

Ukraine in 2020 – a personal view

The current global trend towards impressive growth in the emerging economies' share of the global GDP, leads Nataliya Kozachenko of Vasant Connect to suggest that the overall outlook for Ukraine ten-years hence is optimistic, as her report below explains

According to the latest IMF forecasts, in 2010 emerging and developing economies contributed 3.7% to global growth, almost double the contribution of the advanced economies (1.9%). I believe that this trend is likely to remain for the foreseeable future, which translates for Ukraine as an excellent opportunity to play an active part in the process.

At the recent Ukrainian-Japanese Business Forum the President of Ukraine stated that the country aims to become one of the twenty most developed economies in the world by 2020. My thoughts in this regard? Well, I believe that Ukraine, being one of the biggest European countries by size, the second largest economy in the CIS region and the only WTO member among the CIS majors, has realistic potential to at least progress significantly toward this goal, if not necessarily to achieve it. Reiffisen International Bank estimates that in 2011 Ukraine and Russia will enjoy the strongest GDP growth in Central and Eastern Europe (5%).

Sustaining growth will depend heavily upon how quickly and effectively the Ukrainian authorities address such burning issues as an unfavourable investment climate, the difficulty of doing business in the country, lack of reliable rule of law, corruption and an ineffective tax system. These issues are a 'cancer' in the Ukrainian economy. They also explain why in Ukraine, out of twenty of the largest international companies, just one – Coca-Cola – is present. It is an indicator that the country needs to find appropriate 'treatment' for sooner rather than later to avoid much greater pain in the long run.

Ukraine has a lot to offer to the world community. First, consider its huge reserves of strategically important natural resources:

'One third of the world's black soil'
This alone implies a rare opportunity for Ukraine to become one of the most important international players in the agricultural sector and in food production in the mid- to long-term, especially if land policy issues are resolved by that time. UniCredit estimates the agricultural sector will be one of the best national performers from 2012, following aggressive capital expenditure in 2011 to 2012. The Ukrainian black soil, matched by continuous increases in food prices and a severe undersupply of quality food across the globe will eventually become the nation's oil and gas equivalent in terms of wealth creation and its importance for the development of a fully functioning domestic economy.

'One of the ten largest reserves of iron, manganese, uranium, and coal' This is also a significant asset considering the global upward trend in commodity prices. Mining has traditionally been the backbone of the Ukrainian economy (the country is among the top ten world steel producers). Large coal, iron ore, and manganese reserves enabled the building of vertically-integrated metallurgical giants in Ukraine, achieving strong export potential. However, for exports to remain an important growth driver in the medium to long term, the country should diversify and move up the value chain. It does not make much economic sense for the nation to keep its exports concentrated in raw materials, low value added sectors, with metals, minerals and chemicals comprising more than 60% (which is the current situation in Ukraine).

Iron and steel, the agricultural sector, food and beverages, machinery, hotels, office and retail development, and chemicals will be the national champions by the end of this decade. Some industries, like iron and steel and food and beverages, already have this status. In terms of machinery, nowadays there is limited local demand and the sector needs major investment. In the medium term it could still benefit from CIS orders (especially for train carriages) and possible demand from the agricultural sector. As for office and retail development, progress here will be directly linked to business activity in the country. EURO 2012 also has the potential to become a turning point for the Ukrainian economy.

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National demographics and GDP per capita... The country has the fifth largest population in Europe after Germany, France, Italy, and the UK and is therefore a potentially large domestic market. In previous years Ukraine's population has shrunk due to a decline in birth rates and heavy emigration (the latest available statistics suggest that in 2010 at least 20% of the Ukrainian labour force worked abroad). The national demographic situation is likely to improve in the medium term following attractive increases in the country's GDP per capita. In fact, in 2010 the latter was

one of the lowest in Central and Eastern Europe (€2,317) and just one twelfth of that of the European Union.

Ukraine has a well-qualified and competitive labour force matched by solid scientific and educational potential. To achieve its utmost in this niche, national legislation on intellectual property rights should be brought up to European levels.

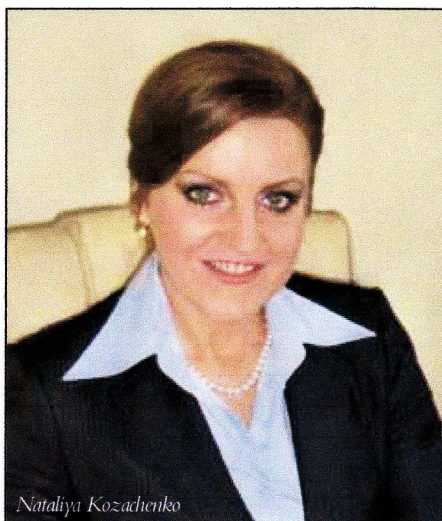
Last but not least, *the country has an excellent geopolitical and economic location.* All the country's neighbours are emerging markets with sound economic outlook in the short, medium and long-term. According to UniCredit, in 2011 Russia, Poland, Belarus, and Turkey will have GDP growth around 4% to 4.5% while Romania will have around 1.7%. Bearing in mind the relative geographic proximity to China and India (the economic superpowers turning into major engines of the world economy), Ukraine indeed has a vast market for its goods and services.

As I write this article, I keep wondering why, having all these riches, Ukraine has not realised its potential (at least partially) by now? Why was GDP per capita in the country in 2010 one third of that in Russia, Latvia, and Lithuania and one fifth of that in Estonia? Moreover, all these countries also emerged from the same Soviet system just twenty years ago. I guess it has much to do with an unfavourable business and investment climate along with a lack of rule of law in Ukraine which shapes the country's image and defines its reputation in the world, thus, influencing the FDI inflow.

Despite the fact that cumulative investments in Ukraine in the previous decade exceeded US\$ 40bn, the country's FDI per capita figure remains considerably less than in other developing and advanced economies. It is 2.2 times less than in neighbouring Russia, 3.5 times less than in neighbouring Poland and 8.4 times less than in Germany. Even though in recent years Ukraine intensified its cooperation with the IMF, IFC, EBRD and other international financial institutions, demand for external financing was far from being met.

It is a short to medium term priority for Ukraine to:

(1) Make its economy more energy efficient. Research by UniCredit suggests Ukraine is



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among the most energy intensive countries in the world. There is hope that IMF requirements for elimination of Naftogaz subsidies and privatisation may help transform the sector.

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(2) Modernise itself. The poor condition of the national transport infrastructure is one of the key problems for the country. The World Bank estimates investment needed for 2006–2015 to be US\$ 100bn. This would imply at least tripling the current level of public infrastructure spending of 2% of GDP (average 2000 to 2009). Hosting the EURO 2012 championship should help boost investment which would then need to continue until Ukraine's infrastructure is brought up to European levels. Investment in roads and airport construction will allow the country to start achieving its high transit potential.

(3) Improve operational efficiency and environmental standards in coking coal mining. Paradoxically, although Ukraine has one of the world's ten largest coal reserves, it currently imports one-third of its coking coal requirements due to the low quality of local coal. It makes more sense that the country should not import anything that it has in abundance at home.

(4) Enhance logistics, which are heavily interconnected with other industries.

(5) Develop the Ukrainian Stock Exchange in line with the established European exchanges.

It is essential for Ukraine to attract much more FDI into its economy in the near future. To achieve this, the country needs to create a level playing field for foreign investors; reform the legal system in line with one of the established European systems; tackle corruption, including doing away with excess red tape; ensure organisational support for investors (with less paper work involved); grant tax, licensing and other preferences for investors; develop relevant infrastructure (industrial parks etc); create national information agencies that would collate information regarding business opportunities and specific features of activity in Ukraine.

These days the competition for investors' capital is not between developing and advanced economies, rather among developing ones. Investors need clear and predictable rules and regulations. They usually go to the countries that have them.

It will take considerable time, effort and capital to successfully implement much needed reforms in Ukraine and create solid foundations for consistent economic development of the country, however, the reward will be worth the effort. The most important thing is to start and stay committed to this worthy goal until the very end.

For a while the world was surprised by the economic miracle of China and India. These days, wherever we are in the world, we hear a lot about the unprecedented growth of Turkey. Let us hope that Ukraine will appear in this praiseworthy list in the foreseeable future. I am convinced the country has all necessary prerequisites to become an important player in the world economy and politics. Whether it will become one is an altogether different question which has much to do with the strength of will and determination of the Ukrainian people to see their country achieve its potential. **UBI**

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