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May 26, 1993

To: Members of the Executive Board

From: The Secretary

Subject: Ukraine - Staff Report for the 1993 Article IV Consultation

Attached for consideration by the Executive Directors is the staff report for the 1993 Article IV consultation with Ukraine, which will be brought to the agenda for discussion on a date to be announced. A draft decision appears on page 22.

Mr. Hole (ext. 38979) or Mr. Bredenkamp (ext. 38881) is available to answer technical or factual questions relating to this paper prior to the Board discussion.

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INTERNATIONAL MONETARY FUND

UKRAINE

Staff Report for the 1993 Article IV Consultation

Prepared by Staff Representatives for
the 1993 Consultation with Ukraine

(In consultation with other Departments)

Approved by John Odling-Smee and Mark Allen

May 24, 1993

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I. Introduction

Discussions for the first consultation with Ukraine under Article IV and Article XIV were held in Kiev from March 31 to April 16, 1993. The staff team 1/ met with the Deputy Prime Minister for Economic Reform, Mr. Pinzenik; the Minister of Finance, Mr. Piatachenko; the Minister for Foreign Economic Relations, Mr. Herts; the Governor of the National Bank, Mr. Youschenko; the Chairman of the Anti-Monopoly Committee, Mr. Zawada; the Chairman of the Commission of the Supreme Soviet on the Budget and Credit, Mr. Pecherov; and senior officials of various government ministries and agencies and of the National Bank.

The March/April mission followed several previous visits by the staff over the preceding 15 months to review the evolving economic situation and to provide policy advice. Over the same period, an intensive and wide-ranging program of technical assistance by Fund staff was also put in place (see Appendix II). This report and the accompanying paper on Recent Economic Developments draw upon information and analysis from this earlier work.

Ukraine became a member of the IMF on September 3, 1992 and is availing itself of the transitional arrangements of Article XIV, section 2. At the Executive Board's pre-membership review on April 2, 1992 (EBM/92/43), Directors emphasized that addressing the difficult situation facing the economy would require both a clear delineation of economic policy responsibilities within government and a strong commitment to a program of mutually supportive policy changes. Directors expressed concern at the delay in implementing measures to stabilize the financial situation, and in particular at the absence of effective policies to control credit. They urged the authorities to lift remaining price controls as soon as possible, to move quickly on small-scale privatization, and to start privatizing agriculture. They warned against any inclination to manage foreign trade and urged the authorities to adopt appropriate payments mechanisms and a high degree of currency convertibility. Finally, Directors encouraged the Government to develop, in consultation with the staff, a comprehensive program of macroeconomic stabilization and reform that would enable the international community to provide effective financial support to Ukraine.

1/ Messrs. Hole (head), Bredenkamp, Ossowski, Schmieding, Sundakov and, as assistant, Ms. Toso (all EUR II), Mr. DeMilner (resident representative), Mr. Felman (PDR) and Mr. Offerdal (FAD).

II. The Economy in 1992

In the event, 1992 was for the most part a year of policy drift, accelerating inflation and continued economic decline. Real GDP fell by 14 percent, bringing the cumulative fall from 1989 to about 28 percent (Table 1). Ad hoc attempts to support production with fiscal subsidies and subsidized credits may have moderated the fall somewhat--and allowed enterprises to grant substantial wage increases--but at the cost of pushing up inflation to dangerously high levels by the end of the year. For the year as a whole, wages and prices both increased faster than in Ukraine's two major trading partners (Table 2). In common with experience elsewhere in the former Soviet Union (FSU), external trade fell sharply, contributing to the output decline; and toward the end of the year--and particularly following Ukraine's withdrawal from the ruble area--the limited availability of external financing began to act as a binding constraint on economic activity. With the exception of first steps to liberalize prices and measures to strengthen the legal and institutional framework for a more market-based economy, progress in the area of systemic reform was limited.

1. Institutional setting

The challenges faced by the authorities in building effective governmental and administrative structures for a newly independent country proved to be particularly thorny in 1992 in the area of economic management. Technically, the economic shocks resulting from the disintegration of the U.S.S.R. and the task of developing the expertise and consensus for introducing fundamental economic reforms posed extraordinary difficulties. Administratively, the ability to deal with these difficulties was handicapped by several factors: the lack of a tradition of coordination across ministries long accustomed to operating independently (and reporting to Union bodies); a weak data base, both in terms of coverage and timeliness; and an unclear division of responsibilities between Government, the President and Parliament. Against this background, and that of rapidly changing events, economic policy in 1992 tended to be reactive. And Government found itself vulnerable to raids by powerful lobbies on the Treasury and the National Bank.

Within government, principal responsibility for economic policy rests with the Deputy Prime Minister for Economic Reform. Under his stewardship, the main center of economic decision-making has devolved to the Ministry of Economy, successor to the former State Planning Committee, although various branch economic ministries--especially Industry and Construction, Agriculture, and Energy, each of which is headed by a Deputy Prime Minister--also exercise considerable influence. The role of the Ministry of Finance in 1992 was relatively narrow, confined largely to drawing up and executing the budget. The National Bank, meanwhile, enjoyed little discretionary authority; it remains, by law, accountable to Parliament and in 1992 tended in practice to be seen as a vehicle for creating and directing credits toward what parliamentarians regarded as priority or deserving sectors, on terms that were negotiable case by case. Branch ministries are also reported to have engaged in this form of lobbying on behalf of enterprises in their sectors. As a result, and given also the collective failure of members of the ruble area to agree on rules and objectives for policy, the traditionally passive role of monetary policy--a prominent feature of the Soviet economy--persisted in Ukraine in 1992.

2. Activity

The further fall in production in 1992 was spread across almost all sectors, including agriculture (Table 3). Little if any of the decline can be ascribed to the effects of positive restructuring, which has yet to begin on a significant scale. Rather, it appears to have originated largely from severe disruptions in Ukraine's traditional trade and payments arrangements, a substantial reduction in procurement by the FSU defense sector from Ukraine's large military-industrial complex, and the effects more generally of recession elsewhere in the former U.S.S.R. A sharp deterioration in Ukraine's terms of trade with the FSU is also likely to have been a depressant, but one which was dampened by the availability for much of the year of external financing, as well as by the fact that enterprises for the most part did not face a hard budget constraint. Much more important was the fall in deliveries of energy resources and raw materials; despite government-to-government agreements, contracts were only partially fulfilled, with imports of crude oil, for example, falling to 34 million tons, against a contracted level of 40 million tons and deliveries in 1991 of 51 million tons.

As in 1991, the brunt of the decline in activity was reflected in a sharp fall in investment. With the surge in inflation, national accounts data are in some disarray, but all indications are that the drop in the volume of gross capital formation was in excess of 30 percent. Consumption also declined, but more modestly as, judging from the monetary data, household savings appear to have been drawn down in real terms in the face of a reduction in the real wage.

Despite the continued fall in activity, the number of registered unemployed has remained modest and in March 1993 still stood at less than 1 percent of the labor force. In a survey of 47 enterprises in early 1993, however, one third of all workers were reported to be on unpaid leave.

3. Inflation

Following a jump of 250 percent in January, in the wake of the freeing of some prices and very substantial increases in prices determined directly by the Government, the rate of increase in consumer prices subsided to 10 percent in March under the influence of initially restrictive budget and credit policies and a partial rollback of some of the January price increases. Subsequently, the rate of inflation accelerated fairly continuously, reaching close to 30 percent a month on average in the fourth quarter (Table 4). The principal immediate cause was a dramatic weakening of the budget and a massive expansion in credit to enterprises.

In striking contrast to the declared aim of reducing the government's financing requirement to 2 percent of GDP (from 15 percent in 1991), in 1992 the imbalance in the State budget in fact widened to 32 percent of GDP (Table 5). Expenditure, narrowly defined, was in line with expectations. Revenue, on the other hand, fell 14 percentage points of GDP below estimate, reflecting a substantial mis-estimation of receipts from a new value-added tax and lower receipts than forecast from profits tax. More important, off-budget subsidies in the form of cheap credits mandated by Parliament to industry and agriculture ballooned to the equivalent of 16 percent of GDP. Including such transfers, total State budget expenditure surged to 61 percent of GDP, while general government expenditure--including outlays of the extrabudgetary pension, social assistance and labor funds--reached approximately 75 percent of GDP, an extraordinarily high ratio by international standards. 1/ With the extrabudgetary funds registering a small surplus, the general government deficit amounted to 28 percent of GDP, double its level in 1991.

Virtually all of the deficit was financed by the banking system. At the same time, bank credit to enterprises also surged, contributing to an increase in net domestic assets of the banking system during 1992 which was double that in Russia and Belarus, and a growth in the money supply of close to 25 percent a month on average during April-December (Table 6). Interest rates, meanwhile, remained a fraction of the inflation rate, leading to continuing weakness in the demand for money and persistent capital flight.

Underlying the loss of monetary control were several forces:

-- the maintenance of substantial but erratic price controls. This contributed to an increasing misalignment of relative prices, which generated a demonstrable need for large subsidies, especially for the agricultural sector;

-- the precarious financial position of many state enterprises. This reduced budget revenue and gave rise to mounting pressures for assistance;

-- the absence of quantified financial policy targets and of a clearly articulated and credible commitment by government to strengthening enterprise financial discipline. This increased the vulnerability of the authorities to such pressures and encouraged a business-as-usual approach. One manifestation of the latter was a recurrent build-up in inter-enterprise arrears, both within Ukraine and between Ukraine and other states of the FSU, which in turn compounded pressures on monetary policy;

-- the ambiguity of enterprise ownership rights and uncertainty about the government's privatization policy intentions. This shortened the time horizon of workers and managers and fueled substantial wage increases, which

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1/ Comparable ratios for Eastern European countries in transition ranged, in 1991, from 35-40 percent in Romania, 50-55 percent in Bulgaria, Czechoslovakia and Poland, and 60-65 percent in Hungary.

fed the demand for cheap credit and gave repeated twists to the inflation spiral;

-- and the perverse incentives, generally, created by the lack of monetary policy discipline in the ruble area.

Against this background, and that of the prevailing balance of political and institutional power, producer subsidies in the budgetary accounts reached an estimated 25 percent of GDP in 1992.

In mid-November, Ukraine formally withdrew from the ruble area, replacing ruble notes and converting all deposits in Ukrainian banks into karbovanets at a one-to-one rate. Credit expansion, however, continued unabated. During December alone, broad money increased by almost one third, adding further to inflationary pressures and precipitating a marked depreciation of the karbovanets (Chart A).

4. The external sector

Few reliable data are available on the balance of payments. The estimates for 1992 in Table 9 were pieced together by the staff from fragmentary information--in particular, enterprise surveys of intra-FSU trade, data on the draw-down of lines of suppliers' credits, the recorded balance on correspondent accounts with other FSU central banks, and convertible currency holdings of the State Foreign Exchange Fund--and should be regarded as indicative only. On the available evidence, however, three things seem reasonably clear: there was a sharp contraction, overall, in external trade; the evolution of the current account with the FSU differed from that with the rest of the world (ROW); and there was a marked deterioration in the overall balance of payments associated in part with the deterioration in the terms of trade, but principally with lax financial policies. As regards the current account, estimates by the staff suggest:

-- for FSU trade: a fall of perhaps 25-30 percent in the volume of exports and non-energy imports; a decline in the volume of total energy imports of 5-10 percent; a deterioration in the terms of trade on the order of 15 percent; and a widening in the current account deficit from about 1 percent of GDP in 1991 to 7 percent of GDP (or about US$1 billion, estimated quarterly at the prevailing market exchange rate) in 1992.

-- for ROW trade: a similar fall in the volume of exports to that experienced with the FSU, but a significantly sharper fall in the volume of imports related to the acute shortage of foreign exchange; little change in the terms of trade; and a current account surplus, perhaps of some US$0.5 billion.

The contraction in FSU trade reflected general economic disorder in the FSU, but in particular a breakdown in the inter-state payments mechanism which caused long delays between shipments and payments and contributed to the emergence of huge inter-enterprise arrears. In addition, steep increases in the relative prices of production inputs, coupled with the imposition by Russia from mid-year of a pre-specified limit on correspondent account credits, reduced not only the volume of financeable imports but also export production. The announcement by the Central Bank of Russia at the end of September that Ukraine's credit ceiling would be raised no further contributed importantly to the decision by Ukraine, in mid-November, to introduce its own currency.

Much of Ukraine's trade in 1992--with the ROW as well as with the FSU--continued to be organized within the framework of inter-governmental agreements. Bilateral agreements were signed with 13 FSU states which outlined specific quantities of goods to be traded; in the event, these "quotas," which were substantially below the previous year's levels, were not fulfilled. Licensing requirements and barter transactions were commonplace. Trade between enterprises at their own initiative was of relatively greater importance with the ROW, but again a high proportion took the form of barter, particularly in view of a tax--of some 40 percent on average--on hard currency earnings.

The combined FSU/ROW current account deficit and a small increase in convertible currency reserves in 1992 were broadly financed by medium-term grain and suppliers' credits from the EC, Germany and the United States and by direct investment inflows. At the same time, however, there was a build-up in correspondent account and other monetary liabilities to FSU countries of some rub 550 billion (US$3 billion). The counterpart capital account items would appear to be the involuntary extension of export credits by Ukrainian enterprises to enterprises in other FSU states (estimated by officials at some rub 250 billion) and substantial capital flight.

The principal evidence for capital flight is the paltry repatriation of hard currency export earnings. Enterprises were discouraged from repatriating earnings by the foreign exchange tax, unremunerative domestic interest rates and currency inconvertibility, while loose financial policies enabled them to meet domestic currency expenses with bank credit. At the same time, the risk of sanctions was low; during 1992, the foreign exchange system was in a regulatory vacuum, and the National Bank was not in a position to verify accurately the foreign exchange receipts of enterprises. The build-up in net inter-state enterprise claims, meanwhile, reflected in part the earlier introduction by Russia of prepayment requirements for exports and the less than complete observation of such requirements, when eventually introduced, by Ukraine.

5. Systemic reform

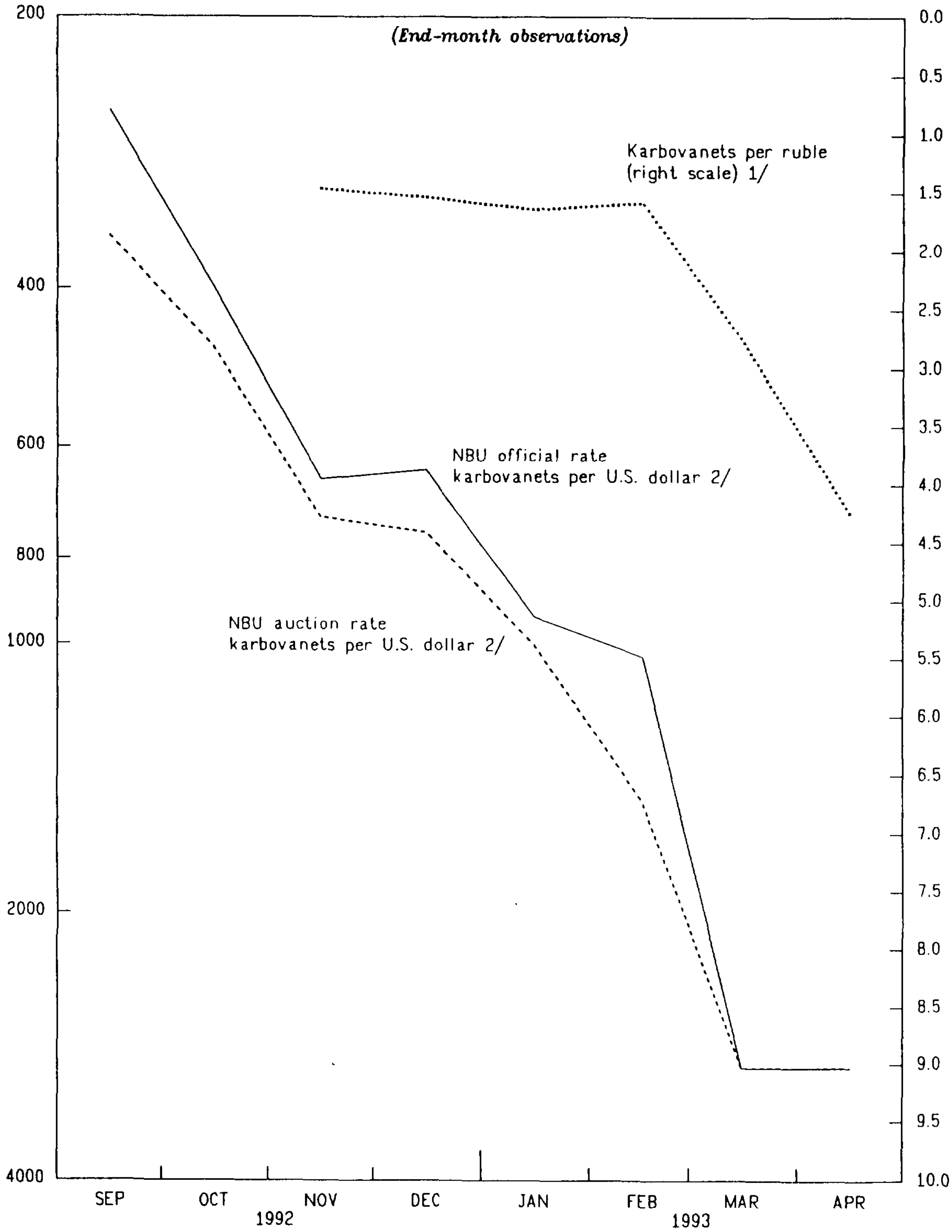
While progress was made during 1992 in strengthening the institutional and legal framework for transition to a market economy, practical implementation of reform remained modest.

a. Legal framework. Much of the basic legislation relating to the protection and transferability of private property, the enforcement of contracts, and mechanisms for dispute resolution have now been put in place.

CHART A

UKRAINE

EXCHANGE RATE DEVELOPMENTS



Source: National Bank of Ukraine.
1/ NBU official rate through March 1993; unified auction/official rate in April 1993.
2/ Rubles per dollar through October 1992; auction and official rates unified in March 1993.

In this context, in 1992 Parliament enacted a bankruptcy law modelled on western practices and a law on foreign investment which permits investment in most types of business, provides for unimpeded repatriation of dividends and capital, and grants substantial tax concessions.

b. Price system. Although a number of prices were freed from the former centralized setting mechanism and the scope of profit margin controls was reduced, price formation generally remained subject to extensive control, both formal and informal, at various levels of government. As a result, prices did not clear many markets or serve as much of a guide to production decisions, and subsidies grew in importance.

c. Centralized direction of production and distribution. Although applied somewhat less rigorously than in previous years, state orders remained extensive, covering an estimated 75 percent of turnover of some 1,200 strategic goods (essentially production inputs and agricultural commodities). Central allocation of inputs was also substantial.

d. Ownership transformation. A number of statutes were passed in early 1992 creating the legal and institutional framework necessary to carry out privatization. However, no medium- or large-scale enterprises were privatized, and small-scale privatization occurred largely "spontaneously," through legally ambiguous leasing arrangements. In agriculture, legislation on land reform and independent family farming allows private ownership subject to restrictions on size, resale and employment of hired labor. The transfer of land to private hands, however, continued to proceed slowly. In 1992, private farms occupied only about 1 percent of the agricultural land area, with household plots of collective and state farm workers and garden plots assigned to city workers taking up an additional 9 percent of that area. Under a decree adopted at the end of 1992, household plots were enlarged and the holders given legal title to the land, but with resale temporarily discouraged by a duty of 80 percent of the sale price; the duty is to be reduced each year and eliminated after six years.

e. Enterprise governance. During 1992, formal lines of accountability between state enterprise managers and branch ministries became weaker, although the authorities continued to exercise influence through the allocation of scarce inputs, state orders and credit policy. In the absence of a hard budget constraint, enterprises tended to focus on short-term objectives, especially maintaining employment and increasing wages. Little progress appears to have been made in strengthening balance sheets or, despite the importance of military conversion, in switching production to goods desired by consumers.

f. Property markets. Legislation was passed in 1992 to accelerate the privatization of housing by entitling each person to take possession of his residence, free of charge up to a stipulated floor area; over the year, however, only about 2 percent of residential property was transferred into private hands. There continued to be no markets for commercial land and buildings. A survey of private enterprises undertaken by the World Bank indicates that while leasing to private business became more common, the lack of a property market and access to commercial real estate were among the most important constraints on the creation and expansion of private businesses.

g. Competition. The degree of monopoly in the economy remained high, with little competition from imports in the absence of currency convertibility. An Anti-Monopoly Law was passed in February which gives the Anti-Monopoly Committee extensive powers to examine monopoly abuses, to issue cease and desist orders, and to seek sanctions through the courts; delays in staffing and in elaborating an action plan, however, left the Committee non-operational in 1992.

6. Technical assistance

Technical assistance provided by Fund staff (and by cooperating central banks and fiscal authorities) in 1992 focused primarily on working with the authorities in their efforts toward establishing a fully functioning central bank, strengthening tax administration and establishing a treasury function in the Ministry of Finance, and modernizing the statistical system. The effectiveness of the assistance varied from project to project. While the receptiveness of officials was generally high, follow through on the recommendations of missions tended, in a number of areas, to be limited or slow. To some extent, absorptive capacity was strained by organizational weakness, which on occasion was compounded by multiple--and not always well coordinated--offers of assistance from multilateral and bilateral sources. More recently, the authorities have begun to bring greater order into the scheduling and administration of technical assistance; a Consultative Group focusing on technical assistance remains to be scheduled. Experience in 1992 also underscored the importance of hands-on assistance, particularly through resident advisors, provided that their expertise was fully utilized. With this in mind, increased priority is being given in the Fund's technical assistance program for 1993 to the placement of one or more resident experts, for varying periods of time, in the National Bank, the Ministry of Finance and the Ministry of Statistics.

III. Current Economic Setting

In late October 1992, following the resignation of the government of Mr. Fokin, a new government headed by Mr. Leonid Kuchma took office. It immediately sought and secured emergency powers to govern by decree for six months 1/ to address what it saw as an "economic crisis" and a "year of lost opportunities." The Government has since issued a spate of economic policy decrees and in January 1993 unveiled a Plan of Action aimed, inter alia, at (i) slowing down the decline in production, (ii) strengthening

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1/ Under the emergency powers--which expired on May 17, 1993, and whose renewal was being debated by Parliament at the time that this report was being finalized--decrees issued by the Government become law unless rejected by Parliament within ten days.

management of the state sector of the economy, (iii) reducing the rate of inflation, and (iv) accelerating privatization. The Plan of Action sets out a wide range of policy intentions and is cast in rather general terms; 1/ it is seen as a working document which is expected to change as economic conditions change. A recurrent theme is the need to re-exert state control over the economy and stabilize production before proceeding much further with liberalization. Potentially heavy reliance is foreshadowed on enforcing the State's ownership rights and, at least temporarily, on price controls, state orders, export quotas and taxes, and other interventionist policies.

The results achieved by the new Government's policy initiatives in the first quarter of 1993 were mixed, and the economy's performance generally remained unsatisfactory. At the same time, the economic outlook deteriorated substantially, as the prospect loomed of a further major increase in the price of imported energy.

1. Policies

a. Budget. In the absence of an approved budget, government expenditure in the first quarter of 1993 was limited to all but unavoidable outlays and the State budget deficit was contained to about 1 percent of GDP. Over the course of the quarter, the Government's financial balance tended to weaken, and officials acknowledged that expenditure pressures were building up. In particular, subsidies were likely to escalate very sharply if prices for coal and food were not raised substantially.

b. Wages. Faced with both an excessively high level of wages and what it saw as a potential for wage increases to become explosive in the prevailing environment of weak enterprise financial discipline, the Government on January 1 introduced a new, and extremely tight, tax-based wage policy. Under it, the average wage and wage bonuses in state enterprises are limited either to 57.5 times their levels in 1990 or to their actual levels in November 1992, whichever is greater; the ceiling is to be adjusted (down, as well as up) for changes in output, and excesses over it are subject to a tax of 300 percent. With this mechanism in place, nominal wages rose by only 15 percent between December 1992 and March 1993. As a result, the statistical real wage fell by more than half between the fourth quarter of 1992 and the first quarter of 1993, and the real product wage (allowing for changes in real value added, employment and the terms of trade) is estimated by the staff to have fallen below its level in 1987--the last year before the upsurge in labor costs got under way (Chart B).

c. Credit. Notwithstanding the minimal financing needs of the budget and the sharp reduction in real labor costs, the rate of credit expansion--which had surged in December--remained excessive (Chart C). During the quarter, net domestic assets of the banking system and broad money both increased by 25-30 percent a month. In part, this stemmed from seasonal

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1/ See Appendix 2 of the Recent Economic Developments paper.

financing of agriculture; but it also reflected a continued loose stance of policy which was amplified by an operation 1/ to monetize net inter-enterprise arrears of some krb 600 billion (equivalent to more than one fifth of the stock of broad money at the end of 1992). Much of the credit continued to be extended on concessional terms, with two thirds of the increase in NBU refinancing credits, for instance, carrying an annual interest rate of 25 percent, as against a posted rate of 100 percent.

d. Price formation. At the same time that the Government took steps to tighten its control over wages, it also modified its policy on prices. While the approach adopted in a package of decisions around the turn of 1992 was eclectic, on balance it represented an intensification of control.

-- in agriculture, all retail prices which had continued to be administered (that is, set directly by government) were freed, subject in some cases to limits on the profit margins of food processors. A number of basic foods, however, remain subsidized, with the subsidy financed off-budget out of an earmarked account into which are paid VAT receipts from the agricultural sector. In addition, following the major misalignment between the prices of agricultural and industrial goods in 1992, a more flexible procurement price system was introduced for 1993. Under the new system, initial indicative prices for the procurement of major commodities are to be adjusted each month during the growing season by the rate of increase in the average cost of production inputs. While this mechanism should protect the agricultural sector from a further deterioration in its terms of trade, it may also tend to validate the old price structure under which relative prices remain out of line with those prevailing on world markets. Producers are free to sell outside the new mechanism, but in that case are not guaranteed deliveries of inputs;

-- in industry, the Government moved to require prior authorization for price increases for a list of enterprises and products estimated to account for some 40 percent of the total value of sales in the economy;

-- in trade, to contain what it saw as excessively high profits, the Government in March set a maximum margin of 25 percent between factory gate and consumer prices;

-- and in energy, while sizable increases were announced, virtually all prices continued to be administered. Large subsidies are required in the case of coal and (for household use) natural gas, communal services and city transport. The cost of imported energy, on the other hand, continued to be passed on in full to industrial consumers. The resulting evolution of the relative price of different energy products--in particular, the sharp fall

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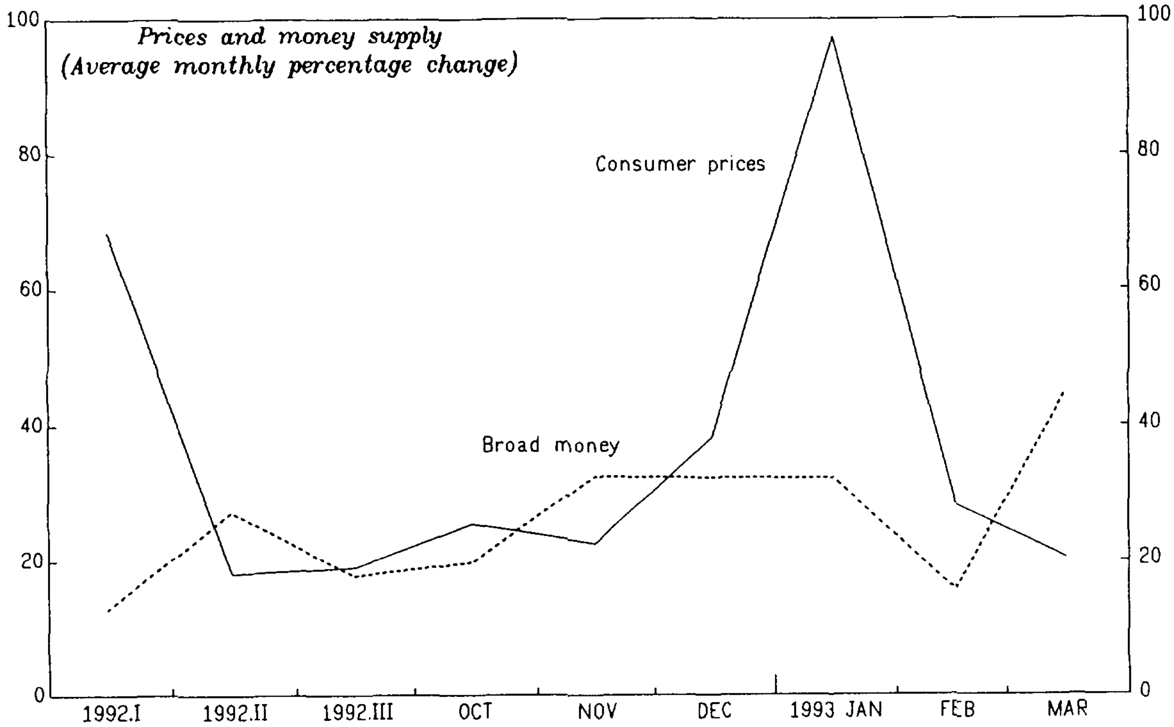
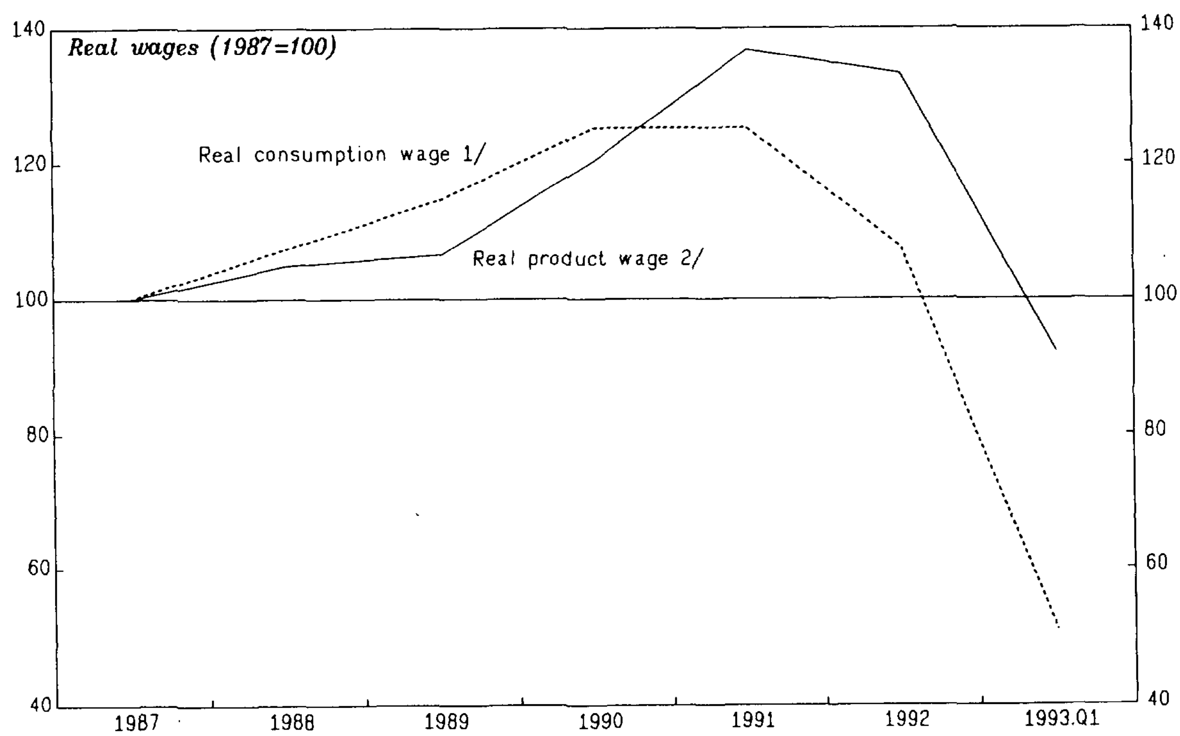
1/ Special accounts were opened in late February and all debtor enterprises were given credit in these accounts with which to pay off arrears. At the end of the operation, krb 600 billion of net arrears remained which were financed by a 60-day loan from the National Bank. In all, krb 1.5 trillion of arrears were eliminated.

CHART B

UKRAINE

PRICES AND WAGES





Source: Staff estimates.

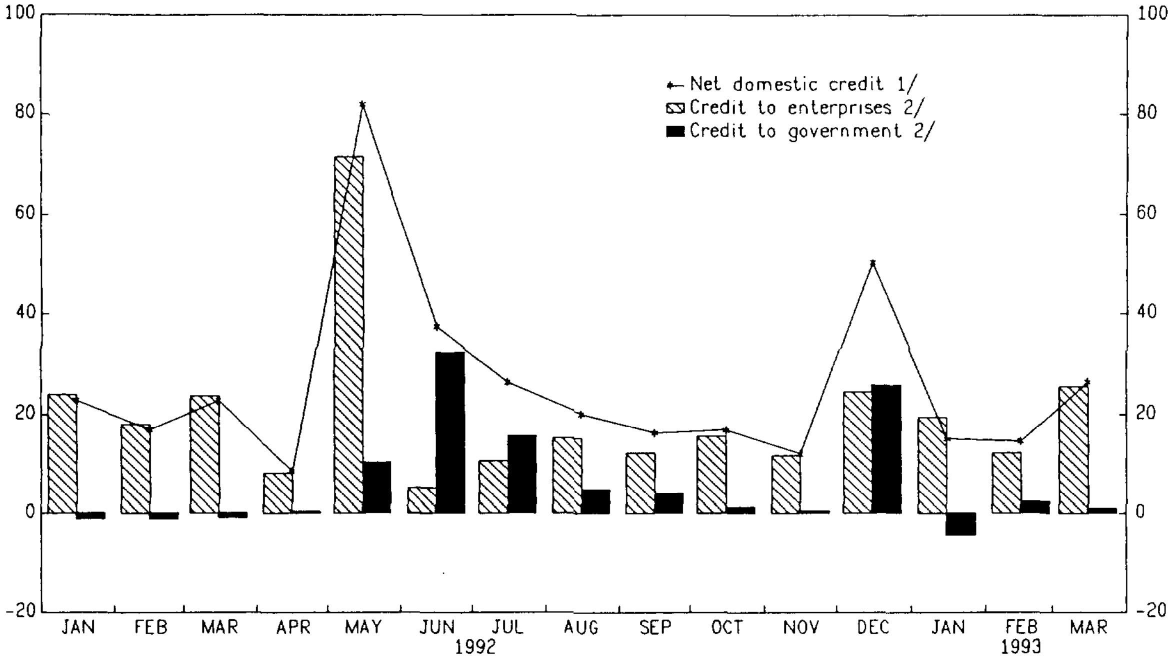
1/ Average wage in the state sector deflated by the consumer price index.

2/ Real consumption wage adjusted for changes in real value added, employment, and the terms of trade.

CHART C

UKRAINE

BANKING SYSTEM CREDIT



Source: Information provided by the Ukrainian authorities.
1/ Percentage change from preceding month.
2/ Contribution, in percentage points, to the increase in net domestic credit.

in the relative price of coal and the sharp increase in the relative price of oil and oil products--is brought out in Table 8.

e. Exchange arrangements. Major steps were taken by the new Government in early 1993 to fill the regulatory vacuum in the foreign exchange system. A decree issued in February provides, inter alia, for (i) the full repatriation of foreign exchange earnings and the surrender of 50 percent of such earnings to the banking system at the market exchange rate (the previous tax on foreign exchange earnings, which lapsed at the end of 1992, has not been renewed); (ii) a substantial degree of current account convertibility of the karbovanets, the principal exceptions being limits on the availability of foreign exchange for personal use and business travel; and (iii) the designation of the NBU as the holder and manager of the official exchange reserves. This was followed, in March, by the unification of the exchange rate for the U.S. dollar--at the rate determined weekly in the NBU-sponsored auction market--and by the decision of the NBU to remove artificial limits on movements in that rate. In April, the exchange rate for the ruble was similarly unified. Although volumes have increased, both markets remain thin--primarily because domestic interest rates are seen by exporters as falling substantially short of the expected rate of depreciation of the karbovanets.

As regards the payments system, since early 1993, with few exceptions, the NBU has prohibited commercial banks from using the inter-central bank correspondent account to settle trade with Russia; this account is now used only for trade under inter-government agreements. Instead, all Ukrainian banks are permitted to open correspondent accounts in Russia, and Russia has allowed its banks to do the same in Ukraine--a change which will help separate technical payments problems from the question of interstate credit.

The recent changes in exchange arrangements represent a significant simplification and liberalization of the system. However, a number of exchange restrictions subject to Fund jurisdiction remain; these are summarized in Appendix III.

f. Trade policy. In its policy toward foreign trade, a sharp distinction has been drawn by the new Government between imports and exports. For imports, a liberal regime has been established, with the elimination of quotas and the introduction of a moderate tariff, generally of 5-10 percent for countries with MFN status. On the export side, by contrast, concern about the large wedge between controlled domestic prices and world market prices for various goods has led to the introduction of a complex array of quotas, licensing requirements and border taxes.

The export regime distinguishes between three categories of goods. For the export of manufactured products, no license is required; a duty of 5 percent must, however, be paid. Firms wishing to export ten groups of "strategic" products (including energy, ferrous and nonferrous metals, and grain) must receive permission from an inter-ministerial commission. For most other goods, a quota is required which may be obtained in one of three ways: signing a state contract, under which the State will purchase exportable goods for karbovanets at domestic market prices and use trading firms to sell them abroad for hard currency (yielding general revenue for the budget); signing a state order to fulfill interstate barter agreements; or purchasing a license at auctions on the Kiev Stock Exchange. Alternatively, firms may export outside the quotas by paying an export tax that varies between 5 and 30 percent of the world price of the product.

2. Current trends

The available indicators for the first quarter of 1993 show real NMP some 11 percent lower than one year earlier and the monthly rate of increase in consumer prices slowing to 20-21 percent in March. Both figures, however, need to be interpreted with caution. The first quarter of 1992 is a low base for output. The deceleration in measured inflation, meanwhile, is likely to have owed much to the tightening of price regulations, as well as to the temporarily very tight containment of wages and the deferment of increases in a number of key administered prices. The underlying rate of inflation clearly remained significantly higher.

With new reporting mechanisms still being put in place, there continue to be few reliable data on a current basis on the balance of payments. However, little foreign exchange appears to have been repatriated in the first quarter, and the karbovanets continued to depreciate rapidly, against both the U.S. dollar and the ruble. Looking ahead, the dominant payments-related concern is the vulnerability of the economy, as a large net importer of oil and natural gas (Table 7), to a further increase in the price of FSU energy supplies toward world levels. Despite sizable price increases in the first quarter (which were financed in part by inter-state credits), the import price for crude oil averaged less than 40 percent of the world market price, while that for natural gas was less than 10 percent of the world level (Table 8). Discussions are currently ongoing between Ukraine and its principal energy suppliers (Russia and, to a lesser extent, Turkmenistan); officials are bracing themselves, however, for a further substantial increase in prices.

IV. Policies for the Period Ahead

Against this background, the main focus of the policy discussions was on combatting inflation and dealing with the prospective further deterioration in the terms of trade.

1. Combatting inflation

The mission emphasized that bringing inflation under control required not only a drastic tightening of budget and credit policies, but also robust mechanisms to implement these policies. It stressed that price liberalization had a key role to play in this effort and cautioned that resolute anti-inflationary measures were unlikely to be sustainable in the absence of complementary action to speed up structural reform and to protect the living standards of the truly needy.

The mission's main interlocutors agreed in broad terms with these imperatives and said that they sensed a growing realization in decision-making circles that there was no alternative to tough macroeconomic stabilization and accelerated economic reform. There were no illusions, however, that putting the needed measures into place would be easy. At one level, it is not clear that there is yet a unanimity of view within government. Outside government, resistance remains considerable. The acid test will therefore be whether the necessary consensus can be mobilized to translate policy intentions into actions that hold. In this context, and with a view to strengthening its authority, the Government is in the process of seeking not only an extension of its emergency powers, but also a strengthening of those powers--to include the subordination of the National Bank and the privatization and anti-monopoly agencies to the Government.

The policy approach envisaged by the mission's main interlocutors is summarized below:

a. Fiscal policy is to be tightened very sharply. The State budget approved by Parliament in April targets a deficit in 1993 equivalent to 6 1/4 percent of GDP. Much the larger part of the improvement from 1992 is seen as resulting from an increase in revenues of about 22 percent of GDP (Table 5). While higher receipts from excises and the land tax seem plausible in the wake of increases in tax rates and the valuation of land, the mission questioned the anticipated scale of the increase in receipts from VAT, foreign trade and privatization (together amounting to more than 10 percent of GDP). This suggested that the budgeted level of expenditure, besides implying a continued very large role of government in the economy, was unlikely to be consistent with a decisive step toward financial stabilization.

More generally, the staff found the budget hard to evaluate inasmuch as the underlying inflation assumption had already been overtaken by events. Officials acknowledged that the revenue and expenditure estimates were inevitably ephemeral and would need to be updated frequently. They also agreed that, given the uncertainties in the outlook for prices and activity, rigorous monthly cash management of the budget would be essential. A draft decree had been prepared to put a framework mechanism for expenditure control in place; and with the deficit target now set, increases were being readied in administered prices in order to contain the burden of subsidies, and work would start to identify additional expenditure cuts.

b. Credit policy, which officials universally judged as having been much too loose, is likewise seen as needing to be tightened drastically. To this end, the National Bank declared a moratorium on new refinancing credit in April and is expecting to withdraw up to one fifth of outstanding central bank credit, net, in April-May by requiring repayment of short-term credits issued to settle inter-enterprise arrears as they fall due and imposing a 1 percent per day penalty fee for late repayment.

Looking beyond the near term, and drawing on earlier discussions with the staff, the NBU has prepared a quantified monetary program which it has submitted to the Government prior to presentation to Parliament. The program discussed with the mission is aimed at bringing down the monthly rate of inflation (abstracting from any unavoidable price shocks due to increases in the price of imported energy) to significantly less than 10 percent by the end of the year. The principal policy instruments envisaged are (i) a strict limit on refinancing credits; (ii) a sharp increase in the refinance rate, to about double its present level; and, as a backstop, (iii) a uniform ceiling on the growth of credit for each bank. The program also envisages no further monetization of inter-enterprise arrears.

The staff strongly endorsed this initiative, as representing a welcome attempted departure from the passive approach in the past. The key issue--as officials themselves identified--is whether such a program will be acceptable to, or respected by, Parliament, and whether the National Bank will be given the authority to implement it.

Regarding implementation, the staff pointed out that a present loophole whereby banks were able to run up seemingly unlimited overdrafts on their correspondent accounts with the National Bank also needed to be closed, and reserve requirements thereby made to bite. As to targeted credits, the staff expressed concern that the National Bank seemed to be contemplating both a greater role in the allocation process and a variety of controls on the banks to mobilize the needed credit resources. The mission argued that, to the extent that official intervention was needed, the task should be assigned clearly to government and not be allowed to subvert the central bank's paramount monetary responsibilities. Reserve requirements, meanwhile, should be seen as an instrument of monetary control, not as a way of raising centralized credit resources. Officials responded that the National Bank would be happy to get out of the directed credits business and was hoping that a separate development bank would assume this task in the future.

c. The authorities see continuation of a tax-based wages policy, as a supplement to tighter financial policies, as essential. At the time of the discussions with the staff, the Government was negotiating with labor representatives an adjustment of the wage ceiling coefficient following the very substantial reduction in real wages in the first quarter. The authorities indicated that they remained intent on limiting wage increases below the rate of price increases, albeit by less than recorded to date. Given the link between the minimum wage and both wages in the budgetary sector and social benefits, the Government was also seeking to avoid a further increase in the minimum wage in the period immediately ahead, its preference being to provide targeted cash benefits to those on the lowest incomes instead. 1/

1/ In the event, an increase of 50 percent in the minimum wage was approved on May 21, 1993.

d. Pending progress in strengthening competitive market forces, the prevailing view of officials was that a substantial element of price control is also unavoidable. Indeed, once a list of monopolies has been drawn up, the Government intends to move from the present system of prior notification of price increases to direct monopoly price regulation. Officials did not contest the view that such regulation, in itself, was likely to deter the entry of new competition, impede the efficient use of resources, and sustain pressures on the government for budget and credit subsidies. The resentment of monopoly profits and the perceived impact of monopoly pricing on supply conditions in the economy, however, left little political alternative. Over time, liberalization was expected to proceed as monopolies were broken up and foreign competition became more effective.

e. With a view to strengthening competition, providing underpinnings in the real economy for a tightening of financial policy, and engendering a greater response of supply--and thus contributing to the fight against inflation--the authorities have assigned enhanced priority to structural policy reforms. They fully accept that there have been too many plans in this area in the past, and too little action.

Particular emphasis is to be given to strengthening enterprise governance in the state-owned sector, speeding up small-scale privatization (which has lagged badly), launching specific demonopolization initiatives, and gradually reducing the scope of state orders. Toward these ends: (i) a decree providing in principle for the corporatization of a large proportion of state enterprises--which was rejected by Parliament earlier this year--is being modified for re-issue; (ii) the auctioning of small enterprises is now proceeding in several regional centers as a forerunner, it is hoped, to a more blanket approach; (iii) projects to break up a number of state enterprises are currently under way; and (iv) the range of goods under state orders has been reduced significantly for 1993.

f. If government expenditure is to be brought under control while the neediest members of society are protected from falling into poverty as a consequence of the adjustment process, the social safety net will need both to be slimmed down and to be targeted more effectively. Currently, over half, the population receives one or more cash benefits, and estimates by IBRD staff at the time of the mid-1992 revision of the budget put the cost of public social spending in 1992 at nearly 25 percent of GDP (excluding consumer subsidies, education and health) and about 44 percent of GDP inclusive of such outlays. Both ratios are extremely high by international standards, with the latter being nearly double that in 1989/90. Yet some pockets of the population are thought to live on the edge of poverty.

Officials accept this analysis, and the Government has stated its commitment to streamline social benefits. A first step has been a cut back in benefits to persons affected by the Chernobyl accident. Shortly, the Government intends to reduce pensions for persons who continue to work and to begin gradually increasing the minimum pensionable age. And in September, it expects to make a start on introducing fees for education.

Renewed emphasis, meanwhile, is to be given to replacing general benefits with better-targeted income transfers.

2. Dealing with the balance of payments

There is considerable uncertainty and much concern about the prospects for the balance of payments. At the core is the cost of imported energy, which officials expect to increase substantially further in the coming months as prices are moved toward or to world levels. While export receipts are also expected to increase with a corresponding shift, in inter-FSU trade, toward world market prices, a deterioration in the terms of trade of some significance is considered a foregone conclusion. In the absence of adequate external financing, this raises the prospect of having to reduce imports of energy and raw materials further, with potentially severe consequences for economic activity.

In forecasts prepared for the annual Indicative Plan, officials projected a fall in real NMP of about 10 percent in 1993 on the assumption that crude oil deliveries would amount to 39 million tons (slightly more than in 1992) and other energy imports would not be constrained. If oil deliveries were 29 million tons, the fall in NMP was thought likely to be closer to 20 percent. To date, however, an agreement with Russia provides only for 20 million tons of oil to be supplied, including deliveries from commercial sources outside inter-government channels. Additional supplies are being discussed with producers in the Middle East, but these would not be expected to be large, given Ukraine's limited facilities for handling sea-borne crude oil.

To examine the possible implications of different developments for the balance of payments, the staff prepared a number of illustrative scenarios. Common assumptions to all scenarios include the following: (i) the cost of natural gas imports, net of fees on the shipment through Ukraine of natural gas and other supplies from Russia to western Europe, would be consistent with a hypothetical "net price" for gas from mid year equivalent to about 30 percent of the world price; (ii) no debt service payments are made on Ukraine's share of the external debt of the FSU, following an interim zero-option agreement with Russia through the end of 1993; (iii) a comprehensive stabilization program is put in place by mid year which, inter alia, limits the outflow of short-term capital to about US$1 billion; and (iv) a within-year technical credit from Russia of rub 250 billion and two swap credits with the Central Bank of Russia totalling rub 80 billion are repaid. 1/ The first assumption is inevitably rough and ready and subject to a particularly wide margin of error; the balance of payments is also quite sensitive to it. It is not out of line, however, with estimates by

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1/ The liabilities that were incurred by the NBU in 1992 on correspondent account with central banks in other states of the FSU are currently subject to bilateral negotiation and are assumed, for simplicity, not to entail any repayment in 1993.

officials that perhaps 70 percent of the gas import bill could be offset by newly-introduced transit fees.

On this basis, three scenarios were prepared (Tables 9 and 10). Scenario I assumes a volume of crude oil imports of 20 million tons, with the price rising steadily during 1993 to reach the world level in the fourth quarter. Scenario II varies from scenario I by assuming oil imports of 35 million tons, broadly the same as in 1992. Finally, scenario III varies from scenario II by assuming that oil is priced at the world market level from midyear. The resulting balance of payments gap, ex ante, ranges from US$2-4 billion. Failure to secure financing to close it would drive the assumed fall in output still lower.

Officials agreed that the potential imminence of a sizable payments gap heightened the urgency of policy action in several areas: first, in exploring the scope for energy saving (including through appropriate pricing and closing down highly energy-intensive activities that would no longer be viable); second, in reducing the current anti-export bias of the trade regime (in particular by radically reducing the scope of export quotas and considering cuts in export duties); 1/ and third, in putting in place a comprehensive stabilization and reform program that would warrant financial support from the Fund and the World Bank and from the international community more generally. In this context, the authorities saw the Fund's STF initiative as potentially helpful in reducing political obstacles to efforts to move needed adjustment policies forward, and they have asked the staff to return to Kiev in the second half of May for discussions on a possible STF program as a precursor to a stand-by arrangement.

V. Staff Appraisal

The two most critical tasks facing Ukraine at the present time are to bring down the rate of inflation and avert a looming balance of payments crisis. Without greater financial stability, there can be little hope of implementing effective market-based economic reform, realizing the necessary level of productive investment, or achieving a sustainable improvement in living standards. Indeed, in the absence of decisive action by the Government to restore financial policy discipline, rising inflationary expectations could precipitate an accelerated flight from money and carry an already dangerous rate of increase in prices to progressively higher levels. Without an effective strategy to deal with an imminent deterioration in the terms of trade, meanwhile, output and employment are likely to be reduced further--perhaps substantially further--than they would otherwise need to be. This would likely reinforce pressures for centralized control and set back Ukraine's transition to a market economy still further.

1/ In mid-May, it was announced that the Government had indeed decided to reduce the scope of export quotas and the levels of export duties on some products substantially. Details are yet to be ascertained and will be reported in a supplement to this report.

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Combatting inflation requires, first and foremost, a drastic tightening of budget and credit policies. But it will require a number of other things in addition: robust mechanisms for implementing those policies (if the Treasury and the National Bank are to have a fighting chance of protecting themselves against raids by powerful lobbies); a credible commitment by government to structural reforms that change the rules of the game in the enterprise and agricultural sectors (if tighter financial policies are to be viable); a more effectively targeted safety net that ensures a minimum level of subsistence for all members of society within available resources (if the adjustment process is to be sustainable politically); and, more generally, a better coordinated and more consistent approach within government itself. Major improvements in the data base will also be required if economic management is to be focused and coherent.

The target of reducing the budget deficit this year to about 6 percent of GDP is commendably ambitious. On present policies, the anticipated increase in revenues, however, does not seem plausible. The deficit target will therefore not be realized without steeper cuts in real expenditure--which are also needed if there is to be a significant move in the direction of a market economy--and without a broadening of the tax base that reduces currently extensive exemptions from the VAT and profits tax. Given the formidable uncertainties surrounding the prospects for prices and activity, as well as continuing pressures from sectional interests, a strengthened mechanism for cash management of the budget will also be essential. The draft framework decree that the Government has prepared in this regard is therefore welcome. If it is to achieve its purpose, the implementing mechanism will need to provide for a specific quantified link, on a monthly basis, between revenue and expenditure; and estimates of revenue will need both to be prudent and to allow initially for a safety margin. More generally, and specifically in connection with forthcoming revisions in the budget estimates, budget preparation procedures need to be strengthened substantially.

The lack hitherto of an explicit policy on credit has left the monetary authorities especially vulnerable to special interests and contributed to the accommodation of excessive credit demands. The apparent determination of the National Bank to strike out on a new path--as reflected in particular by the decision to reverse part of the recent expansion in refinancing credit and the formulation of a quantified credit program for the remainder of the year--is therefore also to be welcomed. Strict cash management of the budget, however, will inevitably subject the monetary authorities to additional pressures. These must be resisted. To this end, a policy consisting of the following elements should be put in place right away.

First, the National Bank should be given the responsibility <u>and</u> the authority for implementing a quantified credit program consistent with a marked deceleration in the rate of inflation. If the Bank remains accountable to the Supreme Soviet, this would require explicit approval of the program by Parliament. Second, no further credits should be issued to settle inter-enterprise arrears. Third, the refinance rate should be raised to a level that, with declining inflation, would become positive in real terms no later than the fourth quarter of this year. All lending by the National Bank, including to government, should be made at this rate, and an agreed portion of the National Bank's profits should be transferred to the budget. Fourth, uniform ceilings should be imposed for the remainder of the year on the growth of lending by each commercial bank; to reduce distortions, margins under the ceilings should be freely transferable between banks. Fifth, the automatic overdraft facility on banks' correspondent accounts at the National Bank should be eliminated. Sixth, any further directed credits channelled through the banking system to preferred sectors should be subject to a sub-ceiling within the program. Release of any such credits should require the approval of both the Governor of the National Bank, who would verify that the credit falls within the ceiling, and the Vice Premier for Economic Reform. Aside from this, and to further insulate it from the lobby groups, the National Bank should cease to be involved in the allocation of directed credits. All subsidies on such credits, moreover, should be charged to the budget.

Under these conditions, the National Bank could begin to focus on the primary functions of a central bank: restoring stability to the currency, providing general liquidity to the commercial banks, and exercising prudential supervision over the financial system.

Price liberalization has a key role to play in contributing to the restoration of financial policy discipline. Ukraine's experience has shown that, in practice, pervasive price controls generate the need for very large subsidies and demands for cheap credit as relative prices become increasingly misaligned. The staff appreciates the concerns of decision makers about monopolies and the lack of competitive markets, the difficulties of liberalizing a number of politically-sensitive prices, and the prospect of a possible substantial increase in energy prices. It believes, however, that

--neither competition nor markets can be created in a vacuum; they are in part the result of the dynamic process brought about by price and trade liberalization. In this respect, temporarily high monopoly profits, by attracting new entrants to the market, are in fact part of the solution. Monopoly abuses should be tackled primarily by structural measures, with price regulation limited to natural monopolies and a small and declining number of artificial monopolies.

--subsidies for politically-sensitive goods and services need to be tailored to what the budget can afford, progressively reduced, and replaced by carefully targeted income transfers. Where controls are to be retained, prices should be adjusted frequently, so as to avoid the need for large, disruptive and politically difficult increases to build up.

--Ukraine cannot afford--for balance of payments, budgetary or efficiency reasons--not to pass on to users the full cost of imported energy, or to pay for the rising cost of subsidies on coal. The latter subsidies should also be progressively reduced.

Resolute action in the foregoing areas is unlikely to be viable or politically sustainable in the absence of parallel action to accelerate structural reform and to protect the most vulnerable groups of the population from falling into poverty. In the structural policy area, the focus needs to be on underpinning financial policies by changing the culture and objectives of the enterprise sector and on stimulating the response of supply in order to reduce the needed compression of demand. Key priorities include strengthening the governance of state-owned enterprises (in particular by establishing financial performance targets and making real the threat of management dismissal and bankruptcy); speeding up small-scale privatization, which has been held up by political controversy, but which could produce early visible results; moving ahead forcefully on land reform; removing administrative obstacles to the formation of new businesses; and accelerating the dismantling of the still extensive system of state orders and central allocation. The staff urges the Government to work intensively with the IBRD and the EBRD in moving forward a reform program that hitherto has advanced little.

Printing money to support various sectors of the economy, and providing an overlapping variety of untargeted subsidies and social benefits, meanwhile, has left little room for improving the situation of the truly needy. The prospective emergence of open unemployment on a sizable scale heightens the importance of radically streamlining and sharply targeting the social safety net. The Government is well seized of this and deserves support in the politically difficult task of translating policy intentions into concrete reforms.

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All indications are that a major balance of payments problem is now imminent for Ukraine. Unless it is addressed seriously, disorderly and costly adjustment is likely to ensue. In the view of the staff, an appropriate strategy would include the following elements.

First, implementing quickly and resolutely the stabilization and reform policies outlined above. This would strengthen the balance of payments, not least by increasing the incentives for exporters to repatriate foreign exchange earnings.

Second, reducing sharply the anti-export bias of the trade regime. The staff applauds the liberalization of the foreign exchange market, the introduction of a high degree of current account convertibility, the removal of the foreign exchange tax, and the establishment of a liberal import regime. As regards exports, however, it believes that the complex array of border taxes, quotas, and state orders and contracts that was put in place earlier this year can only retard growth and delay the restoration of a viable balance of payments. Ukraine's interests would be best served by the immediate elimination of most export quotas, followed by the rapid phasing out of export tariffs. This should be undertaken in conjunction with the progressive removal of domestic price controls--the principal raison d'être for export controls--and with the identification of expenditure savings to compensate for the net loss of budgetary revenue. The very recent announcement by the Government of measures to liberalize the export regime is therefore clearly an important step forward.

Third, giving serious consideration to import savings arrangements, particularly in the energy sector.

Fourth, in light of the critical importance of trade with Russia, clarifying and strengthening financial and credit relations between the two countries.

Fifth, putting in place quickly measures that would enable Ukraine to qualify for assistance under the Systemic Transformation Facility, followed by the adoption <u>this year</u> of a comprehensive program that would meet the requirements for a stand-by arrangement and catalyze concerted international financial support.

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Despite the recent reforms of the exchange and trade system, the authorities continue to maintain exchange restrictions under the transitional arrangements of Article XIV, section 2. The staff encourages Ukraine to apply these restrictions in a liberal manner and to eliminate them as soon as circumstances permit. In addition, a multiple currency practice subject to approval under Article VIII arises from the National Bank of Ukraine's practice of engaging in spot exchange transactions at buying and selling rates whose spread exceeds 2 percent. In the absence of a clear timetable for the measure's removal, the staff does not recommend approval.

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It is proposed that Ukraine be placed on the standard 12-month consultation cycle.

VI. Proposed Decision

The following draft decision is proposed for adoption by the Executive Board:

1. The Fund takes this decision relating to Ukraine's exchange measures subject to Article VIII, and in concluding the 1993 Article XIV consultation with Ukraine, in the light of the 1993 Article IV consultation with Ukraine conducted under Decision No. 5392-(77/63), adopted April 29, 1977, as amended (Surveillance over Exchange Rate Policies).

2. Ukraine maintains multiple currency practices and restrictions on payments and transfers for current international transactions, described in SM/93/..., in accordance with Article XIV, Section 2, except for the multiple currency practice arising from the National Bank of Ukraine's practice of engaging in spot exchange transactions at buying and selling rates whose spread exceeds 2 percent which is subject to approval under Article VIII. The Fund encourages Ukraine to eliminate the measures maintained under Article XIV, section 2 as soon as its balance of payments position permits and urges Ukraine to eliminate the multiple currency practice that is subject to approval under Article VIII.

Table 1. Ukraine: Selected Economic Indicators, 1990-92

	1990	1991	1992
	(Percentage change from previous year)		
Output and employment			
Real GDP 1/	-3½	-13½	-14
Industrial production	--	-4½	-9
Employment	--	-1½	-4
Prices and wages			
CPI 2/	4	91	1,445
Producer prices	4½	125	2,384
Average wages	14	91	1,303
	(Percentage change within year)		
CPI 2/	4	161	2,734
Producer prices	4½	163	4,129
Average wages	...	...	1,523
	(In percent of GDP) 3/		
Public finance			
State budget revenue	...	26.1	29.0
State budget expenditure 4/	...	41.0	61.2
State budget balance	...	-14.9	-32.2
Extrabudgetary funds balance	...	1.3	4.4
General government balance	...	-13.6	-27.8
	(Percentage change within year)		
Money and credit			
Credit to enterprises	--	102	2,596
NDA of banking system	12½	102	1,243
Broad money	13½	101	912
Real broad money	9	-23	-64
	(In billions of U.S. dollars)		
External trade			
Exports	...	...	11.3
Imports	...	...	11.9
Trade balance	...	...	-0.6
Of which:			
Former Soviet Union	...	...	(-1.1)
Rest of world	...	...	(0.5)

Sources: Data provided by the Ukrainian authorities; and staff estimates.
1/ Real NMP in 1990-91; real GDP in 1992.
2/ Retail price index for 1990 and 1991.
3/ Staff estimates of GDP in 1992.
4/ Including off-budget items.

Table 2. Ukraine: Selected Comparative Data With the Russian Federation (RF) and Belarus (B), 1991-92

	1991			1992		
	U	RF	B	U	RF	B
			(Percentage change from preceding year)			
Real GDP	-13½	-9	-2	-14	-19	-10
Industrial production	-4½	-8	-2	-9	-19	-10
CPI	91	93	94	1,445	1,353	1,065
Producer prices	125	138	151	2,384	1,949	2,328
Average wage	91	86	97	1,303	989	852
			(In percent of GDP)			
State budget deficit	-15	-16½ 1/	2	-32	-20	-4½
			(Percentage change within year)			
CPI	161	144	92	2,734	2,318	2,093
Credit to enterprises	102	127	131	2,596	818	1,593
NDA of banking system	...	...	...	1,243	498	540
Broad money	101	77	74	912	814	482
			(In billions of U.S. dollars)			
Trade balance with FSU	...	...	...	-1.1	1.4	-0.2
Trade balance with rest of world	...	...	...	0.5	3.1	0.3

Sources: Data provided by the authorities; and staff estimates.

1/ Notional deficit; excluding import subsidies.

Table 3. Ukraine: Output and Expenditure, 1990-92

(Percentage change at constant prices)

	1990	1991	1992
Net material product	-3.6	-13.4	-16.0
Industry 1/	-0.8	-8.5	-10.2
Agriculture 1/	-7.0	-18.8	-11.3
Construction 1/	0.5	-7.0	-28.4
Personal consumption	2.2	-8.0	...
Public consumption	4.6	19.5	...
Net investment	-22.7	-4.2	...
Gross domestic product	-3.5	-13.5	-14
Consumption 2/	...	...	-5 to -10
Gross investment 2/	...	...	-45 to -30
Memorandum item:			
Nominal GDP in billions of rubles/ karbovanets	165	295	4,220 2/

Sources: Data provided by the Ukrainian authorities; and staff estimates.

Note: There are substantial problems with the data currently available on the national accounts for 1992, related primarily to the estimation of deflators.

1/ In 1992, the share of these sectors in NMP was, respectively, 50.7 percent, 22.5 percent and 14.7 percent. Their shares in employment were 29.2 percent, 25.2 percent and 6.3 percent, respectively.
2/ Staff estimate.

Table 4. Ukraine: Prices and Wages, 1990-93

	Consumer prices 1/	Average wage	Real consumption wage 2/	Real product wage 3/
	Percentage change from preceding period		(1987 = 100)	
1990	4	14	125	120
1991	91	91	125	137
1992	1,445	1,303	108	133
1991 QIV	18	100	180	
1992 QI	360	131	91	
QII	58	107	117	
QIII	75	54	104	
QIV	87	119	119	(125-135) 4/
1993 QI 5/	227	36	51	(90-100) 4/

Sources: Data provided by the Ukrainian authorities; and staff estimates.

1/ Retail price index prior to 1992.
2/ From 1992, calculated by monthly deflation.
3/ Real wage adjusted for changes in real value added, employment and the terms of trade. Staff estimates.
4/ Indicative only.
5/ Preliminary.

Table 5. Ukraine: General Government Financial Operations, 1991-93

(In percent of GDP)

	1991	1992		1993
	Outturn	Budget	Outturn	Budget
A. State Budget balance 1/	-14.9	-2.0	-32.2	-6.2
Revenue	26.1	43.1	29.0	51.3
VAT	(9.4)	(21.8)	(11.5)	(12.6)
Enterprise income tax	(9.6)	(9.7)	(6.5)	(8.5)
Excises	(...)	(1.4)	(1.4)	(5.1)
Land tax	(...)	(0.7)	(0.4)	(3.9)
Revenue from exports, export taxes and import duties	(0.3)	(1.4)	(0.2)	(6.4)
Receipts from privatization	(--)	(--)	(0.8)	(4.1)
Expenditure (narrow definition)	36.9	45.0	45.5	57.5
Consumer subsidies	(13.0)	(5.3)	(5.6)	(7.2)
Producer subsidies	(...)	(0.1)	(9.1)	(3.8)
Education and health care	(9.0)	(13.1)	(10.3)	(14.4)
Defense	(...)	(4.0)	(2.7)	(3.5)
Chernobyl	(1.5)	(4.0)	(2.7)	(3.9)
Off-budget subsidies and capital transfers	4.2	--	15.7	--
B. Balance of extrabudgetary funds	1.3	...	4.4	--
C. General government balance (= A + B)	-13.6	...	-27.8	-6.2

Sources: Data provided by the Ukrainian authorities; staff estimates for GDP for 1992 outturn column.

1/ Including local authorities and off-budget expenditures mandated by Parliament and the Government.

Table 6. Ukraine: Money and Credit, 1991-93

(In billions of rubles/karbovanets)

	1991	1992				1993
	Dec.	Mar.	June	Sept.	Dec.	Mar.
National Bank of Ukraine						
Net foreign assets	0.2	7.0	52.2	-575.6	-613.9	-986.4
Net domestic credit	24.3	38.6	646.5	1,310.8	2,406.8	3,201.0
claims on govt. (net)	(24.5)	(6.6)	(349.0)	(565.7)	(1,732.4)	(1,743.3)
claims on banks	(--)	(28.4)	(292.6)	(741.5)	(677.2)	(1,482.5)
Other items, net	19.6	69.4	-474.1	-265.6	-1,010.8	-292.1
Base money	44.1	115.0	224.6	469.6	782.1	1,922.5
Banking system						
Net foreign assets	0.1	12.2	62.0	-553.8	-868.0	-1,017.6
Net domestic credit	252.7	446.7	1,208.0	2,137.2	4,225.2	7,130.4
claims on enterprises	(97.3)	(294.6)	(720.1)	(1,309.5)	(2,623.3)	(5,456.9)
claims on households	(2.8)	(4.2)	(6.5)	(12.1)	(31.6)	(117.2)
claims on govt. (net)	(152.6)	(147.9)	(481.4)	(815.6)	(1,570.3)	(1,556.3)
Other items, net	10.3	-79.9	-492.2	-315.2	-694.1	-229.1
Broad money	263.1	379.0	777.8	1,268.2	2,663.1	5,883.7
Memorandum items:	(Average monthly percentage change during quarter)					
Base money	...	38	25	28	19	35
NDA 1/ of banking system	...	12	25	37	25	25
Broad money	...	13	27	18	28	30
Real broad money	...	-33	8	-1	--	-10
Base money multiplier (ratio)	6.0	3.3	3.5	2.7	3.4	3.1
Velocity of broad money (ratio)	2.0	4.0	4.1	4.4	4.4	4.4

Sources: Data provided by the Ukrainian authorities; and staff estimates.

1/ Net domestic credit plus other items.

Table 7. Ukraine: Selected Energy Indicators: I

	1991	1992	1992
	Quantity 1/		Value in billions of rubles
Coal			
Production	135.6	133.6	
Imports	...	5.4	21.9
Exports	...	3.4	11.1
Crude oil			
Production	4.9	4.5	
Imports	51.1	34.1	260.9
Oil products			
Imports	...	6.1	69.2
Exports	...	0.4	5.6
Natural gas			
Production	24.4	20.9	
Imports	89.5	89.6	156.5
Electricity			
Production	278.7	252.6	
Imports	...	7.3	5.6
Exports	...	6.2	4.8

Source: Data provided by the Ukrainian authorities.

1/ For coal, crude oil and oil products: million tons. For natural gas: billions of cubic metres. For electricity: billions of kilowatt hours.

Table 8. Ukraine: Selected Energy Indicators: II

	Price per unit in karbovanets 1992 QI	1992 Av.	1993 QI	1993 QI/1992 QI Ratio	Price in 1993 QI in percent of world price
				(Per ton)	
Coal					
Price to industry	1,739	2,619	8,000	4.6	16
Price to households	217	429	1,500	6.9	3
Crude oil					
Import price	1,920	7,651	68,000	35.4	37
Price to domestic producers	640	1,331	30,000	46.9	17
				(Per litre)	
Gasoline					
Price to industry	2.3	14.2	143	62.1	US$0.10 1/
Price to households	0.9	12.4	148	164.4	US$0.10 1/
Diesel oil					
Price to industry	2.0	12.6	154	77.0	US$0.11 1/
Price to agriculture	0.9	10.7	152	168.9	US$0.11 1/
				(Per thousand cubic metres)	
Natural gas					
Import price	429	1,457	6,810	15.9	6
Price to industry	469	1,550	7,128	15.2	6
Price to households	132	132	1,700	12.9	1
				(Per kwh)	
Electricity					
Price to industry	0.5	2.5	7.0	14.0	...
Price to urban households	0.2	0.4	2.0	13.3	...
Memorandum item:					
Change in CPI				17.0	

Sources: Data provided by the Ukrainian authorities; and staff estimates.

1/ Equivalent of domestic price in U.S. dollar terms at the prevailing exchange rate.

Table 9. Ukraine: Summary Balance of Payments, 1992-93

(In billions of U.S. dollars)

	1992	1993 1/		
		Var. I	Var. II	Var. III
Exports	11.3	11.7	12.1	12.1
Former Soviet Union	5.3	5.1	5.5	5.5
Rest of world	6.0	6.6	6.6	6.6
Imports	11.9	13.3	14.7	15.4
Former Soviet Union	6.4	7.4	8.8	9.5
Of which:				
Energy	(2.6)	(3.5)	(4.7)	(5.4)
Rest of world	5.5	5.9	5.9	5.9
Net services	--	-0.1	-0.1	-0.1
Current account	-0.6	-1.7	-2.7	-3.5
Former Soviet Union	-1.1	-2.3	-3.3	-4.0
Rest of world	0.5	0.6	0.6	0.6
Capital account	-2.2	-0.3	-0.3	-0.3
Medium- and long-term loans	0.4	0.5	0.5	0.5
Direct investment	0.2	0.2	0.2	0.2
Credits extended and short-term capital 2/	-2.8	-1.0	-1.0	-1.0
Overall balance	-2.8	-2.0	-3.1	-3.8
Increase in convertible currency reserves (-)	-0.1	-0.2	-0.2	-0.2
Increase in liabilities to Former Soviet Union (+)	2.9	--	--	--
Financing gap	--	-2.2	-3.3	-4.0

Source: IMF staff estimates and scenarios.

1/ The principal variables in the three scenarios are the price and the quantity of crude oil imports. In variant I, the price of crude oil imports is assumed to rise steadily during the remainder of the year to reach the world market level in the fourth quarter; the volume of oil imports amounts to 20 million tons. Variant II differs from variant I by assuming a volume of oil imports of 35 million tons (broadly the same as in 1992). Variant III differs from variant II by assuming that the price of crude oil imports moves to the world level on July 1. For other assumptions, see Table 10.

2/ Including net inter-state interenterprise claims.

Table 10. Ukraine: Balance of Payments--Assumptions Underlying Table 9, 1992-93

(Percentage change, unless otherwise indicated)

	1992	1993 Var. I	1993 Var. II	1993 Var. III
Export volumes				
FSU	-32	-20	-15	-15
ROW	-18	5	5	5
Import volumes: non-energy				
FSU	-28	-20	-15	-15
ROW	-45	5	5	5
Import volumes: energy				
FSU	-7	-18	-7	-7
Terms of trade				
FSU	-16	-8	-18	-25
ROW	--	2	2	2
Imports of crude oil (million tons)	34	20	35	35
Average price of crude oil (US$ per ton) 1/	42	70	70	85
Imports of natural gas (billion cubic meters)	90	80	80	80
Average price of natural gas (U.S. dollars per thousand cubic meters) 2/	9	21	21	21
Memorandum items (in percent):				
Oil import price/world price	32	57	57	69
Gas import price 2//world price	10	22	22	22

Source: IMF staff.

1/ In Variants I and II, the price rises steadily during the remainder of the year to reach the world market level in the fourth quarter. In Variant III, the price moves to the world market level at the beginning of the third quarter.

2/ Price "discounted" from world-equivalent level to make a notional adjustment for transit fees (not included in the services account) for Russian shipments across Ukraine.

Ukraine--Fund Relations

(As of May 10, 1993)

I. Membership Status

(a) Date of membership	September 3, 1992
(b) Status	Article XIV

II. General Department (General Resources Account)

	(In millions of SDRs)	(In percent of quota)
(a) Quota	997.3	100.0
(b) Total Fund holdings of currency	997.3	100.0
(c) Fund credit	--	--
Credit tranche	--	--
CCFF	--	--
(d) Reserve tranche position	--	--
(e) Operational budget transfers (net)	--	--

III. SDR Department

		(In percent of allocation)
(a) Net cumulative allocation	--	...
(b) Holdings	--	...
(c) Designation plan amount	--	--

IV. Outstanding Purchases and Loans: None

V. Financial Arrangements: None

VI. Projected Obligations to the Fund: None

Ukraine: IMF Technical Assistance

Table 1. Staff Missions: November 1991-April 1993

	Purpose
Fiscal Affairs Department	
Dec. 2-20, 1991	Diagnostic: Tax policy, tax administration, social safety net, public expenditure management
Mar. 16-Apr. 1, 1992	Follow-up on tax issues
July 9-23, 1992	Social Safety Net: Discussion of social safety reform options
Nov. 25-Dec. 15, 1992	Treasury Management
Jan. 11-29, 1993	Tax Administration: To develop a strategy to improve the performance of tax administration in the short-term and to launch a program of medium-term modernization
Apr. 12-26, 1993	Tax Administration: Follow-up mission
April 1993	Treasury Management: Discussion of Report of November/December 1992
Monetary and Exchange Affairs Department	
Nov. 20-23, 1991	Diagnostic: Central banking
Feb. 18-Mar. 2, 1992	Modernization of Central Banking and Currency Reform
March 26-Apr. 6, 1992	Monetary and Central Banking, Multitopic: Bank supervision, foreign exchange operations, monetary operations and money market development, organization of the National Bank, and public debt management
July 7, 1992-Mar. 14, 1993	Resident Advisor
July 15-28, 1992	Follow-up Multitopic: Monetary and exchange rate policy matters; preparation of action plan for the modernization of functions and operations of the National Bank

Table 1. Staff Missions: November 1991-April 1993 (continued)

	Purpose
Monetary and Exchange Affairs Department (continued)	
Nov. 11-24, 1992	Monetary and Central Bank, Multitopic: Modernization of the functions and operations of the National Bank
March 7-13, 1993	Follow-up: Clearing and payments system
Statistics Department	
Nov. 16-19, 1991	Diagnostic: Economic statistics
Dec. 8-21, 1991	Multitopic: Introducing the statistical methodologies of monetary, government finance, and balance of payments statistics
Apr. 21-May 4, 1992	Balance of Payments Statistics
Apr. 24-May 11, 1992	In conjunction with EUR II pre-negotiation mission. Compiled monetary statistics according to the analytical framework developed by STA for FSU countries.
May 18-30, 1992	Multitopic: To review and make recommendations on the institutional organization, the collection and compilation of statistical data, and the need for training and further technical assistance
July 15-28, 1992	In conjunction with MAE advisory mission. Advised on the compilation of monetary statistics for monitoring developments under a financial program and developed an action plan for follow-up measures by the NBU.
July 16-17, 1992	Statistical Staff Visit: Steering committee on cooperation in technical assistance with countries in the FSU
Nov. 11-27, 1992	Balance of Payments Statistics: Methodology
Nov. 23-Dec. 14, 1992	Multitopic: Statistical issues

Table 1. Staff Missions: November 1991-April 1993 (concluded)

	Purpose
Statistics Department (continued)	
Jan. 12-26, 1993	Monetary Statistics: Establish framework and procedures for regular reporting of monetary and financial data to IMF
March 1-18, 1993	Consumer Prices: Construction of new urban consumer price index
March 15-25, 1993	Balance of Payments Statistics: Follow-up mission
April 12-23, 1993	Producer Price Statistics

Table 2. Program for the Period Ahead

	Purpose
Fiscal Affairs Department	
May 13-20, 1993	Public Expenditure Management
May 1993-April 1994	Resident Expert: Treasury management
August 1993	Expert Assignment: Tax Administration
August 1993	Public Expenditure Management
August 1993	Tax Administration
November 1993	Expert Assignment: Tax Administration
Institute	
June 21-July 2, 1993	Macroeconomic and Financial Policies: Course
July 5-7, 1993	Macroeconomic and Financial Policies: Seminar
Monetary and Exchange Affairs Department	
May-July 1993	Resident Expert: Foreign exchange
May 12-21, 1993	Central Bank Modernization
September 1993	Central Bank Modernization
Statistics Department	
July 1993	National Account Statistics: Initial review
July 1993	Money and Banking
September 1993	Follow-up on Consumer Price Index
October 1993	Balance of Payments

Ukraine: Exchange Measures Subject to Fund Jurisdiction

The staff has identified the following exchange measures in Ukraine which are subject to Fund jurisdiction: 1/

1. A multiple currency practice subject to approval under Article VIII arising from the National Bank of Ukraine's practice of engaging in exchange transactions at buying and selling rates which exceed 2 percent.

2. Exchange restrictions in the form of limitations on the availability of foreign exchange for tourist travel, business travel, and for payments for other current international invisible transactions. These restrictions are maintained under Article XIV, section 2.

3. An exchange restriction arising from the failure to settle balances within a 90-day period from the correspondent accounts arrangements with a Fund member. 2/

1/ The staff is in the process of clarifying the jurisdictional implications of other measures in Ukraine including: (1) the recent changes to the foreign exchange market in Ukraine; (2) the operation of the state currency fund; (3) Ukraine's correspondent account arrangements with FSU members other than Russia; (4) Ukraine's bilateral payments agreements with certain Fund members including Bulgaria, Hungary, India, Iran, and Mongolia; and (5) the accumulation of external payments arrears.

2/ Ukraine has imposed restrictions with respect to the Federal Republic of Yugoslavia (Serbia/Montenegro) in compliance with United Nations Security Council Resolution No. 757. These restrictions are being notified to the Fund.

Ukraine: Relations with the World Bank

Ukraine joined the IBRD and the IDA (the latter as a Part II member) on September 3, 1992. Since October 1992, the World Bank has maintained a resident office in Kiev with a staff that presently includes three expatriate staff. Prior to formal membership, a number of economic and sector missions visited Ukraine to review government policies and provide initial assistance. A Country Economic Memorandum and sector reports on social sector issues and the energy sector have been prepared. Sector reports on agriculture and environmental issues are under preparation.

Priorities for World Bank assistance to Ukraine include support for structural reforms needed to achieve financial stabilization and establish a market economy, assistance to critical production sectors needed to achieve a rapid supply response, strengthening the social safety net, and selected assistance for critical institutions and investments to maintain productivity.

In 1992 and early 1993, the World Bank provided policy advice and technical assistance to the Government of Ukraine. Bank technical assistance has dealt primarily with enterprise reform and privatization, financial sector reform (including the reform of the domestic payments system), overhaul of the social safety net, energy sector reforms and agricultural reform.

Preparation of a first World Bank loan, of US$27 million for an Institution Building Project, is well advanced. Loan negotiations were concluded in early May and the project is scheduled for Board presentation in early June. The loan would finance assistance in three major areas: (i) enterprise reform, notably in small enterprise privatization and the reform of business regulation in selected oblasts and cities, pilot privatization of medium and large enterprises, and demonopolization; (ii) financial sector reform, notably in the improvement of the domestic payments system, accounting procedures for financial institutions, and institutional strengthening of banks; and (iii) public economic and financial management, notably in the establishment of a Treasury in the Ministry of Finance and the modernization of tax administration (in collaboration with the Fund). Preparatory work is also under way for possible further loans, including a rehabilitation loan and sectoral loans for agriculture, the energy sector, social sectors and telecommunications.

Ukraine: Basic Social Indicators, 1991

	Ukraine
Population	
Total (in millions)	51.9
As a share of total	
Urban	67.6
Rural	32.4
Ethnic Ukrainian	72.1 1/
Births (per thousand)	12.4
Deaths (per thousand)	13.5
Natural rate of growth (per thousand)	-1.1
Health and education	
Child mortality (per thousand born)	13.6
Average life expectancy (in years)	70.5 2/
Men	65.6 2/
Women	74.9 2/
Number of doctors (per 10,000 inhabitants)	42.9 2/
Hospital beds (per 10,000 inhabitants)	135.5 2/
Student/teacher ratio 3/	12.8
Training levels (per 10,000 inhabitants)	
Specialists	
All	1,319 1/
Higher education	569 1/
Scientists	
All	42 1/
PhDs	16 1/
Standard of living	
Housing (square meters per inhabitant)	17.8 1/
Consumption (kilos per inhabitant)	
Meat	67.0 1/
Vegetables	125.0 1/
Household equipments (per thousand inhabitants)	
Televisions	324.0 1/
Refrigerators	288.0 1/
Washing machines	210.0 1/
Private cars (per thousand inhabitants)	60.0 1/

Sources: Ukrainian authorities; World Bank (a) Ukraine: Country Economic Memorandum, May 17, 1993; and (b) Ukraine: Employment, Social Protection, and Social Spending in the Transition to a Market Economy, October 1992.

1/ 1989.
2/ 1990.
3/ Primary and secondary education.