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ICPS newsletter

# Enterprises expect increased production

***The July issue of the Business Opinion Review, presenting the results of the quarterly business opinion survey conducted by ICPS, was published last week. The main objective of the survey is to investigate the perceptions and expectations of managers of industrial firms about the economy in general and the situation at their enterprises in particular. In this issue, ICPS economists analyse the performance of businesses in the first quarter of 1999 and present managers' expectations for the second quarter***

It was the first time in six months that the number of managers expecting an increase in production (42.2 percent) was bigger than the number planning on reductions (16.7 percent). This encouraging news implies that businesses have fully overcome the crisis which broke out in the third quarter of 1998. Managers of enterprises in all sectors except printing expected production to increase in the second quarter of 1999.

In conjunction with increased production, 40.6 percent of managers expected sales to increase in the second quarter of 1999. Taking into account that an increase in the number of new orders in the second quarter is also expected (34.5 percent), it is quite likely that predictions about increased sales will prove to be true. This forecast mostly applies to enterprises of light industry and food processing.

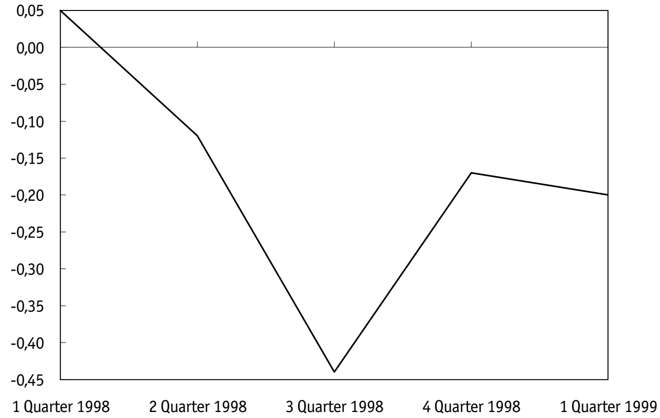
At the same time, in the first quarter of 1999 enterprise managers were more pessimistic than before about the possibility of overall improvements in economic conditions, responding that they do not expect this environment to improve over the next six months.

The excessive tax burden, low demand, and high lending rates remain the most important negative factors for the current business environment. This appears to be a natural reaction of businesses to the absence of government efforts in implementing economic reforms, and a reflection of their profound scepticism that the situation will improve before the presidential elections.

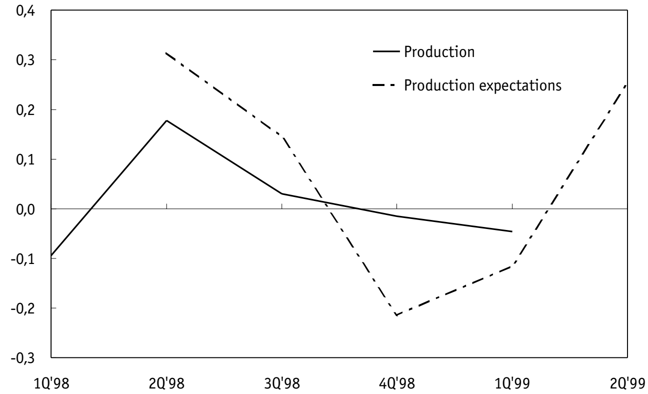
The rating of the factor "shortage of inputs" continued to increase, even since the third quarter of 1998. The largest number of respondents considering shortage of inputs to be a serious limit to production growth was recorded in the food processing (34.9 percent), wood processing (31.6 percent), and construction materials (33.3 percent) industries. This problem is related primarily to an unexpected increase in input prices (unforeseen in the previous quarter), as well as to the deterioration of their own financial status.

The number of firms reporting to barter decreased somewhat;

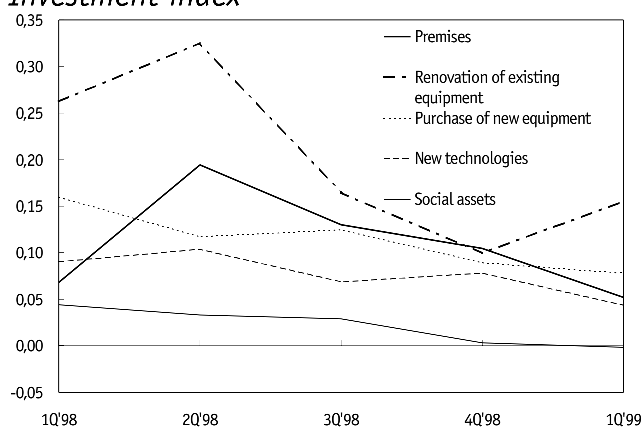
*Index of change in general economic conditions*




*Production dynamics*




*Investment index*



## *Last Week*

**Policy analyst believes that only immediate reforms can balance the current account.** As a part of the ICPS's Centre of Policy Excellence (budget policy) project, Ms. Oksana Filipovych,
a project participant from the Ministry of Economy, gave the first presentation of policy research on July 10, on the subject "Sustainable Current Account Balance".

According to Ms. Filipovych, the causes of the payment deficit are:
(i) significant energy expenditures of export-oriented sectors;
(ii) large payments for external debt servicing; and
(iii) hugely negative net public savings (budget deficit).

Ms. Filipovych defined three different strategies that can be applied by the government to overcome this problem. These strategies are the following:
(i) to maintain current policy;
(ii) to support protectionism; or
(iii) to immediately implement reforms.

Assessment of these strategies' effect on investments, savings, export, import, balance of payments, and economic growth gives occasion to recommend that the government follow the third strategy of urgent implementation of reforms. That will require decisiveness, patience, and an understanding of obstacles to be overcome, but it will have indisputable advantages and results in the long term.

## *This Week*

**The Debt Millstone – Dangers and Solutions.** Participants of the weekly ICPS macroeconomic seminar held on July 13 will discuss the following questions:

1. Debt burden on the 1999 and 2000 budget. Fiscal policy alternatives.

2. Risks for monetary parameters.

3. Tactical and strategic steps to overcome the debt problem.

The presentations will be given by Mr. Serhii Ilchuk, manager of ICPS's Quarterly Predictions project, as well as Ms. Tetiana Sytnyk and Mr. Ruslan Piontkivsky, economists in the Quarterly Predictions division.

### *Factors that limit production growth, %*

| | 1Q/98 | 4Q/98 | 1Q/99 | Compare previous |
|---|---|---|---|---|
| Excessive taxation | 93,4% | 90,0% | 89,3% | *-0,7%* |
| Shortage of finances | 69,0% | 72,3% | 78,3% | *+6,0%* |
| Shortage of orders / low sales / low demand | 67,9% | 60,3% | 52,5% | *-7,8%* |
| High interest rates | 39,0% | 42,7% | 41,5% | *-1,2%* |
| Outdated technology | 22,3% | 14,3% | 15,1% | *+0,8%* |
| Poor regulatory environment | 12,9% | 14,0% | 21,1% | *+7,1%* |
| Shortage of inputs | 16,7% | 20,3% | 25,8% | *+5,5%* |
| Shortage of skilled work force | 3,1% | 2,7% | 2,3% | *-0,4%* |
| Shortage of capacities | 2,8% | 4,0% | 4,9% | *+0,9%* |

this is the first time we recorded a decrease in the last five quarters.
23 percent of enterprises (in comparison with 20.4 percent in the fourth quarter of 1998) does not use barter. In the first quarter of 1999 we also recorded the smallest rates of increase in barter, in enterprises of all sectors of industry. The leaders in bartering are still heavy industry and wood processing.

The number of enterprises where workers received some share of wages in kind increased compared to the fourth quarter of 1998, reaching 51.6 percent. The average share of in-kind payments in salaries increased to 61.9 percent. The biggest share of wages paid in kind were recorded in heavy industry (78.0 percent) and wood processing (73.1 percent), and the smallest in printing (35.0 percent). The average term of wage arrears was 5.6 months.

In the first quarter of 1999 we again observed the trend of reductions of the number of workers. However, in the second quarter the rate of decrease of this indicator was expected to decline significantly. Moreover, managers expected to reduce the number of workers on forced leave over the second quarter.

Similar to the fourth quarter of 1998, one out of every two enterprises reported a decrease in profitability. In the first quarter of 1999 profitability of firms decreased more sharply than managers had expected in the fourth quarter of 1998. However, managers were optimistic about a change in profitability in the second quarter of 1999: 49.1 percent of the respondents did not expect profitability of their firms to decrease, and 28.5 percent of them predicted an increase in profitability.

Among the sectors of industry, food processing and printing enterprises had the best results in terms of profitability: 24.6 percent of food processing and 28.6 percent of printing firms reported increased profitability, 30.4 percent and 28.6 percent reported no change, and 44.9 percent and 42.9 percent, respectively, reported a decrease in profitability.

Despite the trend towards financial stabilization of enterprises, investments continued to decrease. In the first quarter of 1999 the breakdown of investments did not change compared to the structure observed during the whole of 1998. The majority of enterprises doing so invested in renovation of existing equipment and premises. At the same time deterioration of financial conditions forced them to reduce investment in even these short-term measures. In particular, fewer enterprises made such investments in comparison with the previous year. This testifies to the limited potential of increasing output in the current quarter.

*If you wish to receive the Business Opinion Review quarterly regularly, please send your information to the e-mail address: marketing@icps.kiev.ua or contact Oleksii Blinov, ICPS marketing office, tel. (380-44) 463-6337*

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Publications Director Hlib Vyshlinsky (hlib@icps.kiev.ua)
*Newsletter* Editor Yevheniya Yehorova (ee@icps.kiev.ua)
Phone (380-44) 463-6337
English text editor D. (Ksenia) Ovcharenko


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Director of ICPS is Vira Nanivska.
Address: 8/5 Voloska Street, 254070, Kyiv, Ukraine
Phone (380-44) 462-4937/38/58.
Fax (380-44) 463-5970
Web-site: http://www.icps.kiev.ua