

ICPS newsletter[®]

Without serious reforms, Ukraine's economic growth will not be sustainable

The main obstacles to balanced and predictable economic growth are undeveloped domestic markets, an unfriendly business environment, an underdeveloped financial services sector, and a costly economic system. ICPS economists believe that the Government must take a number of key steps to ensure steady economic growth. These include establishing a level playing field for businesses, deregulation, and attracting foreign capital, especially to the financial sector

Although the forecast for Ukraine's mid-term economic growth remains high (7–7.5%) the authors of Quarterly Predictions write that there are a number of serious threats to sustainable economic growth. In addition, they believe that the likelihood of serious fluctuations in GDP dynamics is high. This is because of underdeveloped domestic markets, an over-exposed economy, an unfavorable business environment and low competitiveness, a weak financial sector, and a costly economic system inherited from the USSR.

Over-exposed economy

In the last few years, exported goods and services constituted 50–60% of GDP, one of the highest indicators in Europe. Moreover, steel and steel products constitute almost a third of Ukraine's exports. This means that, as metal prices fall, there will be a steady slowdown in Ukraine's economic upswing—and vice versa.

Unfavorable business environment

Ukrainian business owners say that the business environment has not improved over the last two years. Domestic businessmen list high tax pressure, low demand, and an unfavorable regulatory environment (high regulatory pressure, frequent and unsystematic legal changes, and corruption) among the key barriers to doing business. As a result, the annual

reports of Ukrainian companies show a very high rate of unprofitability despite high economic and export growth.

Although a large number of Ukrainians think of themselves as middle-class, which is a key feature in a stable market society, the contribution of SMEs also plays an important role. Yet this remains impossibly small in Ukraine (10–35% of GDP, according to different estimates). In European countries, this indicator is at least at 50% of GDP.

Foreign direct investment in Ukraine continues to grow year after year, but it remains one-tenth of FDI in CEE countries. This is because of widespread unfair competition, the powerful influence of financial and industrial groups, and high political risk.

Underdeveloped financial services

The opportunities for business and the general population to find financing at a bank or other financial institutions remain inadequate, especially given the short lending terms, high interest rates and poor range of services.

Costly economic system

According to research data, Ukrainian plants typically consume double the energy used in EU countries and the depreciation of fixed assets remains high. Still, there are

many areas where enterprises could save energy.

Agriculture also has a large share of GDP—up to 15%. An intrinsic feature of farming is the high correlation between crops and weather conditions. No matter how fertile Ukraine's soil is, most of it lies mainly at a latitude that represents risks for agriculture.

What the new government needs to do

In the opinion of ICPS, to achieve sustainable economic growth that will guarantee steady improvement in living standards, Ukraine must:

- develop domestic markets by encouraging business initiatives and by deregulation. This would reduce vulnerability to external shocks;
- ensure a level playing field for business operations and transparent requirements, cut back on tax breaks and preferential treatment, and revise the list of priority sectors in order to concentrate state assistance in the most promising and high-tech areas;
- encourage the inflow of foreign capital, in particular to the financial sector;
- develop both mandatory and voluntary insurance, especially in the pension and healthcare systems. ■

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The ICPS is an independent think-tank established in 1994. Among the services provided by the Centre are regular short- and medium-term forecasts for macroeconomic indicators and analytical support for both public and private sector decision-makers.

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