

The OeNB's 85th East Jour Fixe Ukraine: political, economic and migration challenges¹

In cooperation with the National Bank of Ukraine

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The Oesterreichische Nationalbank (OeNB) organized its 85th East Jour Fixe in cooperation with the National Bank of Ukraine (NBU). The event, which took place at the OeNB in Vienna on September 12, 2019, focused on Ukraine, a country that held both presidential and parliamentary elections this year. Against the backdrop of political change, the East Jour Fixe assessed Ukraine's current macroeconomic situation and the challenges ahead. Invited speakers provided insights into the peace process concerning parts of Eastern Ukraine, the country's reform progress, the importance of sound governance for economic growth as well as monetary policy and financial stability. The event also discussed migration, which is an important issue for Ukraine and Central, Eastern and Southeastern Europe (CESEE) at large.

Reflecting the cooperation of the two organizing central banks, the workshop was opened by OeNB and NBU representatives. In her introduction, *Doris Ritzberger-Grünwald*, Director of the OeNB's Economic Analysis and Research Department, pointed to the successes the reform process in Ukraine has achieved so far, mentioning inter alia the transformation of the NBU into a modern and independent central bank, macroeconomic stabilization and important reform steps that have taken place since 2014. However, she interpreted this year's election results as a sign that Ukrainians are not yet satisfied with what has been achieved so far. She explained that it was only reasonable for this event to focus on looming challenges in Ukraine by highlighting some of them: the unresolved conflict in parts of Eastern Ukraine, low FDI inflows against the background of the necessary strengthening of the rule of law, and a very high level of nonperforming loans (NPLs). In his introductory statement, NBU Deputy Governor *Dmytro Sologub* shared his thoughts on the situation in his country by partly complementing some issues raised by Ritzberger-Grünwald. He emphasized some of the achievements that have been made in recent years despite very difficult circumstances, stressing the importance of prudent fiscal and monetary policy and the role of Ukraine's flexible exchange rate. He named the gas sector as one of the key reform areas where change has been significant. Among the main challenges, in his view, will be preventing the reversal of what has been achieved so far and overcoming vested interests. Given external risks, further cooperation with the International Monetary Fund (IMF) will be vital for Ukraine. Regarding emigration, Sologub said he did not expect the current pattern to change and for him, this issue was a long-term policy challenge.

Rémi Duflot, Deputy Head of the Office of the Special Representative of the OSCE Chairperson-in-Office in Ukraine and in the Trilateral Contact Group, gave a keynote speech on the challenge of peace from the perspective of the Minsk

¹ The presentations and the workshop program are available at www.oenb.at/Termine/2019/2019_09_12_east_jour_fixe_85.html.

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negotiations. As a starting point, he explained the origins and the functioning of the Minsk process and presented some striking figures on the non-government controlled area (NGCA) in the Donbas region, also with regard to the prevailing humanitarian situation. He remarked that the different narratives of the conflict complicated its resolution and referred to empirical research that could help discriminate between possible and unrealistic narratives. Dufloth pointed out that according to a SOCIS nationwide survey published in May 2019, 62% of respondents see the conflict as the most pressing issue affecting people's lives. Yet, the U.N. Social Cohesion and Reconciliation (SCORE) survey shows how far views diverge among the population on both sides of the contact line regarding the granting of a special status to the NGCA (a core issue under the Minsk agreements) and that the different views are sometimes even selfcontradictory. Dufloth noted that "such confusion was likely the result of a lack of public pedagogy on this important topic." One of the most urgent issues for the OSCE is to restore connectivity between the NGCA and the government-controlled area. Other priority challenges include stabilizing the security situation and reactivating political discussions. Progress on these matters would help building a convincing case for investors in the government-controlled area in the Donbas region, which is one of the declared objectives of the new Ukrainian government.

In the ensuing discussion, the Ukrainian Ambassador to Austria stressed Ukraine's sensitivity with regard to the nature of the conflict and underlined the need for caution in using terminology. Moreover, discussions of the nexus between EU sanctions on Russia and the Minsk agreements concluded that full implementation of the agreements (and, in turn, a lifting of sanctions) was likely to be still a long way off, which was in itself a reason for intensifying resolution efforts.

The first session chaired by *Helene Schubert*, Head of the OeNB's Foreign Research Division, dealt with Ukraine's economic challenges. The first speaker in this session, *Olena Bilan*, Chief Economist at Dragon Capital (a Ukrainian investment bank), reviewed the reform progress. After providing detailed information on some key reform areas (banking system and NBU transformation, business deregulation, gas sector reform and measures in the fight against corruption), she concluded that the reform progress over the period from 2014 to 2018 was noteworthy, but not sufficient to change the perception foreign investors have of the country. Key obstacles to foreign investment – widespread corruption, lack of trust in the judiciary, and the influence of oligarchs – were not sufficiently addressed. There is hope, however, because the political setup after the elections has been conducive to fulfilling an ambitious reform agenda. The envisaged land reform, in particular, is viewed as transformational for Ukraine, given its potential to attract sizable capital inflows and markedly boost GDP growth. One of the key challenges is to overcome vested interests and resist pressures from oligarchs. In response to a question by the chair, Bilan stressed that the IMF played a major role in pushing for anticorruption measures.

Dimitar Bogov, Regional Lead Economist for Eastern Europe and Caucasus at the European Bank for Reconstruction and Development (EBRD), started his presentation by pointing to the great divergence in economic development between Ukraine and Poland. While at the onset of transition, the two countries had been at the same level, economically speaking, now, 30 years later, Poland is three times richer than Ukraine. He contrasted the comprehensive reforms undertaken in Poland with the lack of political will to reform in Ukraine. The lack of reforms led to a

significant governance gap between Ukraine and Poland, as worldwide governance indicators show. Against this background, Bogov elaborated on why governance was important for economic growth. He also presented some results from recent analytical work carried out at the EBRD, which shows that closing half the gap in the quality of Ukraine's economic institutions relative to the G7 would yield a sizable growth dividend. At the end of his presentation, he presented a list on what remains to be done in Ukraine, e.g. guaranteeing and respecting the independence of the NBU or privatizing state-owned enterprises and state-owned banks.

Sergiy Nikolaychuk, Director of the NBU's Monetary Policy and Economic Analysis Department,³ focused on challenges for monetary policy and financial stability in Ukraine. By way of introduction, he pointed to the disinflation path and declining tensions in the Ukrainian financial sector. Then he presented a risk map for the banking sector. One risk that deserves particular attention is the legal risk that emanates from a number of controversial court rulings on the nationalization of Privatbank. In this regard, Nikolaychuk pointed to NBU efforts and the strong position of the IMF, which will help keep the situation stable. Regarding the economic recovery, he stressed that other policies than monetary policy (i.e. structural policies) should be used to achieve higher growth. External vulnerabilities are still a challenge, but – on the positive side – these have disciplined Ukrainian authorities to maintain prudent policies. Very high NPLs represent a further challenge as they put a drag on lending. Moreover, Nikolaychuk pointed out that structural rigidities and supply-side constraints in the real economy affect monetary policy through various channels.

The three presentations triggered several interesting comments and questions from the audience: The relation between the new Ukrainian president and the oligarch Ihor Kolomoiskyi was debated, but the debate remained inconclusive. The notion of macroeconomic stabilization was questioned with reference to very high real interest rates. The EU Association Agreement and the Deep and Comprehensive Free Trade Agreement (DCFTA) were characterized as being important background elements.

The second session, chaired by NBU Deputy Governor *Dmytro Sologub*, dealt with migration. *Matthias Lücke*, Senior Researcher at the Kiel Institute for the World Economy and member of the German Advisory Group Ukraine, presented preliminary research findings on labor migration from Ukraine since 2014. When assessing the scope of emigration from Ukraine, a key issue is to differentiate between seasonal or temporary migration and permanent migration. According to a conservative estimate, around two million Ukrainian emigrants (still) interacted with the Ukrainian economy in 2017. Approximately three-quarters of these emigrants live in the EU. In fact, there has been a remarkable shift in destination countries, with a sharp increase in the numbers of Ukrainian migrants in Poland and a decline in Russia. After providing further details on migrants from Ukraine, Lücke elaborated on the macroeconomic effects of migration and remittances, pointing out that those working abroad sustained the livelihoods of at least two million Ukrainians and their dependents. Moreover, he characterized sizable remittance inflows as a stable source of foreign exchange earnings. Regarding the impact of emigration on

³ Later in September, *Sergiy Nikolaychuk* became Deputy Minister at the Ministry of Economic Development, Trade and Agriculture of Ukraine.

wages in Ukraine, Lücke concluded that it is unlikely that emigration has had a strong effect on the international competitiveness of the Ukrainian industry

Paweł Strzelecki, Economic Expert at Narodowy Bank Polski (NBP), presented analytical work on the contribution of immigration from Ukraine to economic growth in Poland. This analysis was motivated by the rapid increase in the numbers of Ukrainian immigrants to Poland. Labour Force Survey (LFS) data, however, do not show the full extent of immigration because they only cover persons who have been present in Poland for more than one year and because immigrants show low response rates. This is why Strzelecki and his NBP co-authors estimated the average annual number of employed immigrants to Poland. After applying a decomposition exercise, they concluded that the contribution of immigration to Polish GDP for the period from 2014 to 2018 amounted to 10% and helped stabilize labor supply in this period. Strzelecki saw the potential for the further growth of migration from Ukraine as limited as the Ukrainian economy is improving and the country's working-age population is shrinking. He also pointed to the many similarities that exist between Ukrainian immigration to Poland and Polish emigration to Great Britain and Germany.

Anna Raggl, Senior Economist at the OeNB, brought in a regional perspective on migration based on OeNB Euro Survey data focusing on the question of how the quality of public services shapes migration intentions in CESEE. Raggl highlighted that the CESEE countries recorded considerable out-migration in past decades. Together with unfavorable demographic developments, this adds up to a strong decline in working-age population. According to OeNB Euro Survey data collected in the fall of 2018, 9% of the working-age population in CESEE intend to move abroad within the next year. Factors closely related to individual migration intentions are age and gender, family characteristics, unemployment and networks. Yet, the presented analysis also revealed that people's dissatisfaction with public services plays a role in shaping migration intentions. For policymakers this means that improving the quality of public services can reduce emigration pressures and might incentivize re-migration and immigration.

After the three presentations, the speakers and participants discussed the possible impact of changes in German immigration policies on labor migrant flows from Ukraine. Although the discussants agreed that they did not have in-depth background knowledge on planned changes, the overall tenor was that they expected their impact to be rather limited in this context.