


Ukraine: Reform Progress and the Way Forward

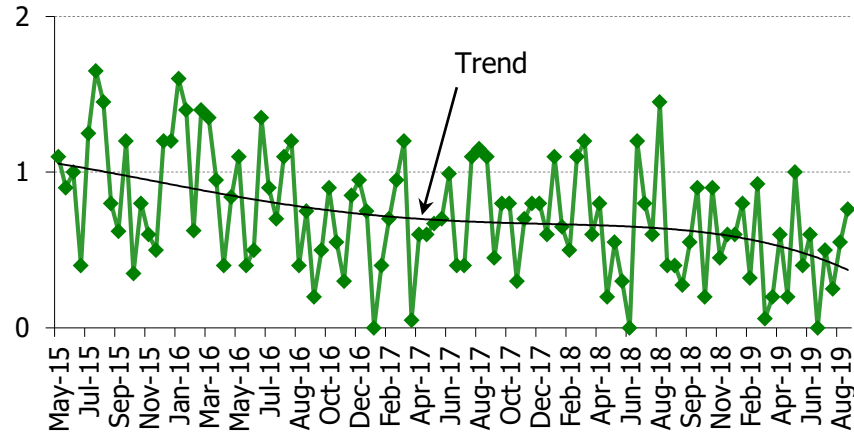


Olena Bilan, Chief Economist
85th East Jour Fixe of the OeNB
Sept. 12, 2019

Reform Progress in 2014-2018

Broad Picture

Index for Monitoring Reforms* (iMoRe)



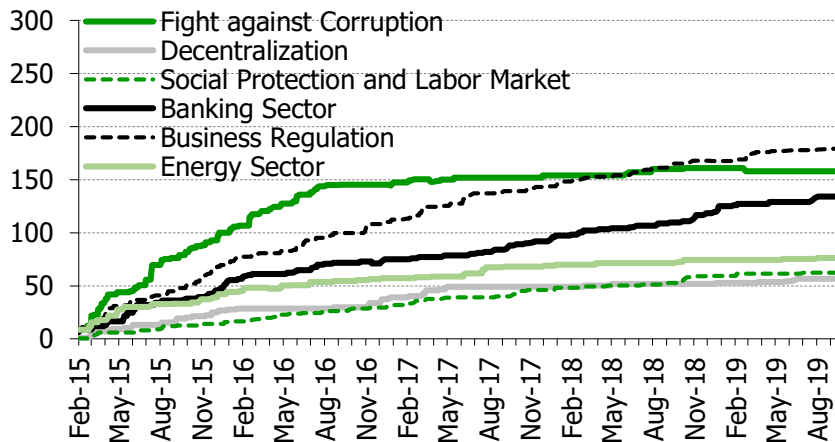
- The **assessment of reform progress** over 2014-2018 has been **mixed**. Some observers consider the progress to be more significant than over the previous 24 years of independence. Others say what has been done is not enough for a breakthrough

- The **expert community praises:**

- central bank transformation and banking system reforms
- business deregulation
- fiscal decentralization
- gas sector reforms
- changes in pension system and healthcare
- selected anti-corruption efforts

- The **population** has been largely **dissatisfied**, giving previous authorities credit only for decentralization and police reform

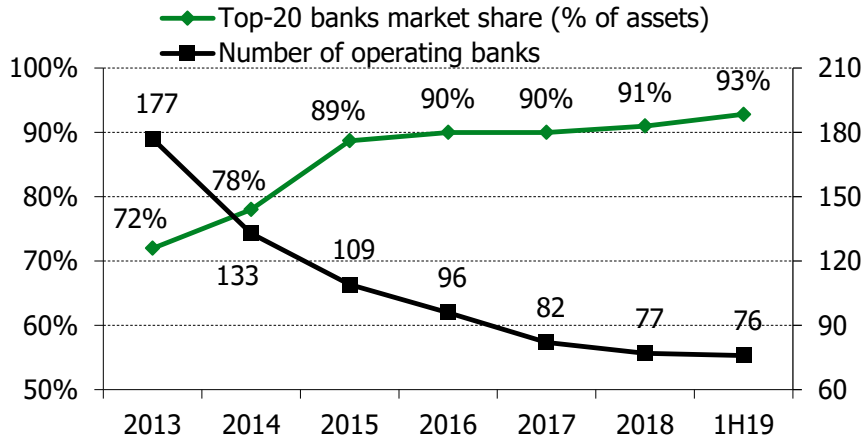
The Most Reformed Areas: Expert Assessment** (points)



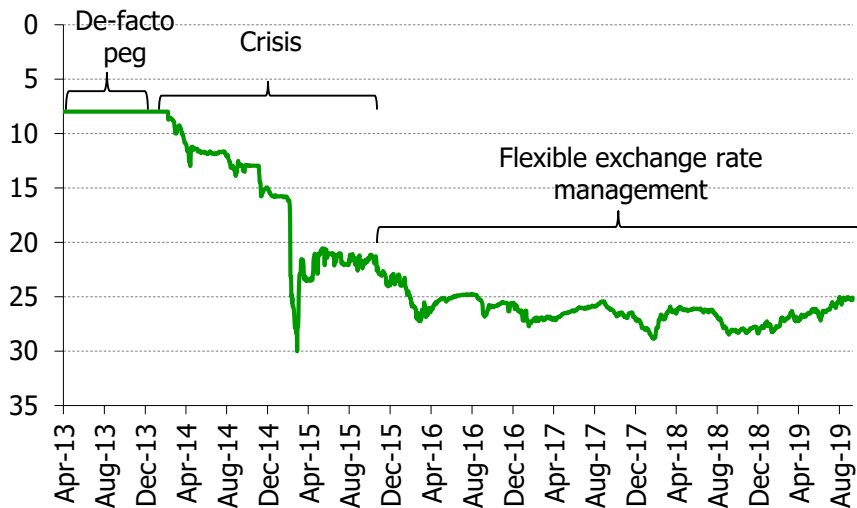
Note: *index assesses economic reform progress on the scale of -5.0 (regress) to +5.0 (progress) based on experts' assessment of legislation; **calculated as cumulative iMoRe score of legislative acts affecting particular area. Source: VoxUkraine

Banking System and NBU Transformation

Number of Banks and Banking Sector Concentration



UAH:USD Exchange Rate

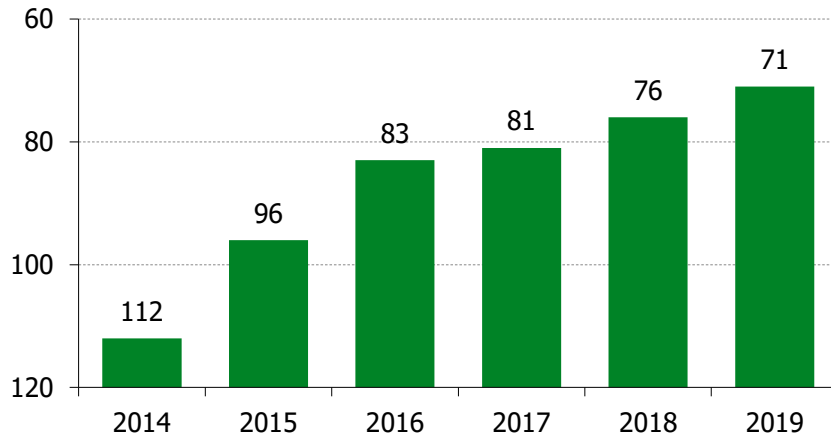


Sources: NBU, Dragon Capital

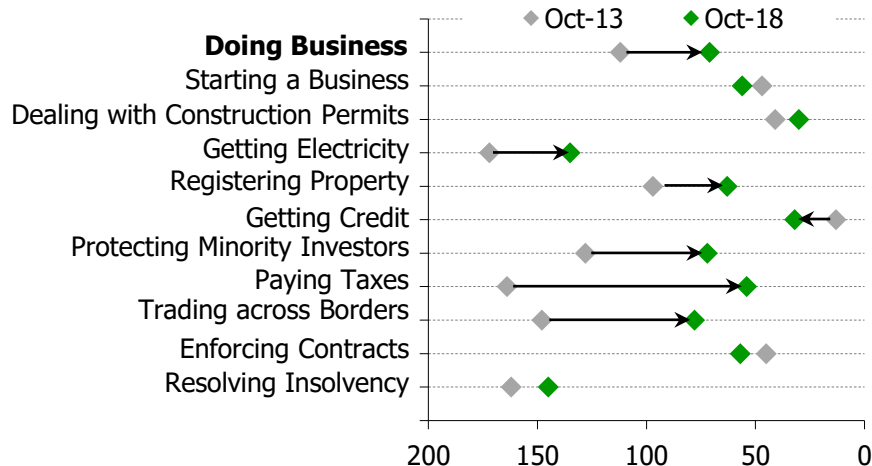
- The **NBU became an independent institution** with reform-minded management and efficient structure
- The Bank abandoned its **de-facto exchange rate peg** and has been shifting towards **inflation targeting**
- The NBU **cleaned the banking sector** of non-viable and money-laundering banks. The top bank, Privatbank (18% of assets), was nationalized smoothly despite risks
- The NBU enhanced requirements for bank UBO disclosure and related-party operations, mandated adequate capitalization and improved supervision, aligning it with EU bank legislation and Basel requirements
- The government recently appointed independent directors and state representatives to the **Supervisory Boards** at three state-owned banks

Business Environment

Ukraine's Doing Business Rank



Ukraine's Progress in Doing Business Survey Components (points)

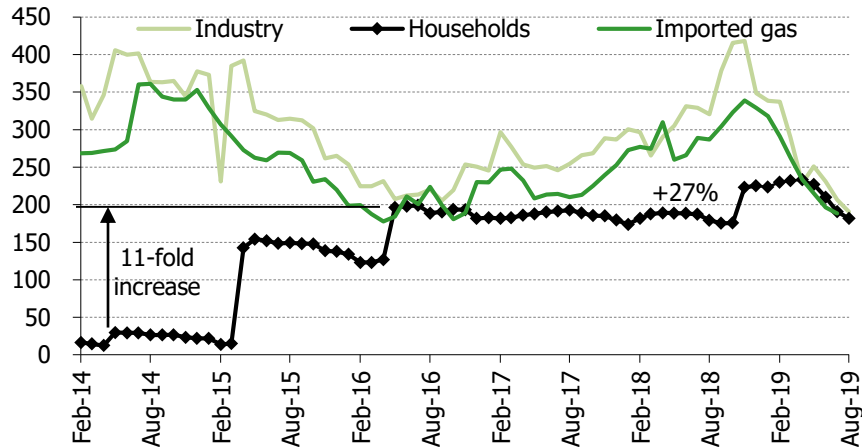


Source: World Bank

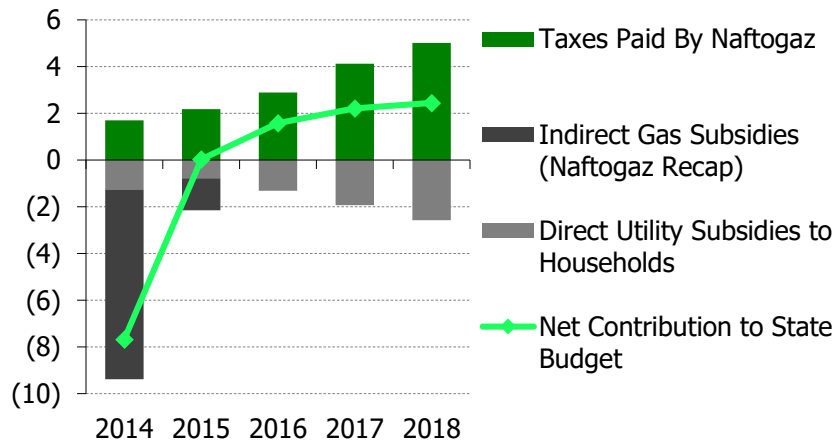
- Ukraine has advanced by **41 spots in the World Bank's Doing Business** survey in the past five years, ranking 71st
- Key improvements in business regulation include:
 - number of licensed activities and permits down 40%
 - payroll tax rate almost halved, from over 40% to 22%, since 2016, bringing tax burden to CEE average
 - Online registry of VAT refund claims launched
 - Over 14,000 Soviet-era safety standards and multiple sanitary norms abolished

Public Finance & Energy

Gas Price (\$/tcm, net of VAT and transportation costs)



Naftogaz Ukrainy Net Contribution to Budget (\$bn)

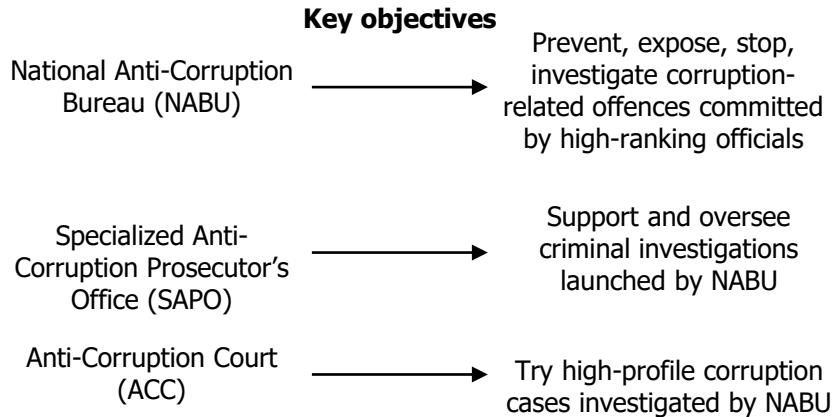


Sources: Finance Ministry, Economic Ministry, Naftogaz Ukrainy, Dragon Capital

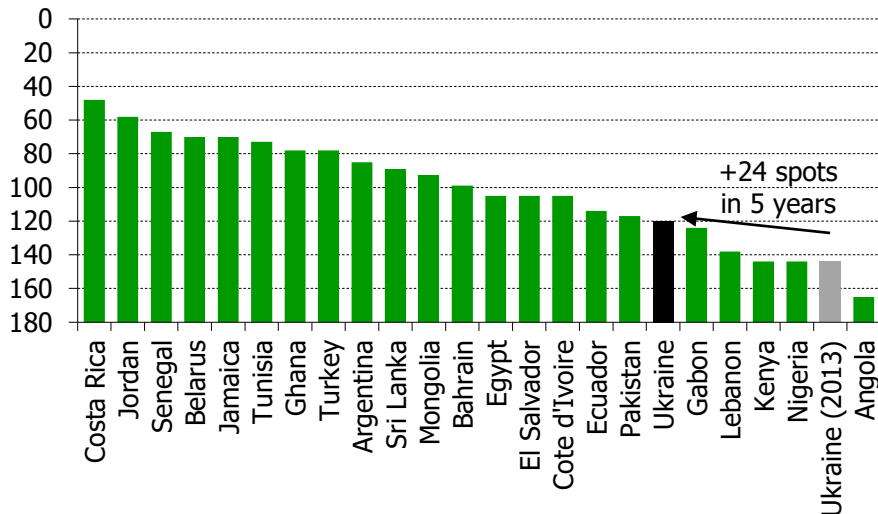
- Retail gas prices rose 11-fold in three years (2014-2016). State-owned gas monopoly **Naftogaz Ukrainy enjoyed a financial turnaround**, which enabled it to invest to expand gas extraction
- Ukraine stopped direct gas imports from Russia in favor of (reverse) supplies from the EU, thus reducing dependence on the adversarial eastern neighbor
- Tight budgetary constraints along with sharp increases in domestic gas tariffs (accompanied by direct subsidies to the poor) helped **slash the broad fiscal deficit from 10% of GDP in 2014 to 2.0% in 2015**, helping push public debt on a downward trend: debt-to-GDP slid by 20pp in to years to 60%.
- The government shifts to medium-term budget planning and is conducting spending reviews aiming to improve efficiency

Fight Against Corruption

Structure of Anti-Corruption Institutions



Corruption Perception Index (2018)

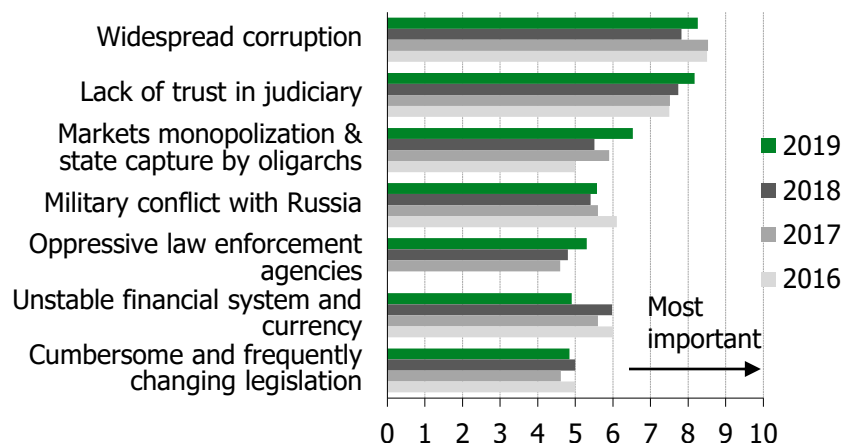


Sources: Transparency International, Dragon Capital

- **New institutions** to fight high-level corruption:
 - National Anti-Corruption Bureau (NABU), Specialized Anti-Corruption Prosecutor's Office (SAPO), Anti-Corruption Court (ACC)
 - Electronic system of assets and income declarations for state officials (not very productive yet)
- **Reducing corruption opportunities:**
 - Transparent and user-friendly electronic public procurement system ProZorro
 - State registries made publicly available, ranging from beneficial ownership, court filings and car registrations
 - Better corporate governance at selected SOEs

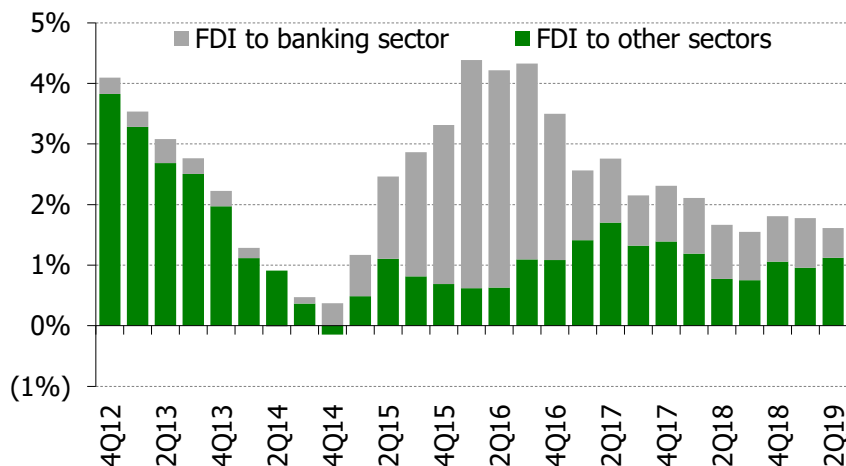
What went wrong?

Major obstacles to foreign investors

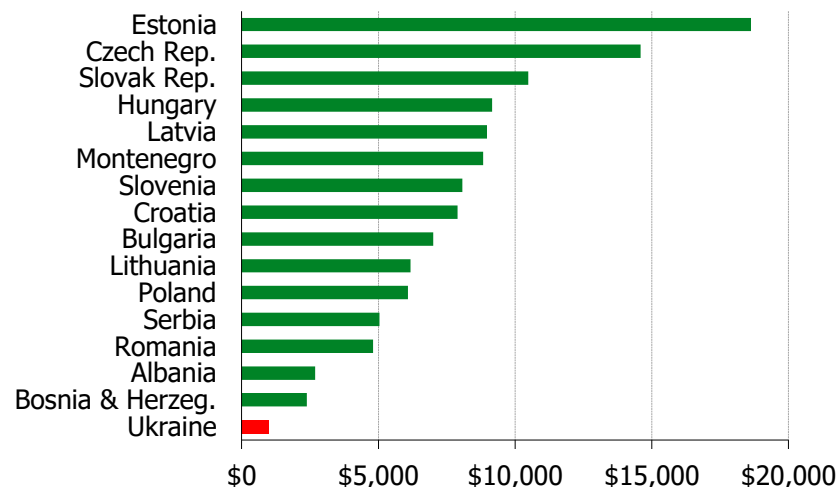


- Reform progress over 2014-2018 was notable but not sufficient to change foreign investors' perception
- Key obstacles to foreign investment – widespread corruption, lack of trust in judiciary and influence of oligarchs – were not sufficiently addressed
- As a result, FDI remained low and post-crisis economic recovery was sluggish

FDI in Ukraine (% of GDP)



FDI stock per capita (end-2018)

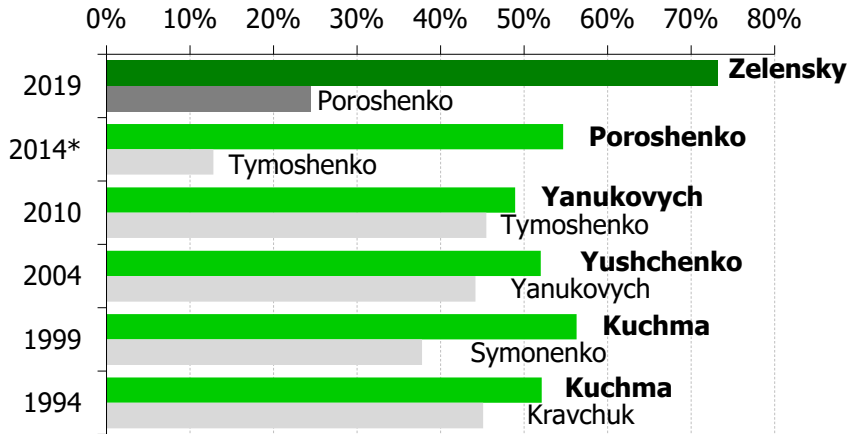


Sources: UNCTAD, NBU, EBA, CES, Dragon Capital

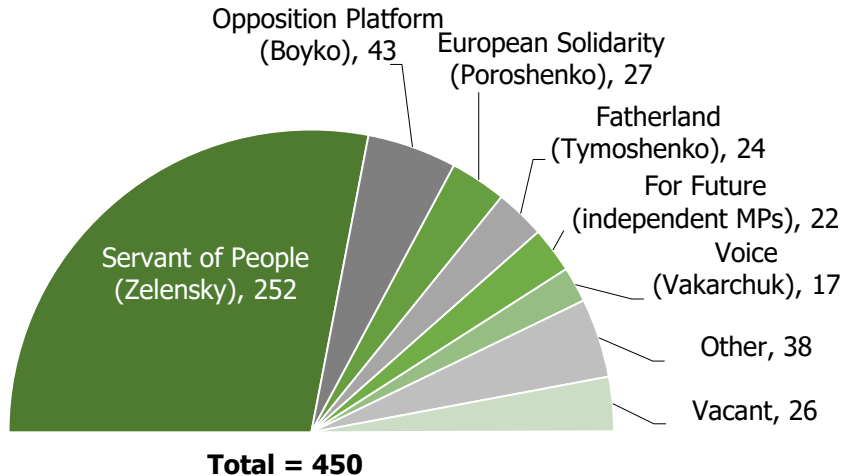
Reform Outlook

Post-Election Political Setup...

Ukrainian Presidential Elections: Votes Cast in Runoff



Composition of Parliament (number of seats)



Note: *there was no runoff election as Poroshenko won more than 50% in first round.
Source: Central Electoral Commission

- Volodymyr Zelensky won a **record 72% of the vote** in the presidential elections
- His political party, Servant of the People, secured an **outright majority in parliament** for the first time in Ukraine's post-Soviet history
- First-time MPs represent 77% of the new Verkhovna Rada, the highest rate since Ukraine's first Rada elections of 1994. The average age of this Rada is 41 years
- The Rada swiftly approved 35-year-old Oleksiy Honcharuk as prime minister and voted in his **reform-minded government, which became the youngest ever in Ukraine**

...Conducive to Fulfilling Ambitious Reform Agenda...

Fight against Corruption/Protection of Property Rights

- Invigorate recently created anti-corruption institutions
- Restore punishment for illicit enrichment
- Downsize and overhaul the Prosecutor General's Office
- Restart judicial reform

Land, State Property and Investment

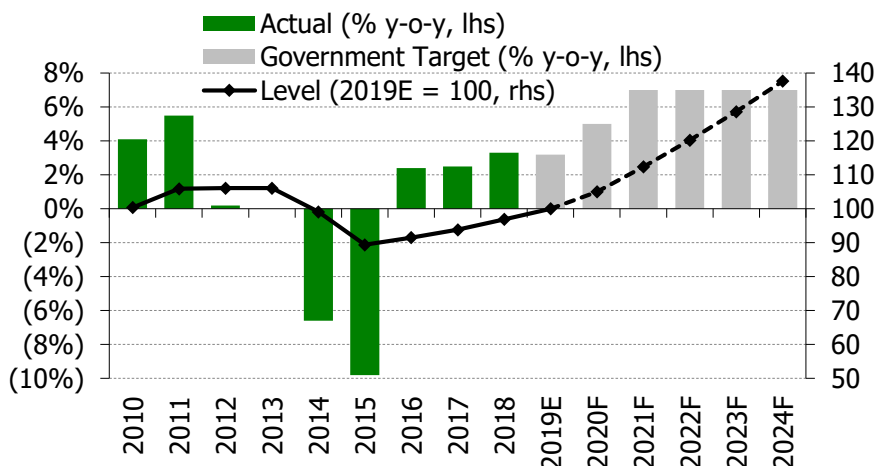
- Lift the ban on farmland sales and launch farmland market from mid-2020
- Resume large-scale privatization of state assets
- Pass legislation on concessions and lease of state/communal property
- Pass new law on investment incentives and protection of foreign investment

Business Environment & De-shadowing

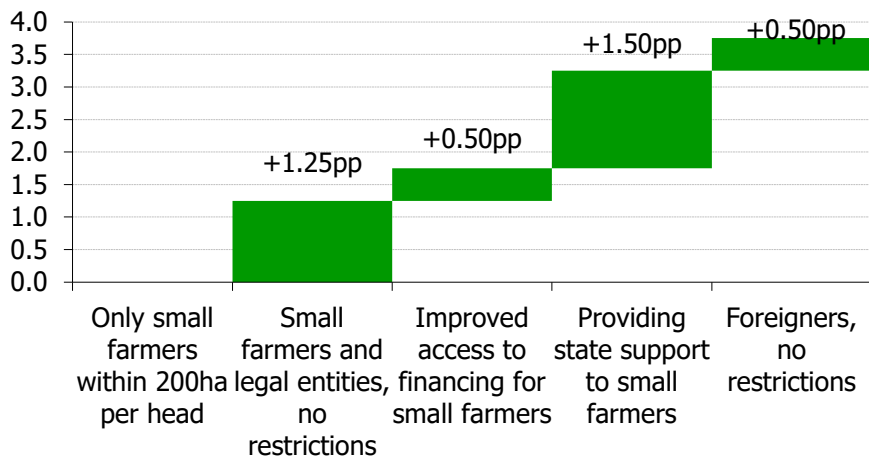
- Revive business deregulation
- Minimize state involvement in the economy, including by trimming authority of the State Security Service
- Create a new analytical financial investigations service
- Foster competition by undermining monopolies, particularly in the energy sector
- Introduce a tax amnesty and replace corporate tax with exit capital tax at a later stage
- Legalize gambling and amber mining
- Reduce the scope for informal employment and simplify procedures to hire and fire personnel

...and Invigorating Economy

Real GDP Growth (% y-o-y)



Land Reform Impact on Growth (pp per annum)

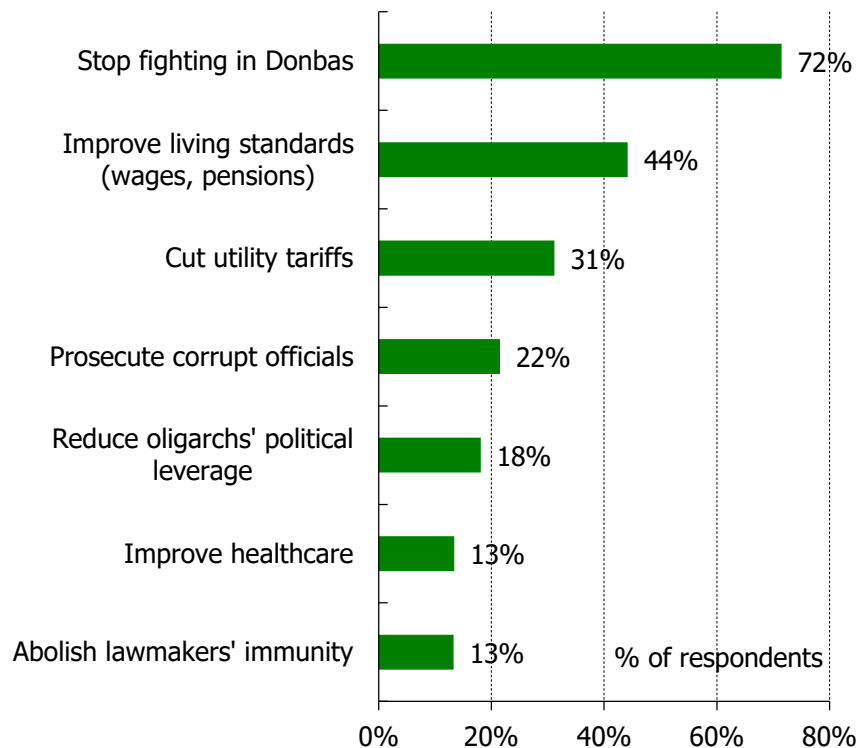


Sources: SSS, Government, Kyiv School of Economics, Dragon Capital

- With this reform agenda, the new administration aims to propel Ukraine to the top-10 of the World Bank's Doing Business ranking, attract foreign investment and **speed up economic growth to 5-7% y-o-y**
- These reform intentions **correctly address Ukraine's most pressing issues**, including those viewed as key obstacles to foreign investment. Some initiatives, such as land reform and privatization, could be implemented quickly and bring visible results within the next several years
- In particular, **land reform is viewed as transformational** for Ukraine for its potential to attract sizable capital inflows and boost annual GDP growth by up to 4.0pp, according to some estimates, via higher private consumption and increased productivity

Challenges/Risks

What Should President Zelensky And His Team Prioritize?



Source: Democratic Initiatives Foundation, Aug. 8-20 poll

- **Overcome vested interests** and resist pressure from oligarchs, particularly in areas such as de-monopolization of markets and reform of judiciary
- **Resist temptation to monopolize political power**, restrict freedoms and undermine independent institutions such as the central bank
- **Balance the desire to preserve popularity and the need for painful reforms** (gas price liberalization, low interest rates)
- **Attract professionals to public service** (especially middle and lower levels) to ensure proper reform implementation and policymaking
- **Strike a balance between the approval speed and quality** of introduced legislative and regulatory changes

Thank you!