CASE - Center for Social and Economic Research

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Priorities of Economic and Institutional Reforms in Ukraine

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Key economic policy challenges

- Macroeconomic problems (slow GDP growth, inflation, fiscal imbalances, rapid credit growth, deteriorating trade and current account balance)
- Consequences of gas price shock
- Excessive and ineffective social programs
- Poor business/investment climate
- Frozen privatization & re-nationalization fears
- Need of deeper integration into the world/European economy (WTO accession, EU-Ukraine economic relations)
### Main Macroeconomic Indicators, 2000-2007:

<table>
<thead>
<tr>
<th>Item</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005(e)</th>
<th>2006(f)</th>
</tr>
</thead>
<tbody>
<tr>
<td>GDP growth rate %</td>
<td>5.9</td>
<td>9.2</td>
<td>5.2</td>
<td>9.6</td>
<td>12.1</td>
<td>2.6</td>
<td>2.4</td>
</tr>
<tr>
<td>CPI % eop</td>
<td>25.8</td>
<td>6.1</td>
<td>-0.6</td>
<td>8.2</td>
<td>12.3</td>
<td>10.3</td>
<td>13.0</td>
</tr>
<tr>
<td>Exchange rate UAH/USD eop.</td>
<td>5.4</td>
<td>5.3</td>
<td>5.33</td>
<td>5.33</td>
<td>5.31</td>
<td>5.05</td>
<td>5.05</td>
</tr>
<tr>
<td>Current account bln. USD</td>
<td>1.5</td>
<td>1.4</td>
<td>3.2</td>
<td>2.9</td>
<td>6.9</td>
<td>2.5</td>
<td>-8.7</td>
</tr>
<tr>
<td>Budget deficit % of GDP</td>
<td>0.6</td>
<td>0.3</td>
<td>-0.7</td>
<td>0.2</td>
<td>2.9</td>
<td>1.8</td>
<td>3.6</td>
</tr>
</tbody>
</table>

*Source: State Statistics Committee of Ukraine, NBU, CASE Ukraine estimates*
Premature post-communist welfare state

- Burden of social privileges inherited from the Soviet period and first years of independence
- Pension system: very low effective retirement age and overly generous system of disability pensions (⇒ high dependency ratio)
- Highly unfavorable demographic trends ⇒ further rapid deterioration of pension fund balances
- Eruption of social populism during and after the Orange revolution
- Negative fiscal and microeconomic consequences
Recent dynamics of social expenditures (2004-2005) in % of GDP

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<tbody>
<tr>
<td>GG expenditure</td>
<td>36.8</td>
<td>39.4</td>
<td>42.7</td>
<td>5.9</td>
</tr>
<tr>
<td>transfers total</td>
<td>14.8</td>
<td>16.7</td>
<td>21</td>
<td>6.2</td>
</tr>
<tr>
<td>transfers to PF</td>
<td>9.1</td>
<td>11.3</td>
<td>14.9</td>
<td>5.8</td>
</tr>
</tbody>
</table>

Source: IMF Country Report No. 05/415 Table 3, p.39
As a result, Ukraine's revenue-GDP ratio is now quite high.

Source: IMF Country Report No. 05/415 Figure 3, p.12
...and the pension spending-GDP ratio is one of the highest in the world.

Source: IMF Country Report No. 05/415 Figure 3, p.12
Key determinants of unfavorable business climate

- Barriers of entry (registration and licensing regime)
- Legal system, its stability and transparency
- Law and contract enforcement, protection of property rights
- Quality of state institutions, including civil service and judiciary, role of law enforcement agencies
- Tax system and administration
- Underdevelopment of financial sector and low quality of financial services
- Underdevelopment and monopolization of infrastructure
Privatization/ re-nationalization

• Slow/ moderate speed of privatization in the past; non-transparent rules of large privatization
• Post-revolutionary reaction: a lot of ownership / re-nationalization claims resulting in deterioration of investment climate
• Krivorozhstal tender gave chance to restart a large privatization on a transparent basis but also created temptation to continue re-nationalization claims
• Many enterprises still state-owned
Trade and economic integration:

• the forthcoming WTO accession (it could happen faster);

• necessity to plan the next steps (EU-Ukraine trade liberalization) in advance on both sides;

• limited effects of classical trade liberalization ⇒ need of “deep FTA” or “FTA Plus”

• adjust FTA with CIS countries to WTO rules