

UKRAINE: Proposed Reform Agenda

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UKRAINE: Economic Highlights

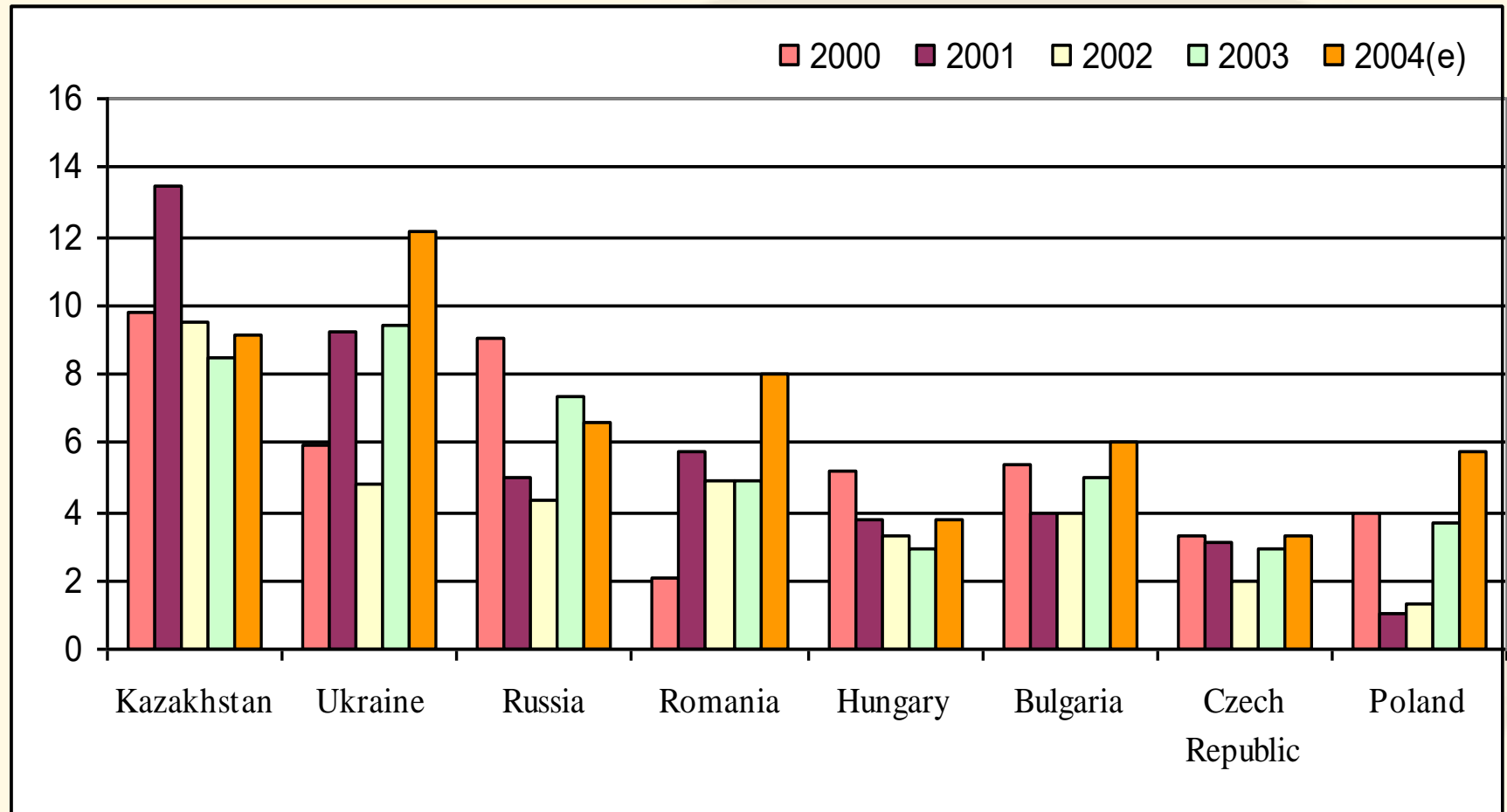
- Few non-oil producing countries in the world can show the following combination of economic achievements over the last three to five years:
 - High average rate of economic growth of about 9% pa
 - Low average annual inflation rate of less than 7% pa
 - Low average fiscal deficit of about 1% of GDP
 - High current account surplus of more than 8% of GDP
 - Fairly stable foreign exchange rate
 - High international reserves (currently \$9.5 billion) in excess of three months of imports
 - Very low ratio of external debt to GDP of 23%

Economic Performance

	2000	2001	2002	2003	2004
Real GDP Growth	6.0%	9.2%	4.8%	9.4%	12.1%
Fiscal Balance (% GDP)	0.6%	-0.3%	0.7%	-0.5%	-3.3%
Inflation	25.8%	6.1%	-0.6%	8.2%	12.3%
Exchange Rate (Hr/\$)	5.4	5.4	5.3	5.3	5.3
Current Account (\$bn)	1.2	1.4	3.2	2.9	7.0
(as % of GDP)	3.7%	3.7%	7.7%	6.3%	11.0%
International Reserves (\$bn)	1.6	1.7	4.4	6.9	9.5
Foreign Debt/GDP	32%	27%	24%	22%	23%

Source: National Bank of Ukraine, State Statistics Committee

Real GDP Growth (%) in Ukraine Compares well with other Transition Economies



Source: WIIW, State Statistics Committee

Ukraine's Economic Success is not an accident

- Since 1999, when Mr. Yushchenko was Prime Minister, a number of crucial reforms were implemented, including:
 - Tightening of financial budget discipline, including elimination of arrears
 - Restricting barter or non-monetary transactions in the energy sector
 - Accelerating privatization
 - Liberalizing monetary and exchange rate policy
 - Progressing with land privatization by allowing transfer of agricultural land to individual farmers
 - Initiating administrative reform
 - Improving the banking system
- External factors also favorable
 - Ukraine's exports were helped by the hryvnia devaluation of 1998
 - Increased demand and prices for Ukrainian goods, particularly metal products

Possible Risks to Future Economic Growth

- Inflationary pressures are emerging in 2005 as a result of:
 - Substantial fiscal loosening approved in 2004 (as a result of the increase in pensions approved in September 2004)
 - Spending of privatization receipts for current, non-investment purposes
- Lack of exchange rate flexibility
- Rapid credit expansion and low quality of credit portfolio
- External shocks (Ukrainian growth is, to a great extent, export-led)

If tight fiscal and monetary policies are not implemented by the new government, inflation may reach double digit levels in 2005, discouraging investments and growth

Policy Actions for Ukraine

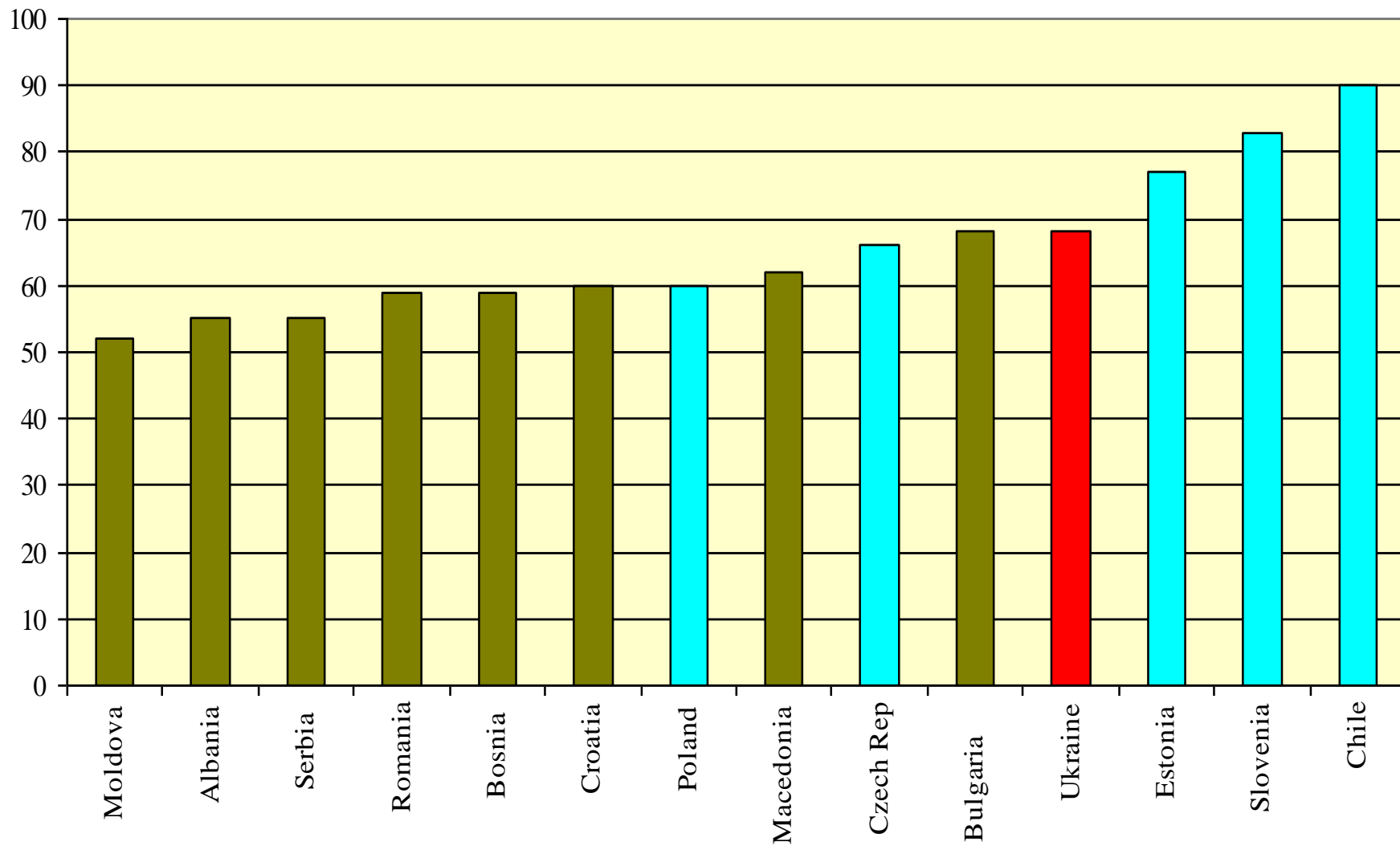
- President Yushchenko is aware that to ensure sustainable economic growth over the medium term, sound monetary and fiscal policies must be maintained and must be complemented by policies facilitating sustainable investment activity or “investment drivers”
 - (1) Macroeconomic stability
 - (2) Business liberalization and de-regulation policies
 - (3) Stable and predictable legal environment
 - (4) Corporate and public governance
 - (5) Foreign trade liberalization and international capital movements
 - (6) Healthy financial sector
 - (7) Eliminating Corruption
 - (8) Reducing Political uncertainties
 - (9) Country promotion and image

Mr. Yushchenko's Presidency

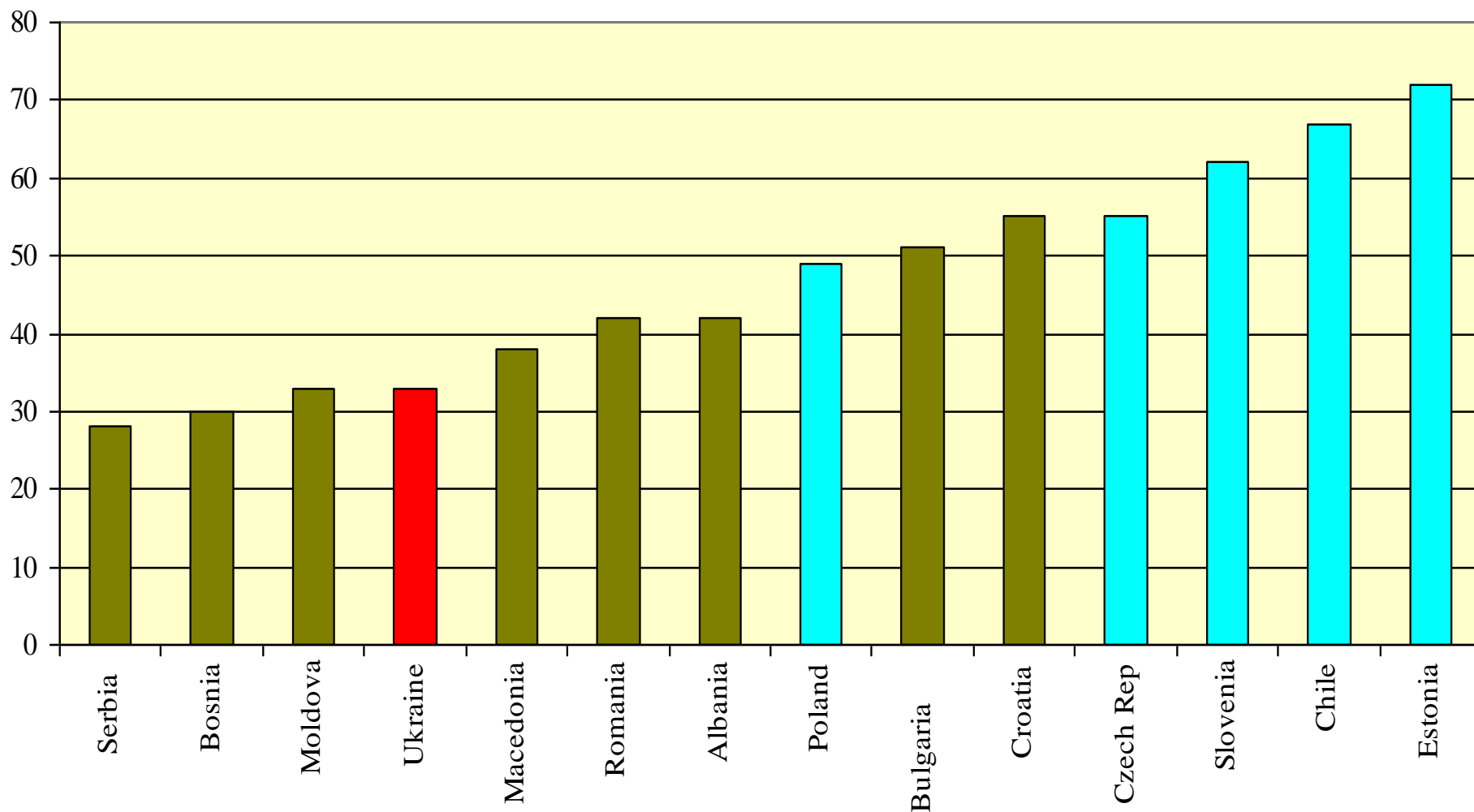
- The following reforms and changes are being taken by Mr. Yushchenko:
 - On March 25, 2005, an amended Fiscal Budget for 2005 was approved by Rada, eliminating most tax privileges and exemptions, introducing moratorium on the creation of new free economic zones, and increasing excise taxes.
 - De-regulation and virtual elimination of the use of government institutions to intimidate the private sector
 - Friendlier approach by Government to small and medium size businesses
 - Reducing the size of the shadow economy
 - Fairer government and legal systems
 - Stronger working relationship between Ukraine and the West
 - Increased interest and support from international institutions
- Yushchenko's track record as both Chairman of the National Bank and Prime Minister set the basis for Ukraine's recent economic performance, and bode well for Ukraine's future

- How Ukraine compares in terms of its business environment with other countries in the region?

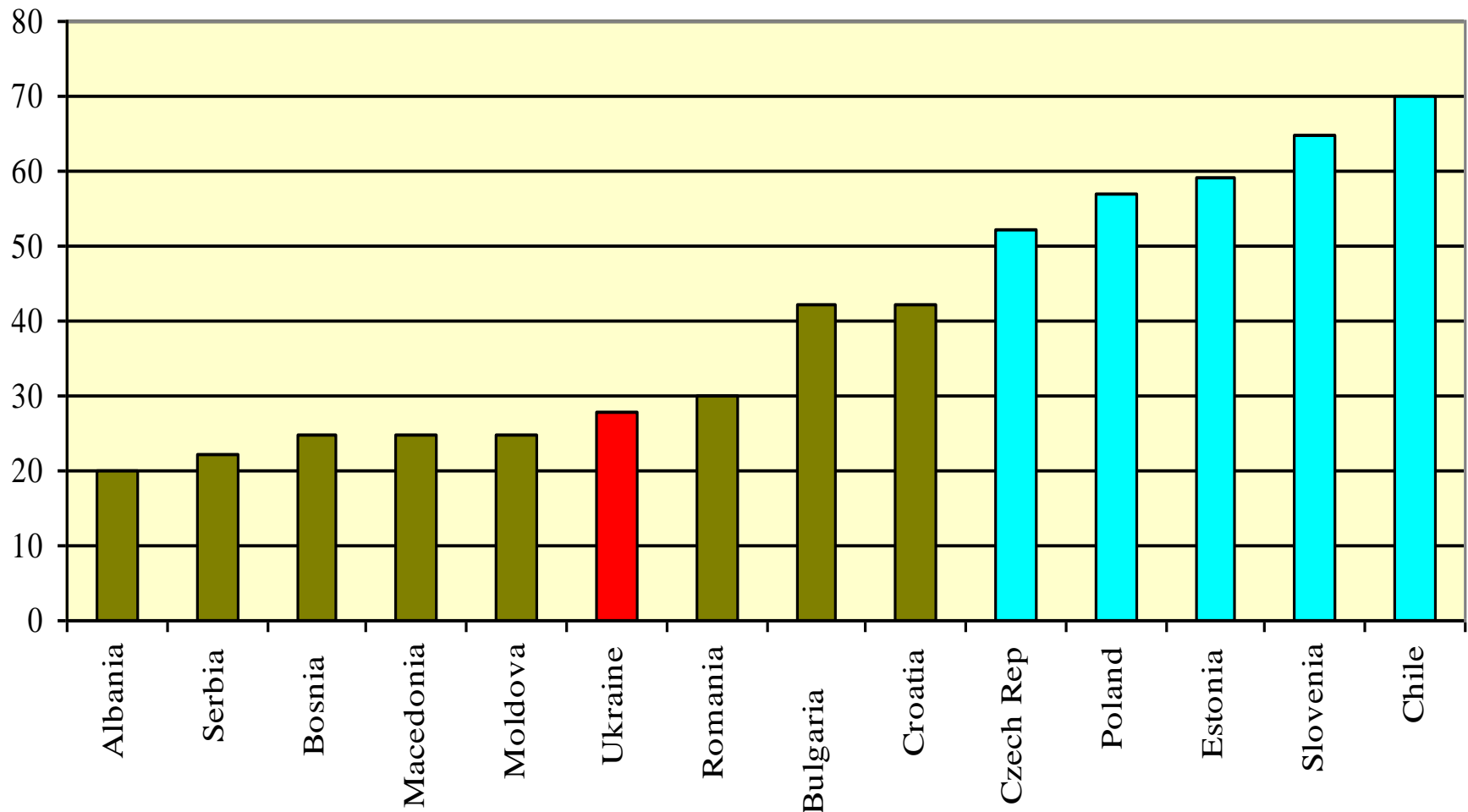
Driver #1: Macroeconomic Stability



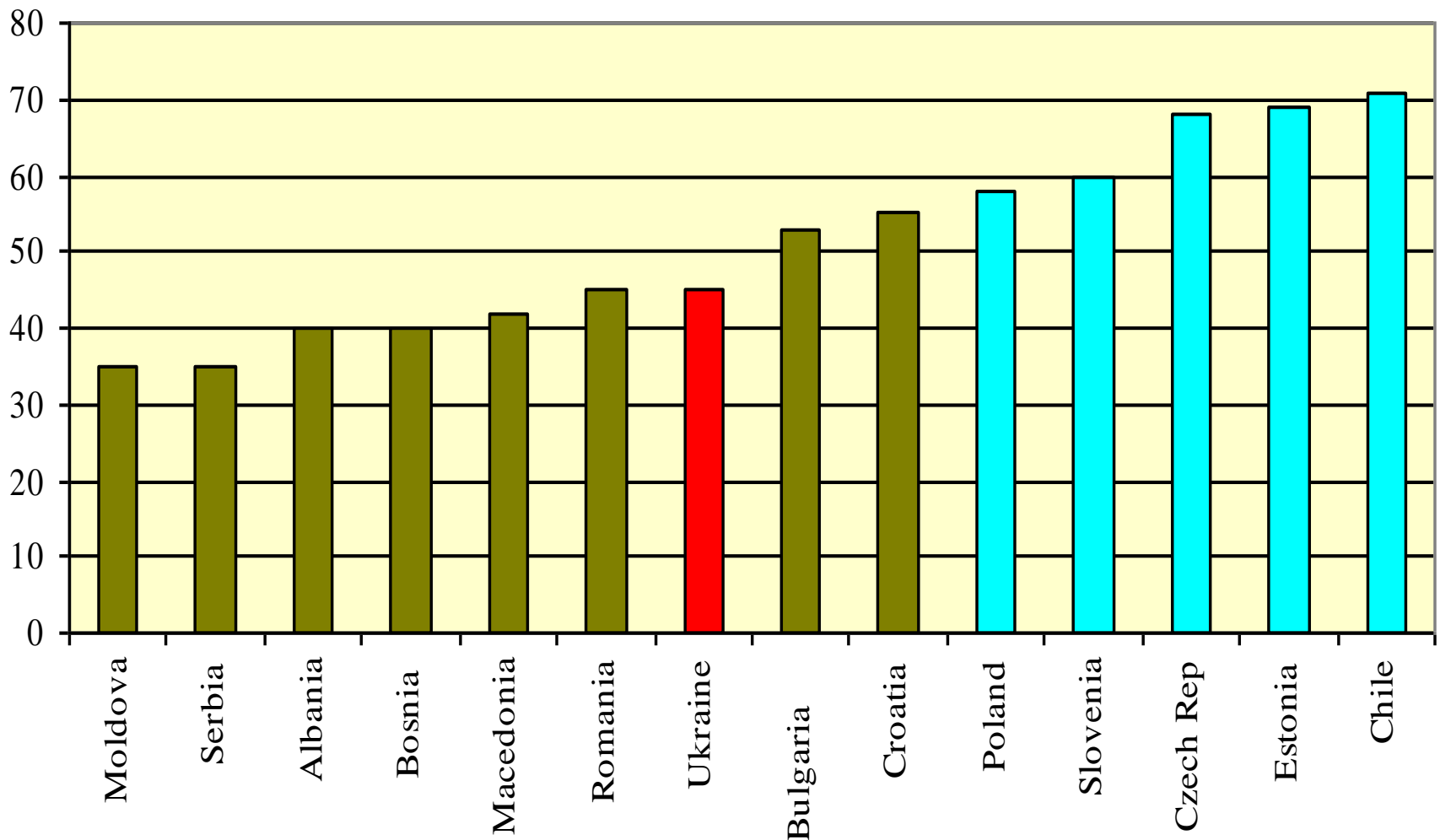
Driver #2: Liberalization and Deregulation of Business Activity



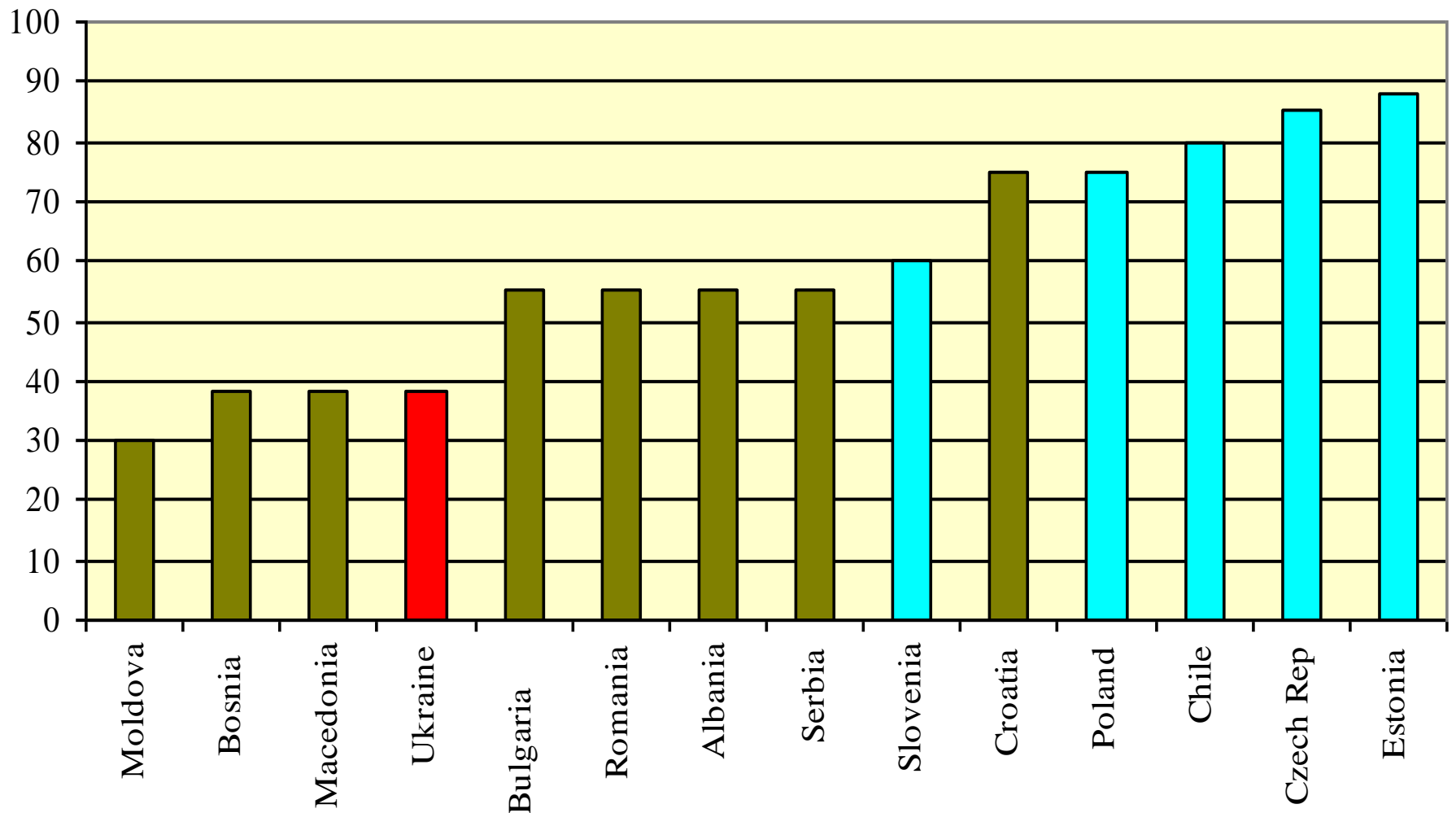
Driver #3: Stability and Predictability of Legal Environment



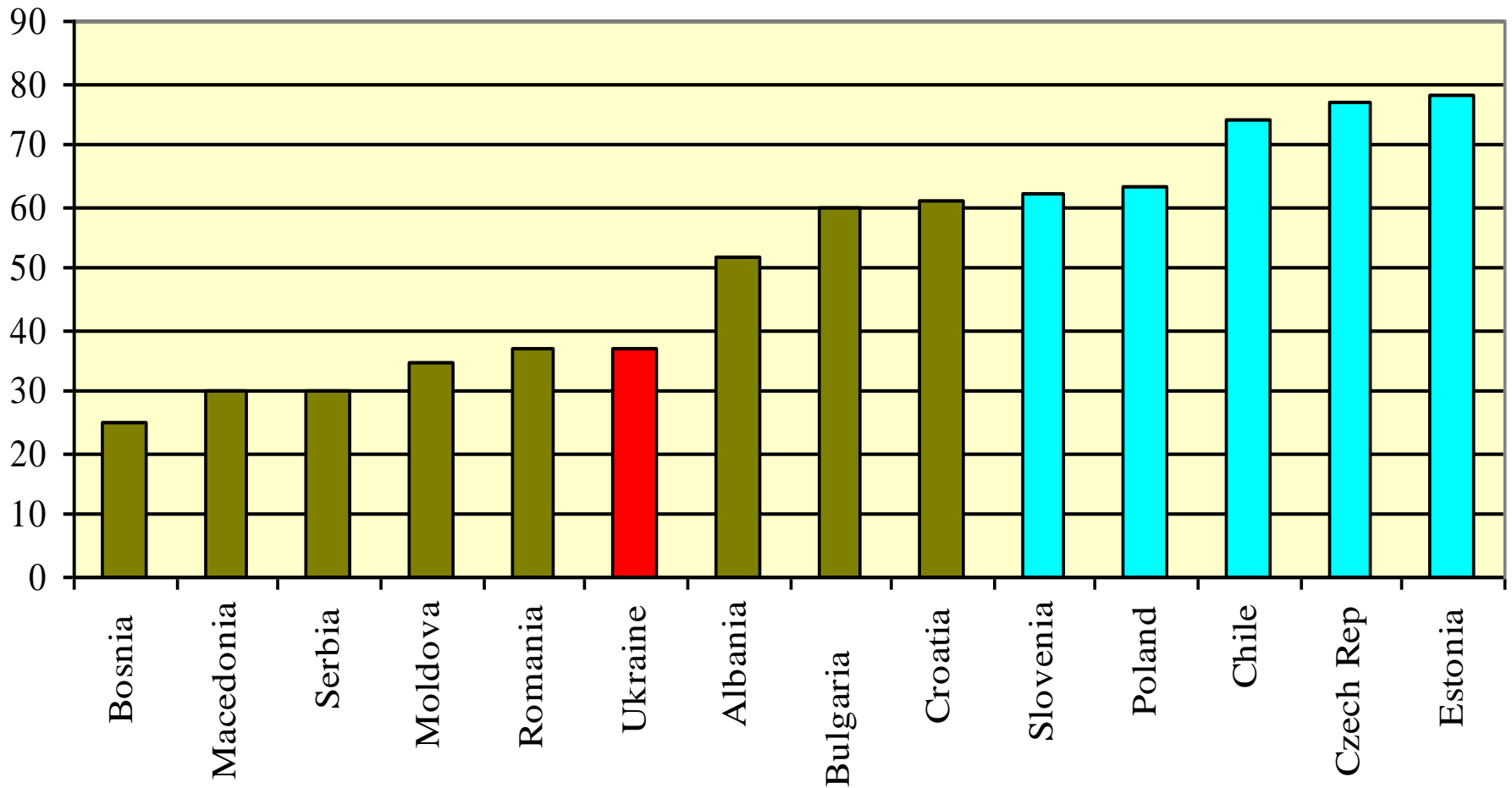
Driver #4: Corporate and Public Governance



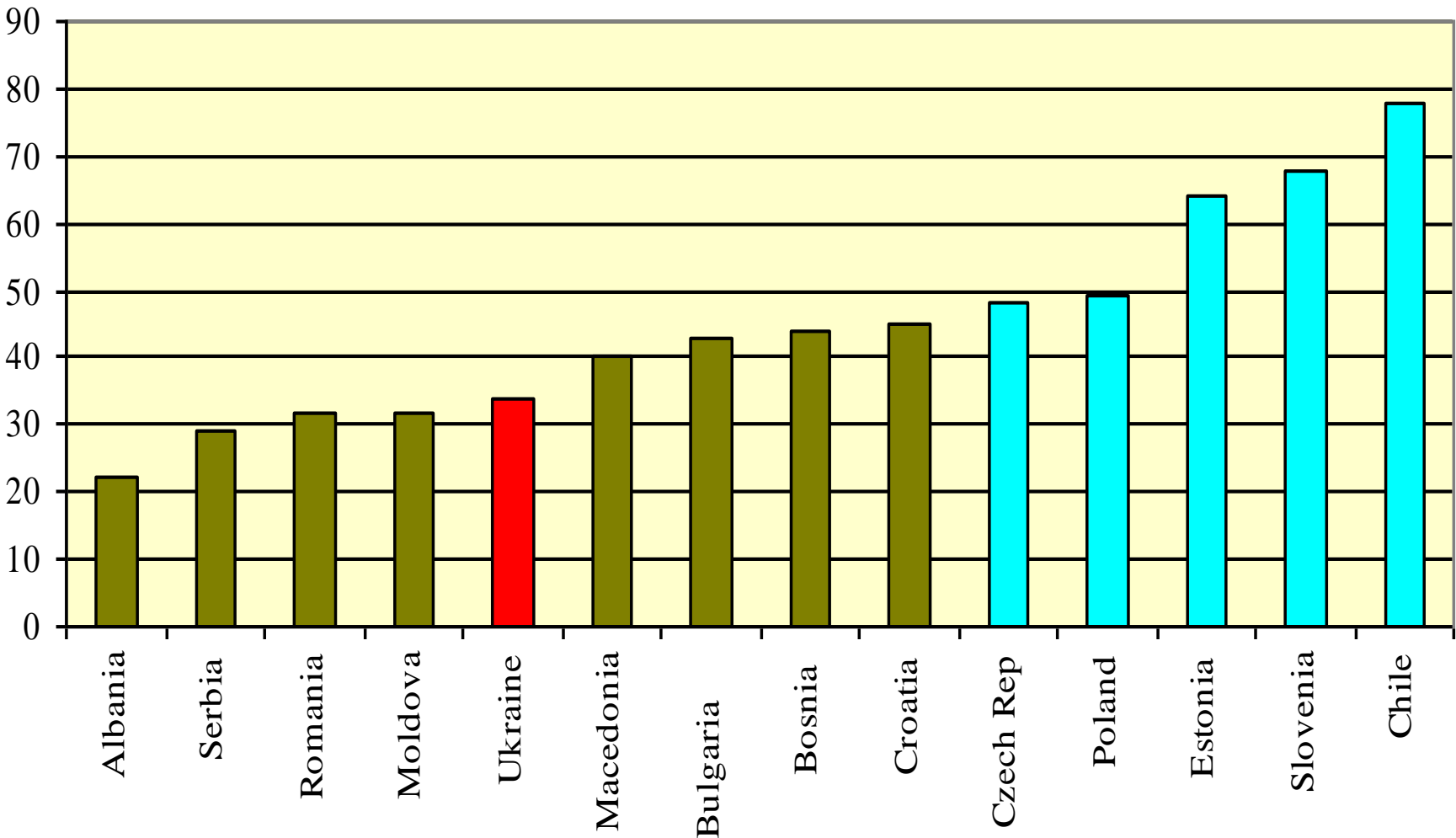
Driver #5: Liberalization of Foreign Trade and Capital Movements



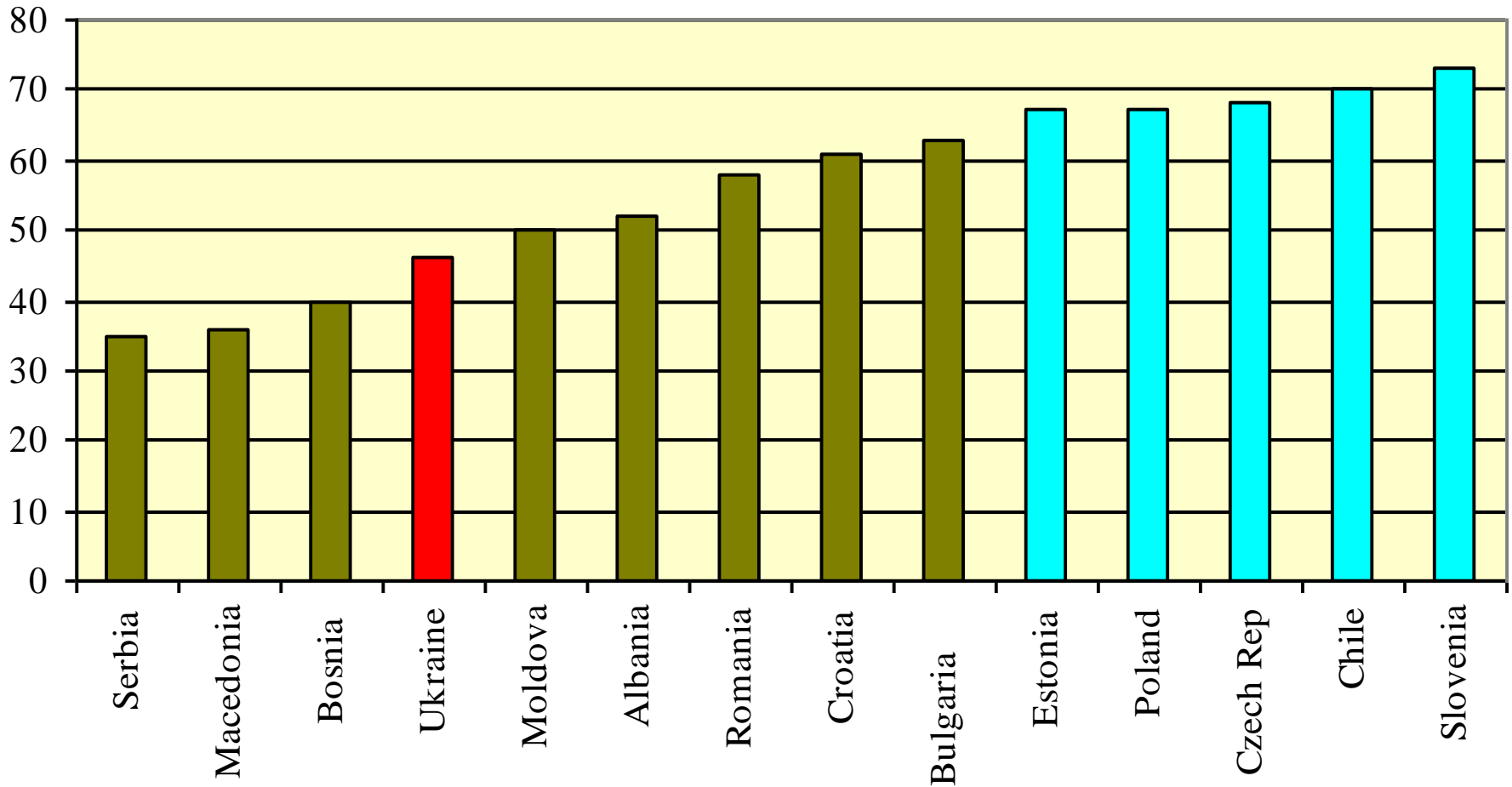
Driver #6: Financial Sector Development



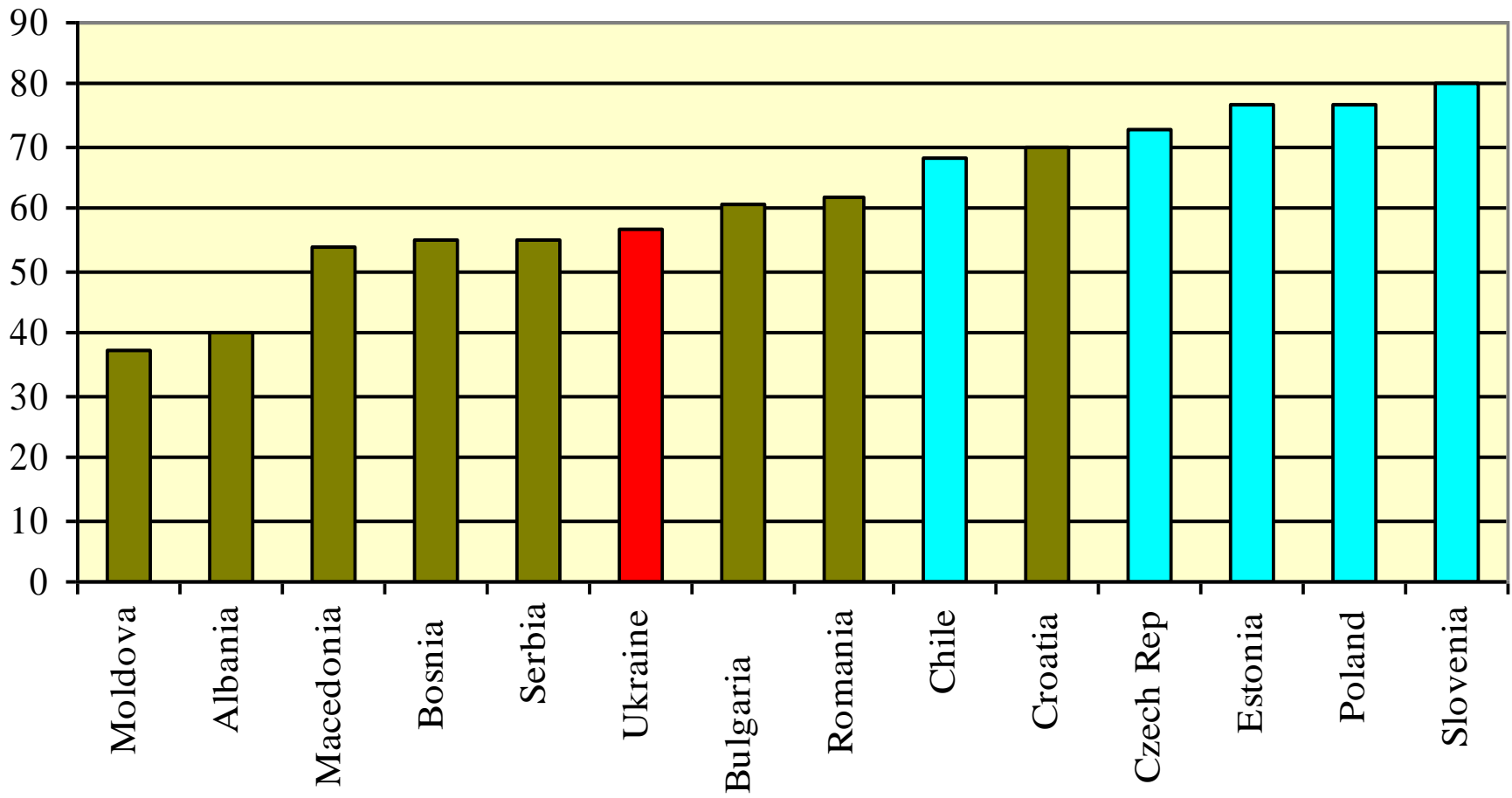
Driver #7: Corruption (100 – no corruption)



Driver #8: Political Risks (100 – no risk)



Driver 9: Country Promotion and Image



Need for Reform

- Although Ukraine demonstrated substantial progress in liberalizing the economy and creating an enabling business environment for the private sector, the reform agenda is still long.
- **President Yushchenko has a strong backing of the electorate and a clear mandate to accelerate reforms and improve living standards.**
- **Only a “big-bang” reform program will have chance to succeed!** Step-by-step reforms do not work over time as too much resistance is created and vested interests are able to stifle reforms.

Outline

Proposed Reform Agenda for Ukraine is divided into three parts:

- **Quick Payout Actions to Show Commitment to Reforms**
- **Fundamental Reforms for the First Twelve Months**
- **Other Economic Reforms to Bring Sustainable Investment and Economic Growth**

1. Quick Payout Actions to Show Commitment to Reforms

The following actions are recommended to demonstrate a great deal of commitment to make changes and create a new country, based on good governance:

■ **Leadership, Communication and Transparency**

- **Establish open communication** of government officials with the public
- **Increase transparency** in government and business (provision of free public access to government information on any non-national security matter; businesses have to keep accounts on the basis of international standards)

■ **Pending Legislation** (a number of pending laws and amendments including the Joint Stock Company Law, the Administrative Court Procedure Code, etc. should be quickly enacted)

■ **Public Finance Discipline**

- **Eliminate tax privileges** and **free economic zones**
- Settle all remaining **arrears on value added tax** reimbursements

■ **International Trade and Capital:**

- **Seek market economy status** and **WTO membership**
- **Promote FDI** by creating a small **Foreign Investment Agency**

2. Fundamental Reforms for the First Twelve Months

The following five key measures are needed facilitate the implementation of economic reforms:

1. Modernize and increase the efficiency of public administration
2. Secure the stability and predictability of the legal environment
3. Strengthen public finance discipline
4. Eliminate the government intervention into private sector activity and further deregulate business environment
5. Liberalize foreign trade and international capital movements

Modernization of Public Administration

Public administration (PA) reform is the key to the success of the implementation of other economic reforms, policies, programs and projects.

- The government should approve a **Plan of Action** for the implementation of the concept of administrative reform.
- **PA Reform Action Plan** would contain the following elements and should state specific timing to complete the Reform steps:
 - A. Redefine the Role of the Government**
 - B. Undertake Functional Reviews**
 - C. Undertake Operational Reviews**
 - D. Carry out a Civil Service Review**
 - E. Delegate More Power to Local Authorities**

...Modernization of Public Administration

A. Redefine the Role of the Government

- The Action Plan should start with a clear definition of the role of the government such as the following:
 - Its role is limited to non-commercial activities and the provision of necessary “public” goods (goods that would not normally be undertaken by the private sector due to externalities) and market-oriented regulatory services.
 - The main objective of the government is to support private-sector led growth, not compete with the private sector.

...Modernization of Public Administration

B. Undertake Functional Reviews

- Review the role and functions of the President's Administration to convert it into a **small Secretariat** for the President
- Review the **structure of the Secretariat to the Cabinet of Ministers (COM)**, to change its role and structure and facilitate decision-making by the Prime Minister.
- Review the structure and **decision making of the Cabinet of Ministers (a)** by eliminating the current overlap of responsibilities between the COM as a whole and individual line ministries, and **(b)** by devolving functions of policy implementation to the line ministries.
- Consolidate and **reduce the number of line ministries and state agencies** in to avoid overlapping responsibilities and introduce a system of clear accountability.
- **Identify** those **public services** that could be **subcontracted or outsourced to the private sector**
- Continue the government's practice of **open public consultations** on issues critical to the business environment

...Modernization of Public Administration

C. Undertake Operational Reviews

- Once the functional reviews have been completed, **operational reviews** of all ministries and government agencies should be undertaken to **simplify their internal processes, practices and procedures.**
- The review would **eliminate un-necessary regulations and licenses** of business activities.
- In order to increase the effectiveness of the government decision-making process, **policy formulation and analysis should be separated from policy implementation.**
- Legislation and **clear procedures** should be established to **improve transparency of government information**, making any non-national security information freely available to the public.
- Continue improving **procurement procedures** to make them more competitive and transparent.

...Modernization of Public Administration

D. Carry out a Civil Service Review

The aim of Civil Service Review to **upgrade the quality of government staff**, including a clear certification system for personnel hiring, payment and advancement linked to good performance and dismissal rules for civil servants.

It would include the following:

- Introduce system of **incentives for civil servants** (review system of benefits to link it to performance)
- **Reduce the number** of civil servants while **increasing the salaries** of the remaining staff this should make civil servants less prone to rent-seeking (corrupt) behavior
- Define roles and process for **monitoring performance for each operational unit**
- **Delegate authority to managers** to empower them
- Introduce **effective training programs** in order to increase civil servants' qualifications to EU standards
- Adopt legal regulations and policy statements in order to improve management efficiency of enterprises in which the state is still a shareholder

...Modernization of Public Administration

E. Delegation to Local Authorities

- The objective of decentralization should be to **bring decision-makers into closer contact with the intended beneficiaries** who can exercise more direct control over performance
- Functional reviews of central agencies should **identify those public goods and services**, provision of which may be **decentralized to the regional and rayon levels**.
- However, decentralization is one of the institutional reforms that may have the highest potential for failure. That is why, **in order to succeed decentralization should include:**
 1. A precise and clear definition of the functions, authorities and responsibilities transferred to local levels
 2. A clear identification of the local entities at the lowest possible level that would receive the delegated functions
 3. The mechanisms to provide adequate financing, technical assistance, and management training to enable local agencies to effectively assume their new responsibilities.

Stability and Predictability of the Legal Environment

To secure the stability and predictability of the legal system, the following actions are recommended:

- Ensure consistency of new laws with the existing legislation
- Improve enforcement of the existing Law on Intellectual Property Rights Protection by delegating the clear responsibilities to enforcement agencies
- Reform of the judiciary system:
 - improve financing of courts and increase salaries of judges and court employees to ensure their independence
 - encourage creation of “legal clinics”
 - enact the Administrative Court Procedure Code
 - abolish the practice of backdating any legal decisions
 - develop sound computerized databases for court decisions and legislation that can be accessed by judges across the country.

Public Finance Discipline

One of Ukraine's most significant achievements in economic policy-making in the past five years was taking control of the country's mismanaged fiscal budget system.

- Before 1998, lack of fiscal discipline and politically motivated decisions were at the root of the macroeconomic instability, with fiscal deficits in excess of 5% of GDP. After financial crisis of 1998 the government realized the need to curb fiscal expenditures, the authorities kept the fiscal deficit below 1% of the country's GDP.
- Unfortunately, the decisions made in September 2004 on pension payments and minimum wages have changed the outlook for the fiscal budget of 2005.

In order to maintain confidence in public finances, the following is needed:

- Ensure fiscal sustainability of the country
- Improve tax administration
- Decentralize fiscal relations (define budget programs which can be locally managed and financed)

Liberalization and Deregulation of Business Activities

- Despite significant progress in reduction of excessive government intervention in businesses activities, the major improvement is required in cutting still high costs of doing business in Ukraine
- The following measures are proposed:
 - Ensure widespread introduction of the one-stop-shop system of business registration across the country
 - Simplify and reduce the number of inspections of private businesses
 - Eliminate the current system of Tax Police
 - Develop transparent procedures for the liquidation of companies, including disclosure of information
 - Make The Law of Ukraine on State Registration of Legal Entities and Self Employed operational

Liberalization of Foreign Trade and Capital

- Since independence, Ukraine has significantly eased its foreign trade regime. However, to sustain export growth, Ukraine needs to act on four priority actions:
 - 1) Become recognized as a Market Economy by the EU and the US;
 - 2) Join the World Trade Organization (WTO)
 - 3) Sign free trade agreements (FTA) with the EU, the CIS countries, and the US
 - 4) Secure an agreement in principle with the EU to begin preliminary consultations on accession, including a date for the beginning of negotiations
- Sign free trade agreements with the country's main trading partners (EU, USA, CIS countries)
- Liberalize recently introduced regulation on foreign capital movements for foreign investors

3. Other Economic Reforms to Bring Sustainable Investment and Economic Growth

- To ensure sustainable economic growth expedient actions should be implemented in the following areas:
 - Corporate Governance
 - Privatization Policies
 - Financial Sector Development
 - Corruption Level
 - Political Risks
 - Country Promotion and Image

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