.5	.	.	.	.	.
Trade balance	-106.6	-30.2	-38.7					
Belgium								
Exports	.	.	115.3	158.9	171.4	138.6	247.9	200.7
Imports	.	.	145.8	252.5	296.7	410.1	493.2	333.0
Trade balance			-30.5	-93.6	-125.3	-271.5	-245.3	-132.3
Luxemburg								
Exports	.	.	1.5	21.6	34.1	1.1	5.4	1.8
Imports	.	.	9.7	17.4	22.4	15.6	15.6	13.3
Trade balance			-8.2	4.2	11.6	-14.5	-10.3	-11.5
Cyprus								
Exports	.	.	191.1	174.4	200.5	127.3	306.9	93.9
Imports	.	.	31.8	3.9	9.2	14.1	45.3	35.2
Trade balance	.	.	159.3	170.6	191.3	113.2	261.6	58.6
Czech Republic								
Exports	68.2	90.3	204.5	302.9	272.1	313.0	456.1	244.5
Imports	39.2	120.1	176.4	477.4	657.2	842.5	935.6	446.5
Trade balance	29.0	-29.8	28.0	-174.5	-385.1	-529.5	-479.5	-202.0
Denmark								
Exports	.	4.2	26.8	85.7	129.8	144.3	132.7	87.8
Imports	.	37.5	73.8	141.4	196.8	209.4	230.7	157.5
Trade balance	.	-33.3	-47.0	-55.7	-67.0	-65.0	-98.0	-69.6
Estonia								
Exports	.	27.5	59.7	100.6	98.3	159.0	118.2	55.7
Imports	.	20.6	49.8	82.5	107.6	111.4	120.8	97.1
Trade balance	.	6.9	9.9	18.1	-9.4	47.5	-2.6	-41.4
Finland								
Exports	81.9	17.4	26.0	23.0	35.9	33.9	40.2	26.9
Imports	18.8	67.6	103.8	282.2	312.0	397.4	466.6	302.6
Trade balance	63.1	-50.2	-77.9	-259.2	-276.1	-363.5	-426.5	-275.6

Table A11 continued

Table A11 (continued)

	(EUR mn)							
France								
Exports	24.7	33.4	121.0	160.6	279.8	354.3	349.1	317.4
Imports	133.9	149.3	255.7	642.1	788.3	970.5	1143.9	697.3
Trade balance	-109.2	-115.9	-134.7	-481.5	-508.4	-616.1	-794.8	-379.9
Germany								
Exports	146.7	258.9	802.8	1033.0	1022.5	1199.9	1249.1	895.8
Imports	394.1	732.6	1228.2	2719.9	3399.4	4253.9	4871.7	2764.8
Trade balance	-247.4	-473.6	-425.4	-1686.8	-2376.9	-3054.0	-3622.6	-1869.0
Greece								
Exports	.	30.3	52.1	110.4	95.7	161.2	230.8	72.0
Imports	.	64.6	41.7	54.4	62.2	85.6	116.8	59.4
Trade balance	.	-34.2	10.3	56.0	33.4	75.6	113.9	12.6
Hungary								
Exports	.	227.9	354.4	553.6	753.5	901.2	929.5	524.1
Imports	.	129.6	179.1	520.6	638.9	905.4	872.1	486.9
Trade balance	.	98.2	175.3	33.0	114.6	-4.2	57.4	37.3
Ireland								
Exports	.	7.1	294.2	5.4	6.9	10.0	19.6	3.0
Imports	.	25.9	27.8	36.3	40.5	64.2	85.9	73.3
Trade balance	.	-18.8	266.4	-30.9	-33.6	-54.2	-66.3	-70.3
Italy								
Exports	120.3	324.6	691.7	1521.3	1993.8	1951.9	1979.7	881.1
Imports	81.9	207.8	374.6	828.0	1168.7	1305.1	1653.6	818.0
Trade balance	38.4	116.8	317.1	693.2	825.1	646.8	326.1	63.0
Latvia								
Exports	.	48.9	180.3	250.3	227.9	188.7	190.7	127.8
Imports	.	62.5	47.1	51.9	72.1	86.5	76.9	79.1
Trade balance	.	-13.6	133.2	198.4	155.7	102.2	113.8	48.7
Lithuania								
Exports	.	97.1	90.2	168.2	221.6	265.1	293.9	138.9
Imports	.	99.4	146.6	160.8	236.8	277.6	492.3	294.5
Trade balance	.	-2.3	-56.5	7.4	-15.2	-12.5	-198.4	-155.6
Malta								
Exports	.	.	4.4	12.2	18.8	23.6	36.1	22.5
Imports	.	.	0.1	0.2	15.9	0.6	1.7	5.5
Trade balance	.	.	4.3	11.9	2.9	23.1	34.5	17.0
Netherlands								
Exports	103.2	86.6	149.4	414.2	564.0	558.7	760.0	427.0
Imports	75.1	114.1	158.7	373.1	510.7	642.8	872.8	486.3
Trade balance	28.2	-27.4	-9.4	41.1	53.3	-84.1	-112.8	-59.3
Poland								
Exports	104.9	209.8	452.5	812.2	1070.8	1194.4	1589.8	867.0
Imports	65.7	364.4	338.4	1130.1	1679.8	2131.0	2910.2	1557.7
Trade balance	39.2	-154.6	114.1	-317.9	-609.0	-936.6	-1320.4	-690.7
Portugal								
Exports	.	7.4	21.8	16.0	29.8	58.9	42.9	45.6
Imports	.	1.2	8.3	22.4	23.5	27.2	41.9	30.1
Trade balance	.	6.2	13.5	-6.4	6.2	31.7	1.0	15.5
Slovakia								
Exports	.	165.4	250.0	408.1	437.7	470.8	618.9	311.3
Imports	.	116.8	134.6	244.4	304.9	382.0	504.8	219.6
Trade balance	.	48.6	115.4	163.7	132.9	88.8	114.0	91.6

Table A11 continued

Table A11 (continued)

Slovenia								
Exports	.	5.4	9.8	26.1	19.9	31.0	18.7	7.9
Imports	.	23.9	32.3	100.5	232.2	397.9	157.7	133.1
Trade balance	.	-18.5	-22.6	-74.4	-212.3	-366.9	-139.0	-125.2
Spain								
Exports	10.2	49.0	176.4	461.0	354.5	406.7	591.5	409.4
Imports	3.4	35.5	108.4	187.7	282.6	313.2	448.9	267.1
Trade balance	6.8	13.5	68.0	273.3	71.9	93.5	142.7	142.3
Sweden								
Exports	2.6	6.0	9.0	33.4	44.3	47.3	71.5	58.2
Imports	8.5	35.9	162.8	440.0	450.0	445.4	473.4	323.9
Trade balance	-6.0	-29.8	-153.9	-406.6	-405.6	-398.0	-401.9	-265.7
United Kingdom								
Exports	30.7	134.5	149.0	288.0	308.7	237.0	435.5	248.5
Imports	45.2	108.9	219.6	404.1	494.3	646.8	935.4	467.3
Trade balance	-14.5	25.6	-70.5	-116.0	-185.5	-409.8	-499.9	-218.8

1) USD converted to EUR using the ECB EUR/USD reference rate.

Source: wiiw Database incorporating national statistics.

Table A12

Ukraine: Exports to the top thirty partners

	1993	1995	2000	2005	2006	2007	2008	2009
Total exports, fob, EUR mn	9247.9	10035.6	15778.0	27512.6	30557.5	35969.4	45522.5	28491.0
Shares in % (ranking in 2008)								
Russia	.	43.40	24.12	21.88	22.55	25.70	23.50	21.40
Turkey	1.31	3.45	5.96	5.92	6.23	7.40	6.92	.
Italy	1.30	3.23	4.38	5.53	6.52	5.43	4.35	3.09
Poland	1.13	2.09	2.87	2.95	3.50	3.32	3.49	3.04
Belarus	.	4.16	1.87	2.60	3.19	3.17	3.14	3.17
USA	1.51	2.08	4.98	2.79	3.15	2.15	2.91	.
Germany	1.59	2.58	5.09	3.75	3.35	3.34	2.74	3.14
Kazakhstan	.	0.72	0.53	1.95	2.15	2.91	2.74	3.57
Egypt	.	0.81	1.52	2.33	1.95	1.79	2.33	.
Hungary	.	2.27	2.25	2.01	2.47	2.51	2.04	1.84
Moldova	.	1.16	1.21	1.98	1.75	1.85	1.75	1.75
Netherlands	1.12	0.86	0.95	1.51	1.85	1.55	1.67	1.50
Bulgaria	1.33	1.37	2.62	1.59	1.55	1.12	1.65	1.00
Syria	.	1.40	1.10	1.96	1.57	1.72	1.55	.
India	.	1.76	1.15	2.15	2.22	1.51	1.50	.
Jordan	.	.	0.31	0.53	0.83	0.87	1.49	.
Saudi Arabia	.	.	0.25	1.13	1.40	1.06	1.43	.
Azerbaijan	.	0.32	0.28	0.85	1.10	1.28	1.36	1.38
Slovakia	.	1.65	1.58	1.48	1.43	1.31	1.36	1.09
United Arab Emirates	.	.	0.47	1.01	1.02	1.24	1.34	.
Spain	0.11	0.49	1.12	1.68	1.16	1.13	1.30	1.44
Virgin Islands, British	.	.	0.69	0.76	1.25	1.24	1.29	.
Iran	.	0.27	0.62	1.69	0.83	1.03	1.28	.
Switzerland	1.84	0.38	1.02	1.16	0.29	0.20	1.24	1.14
Czech Republic	0.74	0.90	1.30	1.10	0.89	0.87	1.00	0.86
Romania	.	1.27	1.13	1.43	1.63	1.28	1.00	0.80
Georgia	.	0.14	0.26	0.58	0.81	1.07	0.98	.
United Kingdom	0.33	1.34	0.94	1.05	1.01	0.66	0.96	0.87
Korea Republic	.	1.37	1.00	0.59	0.23	0.36	0.93	.
Uzbekistan	.	0.87	0.78	0.44	0.55	0.70	0.89	1.02

Source: wiiw Database incorporating national statistics.

Table A13

Ukraine: Imports from the top thirty partners

		1993	1995	2000	2005	2006	2007	2008	2009
Total imports, cif, EUR mn		10807.2	11836.7	15110.5	29046.1	35870.2	44230.6	58155.7	32609.0
Shares in % (ranking in 2008)									
Russia	1	.	53.27	41.74	35.54	30.61	27.78	22.70	29.13
Germany	2	3.65	6.19	8.13	9.36	9.48	9.62	8.38	8.48
Turkmenistan	3	.	4.39	6.78	7.41	7.75	7.04	6.58	1.58
China	4	0.42	0.54	0.94	5.01	5.13	5.46	6.55	.
Poland	5	0.61	3.08	2.24	3.89	4.68	4.82	5.00	4.78
Kazakhstan	6	.	2.09	2.96	0.52	2.14	2.63	3.65	4.48
Belarus	7	.	3.40	4.31	2.60	2.79	2.38	3.28	3.73
USA	8	1.77	2.71	2.58	1.96	1.95	2.31	3.28	.
Japan	9	0.36	0.69	0.71	1.52	1.88	2.32	3.27	.
Italy	10	0.76	1.76	2.48	2.85	3.26	2.95	2.84	2.51
Uzbekistan	11	.	0.47	1.28	0.57	0.93	0.90	2.48	3.61
Korea Republic	12	.	0.18	0.79	1.79	2.08	2.58	2.39	.
Turkey	13	0.09	0.44	1.15	1.68	1.71	1.60	2.28	.
France	14	1.24	1.26	1.69	2.21	2.20	2.19	1.97	2.14
Czech Republic	15	0.36	1.01	1.17	1.64	1.83	1.90	1.61	1.37
United Kingdom	16	0.42	0.92	1.45	1.39	1.38	1.46	1.61	1.43
Netherlands	17	0.69	0.96	1.05	1.28	1.42	1.45	1.50	1.49
Hungary	18	.	1.10	1.19	1.79	1.78	2.05	1.50	1.49
Switzerland	19	1.74	0.85	1.55	0.70	0.63	0.71	1.37	0.96
Romania	20	.	0.98	0.35	0.59	0.99	1.28	1.37	1.07
Austria	21	0.96	0.86	1.33	1.27	1.21	1.32	1.21	1.35
Slovakia	23	.	0.99	0.89	0.84	0.85	0.86	0.87	0.67
Belgium	22	.	.	0.97	0.87	0.83	0.93	0.85	1.02
Lithuania	24	.	0.84	0.97	0.55	0.66	0.63	0.85	0.90
Sweden	25	0.08	0.30	1.08	1.51	1.25	1.01	0.81	0.99
Finland	26	0.17	0.57	0.69	0.97	0.87	0.90	0.80	0.93
Spain	27	0.03	0.30	0.72	0.65	0.79	0.71	0.77	0.82
India	28	.	0.48	0.54	0.89	0.82	0.77	0.76	.
Brazil	29	.	0.89	0.67	0.86	0.62	0.71	0.66	.
Indonesia	30	.	0.11	0.20	0.34	0.37	0.61	0.50	.

Source: wiiw Database incorporating national statistics.

Table A14

Ukraine: Balance of payments

	1992	1995	2000	2005	2006	2007	2008	2009
EUR mn								
I. Current account [1)]	**-483.8**	**-880.2**	**1602.2**	**2030.1**	**-1289.0**	**-3848.5**	**-8721.5**	**-1291.1**
A. Goods and services, net	**-472.1**	**-909.3**	**1521.0**	**538.2**	**-2445.6**	**-5950.9**	**-9806.0**	**-1951.4**
a. Trade balance	**-484.6**	**-2064.5**	**842.7**	**-910.4**	**-4140.3**	**-7717.5**	**-10995.7**	**-3820.4**
Commodity exports, fob	8809.2	10883.6	17008.1	28093.1	31047.7	36382.7	46273.9	28958.5
Commodity imports, fob	-9293.8	-12948.1	-16165.4	-29003.5	-35188.0	-44100.2	-57269.5	-32295.6
b. Services, net	**12.5**	**1155.3**	**678.3**	**1448.6**	**1694.7**	**1766.6**	**1189.7**	**1887.6**
1. Transport, net	.	.	2737.0	1949.1	1708.3	1614.7	673.8	2145.7
2. Travel, net	.	.	-82.2	256.7	518.9	750.4	1192.4	176.4
3. Other, net	.	.	-1976.5	-757.2	-532.5	-598.6	-676.5	-434.4
Credit	.	2174.6	4110.9	7502.9	8999.7	10337.4	12228.4	9935.5
1. Transport	.	.	3158.9	3594.3	4265.5	4463.2	5211.2	4486.4
2. Travel	.	.	426.2	2506.6	2778.0	3355.8	3941.5	2563.6
3. Other	.	.	525.8	1402.1	1956.2	2518.5	3075.7	2885.5
Debit	.	-1019.3	-3432.6	-6054.3	-7305.0	-8570.8	-11038.7	-8047.9
1. Transport	.	.	-421.9	-1645.1	-2557.2	-2848.4	-4537.4	-2340.7
2. Travel	.	.	-508.5	-2249.9	-2259.1	-2605.3	-2749.1	-2387.3
3. Other	.	.	-2502.2	-2159.3	-2488.7	-3117.1	-3752.2	-3320.0
B. Income, net	**-11.7**	**-331.6**	**-1019.1**	**-790.1**	**-1372.7**	**-481.1**	**-1052.4**	**-1749.2**
1. Compensation of employees, net	.	.	33.5	279.9	423.3	1605.3	2467.6	2445.4
2. Investment income, net	.	.	-1052.6	-1070.0	-1796.0	-2086.3	-3519.9	-4194.6
2.1 Direct investment, net	.	.	-46.5	-211.0	-787.6	-846.1	-1698.1	-1777.2
2.2 Portfolio investment, net	.	.	-495.5	-405.1	-377.8	-330.7	-351.2	-368.5
2.3 Other investment, net	.	.	-510.6	-454.0	-630.5	-909.6	-1470.6	-2048.9
Credit	.	188.7	154.7	608.0	1061.8	2668.8	3703.0	3315.0
1. Compensation of employees	.	.	35.7	288.0	430.5	1613.3	2479.9	2456.1
2. Investment income	.	.	119.0	320.0	631.3	1055.6	1223.2	858.9
2.1 Direct investment	.	.	.	4.0	6.4	13.9	14.4	45.2
2.2 Portfolio investment	.	.	3.3	31.3	157.8	381.1	456.5	394.3
2.3 Other investment	.	.	115.8	284.8	467.1	660.6	752.4	419.4
Debit	.	-520.3	-1173.8	-1398.1	-2434.5	-3149.9	-4755.4	-5064.2
1. Compensation of employees	.	.	-2.2	-8.0	-7.2	-8.0	-12.3	-10.8
2. Investment income	.	.	-1171.6	-1390.1	-2427.3	-3141.9	-4743.1	-5053.4
2.1 Direct investment	.	.	-46.5	-215.0	-794.0	-859.9	-1712.5	-1822.4
2.2 Portfolio investment	.	.	-498.7	-436.4	-535.7	-711.7	-807.7	-762.8
2.3 Other investment	.	.	-626.4	-738.7	-1097.7	-1570.2	-2222.9	-2468.3
C. Current transfers, net	**.**	**360.7**	**1100.2**	**2282.0**	**2529.3**	**2583.4**	**2136.8**	**1907.7**
1. General government, net	.	.	.	423.5	400.2	405.9	185.2	253.1
2. Other sectors, net	.	.	.	1858.5	2129.2	2177.6	1951.6	1654.6
Credit (to Ukraine)	.	425.6	1228.9	2495.4	2816.3	3027.3	2846.1	2480.5
1. General government	.	.	.	445.2	428.1	454.1	207.7	270.3
2. Other sectors	.	.	.	2050.2	2388.2	2573.2	2638.4	2210.2
Debit (abroad)	.	-65.0	-128.7	-213.4	-287.0	-443.8	-709.3	-572.8
1. General government	.	.	.	-21.7	-27.9	-48.2	-22.6	-17.2
2. Other sectors	.	.	.	-191.7	-259.1	-395.7	-686.8	-555.6
II. Capital and financial account [1)]	**506.4**	**670.9**	**-1542.7**	**-2133.6**	**1214.8**	**4167.5**	**8358.6**	**820.9**
A. Capital account	**.**	**4.6**	**-8.7**	**-52.1**	**2.4**	**2.2**	**3.4**	**426.6**
1. Capital transfer	.	4.6	-8.7	11.2	17.5	19.7	-0.7	98.2
2. Acquisition of non-financial assets	.	.	.	-63.4	-15.2	-17.5	4.1	328.3

Table A14 continued

Table A14 (continued)

B. Financial account	**506.4**	**666.3**	**-1534.0**	**-2081.5**	**1212.5**	**4165.3**	**8355.2**	**394.3**
1. Direct investment	132.4	196.4	642.6	6042.3	4573.2	6729.1	6767.1	3336.5
1.1 Abroad	.	-7.6	-1.1	-220.6	106.0	-491.3	-690.2	-116.1
1.2 In Ukraine	.	204.0	643.7	6262.9	4467.2	7220.3	7457.3	3452.6
2. Portfolio investment	.	3.1	149.3	2211.4	2856.1	4199.6	-874.7	-1241.7
2.1 Assets	.	-9.2	-4.3	.	-2.4	-21.2	8.2	-5.7
2.2 Liabilities	.	12.2	153.6	2211.4	2858.5	4220.8	-882.9	-1235.9
3. Other investment	-1759.0	839.7	-1895.3	-1973.2	-4623.4	-208.1	3200.8	-5753.8
3.1 Assets	.	-1202.7	-955.2	-6347.1	-12419.4	-16671.5	-15637.6	-8293.8
3.1.1 Trade credits	.	.	.	-174.9	-1049.8	-1055.6	-3916.9	-202.2
3.1.2 Loans	.	.	13.0	-160.4	-176.2	-446.8	-300.0	-248.8
3.1.3 Currency and deposits	.	.	-1672.5	-3148.3	-7619.8	-11230.9	-9753.3	-7199.8
3.1.4 Other assets	.	.	704.3	-2863.5	-3573.6	-3938.3	-1667.4	-643.1
3.2 Liabilities	.	2042.4	-940.1	4373.9	7796.0	16463.5	18838.4	2540.0
3.2.1 Trade credits	.	.	.	-510.1	978.9	2400.2	4006.4	1553.5
3.2.2 Loans	.	.	-1809.9	3682.5	7104.1	12775.6	12450.5	-1043.1
3.2.3 Currency and deposits	.	.	102.8	707.5	12.8	1228.6	2057.5	-883.2
3.2.4 Other liabilities	.	.	767.0	494.1	-299.7	59.1	323.9	2912.8
4. Financial derivatives	.	.	.	.	.	.	.	.
5. Reserve assets (increase: -)	-74.8	-372.9	-430.6	-8362.0	-1593.5	-6555.3	-738.0	4053.4
5.1 Gold, SDR, reserve pos. in IMF	.	13.0	-293.2	-8.0	-15.2	-16.1	-14.4	-18.6
5.2 Foreign exchange	.	-385.9	-137.4	-8354.0	-1578.3	-6539.3	-723.7	4072.0
III. Errors & omissions [1]	**-22.6**	**209.4**	**-59.5**	**103.5**	**74.1**	**-319.0**	**362.9**	**470.3**

1) Converted from USD to UAH to EUR at the average official exchange rate.

Source: wiiw Database incorporating national statistics.

Annex B

Table B1

Gross external debt position of Ukraine (USD million, month/day/year)

Data category	1/1/2007	4/1/2007	7/1/2007	10/1/2007	1/1/2008	4/1/2008	7/1/2008	10/1/2008	1/1/2009	4/1/2009	7/1/2009	10/1/2009	1/1/2010	4/1/2010
General government	**10924**	**10459**	**10825**	**10876**	**11884**	**12359**	**12111**	**11516**	**11959**	**11613**	**13281**	**15909**	**17806**	**17614**
Short-term	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*29*	*211*
Long-term	*10924*	*10459*	*10825*	*10876*	*11884*	*12359*	*12111*	*11516*	*11959*	*11613*	*13281*	*15909*	*17777*	*17403*
Monetary authorities	**880**	**745**	**665**	**540**	**462**	**329**	**290**	**135**	**4725**	**4545**	**6054**	**8225**	**6210**	**6014**
Short-term	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*	*0*
Long-term	*880*	*745*	*665*	*540*	*462*	*329*	*290*	*135*	*4725*	*4545*	*6054*	*8225*	*6210*	*6014*
Banks	**14089**	**17328**	**21205**	**25808**	**30949**	**33870**	**38450**	**42134**	**39471**	**37623**	**35489**	**33984**	**30788**	**29414**
Short-term	*6465*	*6691*	*8232*	*10267*	*11723*	*12059*	*12793*	*12884*	*9377*	*6640*	*6704*	*6468*	*4731*	*4731*
Long-term	*7624*	*10637*	*12973*	*15541*	*19226*	*21811*	*25657*	*29250*	*30094*	*30983*	*28785*	*27516*	*26057*	*24683*
Others sectors	**26676**	**29179**	**30492**	**33890**	**33581**	**37905**	**40290**	**43969**	**41255**	**41547**	**40959**	**41468**	**43441**	**44786**
Short-term	*8747*	*10123*	*9932*	*10241*	*8954*	*11830*	*12931*	*14496*	*10924*	*12497*	*13188*	*13561*	*14301*	*16141*
Long-term	*17929*	*19056*	*20560*	*23649*	*24627*	*26075*	*27359*	*29473*	*30331*	*29050*	*27771*	*27907*	*29140*	*28645*
Gross external debt	**54512**	**59761**	**65285**	**74223**	**79955**	**87802**	**94868**	**102439**	**101659**	**99524**	**100760**	**104795**	**103323**	**102834**

* The debt liability for SDR allocation was partly reclassified to the debt of the general government.

Source: National Bank of Ukraine.

Table B2

Investments in fixed capital by type of economic activity

	% to previous year	including											
		Agriculture, hunting and forestry	Industry	Construction activity	Wholesale and retail trade; transport facilities trade; repair services	Hotels and restaurants	Transport	Financial activity	Real estate activities, rent and service to users	Public administration	Education	Health care and public assistance	Communal, public and personal services
2006	119.0	133.9	115.3	115.5	134.9	83.1	107.2	112.5	130.7	119.6	114.7	124.3	138.3
2007	129.8	118.4	127.0	128.6	130.8	145.3	133.5	159.5	133.4	128.9	117.8	117.5	125.9
2008	97.4	142.3	94.7	106.0	109.0	96.1	82.4	88.2	94.2	94.1	110.3	113.0	102.5
2009	58.5	49.8	67.6	37.8	51.7	72.1	66.7	64.6	47.2	44.4	56.9	49.3	81.6

Source: National Bank of Ukraine.

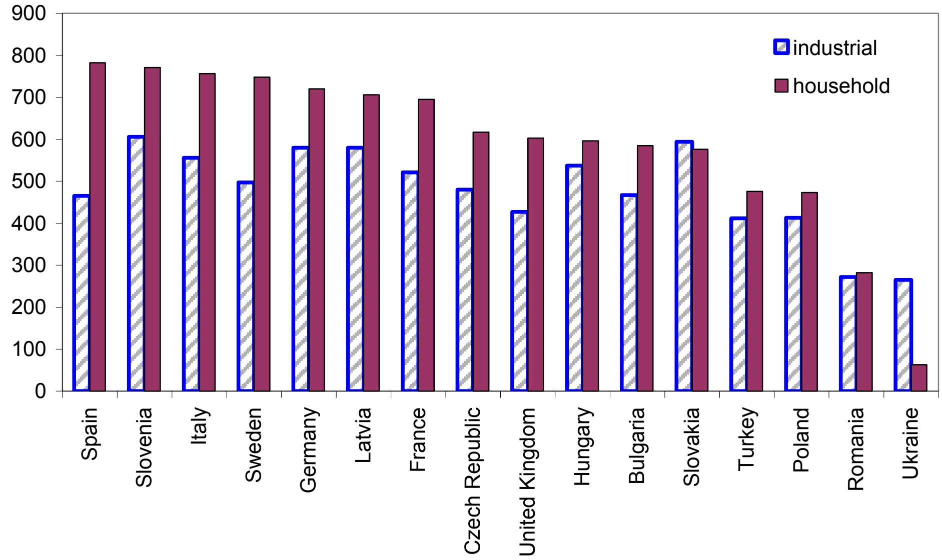
Annex C1

Energy pricing

Figure C1

End-consumer gas prices in Europe and Ukraine

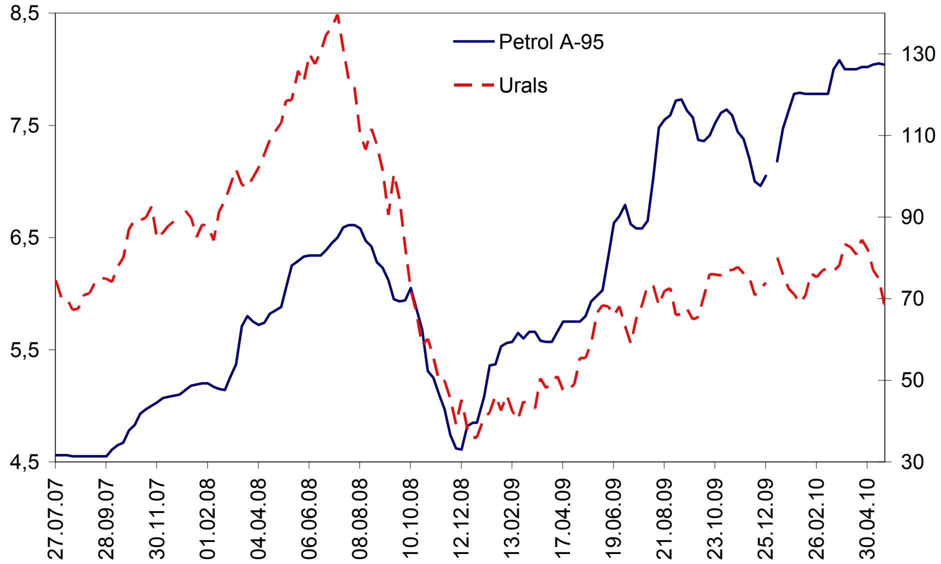
(2009 average, USD)



Source: Kyiv Post, 7 May 2010, p. 9 (Eurostat).

Figure C2

Prices of oil at international markets (USD/bbl, right scale) and prices of petrol at domestic markets (UAH/l)



Source: Derzhcomstst.

In deregulation processes, state monopolies, particularly the gas sector, should certainly be involved. Despite its visible ‘benefits’, i.e. low gas prices for households, it is too expensive for the economy in general (for example, due to ever growing deficits in public finances) (Figure C1). At the same time, oil markets are quite competitive, and prices for petrol in the domestic market are even lower than the prices in neighbouring countries (Figure C2).

Annex C2

People's expectations

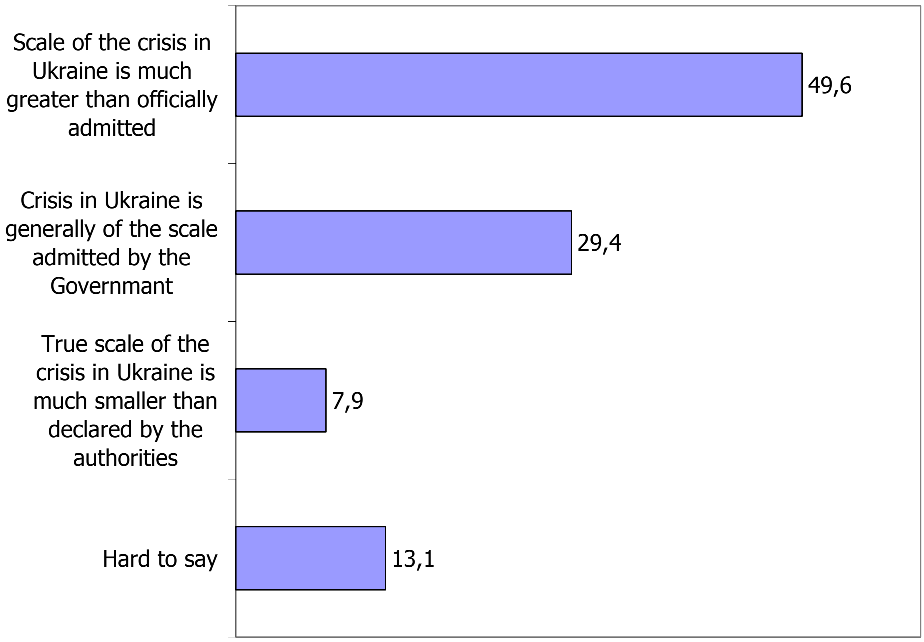
The effectiveness of the state policies is impossible to estimate without the analysis of the citizens' situation, understanding and expectations and their ideas for the ways of reversal of negative developments. Thus people's assessments of the economic situation were in the focus of the survey performed by the Razumkov Centre Sociological Service in April, 2010[60]. Several observations would be reasonable to mention.

Assessment of the economic situation. Ukrainian citizens assess the situation in the economy worse than in other sectors: the economic situation and wages – 1.9 points on a five-points scale. The state of the social security and pension systems is also described as poor – 2.2 points. Such assessments correlate with the opinion that the scale of the economic crisis is much greater than admitted by the authorities, shared by more than half of citizens (Figure A3). 72.8% of citizens believe that exactly the crisis brought about unemployment growth in Ukraine.

Figure C3

How would you assess the scale of the economic crisis in Ukraine

% of those polled



Source: Razumkov Centre.

[60] The poll was held on April 14-21, 2010. 2009 respondents aged above 18 years were polled in all regions of Ukraine, using a sample representative of the adult population by the key socio-demographic indicators. The poll sample was built as stratified, multistage, random, with respondent quotas at the last stage. The sample theoretical error (without the design effect) does not exceed 2.3% with the probability of 0.95.

Expectations of changes in the situation. Rather pessimistic assessments of the current situation noticeably contrast with unusual high social expectations for the nearest future – apparently, in connection with the change of the Power (new elected President and government). After new President V. Yanukovych came to power, a relative majority (44.5%) of citizens reports their hope for improvement of the economic situation in the country before the end of 2010; 38.1% hopes for higher wellbeing of their families; 36.1% − for higher wages; and 35.3% − for social security (Table A1).

Table C1

How will the situation in Ukraine change in the following sectors before the end of 2010?

% of those polled

	Will change for better	Will change for worse	Will not change	Hard to say
Economic situation in Ukraine	44.5	9.6	29.1	16.8
Respondent's family level of wellbeing	38.1	9.3	36.4	16.2
Wages	36.1	14.8	31.8	17.3
Situation in the country as a whole	38.2	12.0	32.4	17.4
Confidence of citizens in the future	34.0	12.8	34.9	18.3

Source: Razumkov Centre.

Employment policy. Ukrainians aspire to wide-ranging changes in wage and employment policies. Actually the efficiency of the implementation of these policies will depend on the confidence and trust of the people. What can we observe now?

Table C2

How effective would the following measures be to fight unemployment in Ukraine?

% of those polled

	Very effective	Rather effective	Ineffective / almost ineffective	Hard to say
Wage reform in the direction of its substantial rise (in times) with simultaneous easing of the tax pressure on the enterprise wage funds and toughening enterprise owners' responsibility for timely and full payment of wages to employees	43.0	35.1	4.5	17.4
Implementation of a large-scale national programme of public works for modern infrastructure creation in Ukraine within two or three years – from local roads to telecommunication networks; restoration of social infrastructure of rural areas; mass construction of social housing	37.0	37.7	6.3	19.0
Reorientation of state policy (budget, investment, tax, etc.) from predominant support for big capital (business) to promotion of small and medium business	30.2	40.2	7.4	22.2

Source: Razumkov Centre

Ukrainians describe as ‘very effective’ and ‘rather effective’ the method of fighting unemployment by wages reform, which will substantially raise the general level of wages, with simultaneous easing of the tax pressure on the enterprise wage funds and toughening enterprise owners’ responsibility for timely and full payment of wages to employees (43% and 35%, see Table A2). They mean therefore a substantial rise of wages as a means of fighting unemployment – since the **unemployed often reject employment proposals exactly because of the low wages offered**.

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