

# ICPS newsletter

## Decision to build Danube–Black Sea canal turns a blind eye to other alternatives

***Ukraine is extremely interested in having its own navigable canal from the Black Sea to the Danube. But in its desire to get the canal as soon as possible, the Cabinet of Ministers of Ukraine did not pay proper attention to considering all the alternatives, and approved an unjustified decision that violates Ukraine's environmental interests and will heap greater expenditures upon the budget than those intended to be reduced by the building of the canal***

Since the Prorva Canal became silted in 1997, Ukraine no longer has its own deep-water canal between the Danube and the Black Sea. Consequently, part of Ukrainian shipping passes through the linking canal of the Ust-Dunaisk port, while the other part passes via the Sulyn Canal, located on the territory of Romania. The value of passages through Romanian waters adds up to 0.7–1.2 million UAH annually. In addition, Ukraine is losing the market for international transportation, which occurs mainly via the Romanian ports of Constanza and Cernovoda. Therefore, Ukraine has arguments in favour of building the deep-water Danube–Black Sea canal.

Considering the alternative projects for the canal, it is worthwhile noting:

- particularities of the Ukrainian part of the Danube delta, formed by the Kiliy branch. It is newly formed and is undergoing constant changes owing to alluvial deposits from the Danube and the sea; namely, the littoral region is getting narrower by more than 100 metres towards the sea each year. Roughly 20% of the Danube empties into the Bystre estuary, where alluvial processes are particularly pronounced;
- the ecological importance of the Ukrainian Danube delta, which is one of the biggest wetland areas in Europe and is within the purview of the Ramsar convention dated 2 February 1971. The Ukrainian–Romanian Danube Biosphere Reserve (DBR) located here is included in the UNESCO world network of biosphere reserves—one of six transfrontier biosphere reserves in the world.

Without regard to the foregoing, the Ministry of Transport of Ukraine has been lobbying for two years to build the canal across the Bystre arm, which is located in the strictly reserved area, where any economic activities are prohibited by the Law of Ukraine “On the nature reserve fund

of Ukraine”. To this end, the ministry is striving to cut out the straits and internal reservoirs from the reserve’s territory, as well as reduce its strictly reserved zone almost tenfold. Furthermore, the Ministry of Transport is ignoring any alternatives to building the canal, which private investors are ready to undertake.

The option of the canal across the Bystre is attractive, because it would take relatively little time to build, although it fails to take into account the entire set of possible environmental, legal, and economic implications, such as:

- irreparable loss of the reserve’s ecological functions as a result of dismembering its most important part—the strictly reserved zone, or its core; pollution of waters with petroleum products; disruption of delta-formation processes;
- violation by Ukraine of its international obligations in environmental protection, which will further tarnish Ukraine’s image in the world;
- losses from the reduced catch of Danube herring (experts assess these losses to be up to 2 million UAH per year);
- annual increases in dredging works and building of additional dams, which will require constant increases in budget expenditures for operating canal, whose functional lifespan is estimated by experts to be only 7–10 years.

According to experts’ estimates, in the first years of the canal’s exploitation, dredging works will cover several million cubic metres of soil (2.05–2.10 USD per cubic meter of the soil dredged) and will be on the constant rise. A vivid example is the experience of the Prorva canal exploitation; after the canal was constructed in 1957, dredging works spread over about 200,000 cubic metres annually, and by the mid-1980s had enlarged twenty-fold.

### **Government brainstorms for new ideas to boost economic growth**

From 10 to 12 October, the town of Yaremche hosted a conference on “Acceleration of Ukraine’s Economic Growth: Priority Objectives”, organised by the Ministry of Economy and European Integration of Ukraine, together with the Agency for Humanity Technologies, sponsored by USAID and the Europcar Company. About 80 representatives from the Ukrainian government, international organisations, non-governmental think tanks, and businesses from over 20 organisations met to devise recommendations for the government to accelerate economic growth. Recommendations for essential governmental decisions were formulated by conference attendees in thematic working groups.

Boosting Ukraine’s investment attractiveness was acknowledged by conference attendees as being one of the key factors required for improved growth. Participants believe that in this regard, the government should discontinue extending benefits to individual enterprises and sectors, eliminate free economic zones and priority development territories, and instead create viable mechanisms for VAT reimbursements to exporters, as well as postpone the adoption of the Economic Code, which in its present redaction not only contradicts the Civil Code but legalises government interference in private business affairs, which is not tolerated in economically developed countries.

*Conference materials will soon be made available for public use. For further information, please contact Vitali Bigdai at tel.: (38-044) 236-1292 or email to vbigdai@icps.kiev.ua.*

Other alternatives to the Bystre include, for example, the project of a lock canal via Solomoniv arm–Zhebryian harbour, which the private sector is willing to carry out. This project, supported by the National Academy of Sciences of Ukraine, envisages the creation of a canal bypassing both the DBR reserve area and the zone of active

delta formation. This option features greater reliability of the canal and far lesser annual dredging volumes; experts estimated that dredging operations for the lock canal

would amount to about 200,000 cubic metres annually, which is ten times less than for the projected canal across the Bystre. ■

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## Power struggles in Ukraine stymie reforms

**The fourth issue of ICPS's monthly Political Commentary has been published, featuring an overview of major trends in Ukrainian policy during September 2003. ICPS experts believe that the current arrangement of political forces will persist till the upcoming elections in October 2004, with all efforts of politicians focused on the desire of the current powers to retain their standings after the election, and the reaction of the opposition forces to this. ICPS analysts assessed negatively the current prospects for creating the Common Economic Area; however, forecasts for the growth of the Ukrainian economy were upgraded from, 4% to 6.5%**

### Foreign relations

Creation of the Common Economic Area regional union by Ukraine together with Russia, Belarus, and Kazakhstan is a mistake that could increase the political and economic dependence of Kyiv on Moscow. If this scenario comes about, it will have negative consequences for Ukraine's European integration, although the EU's desire to have peaceful and predictable neighbours will leave Ukraine the possibility of benefiting from the expansion of the European Union. Further development of Ukrainian-American relations, which had been renewed in conjunction with the war in Iraq, are hindered by insufficient reforms in Ukraine—particularly in the area of its democratisation.

Further improvement of relations with the USA will be possible only if Ukraine undertakes quality reforms, otherwise the relations risk coming to a standstill. The development of relations between Russia and Ukraine will be more difficult if Ukraine's leaders pay attention to their own country's political interests; however, this would increase Russia's attempts to influence decision making in Ukraine. If this happens, there will be negative consequences for Ukraine's European integration process, but the EU's desire to have peaceful and predictable neighbours will leave Ukraine the possibility of benefiting from EU expansion.

### Political competition

Poor success in Ukraine's foreign and domestic policies is again undermining the coalition of pro-government forces; as a result, there may be a partial cabinet shuffle. Although the coalition remains a leading force in Ukrainian politics, it is finding it more and more difficult to conduct an effective state policy. Meanwhile, radicalisation of the political conflict, which is a result of the upcoming

election, is making the political environment ever more unpleasant.

We expect that the pro-government coalition will survive until the election, with a possible small shuffle during the next two months. Until autumn 2004, the united pro-government forces shall maintain their control over the parliament and executive; this situation will be helped by the clear division of the opposition camp into two or more parts. The government also has a great chance to take advantage of this split in order to conduct political reforms that would transform Ukraine from a presidential-parliamentary to a parliamentary-presidential republic. At the same time, the coalition will be less successful in other areas of national policy, leaving Viktor Yushchenko still in the best spot to become Ukraine's new president.

### State policy

Among all the all the reforms needed in Ukraine, the coalition primarily concentrated on changing the model of government. Actually, they will first of all have to reduce the negative effects of the presidential election in 2004 (opposition leader Viktor Yushchenko looks set to win). This increases the risks of not correcting but intensifying the faults in the present model. As earlier, economic policy is missing reforms and market attitudes to the government officials, although stable budget and moneys will allow further economic growth.

The agreement on creating the CEA will not bring Ukraine into a free-trade zone with Russia, though it may provide Moscow an additional instrument with which to put pressure on Kyiv during the pre-election period. Ukraine's European integration policy will have only fragmentary success, given that Ukraine's demand that the EU recognise its European future correlates poorly with its consent to come under greater influence from, and also given its halfhearted political and economic reforms.

While they are providing slow progress for the country, their chances for improvement or acceleration before the 2004 election are very small.

### Economic environment

After stalling this summer Ukraine's GDP growth is slowly accelerating, thanks to a better harvest of late crops and growth in construction and industry. This will facilitate budget revenues that will permit the government to finance its expenditures. At the same time, low turnaround on increasing social expenditures could be hindering any increase in incomes of the population from GDP growth. Another remaining threat is rising inflation—which, as earlier, is held back by administrative regulation of bread prices.

We forecast an increased real GDP at year-end 2003 by 6%. We do not anticipate any worsening in the foreign economic situation in Ukraine's export markets, at least until the end of 2003. However, regardless of the increased import of grains, the positive current account balance not only will not shrink—it will continue to increase, reaching 3.3 billion USD by year-end. The nominal hryvnia to dollar exchange rate will remain stable, while consumer price growth will continue during the next few months, and will achieve 6.5% in 2003. We forecast that in 2003 the consolidated budget will be executed in full measure, with a deficit of 0.5% of GDP that will be financed above all by means of foreign public borrowing and privatisation. ■

*political commentary* offers the international community a monthly overview of trends and a forecast by ICPS experts on the development of Ukraine's domestic and foreign policy. The publication gives an informed picture of the level and direction of changes unfolding in Ukraine, as well as assists foreign investors to realistically assess political risks.

Starting from this issue, **political commentary** will be disseminated by subscription. If you wish to regularly receive subsequent issues, please contact Maksym Korepanov at tel.: +380-44-236-5464 or email: [marketing@icps.kiev.ua](mailto:marketing@icps.kiev.ua).

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