

# MEMU Supplement No.12-2007

## Delay in infrastructure reforms endangers economic growth in Ukraine

Real GDP growth is estimated to remain over 7% in 2007 and around 6% in 2008. The traditional risks for the economic growth are external shocks, in particular sharp decrease in exports prices for metals and chemicals and higher energy prices, as well as range of internal factors like political uncertainty or credit crunch. But apart from those risks, currently a risk of infrastructure breakdown becomes more and more crucial, adding to the likelihood of the significant slowdown of the economic growth in the country.

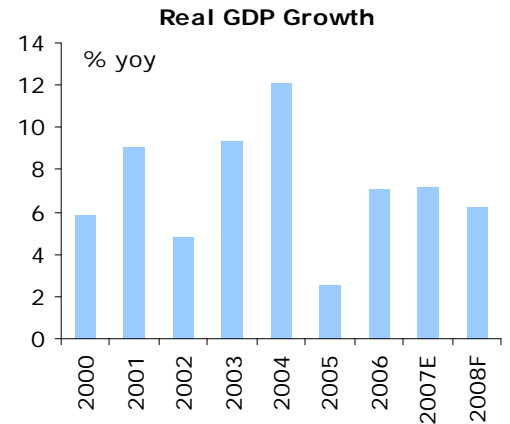
One of the key problems is a high share of obsolete stocks in the sectors. According to the Derzhkomstat, the level of outdated assets is 56% in water and wastewater sector, 60% in heating industry, 67% in electricity, and 80% in railways. Inadequate tariff policy not allowing setting the tariffs at cost-covering level and insufficient payment discipline reinforce the situation, not allowing large investments and implementation of cost-cutting technologies. All this significantly reduces the level of safety in sectors. The latter can lead to accidents, fatalities and environmental disasters, which can significantly increase economic losses, have negative impact on the economic efficiency and competitiveness of the country, cause lower receipts and higher costs to the central and local budgets. In this respect, the first necessary steps should be directed to improve current situation and accelerate the reform process.

No significant reforms in infrastructure have been observed during last years. The situation has remained almost the same in roads sector, there has been deterioration of regulatory environment in gas, water and railways industries, and only slight improvements were observed at power sector and telecommunications as the result of tougher competition. The quality and effectiveness of regulatory institutions (if they exist) have remained weak, while they have stayed largely dependent from the government. All sectors need regulatory improvements, more transparency in decision-making and implementation of fair play rules. The regulatory bodies have to become coherent, predictable and capable to behave proactively to ensure sustainable infrastructure development and transparent tariff-setting.

Nowadays in Ukraine the state is the major provider of infrastructure services. Therefore, the issue of financing in corresponding sectors arises because Ukrainian fiscal policy is not adequate to satisfy infrastructure needs. The horizon of the budget planning is one year, what in fact hampers the progress of reforms and implementation of long-term infrastructure projects. Moreover, the budget of Ukraine is socially oriented. For instance, according to the revised Draft State Budget for 2008, fairly all planned additional revenues should be directed to finance current expenditures that means further increases in social standards, including minimum wages, subsistence minimum, minimum pensions, and other social payments. The projected level of capital expenditures remains insufficient to cover the need of the economy.

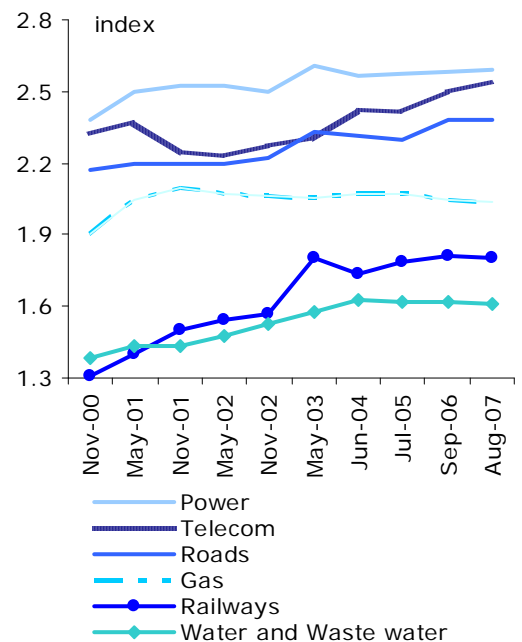
To improve the financing of infrastructure objects, it is necessary to: (i) implement middle-term budget planning; (ii) refuse from financing current expenditures at the expense of capital investments, which are often covered according to the "residual" principle; (iii) at last introduce the public-private partnership practice in infrastructure sectors.

Only active and prompt measures can prevent country from a series of technological disasters and ensure the stable and sustainable economic growth of Ukraine in forthcoming years.



Source: Derzhkomstat, IER  
E - IER estimate, F - IER forecast

### Infrastructure reforms in Ukraine: development indicators



Source: IER, Infrastructure Monitor Ukraine 2007

Note: 1 - reforms are absent;

4 - market-oriented reforms are almost finished

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**Quarterly trends**

<b>National accounts</b>		<b>Q2 04</b>	<b>Q3 04</b>	<b>Q4 04</b>	<b>Q1 05</b>	<b>Q2 05</b>	<b>Q3 05</b>	<b>Q4 05</b>	<b>Q1 06</b>	<b>Q2 06</b>	<b>Q3 06</b>	<b>Q4 06</b>	<b>Q1 07</b>	<b>Q2 07</b>
GDP	UAH bn	78.6	99.4	100.1	84.3	97.5	119.4	123.6	105.4	124.1	150.4	157.7	133.1	161.4
GDP (real)	% yoy	12.7	14.3	9.1	4.9	3.4	1.4	1.7	4.1	6.8	6.9	9.5	8.0	7.9
Households consumption (real)	% yoy	18.0	9.7	12.5	14.3	17.7	17.0	17.1	20.2	18.2	11.8	9.9	14.7	15.5
State consumption (real)	% yoy	1.3	3.9	0.9	6.1	0.0	1.0	4.0	9.6	5.8	5.8	1.0	0.8	6.2
Gross fixed capital formation (real)	% yoy	22.6	23.8	16.8	-2.3	-0.5	0.2	0.3	19.9	19.3	17.9	18.3	24.4	23.5
Exports of goods and services (real)	% yoy	21.1	14.3	11.7	-0.6	-14.0	-12.7	-15.5	-14.9	-9.6	3.2	1.0	4.9	5.2
Imports of goods and services (real)	% yoy	10.9	7.2	8.7	2.8	3.2	3.9	-0.9	10.7	0.9	8.3	6.4	12.9	19.6
Agriculture, hunting, forestry (real)*	% yoy	0.2	35.6	11.3	5.8	8.3	2.6	-7.2	3.8	2.8	-5.6	8.1	4.8	6.8
Manufacturing industry (real)*	% yoy	15.0	9.9	6.9	7.0	1.8	-1.1	2.0	-1.5	6.1	7.3	7.2	15.0	13.2
Construction (real)*	% yoy	23.3	11.9	23.3	-8.4	-11.3	-8.5	-7.5	0.1	0.8	1.4	4.2	13.3	8.2
Trade, repair services (real)*	% yoy	17.4	13.9	2.5	-2.1	-10.7	-11.7	-11.9	6.2	16.4	20.0	21.9	14.3	17.5
Transport (real)*	% yoy	14.9	12.5	6.4	6.6	5.7	2.8	7.8	4.9	7.7	9.4	5.3	7.0	5.6
<b>Balance of payments</b>														
Current account balance	USD bn	2.3	2.1	1.1	1.6	0.6	0.4	-0.1	-0.8	0.0	0.5	-1.4	-1.3	-0.7
Current account balance	% of GDP	15.8	11.0	5.7	10.1	3.2	1.7	-0.4	-3.7	0.0	1.7	-4.3	-5.0	-2.0
Trade balance in goods	USD m	1552	774	482	1020	-236	-1131	-788	-1353	-935	-884	-2022	-1753	-1430
Trade balance in services	USD m	198	749	157	188	392	1035	191	219	506	1054	347	50	403
Current transfers	USD m	758	720	623	626	694	745	780	622	790	851	910	789	923
Direct investment (FDI)	USD m	614	420	344	247	365	477	6474	1053	1389	1636	1258	1162	1772
Portfolio investments	USD m	149	1313	156	397	923	90	1347	4	-141	370	3350	1818	1519
Gross international reserves	USD bn	9.6	12.1	9.5	12.0	13.1	14.3	19.4	17.3	17.6	19.1	22.3	23.5	25.6
Exchange rate, UAH/USD	aop	5.33	5.31	5.31	5.30	5.10	5.05	5.05	5.05	5.05	5.05	5.05	5.05	5.05
<b>Fiscal indicators</b>														
Consolidated fiscal revenues	% of GDP	26.9	26.3	25.9	32.1	35.1	31.5	31.0	31.2	31.7	31.9	32.8	33.3	32.8
Personal income tax	% of GDP	4.1	3.8	3.8	4.3	4.4	3.9	4.2	4.4	4.6	4.1	4.1	5.1	5.3
Enterprise profits tax	% of GDP	4.0	4.1	6.1	4.8	5.9	5.3	6.3	3.4	4.6	4.3	6.7	3.8	4.1
Value-added tax	% of GDP	5.7	5.1	4.1	8.6	9.2	7.9	7.3	9.2	9.2	9.7	9.3	10.4	9.8
Excise tax	% of GDP	2.1	2.0	1.8	2.0	2.0	2.0	1.7	1.8	1.7	1.5	1.5	1.8	1.7
Consolidated fiscal expenditures	% of GDP	26.5	26.8	35.2	28.3	36.4	28.1	41.7	30.9	32.8	29.4	36.6	28.4	31.0
Current expenditures	% of GDP	22.7	21.7	27.2	26.5	33.6	24.0	34.2	28.9	29.7	24.9	29.2	26.9	28.4
Capital expenditures	% of GDP	3.8	5.1	8.0	1.8	2.7	4.1	7.5	1.9	3.2	4.5	7.4	1.6	2.6
Consolidated fiscal balance	% of GDP	0.4	-0.5	-9.3	3.7	1.0	-5.0	6.2	-0.4	1.1	-2.4	4.0	-4.8	1.7
Privatisation receipts	% of GDP	3.7	3.5	1.0	0.2	0.6	0.6	16.0	0.1	0.1	0.1	0.1	0.5	0.5
<b>Labour market</b>														
Average wage (real)	% yoy	18.6	14.7	15.4	15.0	19.0	19.6	26.4	23.8	22.6	18.8	11.3	11.5	12.0
Household income (real)	% yoy	16.3	11.3	16.6	24.0	28.0	19.4	18.9	22.1	18.6	20.3	16.3	11.1	10.8
Unemployment rate (ILO methodology)	% cum	8.3	8.1	8.7	8.7	7.1	5.2	7.8	7.9	6.8	6.4	6.8	7.4	6.6
<b>Banking system</b>														
Monetary aggregate M0	% yoy cum	25.6	37.1	27.9	28.2	39.1	31.1	42.2	36.2	25.3	23.7	24.5	22.9	30.4
Monetary aggregate M2	% yoy cum	44.8	51.5	32.3	38.9	37.4	31.3	53.9	39.2	36.6	36.7	34.3	38.6	40.7
Household deposits in national currency	% yoy cum	67.3	67.9	26.2	28.3	31.6	30.4	90.8	54.6	41.1	39.7	37.3	50.7	56.3
Household deposits in foreign currency	% yoy cum	61.7	55.2	54.3	51.8	45.4	46.4	59.1	54.5	66.2	64.3	57.5	52.3	43.8
Com. bank credits in national currency	% yoy cum	52.1	44.3	29.4	28.3	32.6	43.4	58.7	59.8	53.7	49.0	52.3	52.4	57.2
Com. bank credits in foreign currency	% yoy cum	56.2	43.5	32.2	33.1	36.8	47.1	66.3	72.0	82.1	90.4	95.4	98.9	97.4
Long-term com. bank credits	% of total	102.7	82.7	57.1	49.5	53.0	70.1	84.6	87.6	86.7	76.6	79.5	84.1	86.5
Average lending rate on national cur. credits	% p.a.	49.3	50.9	54.2	54.4	56.1	59.7	61.8	63.1	63.4	63.5	64.9	65.8	67.3
Average lending rate on foreign cur. credits	% p.a.	16.6	17.0	17.6	17.0	15.4	15.4	16.4	15.8	15.5	14.6	15.1	14.0	13.9
	% p.a.	12.1	12.6	12.2	12.1	11.0	11.3	11.7	11.5	11.3	11.3	11.5	11.5	11.4

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

\* change in value added

° preliminary