UKRAINE -- Country Assistance Strategy -- Progress Report

Introduction

This progress report on the CAS for Ukraine describes the positive achievements reached in macroeconomic stabilization and other areas since approval of the CAS in 1996, as well as the very serious challenges remaining. We appreciate this realistic assessment of the risks and alternatives available.

Among the several positive developments, the report notes some success in reducing inflation, privatization, trade liberalization and care of the environment. These are welcome.

More importantly, however, the progress report also describes the difficult obstacles, some new and others more entrenched, that the country is facing. Political uncertainties and renewed fiscal pressures seem to be the most significant, along with continuing inefficiencies in the public sector, slow structural reforms and remaining problems for private sector development.

In spite of our hopes for a more positive assessment, under these circumstances it seems clear that a long-term strategy cannot yet be elaborated. We fully agree that the Bank has to move very cautiously until there is some further clarification of where it can be most effective. We welcome the forthright statement along these lines and endorse this approach, a restrained yet supportive strategy, for the period until next full CAS, when we hope that the situation will allow for renewed progress.

Comments on the Progress Report

While there has been some progress in macroeconomic stabilization, as described in the CAS progress report, much remains to be done in many other areas, in particular in public sector reforms, institution building, enterprise governance, and the reduction of poverty.

We are very pleased to learn that inflation dropped dramatically in 1997. However, it is apparent that macroeconomic stabilization remains very fragile. Furthermore, GDP has declined for the eighth consecutive year. It has raised poverty indicators to a very high level, although this could decline rapidly with renewed economic progress.
Moreover, this persistent decrease in the output – over 60 percent – is alarming. It should galvanize both Bank planners and Ukraine authorities as the process for preparing the next CAS is begun.

Paradoxically, this uncertainty contributes to the political difficulties faced by Ukraine while preventing ownership and implementation of decisive reform policies. Each country must, of course, decide its appropriate level of political determination to undertake reform. We think, however, that Ukraine should consider carefully if it can press harder since results of the most recent CAS have been described as no better than “mixed.”

There is a brief mention of the “burgeoning” informal sector with no details. We would appreciate more complete information describing this area. This is important because the progress report also describes the country’s fiscal situation as becoming increasingly fragile, a development that appears to reflect, at least in part, this growing informal sector.

At the same time, despite the privatization of a large number of small and medium enterprises that is scheduled to continue at a very high pace, potential impact has been diminished by “the retention of substantial de facto powers of control by Government line ministries and other government agencies, and by complex, multi-layered and outdated regulatory systems”.

We think this is a crucial observation. Considering that privatization of medium and large enterprises is not yet completed, these remaining controls can certainly continue to result in sharp distortions in relative prices, complicate the allocation of resources, and may significantly damage the benefits associated with the privatization process.

Moreover, maintaining these regulatory controls will continue to undermine the level of foreign direct investment, resulting in a poor development of the private sector and impeding the achievement of a path of sustainable growth that could bring poverty alleviation. We would also appreciate staff comments on this issue. In spite of the changes that have occurred, overall Ukraine has not yet achieved the conditions for promoting a sustainable and stable market based economy.

As noted above, it hardly needs to be said that driving small and medium businesses into the informal sector (as appears to be happening) contributes directly to the fiscal stress by (a) decreasing tax revenues and (b) not decreasing the costs of supporting government agencies and ministries who might better be downsized. This is an issue to be addressed that should be central for the next CAS.

In that regard, can staff advise if there are plans to consider how other countries have dealt with obtaining tax revenues from the informal sector, as well as to better define government’s role in the regulation of privatized companies? Tax reforms based on consumption and wealth taxes might be appropriate in this situation to raise government income since other taxes do not seem to be doing this.
Turning to the social sector, we welcome the commitment of the Government to address problems in this area, as indicated in the report. Reform of the pension system is critically needed in order to contribute to improved fiscal sustainability. We would also appreciate further staff comments on the Bank’s strategy in this field, since preparation of a framework for the introduction of a privately funded pension system seems to be crucial.

While good progress has been achieved in restructuring a large number of farms and demonopolizing agro-industrial enterprises, we remain concerned that efforts in land reform and privatization of marketing and distribution enterprises have slowed. Regarding this sector we would have liked to find information on gender issues and would appreciate additional details on this particular subject.

The Proposed Interim Strategy

We think it appropriate to again note that -- while each country’s needs and possibilities must be assessed individually -- other countries have had to make much deeper reform efforts to achieve lower levels of Bank support. In this particular case, the level of lending appears to be high, taking into account the actual pace of the reform process. However, we are also convinced that deepening structural reforms is necessary and ultimately beneficial to achieve progress. As such, we would certainly endorse moving to the most generous lending levels should Ukraine be able to undertake a major reform program.

The risks involved in Bank strategy are well described in the CAS progress report. As noted, it is very difficult to predict about the ability of the authorities to implement and accelerate the reform process, due to the political uncertainties. We understand full well those uncertainties and that it may not be possible in this situation to do more than is now proposed.

In fact, as stated above, we would welcome being able to move to a lending scenario of US $800 million–US $1 billion and fully agree that if a strong EFF program is implemented, the Bank should continue proceeding with the near-term lending scenario, implementing the two new adjustment operations, as well as presenting to the Board the Coal SECAL and release of the Agricultural SECAL second tranche. In the absence of an EFF program, showing no commitment of authorities to accelerate the reform process, the Bank should only continue with those operations that are less affected by macroeconomics policies and performances.

Finally, we encourage Staff to continue working closely with Ukraine authorities in order to develop programs that will bring important economic benefits to all the people of Ukraine.