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UKRAINE

Special Focus: A Roadmap for Urgent Macroeconomic and Structural Reforms

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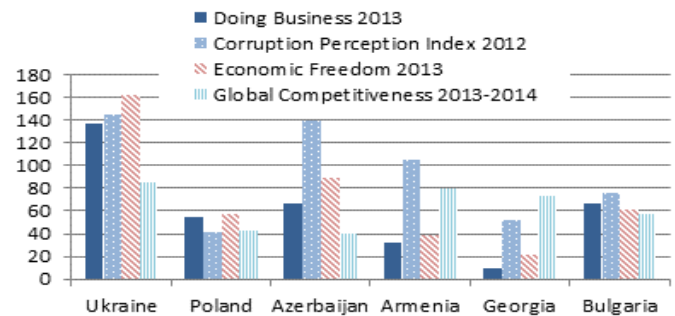
- *Long delays in economic reforms have created a challenging economic environment in Ukraine – and this is being accentuated by recent political and global tensions.*
- *Accumulated large macroeconomic imbalances, deep structural distortions, and lack of transparency in the public sector require urgent remedial actions.*
- *These remedial measures – macroeconomic stabilization and key structural reforms – could be painful in the short run, but they are necessary for the economy to grow in a sustainable and inclusive manner.*

High Expectations, Tough Choices

During recent events, it was clear that Ukrainians were demanding a transparent government, easy access to reliable public services free of corruption, good quality jobs and rising standards of living comparable to those in the neighboring EU.

Against the backdrop of high expectations following recent events in February, the newly-formed Government of Ukraine faces a daunting task of implementing tough macroeconomic and structural reforms. The Government has a short window to undertake corrective actions, and their job is made all the more difficult because they are currently facing a still weak global economy and high regional tensions.

Ukraine's progress in structural reforms vs peer countries (higher score indicates poorer performance in a specific ranking)



Source: World Bank, Private Sector Development Report

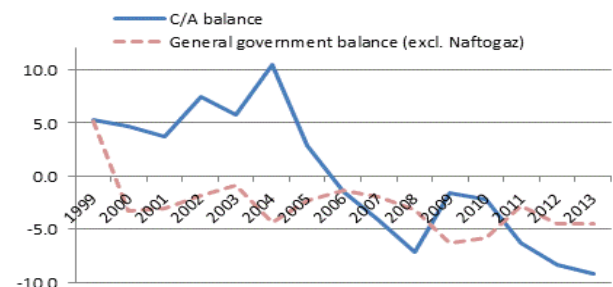
A Vast Reform Agenda Ahead

The reform agenda that lies ahead of the Government is vast and challenging to implement. Large internal and external imbalances have built up over the years and long delays in structural reforms have impeded economic growth for the past few years. Meanwhile, lack of transparency in the public sector and corruption has resulted in wasteful use of public resources and inefficient delivery of services. To set the economy on a sustainable growth path in the long run, concerted action is needed across several fronts.

Coordinated reforms to reduce fiscal imbalances, provide an enabling business environment, and resume healthy financial intermediation are needed to rekindle growth in Ukraine:

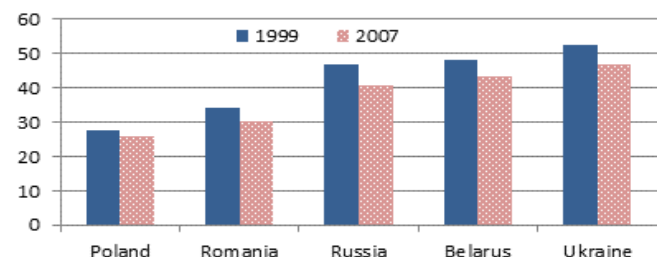
- Without fiscal discipline, economic recovery would not be possible and investors would be skittish. Going beyond immediate measures to reduce expenditures and increase revenues, longer-term measures are needed to reduce the deficit in a sustainable way. For example, reforming the pension system to make it more sustainable as well as targeting social assistance better to more deserving groups will be crucial. Equally important is the need to improve the efficiency of public expenditures to get better value for money in all sectors.

Dynamics of external and budget deficits (% GDP)



Source: NBU, IMF, WB

Size and Development of the Shadow Economy (%)



Source: World Bank, Private Sector Development Report

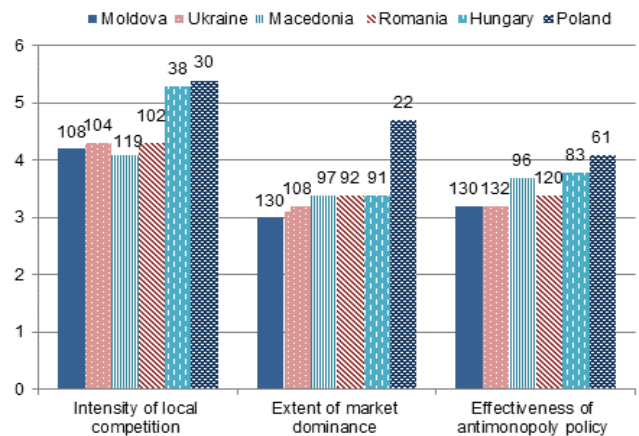
- But for fiscal consolidation to be successful there needs to be an enabling environment in which the private sector can thrive and operate efficiently to fuel growth and also to provide banks profitable lending opportunities.
- This, in turn, requires a stable and robust financial sector so that private enterprises will have adequate access to finance to support their investment and working capital needs.

In addition, infrastructure investments are needed to help generate growth by supporting the private sector and also to improve service delivery. These investments would:

- Develop the road network through prioritized construction, upgrades and maintenance of key roads, improved road safety, and reform in roads sector governance.
- Improve energy efficiency and transparency of the gas sector.
- Improve efficiency and invest in providing district heating services.
- Upgrade and expand aging generating capacities to meet the annually growing industrial demand for electricity.

Underpinning all these important measures is the critical need to reform the labor market to enhance labor productivity, especially in the view of worrisome demographic trends

Indicators on Market Competition and Competition Policy *



*Height of bar corresponds to score (scale is 1-7 with 1 being worst). Number shown corresponds to rank out of 144 economies (higher score indicates poorer performance)

Source: World Bank, Private Sector Development Report

Prioritize Reforms – Macroeconomic Stabilization Balanced with Structural Reforms

Given the vast reform agenda, what should Ukraine do first? Clearly, it is difficult for the Government to move on all fronts at the same time and there is need to prioritize reforms. The first priority should be to establish macroeconomic and financial sector stability and this should be accompanied by key structural reforms to jump start growth. Equally important are measures to improve governance and increase transparency because, among other reasons, they help increase efficiency of public expenditures, reduce losses through corruption, and help improve public service delivery.

Early implementation of reforms in the following key areas will send a strong signal to the population and investors that the Government is serious about tackling corruption and will also garner support for more reforms: gas sector restructuring, public procurement reforms, and comprehensive business deregulation. These measures will help reduce fiscal and quasi-fiscal subsidies, enhance efficiency of public expenditure, increase revenue, improve governance, help the private sector and spur economic growth.

Delays are Not an Option

While implementing the vast reform agenda is tough, delays are no longer an option because macroeconomic instability and stagnating growth are beginning to take a toll on ordinary citizens. Weak investor confidence, low growth, deteriorating public service delivery, and lack of good quality jobs are, in large part, consequences of delays in domestic policy adjustments. More importantly, weak governance, corruption, and concentration of private sector activity in the hands of a few are only making the situation worse and is adversely affecting the quality of life in Ukraine. Further delays in macroeconomic adjustment and structural reforms could only mean that the required correction is much sharper when status quo is no longer sustainable.

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