G-7 CONFERENCE ON THE PARTNERSHIP FOR THE ECONOMIC TRANSFORMATION IN UKRAINE

WINNIPEG, CANADA

OCTOBER 27, 1994

OBJECTIVES OF THE CONFERENCE ON PARTNERSHIP FOR ECONOMIC TRANFORMATION OF UKRAINE

Overview

- At the Naples Economic Summit, the Group of Seven leading industrialized countries (G-7) endorsed Canada's proposal for a conference on Partnership for Economic Transformation in Ukraine to be held in Winnipeg on October 27.

- The Winnipeg conference takes place in the context of both the Summit economic framework and the multilateral assistance efforts led by the International Monetary Fund (IMF), the World Bank and the European Bank for Reconstruction and Development.

- Two of Ukraine's major economic partners and creditors – Russia and Turkmenistan – will participate in the Conference alongside the G-7, the European Union (EU), and the international financial institutions (IFIs).

- The conference will focus on the economic policy issues associated with Ukraine's transformation. It will not focus on Ukraine's financial requirements, or on bilateral financial support. As with other assistance efforts, the latter issues are best addressed through Consultative Group meetings hosted by the World Bank.

- The Canadian government's initiative to host a conference on Ukraine reflects the concerns of Canada and its G-7 partners regarding Ukraine's difficult economic situation. Ukraine is a key player in Eastern Europe, representing the second-largest economy to emerge from the former Soviet Union (FSU). Promoting economic renewal in Ukraine will not only benefit the Ukrainian people, but is an essential part of securing political and economic stability in Eastern Europe.

Conference Objectives

- One of the principal objectives of this conference is to ensure that the Ukrainian government becomes, and remains, fully engaged with the IFIs, the G-7, and its other major economic partners during its difficult transformation into a fully-fledged market economy. The ultimate aim is to guide and support Ukraine on the path to becoming a market economy, fully integrated into the world economy.

- A key short-term objective is to encourage the Ukrainian authorities to steadfastly implement a comprehensive economic stabilization and reform program to be supported by resources provided by the IMF under the Systemic Transformation Facility (STF).

- The full implementation of the economic policy measures outlined in the STF agreement should help create the initial conditions for a stable economy in which private markets and foreign trade can begin to flourish.

- The key medium-term objective is to set out in some detail the policy requirements for a comprehensive reform program that would go well beyond current plans and achieve full-scale transformation to a market economy, thereby allowing Ukraine access to the US$4 billion in potential assistance from the IFIs that was announced at the Naples Economic Summit.

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ECONOMIC SITUATION IN UKRAINE

Overview and Structure of the Economy

- Ukraine is the second most populous country in Eastern Europe following Russia, with a population of 52 million, and the third-largest, with an area of 603 700 square kilometres. Both its population and size are roughly equivalent to those of France. Ukraine borders Russia, Belarus, Moldova, Romania, Hungary, the Slovak Republic, and Poland.

- Ukraine is abundantly endowed with arable land and natural resources, and has a well-educated workforce. Its economy is well diversified. The industrial sector is large and dominated by heavy industry and mining. Ukraine was the second-largest economy in the former Soviet Union (FSU), accounting for 16 per cent of total Soviet output. Ukraine was also the largest producer of iron ore, and the second-largest producer of most material inputs to production in the FSU.

- Vast tracts of fertile land have supported a large and diversified agricultural sector. Ukraine's per capita production of key agricultural products such as grain, meat, and milk is larger than Germany's and equivalent to per capita levels in France.

- Ukraine's most important trading partners are Russia, other former Soviet republics such as Turkmenistan and Belarus, and Central European countries. Trade with industrial countries is modest (estimated at over US$5 billion in 1993), but will likely grow rapidly as Ukraine deepens its integration into the world economy. Ukraine's largest trading partners outside Eastern Europe are Germany and China.

- Ukraine's exports consist primarily of raw materials, agricultural products, and semi-finished products; its imports consist mainly of energy supplies, timber, and finished consumer and producer goods.

- Ukraine has tremendous potential for economic growth and prosperity. To fully realize this potential, the Ukrainian government has acknowledged that it must embark on a comprehensive reform program to stabilize the economy and to create incentives for private market growth and foreign investment.

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Inflation and Exchange Rate Developments

- Although Ukraine has enormous economic potential, recent economic conditions have been very difficult. Between 1991 and 1993, prices increased by more than 7 000 per cent. The rapid acceleration in inflation following the collapse of Soviet central planning and Ukrainian independence resulted from explosive money and credit growth needed to recover the government's massive budget deficits and the financial losses of state enterprises, which account for the largest share of economic activity.

- High inflation has led to plummeting real incomes and living standards, as inflation-adjusted average wages have fallen by over 50 per cent over the last three years. It has also led to the steady erosion in value of the domestic currency — the *karbovnets*. Since its introduction as a separate national currency in November 1992, the market exchange rate of the *karbovnets* has steadily depreciated, falling to its current rate of 100 000 per U.S. dollar from its initial rate of 200 per U.S. dollar.

- The plunging value of the Ukrainian currency has disrupted traditional production and supply links both internally and with other FSU states.

- The implementation of financial policies aimed at stabilizing the economy in late 1993 reduced inflation substantially in the first eight months of 1994, with monthly inflation falling to less than 3 per cent in August, or 40 per cent on an annual basis. Underlying inflation is likely to be far higher, however, since the prices of key consumer goods and productive inputs are controlled by the governement.

Output and Employment

- Economic dislocation associated with the collapsing value of the domestic currency, the dismantling of central planning mechanisms, worsening energy shortages associated with sharp increases in the prices of energy imports from Russia, the compression of other imports, and an FSU-wide fall in aggregate demand has led to a steep fall in measured economic activity.

- Between 1990 and 1993, officially recorded gross domestic product (GDP) contracted by over 40 per cent. In the first six months of 1994, the decline in measured output accelerated at an alarming pace, with real GDP and industrial production falling 34 per cent and 40 per cent, respectively, on a year-over-year basis. For 1994 as a whole, measured GDP is expected to be 23 per cent lower than in 1993.

- The output collapse has been partially offset by the rapid growth of the "shadow" (or informal) economy, which is estimated to be at least as large as the formal economy. Indeed, anecdotal evidence suggests that the shadow economy is booming, as an increasing number of Ukrainians turn to U.S.-dollar dominated black market and barter trade to acquire key consumer goods.

- Despite the sharp decline in output, open unemployment remains low at less than two per cent of the labour force. Because basic social services such as health care, child care, and education remain tied to employment in state-owned enterprises, many individuals have preferred to take unpaid leave and seek work in the informal economy. Taking these factors into account, underlying unemployment is closer to 10 per cent.

External Trade and the Balance of Payments

- Although data on balance of payments remain incomplete owing to a substantial underreporting of barter trade and capital flight, all available evidence points to a steady erosion of Ukraine's external position over the last two years. Ukraine's reserves of hard currency have depleted to an amount equivalent to two weeks' worth of imports.

- In 1993 and the first half of 1994, rising prices for imports of gas and oil supplies from Russia and Turkmenistan put increasing pressure on Ukraine's balance of payments. As energy prices moved closer to world levels, the terms of trade deteriorated markedly.

- The rising energy import bill has been financed primarily by accumulating payments arrears with Russia and Turkmenistan and these arrears continue to accumulate at the alarming rate of US$1 billion every three months. Meanwhile, non-energy imports have been compressed dramatically, falling by more than 20 per cent in the first half of 1994.

Economic Stabilization and Reform

- However, more encouraging developments may be in sight. The Ukrainian government recently declared its intention to implement an economic stabilization and reform program to be supported by credits under the Systemic Transformation Facility, subject to approval by the IMF Board of Directors.

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- The program includes strong measures to reduce the budget deficit to 10 per cent of GDP through a compression of subsidies and a broadening of the tax base, to limit credit growth to rates consistent with low single-digit monthly inflation, and to improve Ukraine's external position through the introduction of a unified free exchange rate.

- The program also calls for the freeing of most non-energy prices and the acceleration of other key structural reforms, particularly the privatization and restructuring of large state enterprises, as well as improvement of social safety net policies to protect vulnerable groups from the reform measures.

- Full implementation of the policy measures outlined in the program should bring about a sharp decline in inflation by reducing the government's large budget deficit — which is financed entirely by printing money — and foster private market growth and external trade.

- Progress under the stabilization program and further reform initiatives would pave the way to assistance from the IMF and the World Bank, as envisaged in the US$4- billion assistance package announced at the Naples Economic Summit, as well as to the much larger inflows of private capital that would result under stable economic conditions.

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INTERNATIONAL ASSISTANCE TO UKRAINE

Multilateral Assistance

- The Group of Seven leading industrialized countries (G-7) and other countries, as well as the international financial institutions such as the International Monetary Fund (IMF), the World Bank and the European Bank for Reconstruction and Development (EBRD), have shown a strong willingness to help Ukraine with economic reform in the last four years.

- The G-7, as large shareholders in the international financial institutions, have encouraged these organizations to support economic reform in Ukraine. All these institutions are working diligently to that end.

- One of the largest and perhaps most important components of any foreign assistance package for Ukraine will be lending from the IMF. In keeping with its goal of assisting with the implementation of economic stabilization and reform measures, the IMF has developed different lending facilities that are geared to different phases of reform. Recently, the IMF and the Government of Ukraine reached an understanding on an economic program to be supported by financial resources equivalent to US$730 million under the Systemic Transformation Facility (STF).

- The STF is a new mechanism which was developed by the IMF in 1993 to meet the specific needs of economies in transition from central planning to Western-style markets. Agreement on an STF requires that the Ukrainian government commit to a specific economic policy course as well as to certain policy actions (such as a reduction in government subsidies). An STF is typically made available in two equal drawings.

- Satisfactory progress under the STF-supported program (i.e., meeting key economic objectives outlined in the STF), would qualify Ukraine for financing of nearly US$1 billion under an IMF Stand-By Arrangement (SBA), given the current access limit of 68 percent under this arrangement.

- The World Bank, which focuses mainly on infrastructure, institution building and sectoral reform, could commit up to US$800 million for project loans in the next two years. It has approved one loan, worth US$27 million, for assistance with privatization and public sector reform.

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Department of Foreign Affairs and International Trade
Ministère des Affaires étrangères et du Commerce international

- Both the IMF and the World Bank have been active in providing technical assistance t Ukraine.

- The EBRD has undertaken an active lending program in Ukraine and may soon establish a venture capital fund to mobilize private capital. It could commit up to US$150 million in loans in the next two years.

Bilateral Assistance

- In terms of bilateral assistance from governments, there have been several areas targete for technical assistance funds, including democratic development and good governance, private sector development, social sector development, agriculture, environment and health.

- Canada's technical assistance program in Ukraine is aimed at supporting political and economic reforms and promoting long-term business links. To date, more than 60 projects, valued at more than C$27 million, have been undertaken. These have included bringing senior Ukrainian government officials to Canada for training in different areas. Canada has also provided humanitarian assistance to Ukraine, through the Red Cross and the United Nations Children's Fund. It has also extended a C$50 million line of credit through the Export Development Corporation.

INTERNATIONAL ASSISTANCE FOR NUCLEAR SAFETY

'ourteen operating nuclear power units currently provide about 40 per cent of Ukraine's lectricity generation. Recently, the Ukraine government has had to depend more on the 'peration of these nuclear units to provide essential electrical supplies in view of the cost nd reduced availability of fossil fuel imports.

'he operating nuclear plants in Ukraine include two Chernobyl units similar to the one, unit four", that caused the disastrous accident in 1986. Several major modifications have een made to the safety systems for the units still in operation and operating procedures .ave been upgraded. This has been done in close collaboration with the Russian designers nd international experts who are providing assistance and training on nuclear safety in the ountries of the former Soviet Union.

Canada is assisting in several areas of nuclear safety and radiation protection. The Atomic Energy Control Board is cooperating with the Ukraine State Committee for Nuclear and Radiation Safety to help it develop a legislative and regulatory framework for the control of nuclear facilities. Another project just announced, valued at $3 million, will help build .rgently needed spent fuel storage facilities at the Chernobyl and Rovno plants. This project will be managed by Ontario Hydro International Inc. of Toronto.

t is anticipated that Ukraine and Canada, along with other Group of Seven leading ndustrialized countries (G-7), will continue to work together on raising nuclear safety evels and finding longer-term energy solutions. These solutions would be expected to nclude the introduction of energy reforms, efficiency and conservation measures, and eplacement by newer nuclear and conventional power plants. This is in accordance with he Naples Economic Summit announcement of an action plan, which included a G-7 grant of up to $200 million and a provision for closure of the Chernobyl Plant. The European Commission will also provide a further $100-million grant and a $400-million loan.

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FACT SHEET ON UKRAINE
VITAL STATISTICS

ummary of Economic Indicators	1992	1993	1994[1]
ɔnomic Activity			
ıl GDP (% change)	-17	-14.2	.23
minal GDP: in trillions of karbovnets	4.2	153	1.055
lustrial production (% change)	-6.5	-14	-34.5
ces and Wages			
nsumer prices (% change)[2]	1 210	4 735	842
erage wages (% change)[2]	1 577	2 236	693
ıl wages (1991 = 100 end of period)	176	68	42
dget (as % of GDP)[3]			
nsolidated state budget balance	-34	-10.8	-9.4
neral government balance	-29.3	-9.7	-9.1
ternal Trade (in US$ billions)			
ports	11.3	14.9	n.a
ports	11.9	15.8	n.a
ade balance	-0.6	-0.9	n.a
Former Soviet Union	-1.1	-2.5	n.a
Rest of world	0.5	1.6	n.a

.. International Monatary Fund forecast
:. Percentage change over previous period.
ı. The difference between the consolideted state budget balance and the general government balance reflects the balance on extrabudgetary funds.
ı.a Not available

Ɔutput by Sector (%) (1990 - 1992)	1990	1991	1992
ɔtal Ouput			
dustry and Minig	60.2	61.7	67.3
griculture and Fisheries	21.5	20.1	14.4
ɔrestry	0.1	0.1	0.1
ɔnstruction	7.9	8.5	11.2
ate Procurement	0.3	0.4	0.4
ransport and Communications	4.2	3.6	3.2
ther Services	3.9	4.2	2.9
rade	1.9	1.4	0.5
	100	100	100
ɔcial and Demographic Indicators			
ɔpulation	52 million		
ɔpulation Density	86.2 km²		
rea	603 700 km²		

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