

ICPS newsletter

Which factors affect the selection of goods traded abroad by Ukraine?

One of the key issues on the agenda of today's foreign trade policy in Ukraine is accession to the World Trade Organisation (WTO), which the government plans to accomplish at the end of 2003. This event may result in both positive and negative effects on the Ukrainian economy. In particular, WTO accession can affect the assortment of goods traded by Ukraine throughout the world. The current issue of ICPS's economic journal Quarterly Predictions offers our forecast and analysis of factors affecting the selection of commodities in Ukraine's foreign trade. ICPS economists believe that presently three key factors are having the biggest impact on this selection, namely: physical capital and labour, human resources, and protectionism

Capital assets and labour

Over the past decade, Ukraine's capital assets have received extremely few investments. Consequently, Ukraine is now relatively less endowed with physical capital than the majority of its trading partners. This situation has also been prompted by the following: (1) technologies have become more labour-intensive (that is, the ratio of capital to labour has dropped); and (2) a sizable share of equipment has become physically and morally outdated.

In view of these circumstances, Ukraine now has competitive advantages in production and mostly exports goods the production of which is relatively labour-intensive, while imports are dominated by capital-intensive goods.

Human resources

In order to measure human resources, ICPS economists used the share of

¹ This conclusion is supported by a regression analysis, in which a dependent variable is net merchandise exports as a share of sectoral products, while explanatory variables include capital per worked hour, a share of sectoral workers with higher education, labour productivity in the sector, tax benefits and non-tariff barriers in the way of sectoral merchandise imports. The data of the State Statistics Committee, the State Tax Administration, and the State Customs Service covering 16 sectors over 1999 and 2000 feed into the analysis.

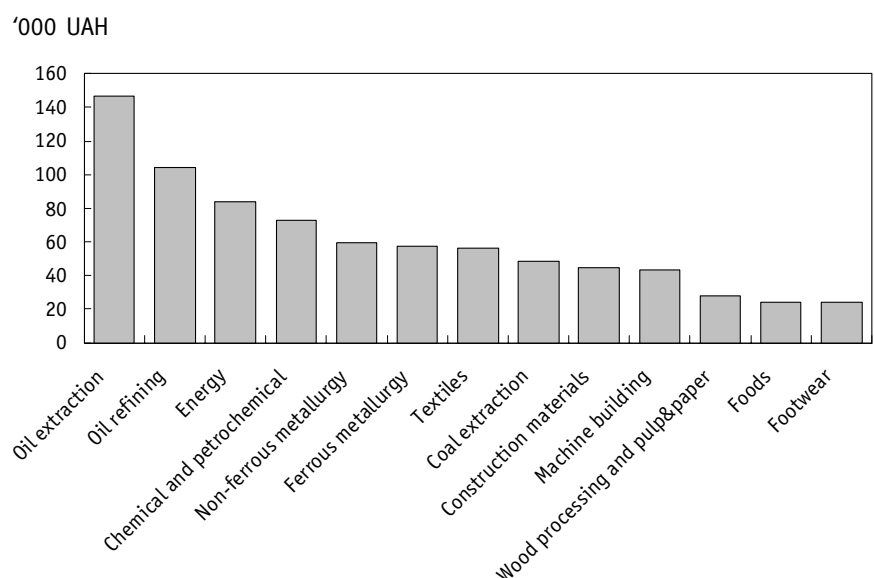
workers in a given sector with a higher education. It turned out that regardless of the relative excess of human resources (Ukraine occupies one of the top spots in the world by the share of people with a higher education), the country still imports goods manufactured with relatively intensive human input. This shows that the knowledge and skills acquired by Ukrainians in higher educational establishments is irrelevant and falls short of business needs.

Protectionism

The results of regression analysis show that the selection of commodities for of Ukraine's external trade is dramatically affected by tax benefits and non-tariff barriers. The State Tax Administration reports that the biggest tax benefits are extended to the electricity sector, coal-extracting industry, ferrous metallurgy, and chemical industry. The biggest non-tariff barriers are raised against imports of oil and petrochemicals, machinery and equipment, vehicles, chemical products, and foodstuffs.

Protectionism makes resource allocation inefficient, with resultant increases in the production and consumption of goods in which Ukraine is not competitive. Moreover, incomes are re-distributed in favour of protected producers at the expense of consumers and non-protected

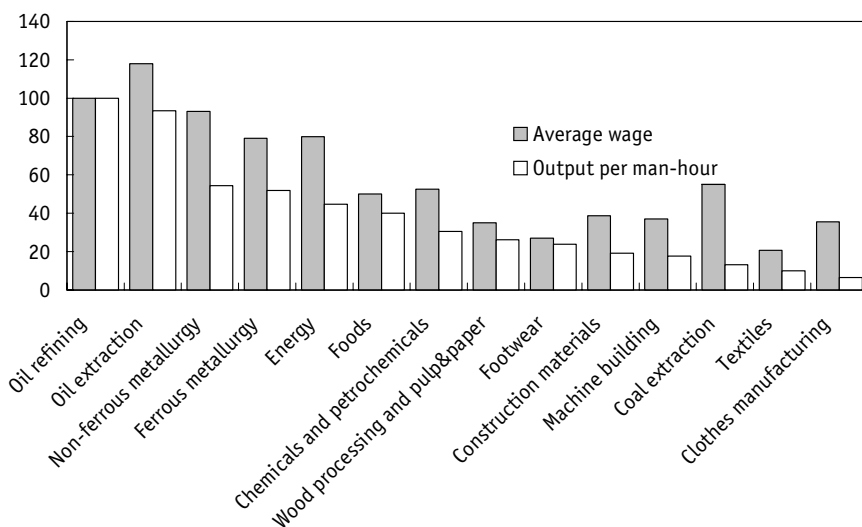
Capital per hour worked in 2000



Source: State Statistics Committee

Average wage and output per man-hour in 2000

index for the oil-refining sector=100%



Source: State Statistics Committee

producers. An example of inefficiency in Ukraine is the discrepancy in the ratios of average wages to labour productivity in industrial sectors; the highest ratio is reported in the coal-extraction industry, which testifies to the distortions in recouping production factor costs. Consequently, the protectionism policy leads to net social losses. ■

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WTO accession: how to multiply positive and diminish negative effects

ICPS economists believe that positive effects of Ukraine's accession to the WTO can be the following:

- Liberalisation of external trade and of investment activities will spur competition and, subsequently, enhance the efficiency of enterprises and welfare of consumers, who will be able to afford less expensive products of higher quality;
- Harmonisation of legislation and public policy with WTO norms will promote trust in the country by foreign partners, and hence will bring in more foreign direct investments (FDI). The inflow of foreign investments will permit to more efficiently employ human resources at more technology-oriented enterprises;
- The possibility of employing mechanisms to resolve trade disputes will allow to diminish the number of discriminatory anti-dumping measures against Ukrainian goods;
- Participating in decision making will allow to more effectively lobby Ukraine's interests when devising WTO policy. For example, Ukraine will be able to join the group of countries calling for the reduction of support extended to agriculture, which would clear the way for Ukraine's grain exports.

However, higher imports and the inflow of foreign investments, inducing economic restructuring and fiercer competition, may drive up unemployment in relatively non-competitive sectors, and lead to regional disparities across Ukraine. Such a situation was typical for many Central and Eastern European countries. A possible way of mitigating adverse social implications is to channel the money used for protectionism purposes for re-training and assistance to the unemployed.

Moreover, the experience of the Slovak Republic and Romania showed that accession to the WTO does not suffice to attract more FDI. Till 2000, FDI inflows to Slovakia were scarce, which, combined with the huge negative trade balance, resulted in a dramatic depreciation of the national currency. It was only after the approval of the program for FDI stimulation in 1999, aimed at improving informational support and simplified investment terms, that foreign capital gushed in. FDI volumes in Romania still remain low, discouraged by sluggish privatisation and the gloomy investment climate.

In the meantime, Poland, Hungary, and the Czech Republic may be looked at as optimistic examples; imports in these countries went up, along with huge FDI inflows, which fostered the restructuring of industrial production and exports (the share of relatively more technological goods with high processing level became comparatively higher).

Therefore, implications of WTO accession depend heavily on the policy pursued by a given country with respect to its investment climate and assistance to the unemployed.

ICPS economists believe that joining the WTO is an indispensable prerequisite for restructuring the Ukrainian economy, otherwise the country's existing structure will remain. However, before actually acceding, the potential adverse implications for certain sectors should be assessed, and mitigation measures should be devised.

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