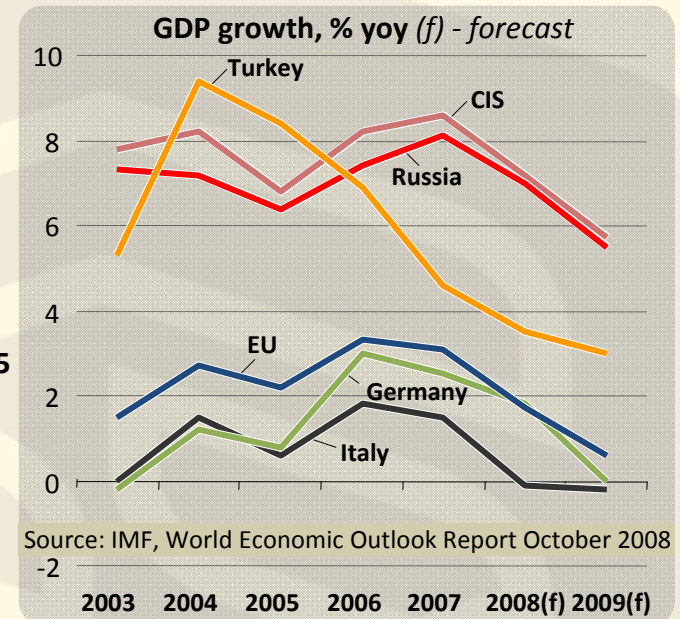
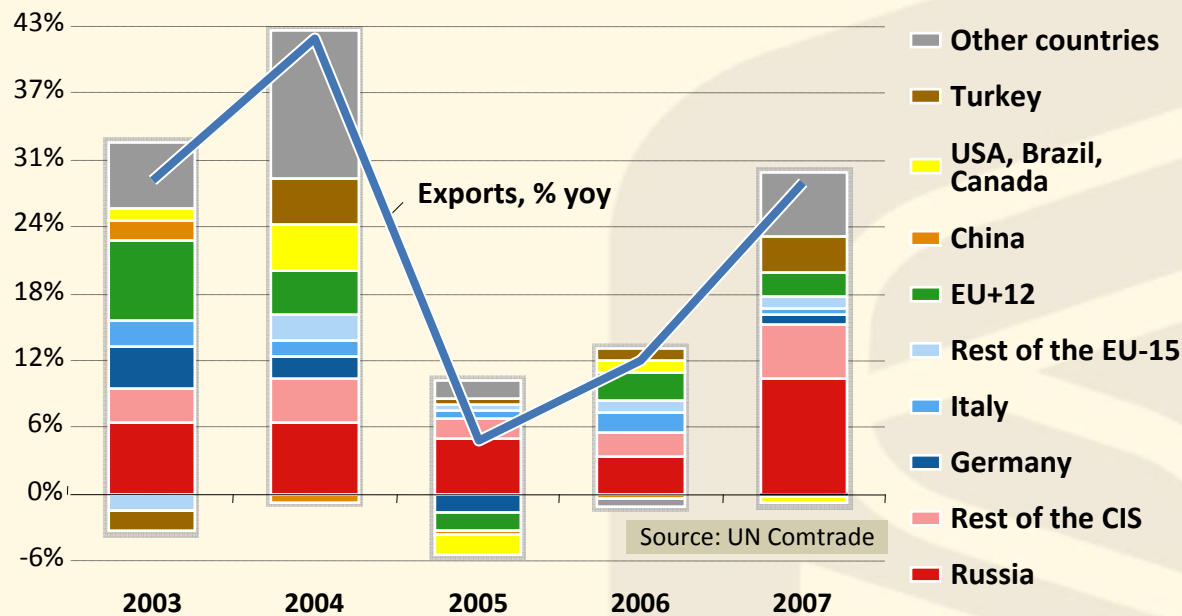


Ukraine

in the Global Economy

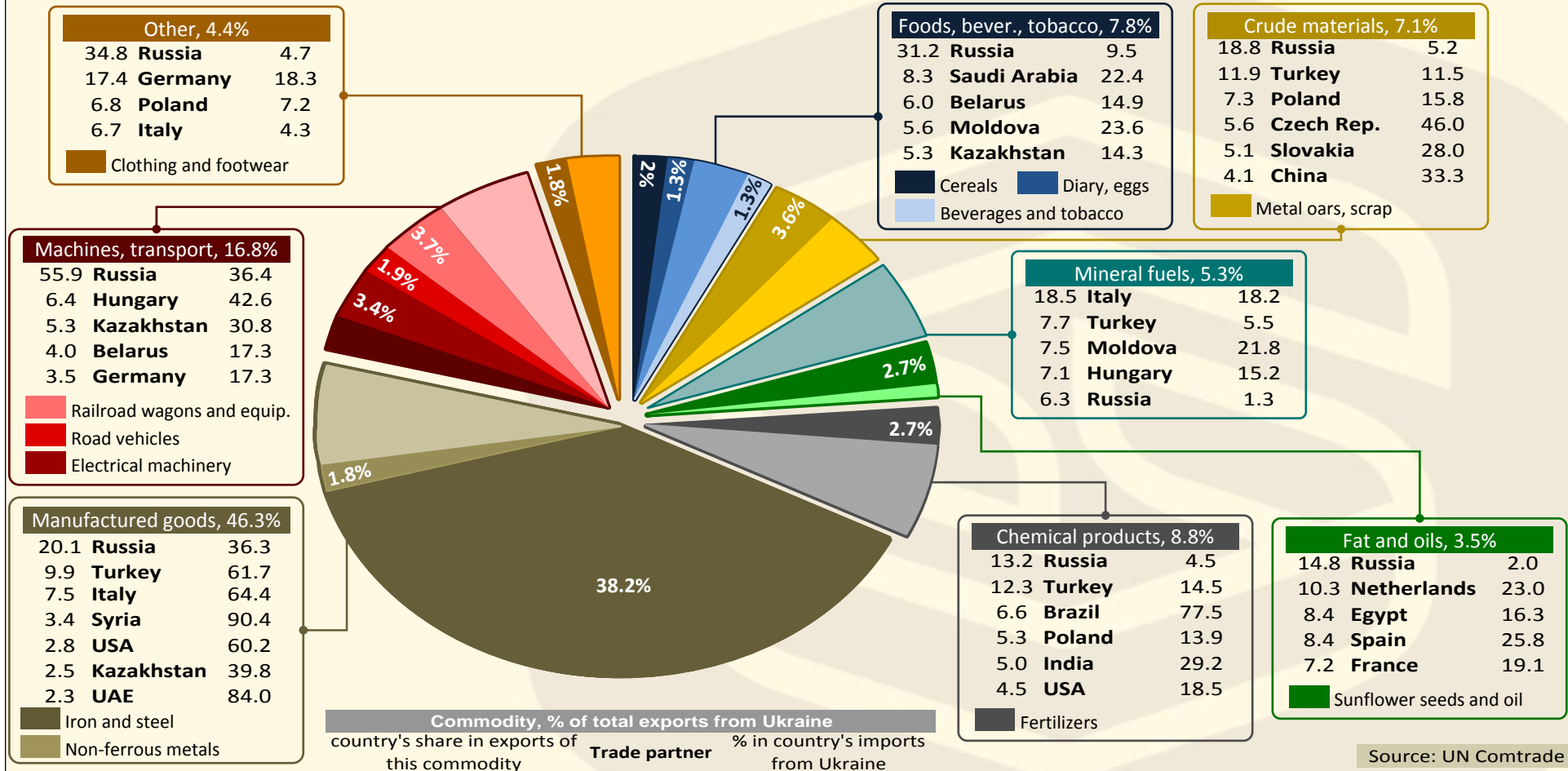
Dr. Edilberto Segura
Partner and Chief Economist
SigmaBleyzer, The Bleyzer Foundation
November 2008

Ukrainian Exports – Contributions by Key Trading Partners



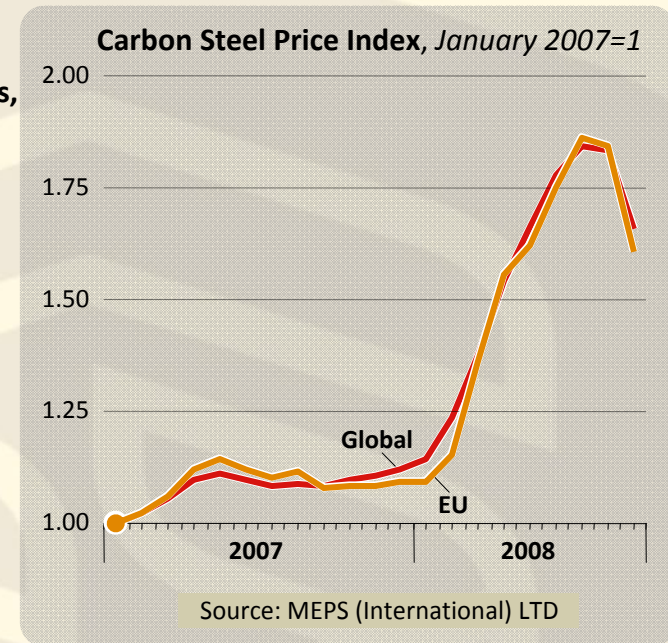
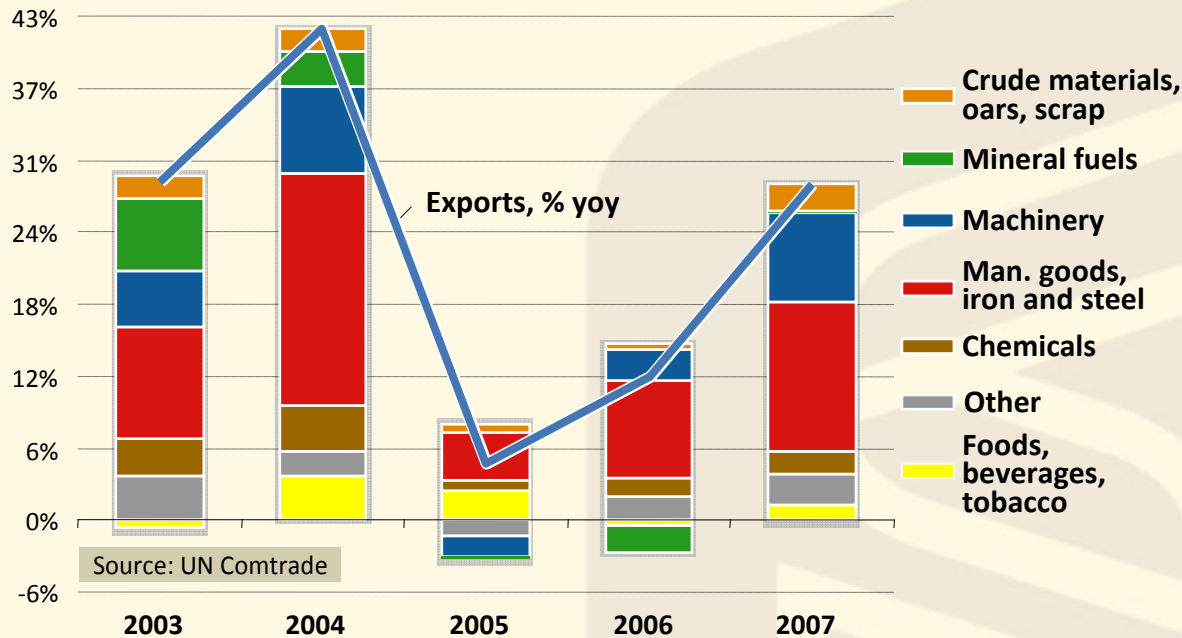
- ▶▶ Ukrainian exports are becoming less oriented towards Europe and more dependent on Russia and the CIS countries.
- ▶▶ While in 2003 Europe contributed 42% of Ukrainian export growth, by 2007 its contribution was reduced to 15%. On the other hand the contribution of the CIS countries to Ukrainian export growth increased from 19% in 2003 to 55% in 2007.
- ▶▶ In 2005-2007, almost half of the growth of exports was generated by only two countries – Russia and Turkey.
- ▶▶ The export outlook for 2009 remains weak due to economic slowdown in key export markets.

Exports, by Commodities and Key Trading Partners (2007)



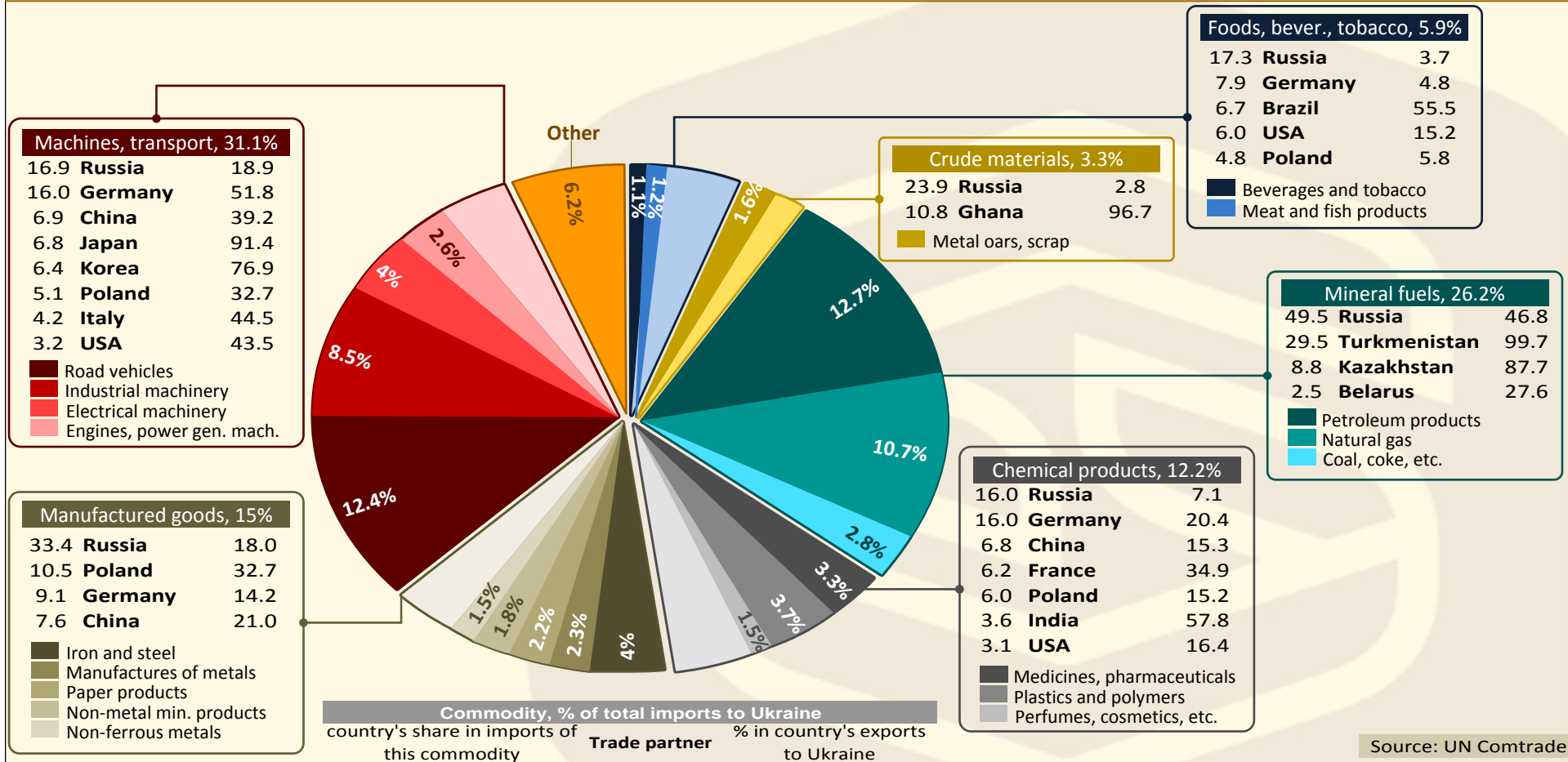
- » Iron & steel products represent 38% of exports, followed by machinery and transport with 17%.
- » Each of these two product groups account for 36% of Russian imports from Ukraine.

Ukrainian Exports – Contributions by Commodities



- ▶▶ Ukrainian exports have fluctuated widely in the past, due mainly to fluctuations in external demand and prices for iron and steel. Steel prices are likely to decline in future years.
- ▶▶ Exports of machinery and transportation equipment have also fluctuated widely.
- ▶▶ These products therefore are quite vulnerable to a slowdown of world's industrial production.
- ▶▶ Agriculture may potentially support export performance. However, poor infrastructure, unsustainable crop yields and undeveloped market for land are major bottlenecks.
- ▶▶ Export diversification by products and country of destination is a key priority for Ukraine.

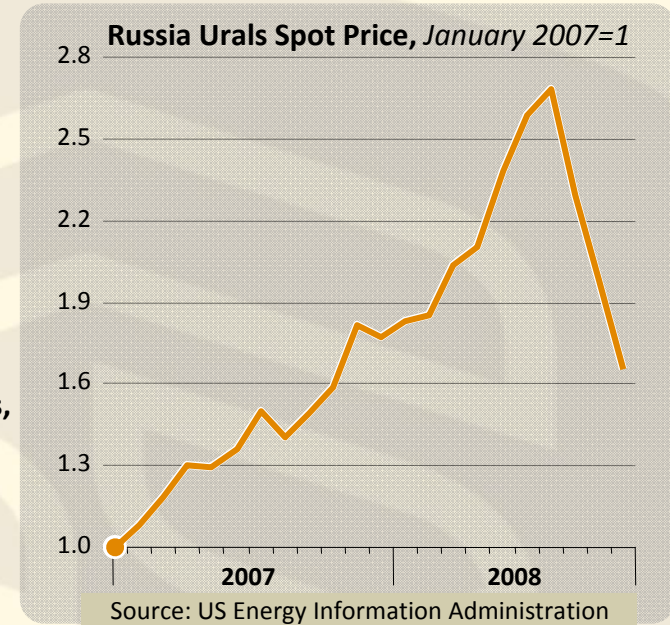
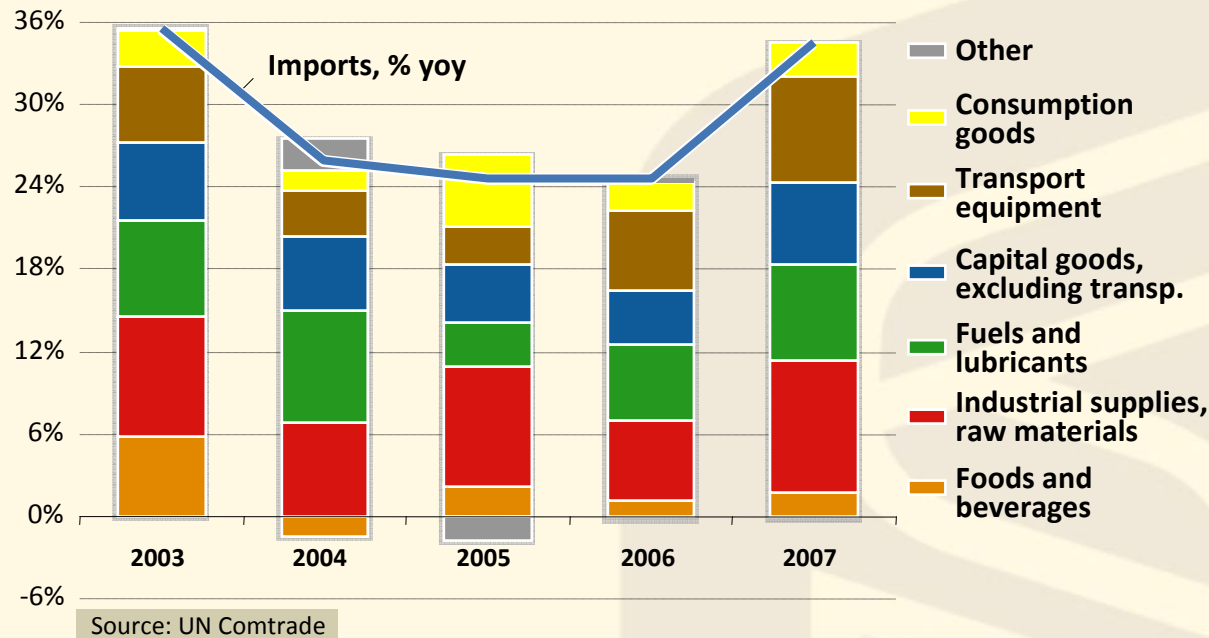
Imports, by Commodities and Key Trading Partners (2007)



Source: UN Comtrade

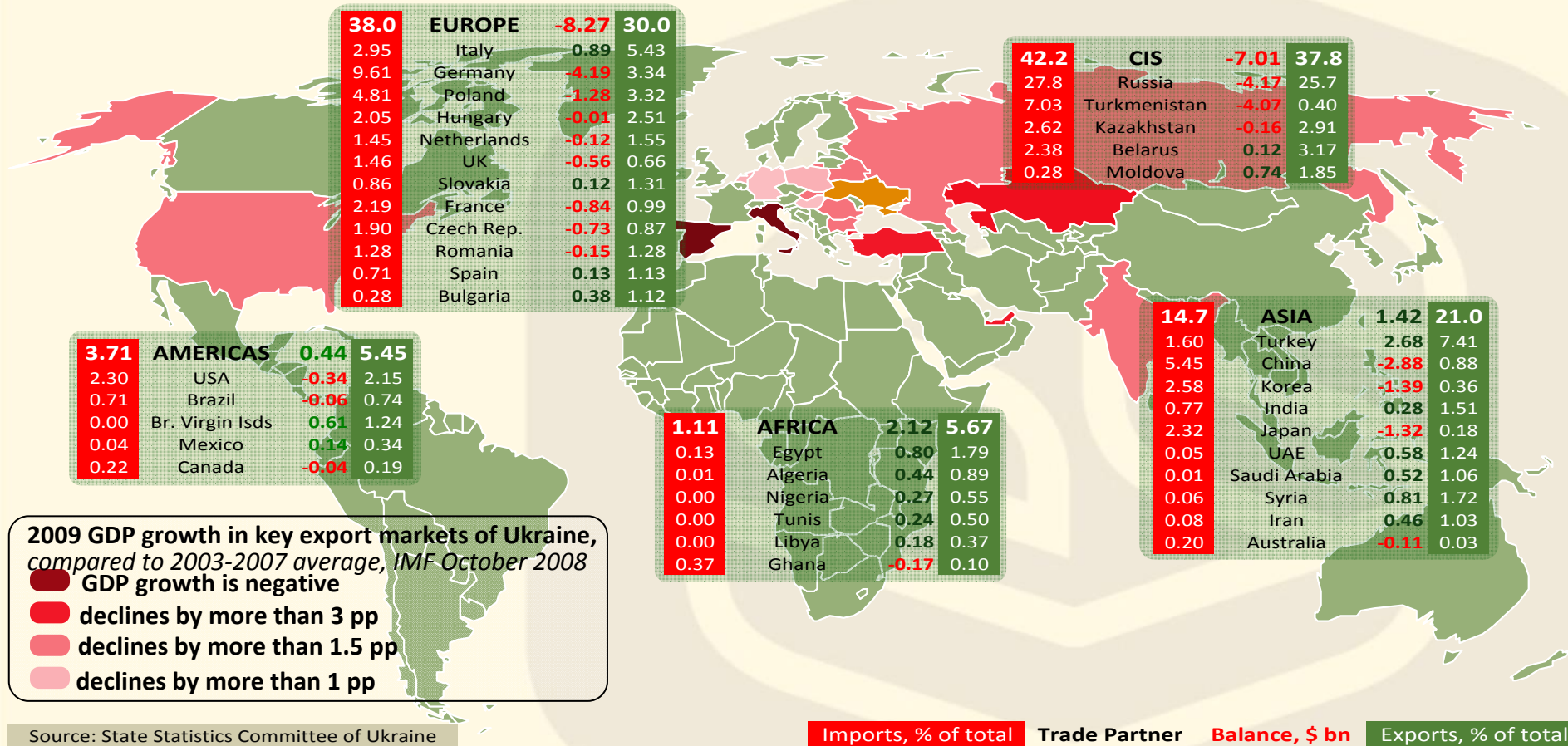
- ▶▶ About 60% of Ukrainian imports are relatively “inflexible” consisting of energy, raw materials, chemicals and equipment.
- ▶▶ Russia remains the largest supplier of these products to Ukraine. Europe provides principally higher value products

Ukrainian Imports – Contributions by Commodities



- ▶▶ Imports have accelerated rapidly in the past due to strong investment and consumer demand.
- ▶▶ Easy access to credit allowed the purchases of imported consumer durables and passenger vehicles.
- ▶▶ High per-capita energy consumption and excessive reliance on imported energy continue to exert pressure on external balances of Ukraine.
- ▶▶ **Energy Savings is a priority on the import side.**
- ▶▶ Imports will decelerate in 2009 due to: (1) falling energy prices, (2) devaluation of hryvna, (3) slower growth of consumer incomes, (4) decelerating industry and (5) tight access to banks' credit by both households and the corporate sector.

Foreign trade of Ukraine by Key Trading Partners (2007)



- ▶▶ Ukraine runs large trade deficits with its two main trading partners, CIS and Europe.
- ▶▶ Ukraine long-term trade sustainability will depend on its capacity to diversify exports and reduce energy consumption.

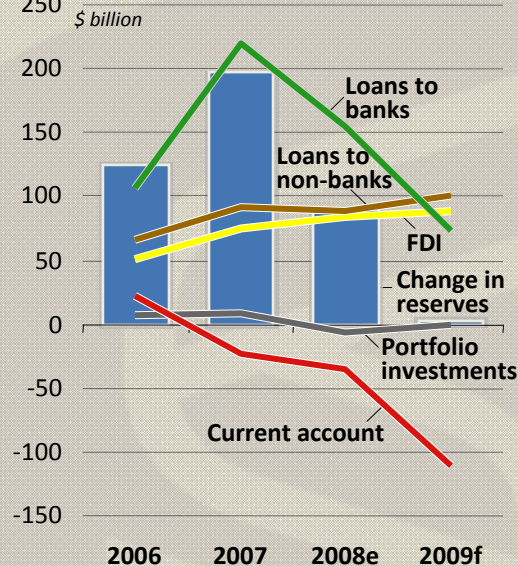
Ukraine – Cross Border Capital Flows

Ukraine – Balance of Payments

\$ billion	2006	2007	H1	
			2007	2008
Current account	-1.6	-5.9	-1.7	-6.8
External Financing	3.9	15.8	5.9	8.6
Direct Investment	5.7	9.2	3.6	5.5
Portfolio investment	3.6	5.8	3.3	0.4
Loans to Banks	2.2	6.8	2.2	4.0
Loans to Non-banks	3.6	5.8	1.3	2.7
Other	-11.2	-11.8	-4.6	-4.0
Change in Reserves	2.4	9.4	3.4	2.1

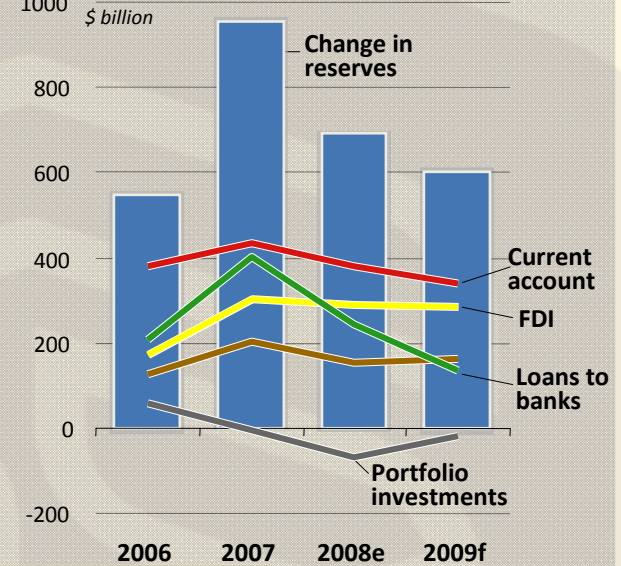
Source: National Bank of Ukraine

Emerging Europe - External Financing



Source: Institute of International Finance

Emerging Markets - External Financing

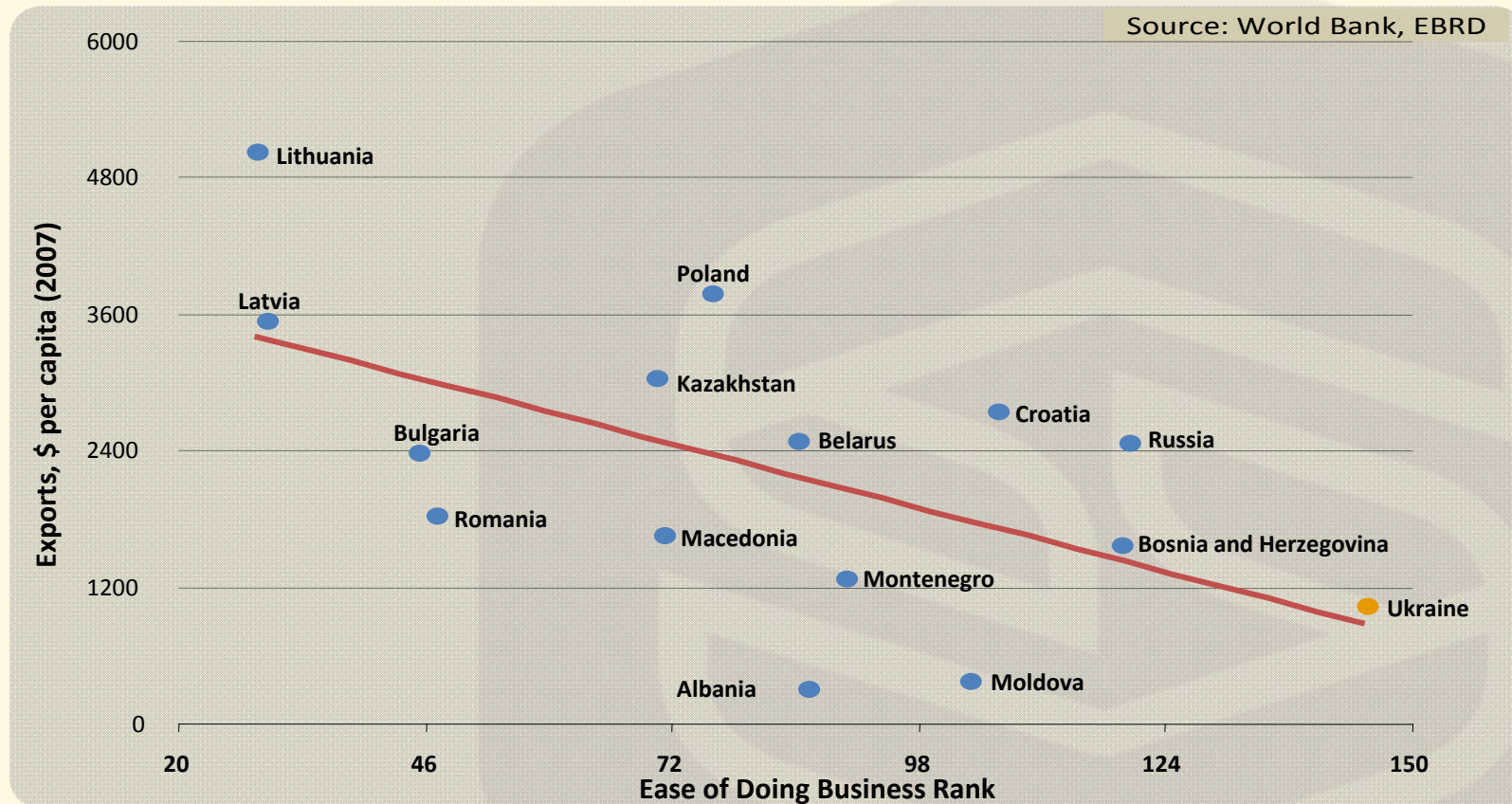


- ▶ Over the last several years, robust inflows of private debt and equity capital prompted accumulation of forex reserves and supported strong currencies in Ukraine and other of the emerging markets.
- ▶ However, external financing needs of the emerging markets in general and Ukraine in particular are expected to increase in 2009. The Institute of International Finance estimates that emerging economies have to repay around \$90 billion in the last quarter of 2008, and \$250 billion in 2009.
- ▶ With the global credit crisis, lack of financing will undermine FX stability and deplete FX reserves.
- ▶ **Re-establishing growth and exports will require a program to deal with the effects on Ukraine of the global credit crisis and major improvements in the country's business environment.**

Ukraine – Responding to the Financial Crisis

- ▶▶ To achieve durable and meaningful results of economic stabilization measures the government has to implement a broad reform program:
- ▶▶ Although, a recent decision of the IMF to consider lending Ukraine \$16.5 billion may mitigate the impact of the global financial meltdown, Ukraine still faces elevated risks to financial stability.
 1. As in many other countries, the IMF Program is likely to include measures to reduce external imbalances by (i) maintaining a minimum level of reserves which will lead to a more flexible foreign exchange rate, (ii) running a balanced fiscal budget and (iii) controlling money and credit growth to eliminate unsustainable consumption behavior. It would also include a program to recapitalize the banking sector. This program should be built on the successful experience of the past international banks' rehabilitation programs.
 2. But this IMF program, though necessary is not sufficient to revive growth.
 3. **Immediate stabilization measures must be supported with structural reforms that would enable economic growth and promote Ukraine's international competitiveness.**

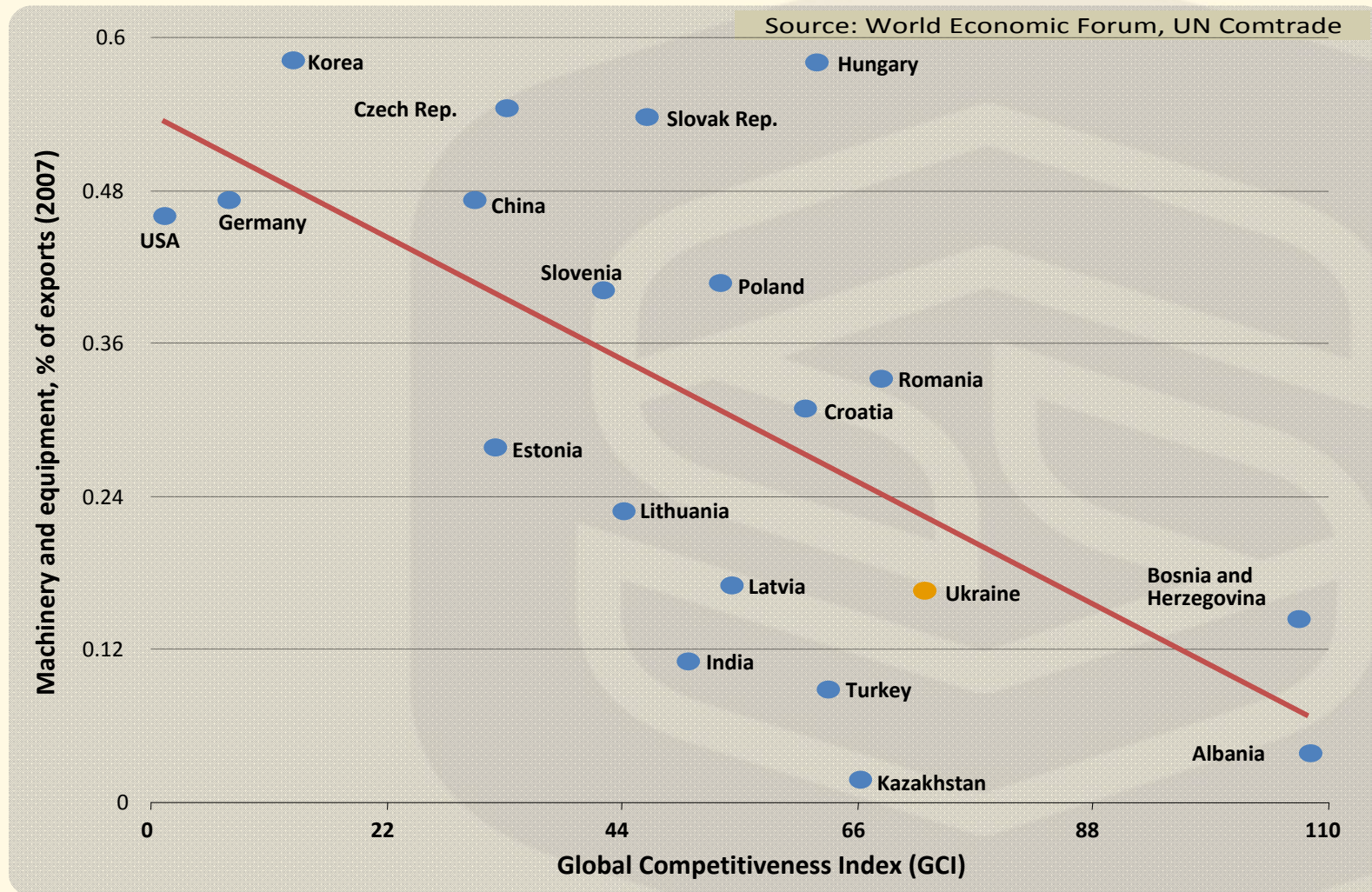
Exports and Ease of Doing Business



▶▶ **Countries with better business climate tend to have higher exports per capita:**

- ▶▶ More open business environment promotes productivity growth through competition;
- ▶▶ Lower regulatory and taxation burden improves international competitiveness of local firms.

Ukraine – International Competitiveness



►► More competitive countries tend to export higher quality products.

Ukraine – IFC/WB’s Ease of Doing Business

UKRAINE			Ukraine	Region	OECD
Ease of Doing Business	145				
Starting a Business	128	Procedures (number)	10	7.7	5.8
Construction Permits	179	Duration (days)	27	22.6	13.4
Employing Workers	100	Cost (% GNI per capita)	5.5	8.6	4.9
Registering Property	140				
Getting Credit	28	Procedures (number)	30	23.6	15.4
Protecting Investors	142	Duration (days)	471	257.2	161.5
Paying Taxes	180	Cost (% of income per capita)	1901.7	680.4	56.7
Trading Across Borders	131				
Enforcing Contracts	49	Payments (number)	99	47.2	13.4
Closing a Business	143	Time (hours)	848	366.8	210.5
		Profit tax (%)	11.5	11.8	17.5
		Labor tax and contributions (%)	43.3	26.1	24.4
		Other taxes (%)	3.7	10.2	3.4
		Total tax rate (% profit)	58.4	48.1	45.3

Source: World Bank

- ▶▶ The quality of the business environment in Ukraine remains unsatisfactory – Ukraine is ranked 145th out of 180 countries in terms of Ease of Doing Business by IFC/WB.
- ▶▶ Domestic and foreign business still face an onerous burden of excessive and costly regulatory, licensing and taxation procedures.
- ▶▶ Weak investment climate continues to hold back the development of the Ukrainian private sector, which restraints the growth of investments, employment, output and exports.

Ukraine – International Competitiveness

UKRAINE		Major Competitive Disadvantages
GCI 2008–2009	72	
Basic requirements	86	
1st pillar: Institutions	115	Property rights
2nd pillar: Infrastructure	79	Intellectual property protection
3rd pillar: Macroeconomic stability	91	Judicial independence
4th pillar: Health and primary education	60	Efficiency of legal framework
Efficiency enhancers	58	Transparency of government policymaking
5th pillar: Higher education and training	43	Reliability of police services
6th pillar: Goods market efficiency	103	Ethical behavior of firms
7th pillar: Labor market efficiency	54	Strength of auditing and reporting standards
8th pillar: Financial market sophistication	85	Protection of minority shareholders' interests
9th pillar: Technological readiness	65	
10th pillar: Market size	31	Intensity of local competition
Innovation and sophistication factors	66	Extent and effect of taxation
11th pillar: Business sophistication	80	Total tax rate
12th pillar: Innovation	52	Agricultural policy costs
		Prevalence of trade barriers
		Prevalence of foreign ownership
		Business impact of rules on FDI
		Burden of customs procedures

Source: World Economic Forum

- ▶▶ Poor institutions, weak judiciary and corruption are major competitive disadvantages of Ukraine.
- ▶▶ As a result, country's foreign trade is dominated by relatively low value added products, which fail to deliver sustainable performance of exports.
- ▶▶ Notwithstanding large potential for productivity and economic growth, Ukraine's competitive disadvantages are systemic and can only be remedied with a strong and broad reform program.

How to Improve International Competitiveness

1. Maintain macroeconomic stability.
2. Improve public governance.
3. Support stable and predictable legal environment.
4. Advance business liberalization and deregulation.
5. Strengthen corporate governance.
6. Liberalize foreign trade and international capital movements.
7. Reform financial sector
8. Put an end to corruption.
9. Eliminate political uncertainties and promote country's image.