Ukraine After the Crisis: the Road to Recovery

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Chairman, Advisory Board, The Bleyzer Foundation
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### Macroeconomic Performance

From 2000 to Sept. 2008, Ukraine enjoyed excellent economic results.

<table>
<thead>
<tr>
<th></th>
<th>2000-07 average</th>
<th>2008</th>
<th>2009</th>
<th>2010 (f)</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Real GDP Growth, % yoy</strong></td>
<td>7.5</td>
<td>2.3</td>
<td>-15.1</td>
<td>3</td>
</tr>
<tr>
<td><strong>Fiscal Balance, % GDP</strong></td>
<td>-0.8</td>
<td>-2.1*</td>
<td>-11.0**</td>
<td>-6</td>
</tr>
<tr>
<td><strong>Consumer Inflation, %, eop</strong></td>
<td>11.3</td>
<td>22.3</td>
<td>12.3</td>
<td>13-15</td>
</tr>
<tr>
<td><strong>UAH/$ Exchange Rate, eop</strong></td>
<td>5.2</td>
<td>7.7</td>
<td>8.0</td>
<td>7.8-8.5</td>
</tr>
<tr>
<td><strong>Current Account, % GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000-05</td>
<td>5.7</td>
<td>-7.0</td>
<td>-1.5</td>
<td>0</td>
</tr>
<tr>
<td>2006-07</td>
<td>-2.6</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Gross Int. Reserves, $ bn</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>1.5</td>
<td>31.5</td>
<td>26.5</td>
<td>28</td>
</tr>
<tr>
<td>2007</td>
<td>32.5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Foreign Gov’t Debt, % GDP</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>21.3</td>
<td>9.2</td>
<td>19.8</td>
<td>23</td>
</tr>
<tr>
<td>2007</td>
<td>8.7</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>Foreign Private Debt, % GDP</strong></td>
<td>26.2</td>
<td>47.1</td>
<td>66</td>
<td>58</td>
</tr>
</tbody>
</table>

* Includes implicit pension fund deficit (credits from unified Treasury account (state budget) to cover pension fund expenditures)

** Includes expenditures on commercial banks recapitalization and capital injections to Naftogaz (5.2% GDP), implicit pension fund deficit (1.8% GDP), and expenditures covered by IMF’s special SDR allocation to Ukraine (1.7% GDP).
The International Liquidity Crisis Hit Ukraine Hard

- PFTS stock index: -74% (2008)
- UAH/$ Exchange Rate: 58% Depreciation (4Q 2008)
- Real GDP: -15.1% yoy (2009)
- Export of goods: -40% yoy (2009)
- Industrial production: -22% yoy (2009)
- Unemployment (ILO): 9.4% (4Q 2009)
- Real households’ income: -8.5% yoy (2009)
- Broad fiscal balance: -11% of GDP (2009)
## The Crisis Affected Ukraine Harder than other EMs

<table>
<thead>
<tr>
<th>Country</th>
<th>GDP, % yoy 2009</th>
<th>Local Currency Depreciation vs. US Dollar (mid-2008 to end-2009)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Ukraine</td>
<td>-15.1</td>
<td>65%</td>
</tr>
<tr>
<td>Latvia</td>
<td>-17.5</td>
<td>9%</td>
</tr>
<tr>
<td>Lithuania</td>
<td>-14.4</td>
<td>9%</td>
</tr>
<tr>
<td>Estonia</td>
<td>-14.5</td>
<td>9%</td>
</tr>
<tr>
<td>Russia</td>
<td>-8.0</td>
<td>29%</td>
</tr>
<tr>
<td>Mexico</td>
<td>-6.9</td>
<td>27%</td>
</tr>
<tr>
<td>Romania</td>
<td>-7.1</td>
<td>27%</td>
</tr>
<tr>
<td>Hungary</td>
<td>-6.7</td>
<td>26%</td>
</tr>
<tr>
<td>Taiwan</td>
<td>-3.5</td>
<td>6%</td>
</tr>
</tbody>
</table>

*The Bleyzer Foundation for Ukraine and Romania, The Economist for others countries
Sources: The Economist, Central banks of the respective countries, The Bleyzer Foundation*
Collapse in Sources of GDP Growth

- GDP growth was driven by:
  1. exports in early 2000s &
  2. domestic consumption in later years,
     --- both spurred by a credit boom and social spending.

- But in 4Q 2008 and 2009 both exports and domestic demand fell sharply.

- Real GDP declined by about 15% yoy in 2009.

Source: State Statistics Committee, The Bleyzer Foundation (TBF)
Real Sector Performance in 2009

• The major drop in output took place in November 2008 – February 2009.

• Export-oriented industries (metals & chemicals) and credit-dependent sectors (construction, machine-building) were affected the most.

• Since then, output stabilized at low levels.

• But exports and consumption are unlikely to be the main growth drivers in the future.

Sources: State Statistics Committee, The Bleyzer Foundation
Why Ukraine Was Affected So Severely?

Due to the combination of four vulnerabilities:

1. Open but Undiversified Economy
2. Large Current Account Deficits
3. Large External Debt Repayments
4. Banking Sector Weaknesses
Vulnerability #1 – Open & Undiversified Economy

- Exports represent 50% of GDP
- But exports are undiversified:
  1. Metals, Minerals and Chemicals account for ~60% of exports.
  2. Geographic diversification is narrow with Russia as the main buyer.

- This lack of product and geographical diversification is the result of lack of economic reforms in the past.

Ukraine’s Exports by Commodities, % of Total, and Key Trading Partners, % of Commodity Exports, 2008

Sources: UN Comtrade, The Bleyzer Foundation
High Dependence on Steel Prices

- Ukraine’s exports and industrial production are very dependent on international steel prices, which are very vulnerable to crises, as people stop buying cars and houses.
- World steel prices fell sharply from mid-2008 to mid-2009.
- Ukraine’s exports of goods dropped by 40% yoy in US$ terms in 2009.
- Industrial production declined by 22% yoy.
- Product diversification must be a priority for economic reforms.

Source: State Statistics Committee, NBU, MEPS, TBF
Exports by Key Trading Partners

- Ukraine wants geographical diversification.
- But Russia remains as the main export market.
- Ukraine talks about closer integration with the EU.
- But its trade with the EU has been deteriorating.
- Export diversification should be a key item in the reform agenda of Ukraine.
- Entering into FTAs is now essential for Ukraine.

**Ukraine’s Merchandise Exports to EU and CIS Countries, % of total**

Sources: UN Comtrade, SSC of Ukraine
Vulnerability # 2 – Large Current Account Deficits

Ukraine’s Foreign Trade in Goods Performance and Current Account Balance

- Over 2003-2008:
  - Exports grew by 25% pa
  - But imports – by 30% pa
  - CA deficits emerged in 2006 and widened to 7% of GDP in 2008.
- Before the crises, the CA deficit for 2009 was forecast at 13% GDP.
- Uncertain foreign financing of this CA put pressures on the Hryvnia.
- In the near future, due to the decline in imports, the CA deficit is not be a problem.

Source: NBU, SSC, The Bleyzer Foundation
Vulnerability # 3 – Large External Debt Repayments

- External debt tripled in three years (2006-08) to about $100 billion (90% of GDP).
- As of mid-2008, ~ $40 billion of debt was due in 1 year –vs- $35 billion of international reserves.
- Debt rollover became very difficult during the initial stages of the crisis, pressuring the Hryvnia.
- But eventually, private external debt rollover was rather high in 2009 at 80%.

Source: NBU, TBF
<table>
<thead>
<tr>
<th>Country</th>
<th>ED/GDP</th>
<th>ED/Exp</th>
<th>Country</th>
<th>ED/GDP</th>
<th>ED/Exp</th>
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<td>128</td>
<td>143</td>
<td>Malaysia</td>
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<td>Bulgaria</td>
<td>110</td>
<td>159</td>
<td>Indonesia</td>
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<td>123</td>
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<td><strong>Ukraine</strong></td>
<td><strong>90</strong></td>
<td><strong>204</strong></td>
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<td>28</td>
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<td>Poland</td>
<td>58</td>
<td>125</td>
<td>Ecuador</td>
<td>25</td>
<td>95</td>
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<td>Panama</td>
<td>56</td>
<td>76</td>
<td>S. Africa</td>
<td>25</td>
<td>81</td>
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<td>Korea</td>
<td>45</td>
<td>83</td>
<td>Thailand</td>
<td>24</td>
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<td>176</td>
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<td>130</td>
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<td>Argentina</td>
<td>42</td>
<td>182</td>
<td>Dom Rep</td>
<td>20</td>
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<td>Czech Rep</td>
<td>41</td>
<td>56</td>
<td>India</td>
<td>18</td>
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<tr>
<td>Philippines</td>
<td>40</td>
<td>121</td>
<td>Mexico</td>
<td>18</td>
<td>62</td>
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<tr>
<td>Russia</td>
<td>38</td>
<td>125</td>
<td>Venezuela</td>
<td>16</td>
<td>100</td>
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<tr>
<td>Uruguay</td>
<td>37</td>
<td>152</td>
<td>Brazil</td>
<td>14</td>
<td>122</td>
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<tr>
<td>Pakistan</td>
<td>36</td>
<td>322</td>
<td>China</td>
<td>8</td>
<td>33</td>
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<tr>
<td>Chile</td>
<td>35</td>
<td>82</td>
<td><strong>MEAN</strong></td>
<td><strong>35</strong></td>
<td><strong>120</strong></td>
</tr>
</tbody>
</table>
External Debt Financing Needs in 2010

- With external debt at 90% of GDP, Ukraine is not a low-debt country. The average external debt/GDP for EMs is 35% of GDP.
  - In 2010, external government debt is forecast at 23% of GDP;
  - External private debt is about 66% of GDP.
- Out of total external debt, in 2010 principal repayments are estimated at $35 billion, as follows: $5 billion is due by banks, $15 billion is due by Corporations, $14 billion is the short term maturity of medium term debt (which is ignored in official statistics), and $1 billion is external government debt (excluding debt restructuring recently arranged).
- Of this $35 billion, about $12 billion are Trade Credits and $23 billion will need to be rolled-over or paid in 2010.
- Therefore, Ukraine will need to maintain a good degree of confidence among foreign investors to keep high debt rollover ratios in the year.
Vulnerability # 4 – Banking Sector Weaknesses

- Bank lending grew by 70% pa over 2006-08.
- This high credit growth led to a high ratio of non-performing loans (NPLs) of 14.5% of loans in 2008 and around 40% currently.
- Credit growth was mainly financed by foreign borrowings, with 50% of total loans issued in foreign currency.
- All this created uncertainties and about ¼ of bank deposits were lost.

- Although the deposit base was stabilized in mid-2009, in 2009 the banking sector as a whole made $3.9 billion in loses.
- In the near future, further and better-supervised financial support to the banking sector will be essential to revive credit and GDP growth.

Source: NBU, IMF, TBF

![Graph showing trends in non-performing loans, total loans, and deposits over 2007-2010.](image-url)
Hryvnia Depreciation – One of the World’s Largest

- Ukraine’s four vulnerabilities (undiversified exports, large CA deficits, large foreign debt and weak banks) led to a large Hryvnia depreciation.
- During the last quarter of 2008, the Hryvnia lost more than 50% of its US$ value.
- However, due to this depreciation, Ukraine regained competitiveness lost since the early 2000s due to high inflation.

**Source:** NBU, Finance.ua, TBF
• High inflation in Ukraine – 12.5% pa on average over 2000-2008.
• Virtually stable exchange rate.
• Over time, loss of competitiveness adjusts through exchange rate depreciation.

### PPP with Base Year 2002

<table>
<thead>
<tr>
<th></th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
<th>2010</th>
</tr>
</thead>
<tbody>
<tr>
<td>Inflation Diff Index Ukr-Us</td>
<td>100</td>
<td>106</td>
<td>115</td>
<td>123</td>
<td>134</td>
<td>150</td>
<td>182</td>
<td>210</td>
<td>237</td>
</tr>
<tr>
<td>RER - US</td>
<td>5.3</td>
<td>5.7</td>
<td>6.2</td>
<td>6.5</td>
<td>7.1</td>
<td>8.0</td>
<td>9.7</td>
<td>11.2</td>
<td>12.6</td>
</tr>
<tr>
<td>Inflation Diff Index Ukr-MTP</td>
<td>100</td>
<td>101</td>
<td>105</td>
<td>109</td>
<td>115</td>
<td>124</td>
<td>141</td>
<td>154</td>
<td>167</td>
</tr>
<tr>
<td>REER - MTP</td>
<td>5.3</td>
<td>5.4</td>
<td>5.6</td>
<td>5.8</td>
<td>6.1</td>
<td>6.6</td>
<td>7.5</td>
<td>8.2</td>
<td>8.9</td>
</tr>
</tbody>
</table>

REER - Real Effective Exchange Rate
Nominal Exchange Rates (per US dollar) and Inflation Differential with the US, 1972-2000

Source: Mankiw, Macroeconomics, IMF International Financial Statistics
Exchange-Rate Changes and Inflation in Selected Countries (Annual Averages), 1965–1985

Source: Sachs and Larain; Macroeconomics, 1993
Short-Term Challenge: Improve Public Finances

Ukraine’s Fiscal Deficit in 2009, % of GDP

<table>
<thead>
<tr>
<th>Official consolidated budget deficit</th>
<th>2.3</th>
</tr>
</thead>
<tbody>
<tr>
<td>Special SDR allocation,</td>
<td>1.7</td>
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<tr>
<td>treated as budget revenues</td>
<td></td>
</tr>
<tr>
<td>Banks’ recapitalization</td>
<td>5.2</td>
</tr>
<tr>
<td>Naftogaz capital injection</td>
<td></td>
</tr>
<tr>
<td>Implicit pension fund deficit</td>
<td>1.8</td>
</tr>
<tr>
<td>Overall budget deficit</td>
<td>11.0</td>
</tr>
</tbody>
</table>

Sources: Ministry of Finance, Presidential Secretariat, NBU, The Bleyzer Foundation

• Budget revenues fell sharply in 2009
• And expenditures remained virtually unchanged, thanks to a 50% decline in capital spending, despite a 7% increase in current expenditures.
• Public finances are under significant strain in 2010 due to:
  • slow economic recovery
  • pre-election hikes in social standards (pensions, minimum wages)

  • the 2009 practice of collecting taxes in advance
  • the delays in tariff increases to population for natural gas and utilities.

• A comprehensive revision of Ukraine’s fiscal policy is needed…

… otherwise Ukraine may loose control over inflation, public debt, and face another large depreciation.
Short-term Measures – Rebalance Public Finances

- International experience suggests that:
  - Successful fiscal adjustments are almost always expenditure based, which require public administration reform, public expenditure management reform, and privatization.
  - Fiscal deficit reductions are more likely to improve economic growth if they involve cuts in transfers and government wages.
- The high tax burden in Ukraine leave little scope to raise taxes.
- But introduction of a local real estate tax may be appropriate, if accompanied by transfer of specific functions to local levels.
- This will also help to reduce budget transfers to local budgets:
  - The share of local governments in total government spending increased from 35% in 2000 to 41% in 2008
  - while the local governments’ tax share declined from 38% to 26% respectively.
In order to make public finances sustainable, Ukraine needs to:

- Rebalance the finances of Naftogaz by raising natural gas tariffs to population and utility sector;
- Increase cost-recovery of other utilities and transportation services;
- Reform the pension system, including early retirement schemes:
  - \textit{Pension spending account for about 18\% of GDP}
  - \textit{The retirement age is one of the lowest in Europe}
  - \textit{Early retirement pensioners account for \sim 20\% of total.}
- Reform Public Administration by eliminating overlapping/duplicative functions and decentralizing functions to local authorities.

Deficit financing in the short term:

- Over the short-term Ukraine has no alternative but to resume the IMF program and/or secure other multilateral or bilateral financing.
- Although privatizations may provide fiscal revenues, in the short term political instability makes this option unfeasible.
Medium-Term Prospects

- Past sources of economic growth (exports and domestic consumption) will be limited in the future: exports prices are unlikely to increase as fast as in the past; credit will not be available to boost consumption.
- Therefore, Foreign Investments must become the new GDP growth engine, not only to induce growth but to diversify exports and output.
- Ukraine has a number of comparative advantages for FDIs:
  - Borders with the EU
  - Posses abundant and educated labor
  - Wages are 1/3 of those in Eastern Europe
  - Ukraine’s 46 million population is an attractive market
  - Agricultural potential is quite high
  - Infrastructure and technological base are reasonable.
- But to realize this potential, Ukraine needs to make a quantum jump in economic reforms to improve its investment climate.
## Ukraine – IFC/WB’s Ease of Doing Business

<table>
<thead>
<tr>
<th>UKRAINE</th>
<th>Ukraine</th>
<th>Region</th>
<th>OECD</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Ease of Doing Business</strong></td>
<td>145</td>
<td>7.7</td>
<td>5.8</td>
</tr>
<tr>
<td>Starting a Business</td>
<td>128</td>
<td>22.6</td>
<td>13.4</td>
</tr>
<tr>
<td>Construction Permits</td>
<td>179</td>
<td>8.6</td>
<td>4.9</td>
</tr>
<tr>
<td>Employing Workers</td>
<td>100</td>
<td>128</td>
<td>140</td>
</tr>
<tr>
<td>Registering Property</td>
<td>140</td>
<td>140</td>
<td>140</td>
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<tr>
<td>Getting Credit</td>
<td>28</td>
<td>28</td>
<td>28</td>
</tr>
<tr>
<td>Protecting Investors</td>
<td>142</td>
<td>142</td>
<td>142</td>
</tr>
<tr>
<td>Paying Taxes</td>
<td>180</td>
<td>180</td>
<td>180</td>
</tr>
<tr>
<td>Trading Across Borders</td>
<td>131</td>
<td>131</td>
<td>131</td>
</tr>
<tr>
<td>Enforcing Contracts</td>
<td>49</td>
<td>49</td>
<td>49</td>
</tr>
<tr>
<td>Closing a Business</td>
<td>143</td>
<td>143</td>
<td>143</td>
</tr>
</tbody>
</table>

### 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.
Ukraine–World Ec Forum: International Competitiveness

<table>
<thead>
<tr>
<th>UKRAINE</th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>GCI 2008–2009</td>
<td>72</td>
</tr>
<tr>
<td>Basic requirements</td>
<td>86</td>
</tr>
<tr>
<td>1st pillar: Institutions</td>
<td>115</td>
</tr>
<tr>
<td>2nd pillar: Infrastructure</td>
<td>79</td>
</tr>
<tr>
<td>3rd pillar: Macroeconomic stability</td>
<td>91</td>
</tr>
<tr>
<td>4th pillar: Health and primary education</td>
<td>60</td>
</tr>
<tr>
<td>Efficiency enhancers</td>
<td>58</td>
</tr>
<tr>
<td>5th pillar: Higher education and training</td>
<td>43</td>
</tr>
<tr>
<td>6th pillar: Goods market efficiency</td>
<td>103</td>
</tr>
<tr>
<td>7th pillar: Labor market efficiency</td>
<td>54</td>
</tr>
<tr>
<td>8th pillar: Financial market sophistication</td>
<td>85</td>
</tr>
<tr>
<td>9th pillar: Technological readiness</td>
<td>65</td>
</tr>
<tr>
<td>10th pillar: Market size</td>
<td>31</td>
</tr>
</tbody>
</table>

**Innovation and sophistication factors**

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<table>
<thead>
<tr>
<th></th>
<th></th>
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</thead>
<tbody>
<tr>
<td>11th pillar: Business sophistication</td>
<td>66</td>
</tr>
<tr>
<td>12th pillar: Innovation</td>
<td>52</td>
</tr>
</tbody>
</table>

**Major Competitive Disadvantages**

- Property rights
- Intellectual property protection
- Judicial independence
- Efficiency of legal framework
- Transparency of government policymaking
- Reliability of police services
- Ethical behavior of firms
- Strength of auditing and reporting standards
- Protection of minority shareholders’ interests
- Intensity of local competition
- Extent and effect of taxation
- Total tax rate
- Agricultural policy costs
- Prevalence of trade barriers
- Prevalence of foreign ownership
- Business impact of rules on FDI
- Burden of customs procedures

Some of the major competitive disadvantages of Ukraine originated from Weak Judiciary and Legal Systems, Inadequate Protection of Property Rights, Poor Public Governance and Institutions, Excessive Taxation, Corruption and Macroeconomic Instability.
Future Reform Agenda

• The reform agenda in Ukraine is large and has been stated and re-stated by many international and domestic agencies over-and-over.

• By now, the authorities know well “what” should be done and there is no need to re-state this agenda one more time.

• The lack of reform progress is not due to ignorance on what has to be done, but it is due to implementation failures.

• These implementation failures are due to a combination of:
  • “resistance” from vested interests,
  • lack of reform priorities with an excessive number of reform proposals by many agencies that just paralyzes the administration, and
  • lack of knowledge on “how” to proceed with implementation of key reforms based on best practices in successful countries.
Future Reform Agenda (cont.)

• The support from the international community should recognize these problems and should:
  • Concentrate in a limited number (about four) key priority reforms that may have a synergetic effects.
  • Put the entire emphasis in assisting on implementation, rather than just enunciating in great detail what has to be done. This requiring showing “how” other similar countries implemented the reforms.
  • We also feel that the international community (multilateral, bilateral agencies and NGOs) should closely coordinate and even jointly support the implementation of these key reforms.

• On this basis, we propose the following four key reforms
  1. Comprehensive Public Administration Reform
  2. Deep business de-regulation
  3. Carry out strong anti-corruption measures.
  4. Fast agreement & implementation of an enhanced FTA with the EU

1. Comprehensive Public Administration Reform

- Although the size of the Central Government (excluding health, education and the military) is not excessive in terms of numbers of people, there is an excessive number of central public agencies with unclear roles and responsibilities, overlapping functions, coordination problems, cumbersome decision-making with multiple consultations, and excessive intervention in productive and semi-commercial activities.
- As a result, public administration is one of the main obstacles for the effective implementation of economic reforms in Ukraine.
- Upgrading the capacity of Government institutions, both at the central and local levels, is necessary both (i) to ensure the success of the implementation of other reforms, programs and projects that the Government wishes to execute to sustain growth, and (ii) to improve the delivery of services to the people.
- In fact, public administration reform is the reform that would facilitate the implementation of all other economic reforms.
Comprehensive Public Administration Reform

The PA reform should contain the following elements:

A. Redefinition of the Role of the Government  
B. Undertaking of Functional Reviews  
C. Undertaking of Operational Reviews  
D. Carrying out a Civil Service Review  
E. Decentralization

A. Role of the Government

• The Government’s role should be compatible with a market economy: limited to non-commercial activities and the provision of “public” goods and market-oriented regulatory services. The main objective of the government is to support the private sector, not compete with it.

B. Functional Reviews

• The fragmentation of functions at the Center should be addressed by a “Horizontal” Functional Review aimed at the consolidation, elimination of overlapping functions/responsibilities, transfer to local governments, or privatization of activities.
Comprehensive Public Administration Reform

• This would lead to a new Organization chart for the government based on Functions, not Sectors, and the definition of broad roles for each agency.
• “Vertical” Functional Reviews would be undertaken to re-define the detailed functions/roles of individual agencies and departments.

C. Operational Reviews

• Once the functional reviews had been completed and new organizational set-ups established, operational reviews of all ministries and government agencies would be undertaken to simplify their *modus operandi*, including improvements in internal processes, practices and procedures.
• In each agency, there will be a clear separation of functions: decision-making processes, policy formulation and analysis, policy implementation, and service delivery.
• These reviews would also eliminate un-necessary regulations and licenses.
• Government procurement and information procedures would be improved.
D. Civil Service Reform

- Strengthening the Civil Service is a “Key” element for the success of Public Administration Reform
- The Civil Service suffers from low salaries, lack of performance incentives, and unclear rules for civil service hiring, promotion and separation.
- Civil service reform should aim 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.
- 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.
E. Decentralization to Local Administrations

• The Functional Reviews of Central agencies should have identified those public goods and services that should be decentralized to the Regional, Oblast or Rayon levels.

• An objective was to empower communities and bring decision-makers into closer contact with the intended beneficiaries (improving information and shortening the political feedback loop) who can exercise more direct control over performance.

• Decentralization would also increase opportunities for local initiatives, reduce internal communication and decision-making costs (reducing the time and money costs of consultations and approvals from the center).
2. Deep Business De-Regulation

- Most studies show that businesses in Ukraine are over-regulated:
  - More than 2,000 activities require licensing
  - 85 controlling bodies. Different ministries have several controlling bodies (e.g., there are 10 in the Ministry of Agricultural Policy).
  - Dealing with construction permits is one of the worst in the world

- International experience suggests:
  - A comprehensive approach, such as “The regulatory guillotine™” is likely to be more successful in achieving deep de-regulation.
  - If it is designed with a clear and transparent sequence of actions, it can produce good results even when resistance against reform is high
  - Essentially, it is an orderly and transparent process of rapidly reviewing and evaluating a large number of regulations against clear criteria, to select for future use only those regulations that pass the criteria.
  - Any regulation that is not successfully justified as needed for policy reasons in a market-led economy will be eliminated; and any regulation that is needed but is not business-friendly will be simplified to the extent possible.
2a. Implementation of the Regulatory Guillotine™

- Adopt a legal instrument – usually a law -- that sets out the entire guillotine process, schedule, and institutions. The reform should be completed in less than 18 months.
- Create a central guillotine unit that manages the whole reform process and carries out the independent reviews.
- Each regulation must be justified as meeting three basic criteria:
  - Is the regulation legal and needed for the smooth operations of the market?
  - Is the cost of administering the regulation substantially lower than its benefits?
  - Is the regulation business-friendly?
- The regulation passes three levels of review – by ministries, business, and the central unit. In each review, only necessary, simple and easy to administer, business friendly rules are identified.
- Surviving regulations are sent as a single package to the Parliament.
- After clearly specified date, all other regulations not approved are cut off.
- A comprehensive electronic regulatory registry is maintained and any new proposed regulation would be subject to a thorough evaluation.
3. Anti-Corruption Measures

- Transparency International ranked Ukraine as 146th out of 180 countries in its degree of perceived corruption (the lower position, the worse the situation).
- Ukraine should implement corruption prevention measures to make corruption more difficult and costly to do (with transparency and eliminating corruption opportunities).
- It should then create a high level Anti Corruption Bureau, with power to:
  - Investigate public officials against corruption.
  - Constantly monitor expenditures of the government officials and their families against their incomes.
  - Monitor draft legal acts to eliminate possible opportunities for corruption.
  - Launch a broad public awareness program.
- It should undertake a fundamental reform of the Judiciary to improve judges' decisions and enforcement and to minimize abuses of power.
- Other measures may include:
  - Approve the Criminal Procedure Code
  - Make trial and court documents open to the public
  - Ensure implementation of the new Anti-corruption law (enforced in April 2010)
  - Reduce corruption at Ukrainian Customs, by outsourcing custom management (e.g., international Crown Agents team is assisting the Government of Bulgaria since 2002; custom revenues grew by 53% during 2002-03 and by 182% in 2006).
4. Free Trade Agreement (FTA) with the EU

- One of the main reasons for failures in reform implementation has been the lack in Ukraine of a middle class with vested interest in reform implementation and who could lobby and apply pressure to authorities to achieve their implementation.

- A FTA is one of the few measures that may help in creating a strong constituency in favor of reform implementation.

- As a tactical step, we believe that a FTA should be entered as quickly as possible, without excessive prior actions and conditionality on reforms that may just delay indefinitely its approval.

- Most reform conditions should be agreed under a Plan of Action, with the expectation that once the FTA is signed, a constituency of vested interest will push for the implementation of the reforms.
4. Free Trade Agreement (FTA) with the EU (Cont.)

- FTA+ would also:
  - Facilitate approximation to European standards
  - Favor Ukraine’s competitiveness through the use of new technologies
  - Improve institutions and governance
  - Help to diversify industrial and service sectors
  - Improve the investment environment, thus encouraging FDI inflows
  - Bring Ukraine into the European food supply chain, facilitating exports

- International experience shows that countries entering FTAs experience higher export and GDP growth, and larger FDI inflows.
  - Chile has about 25 FTAs including with the US (2003) and EU (2002).
  - Real GDP growth averaged 5.2% over 2003-2006 vs. 3.4% in 1999-2002; exports grew by about 35.5% pa vs. 4.4% pa over the periods respectively.
  - Mexico has more than 40 FTAs. The pace of economic growth doubled in the years succeeding the year of enforcement of the most powerful FTAs (NAFTA (1994), the EU (2000)).