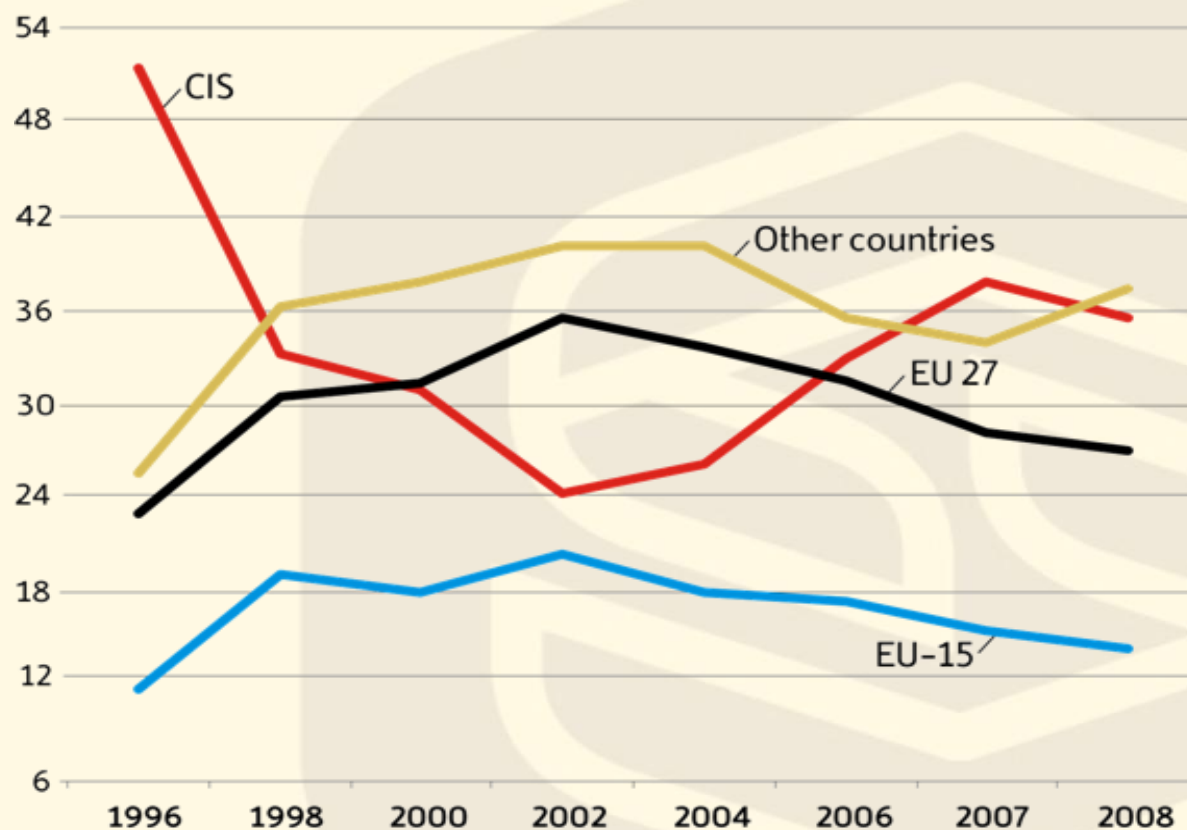


Trade Between Europe and Ukraine

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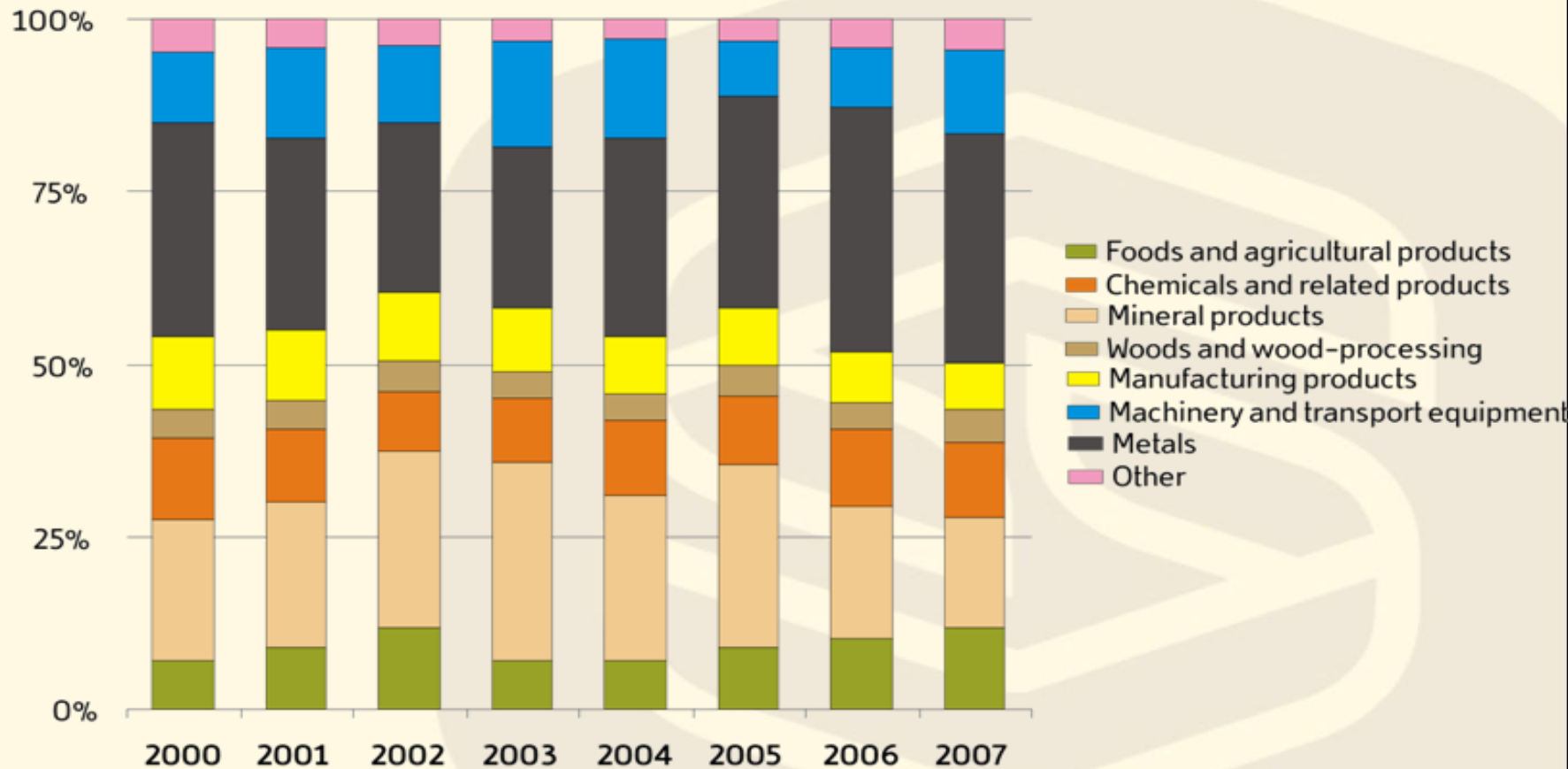
Destination of Ukrainian Exports (% of total)



Source: SSC

- Instead of greater trade integration between Ukraine and the EU, since 2002, the share of the EU on Ukrainian exports has been declining.

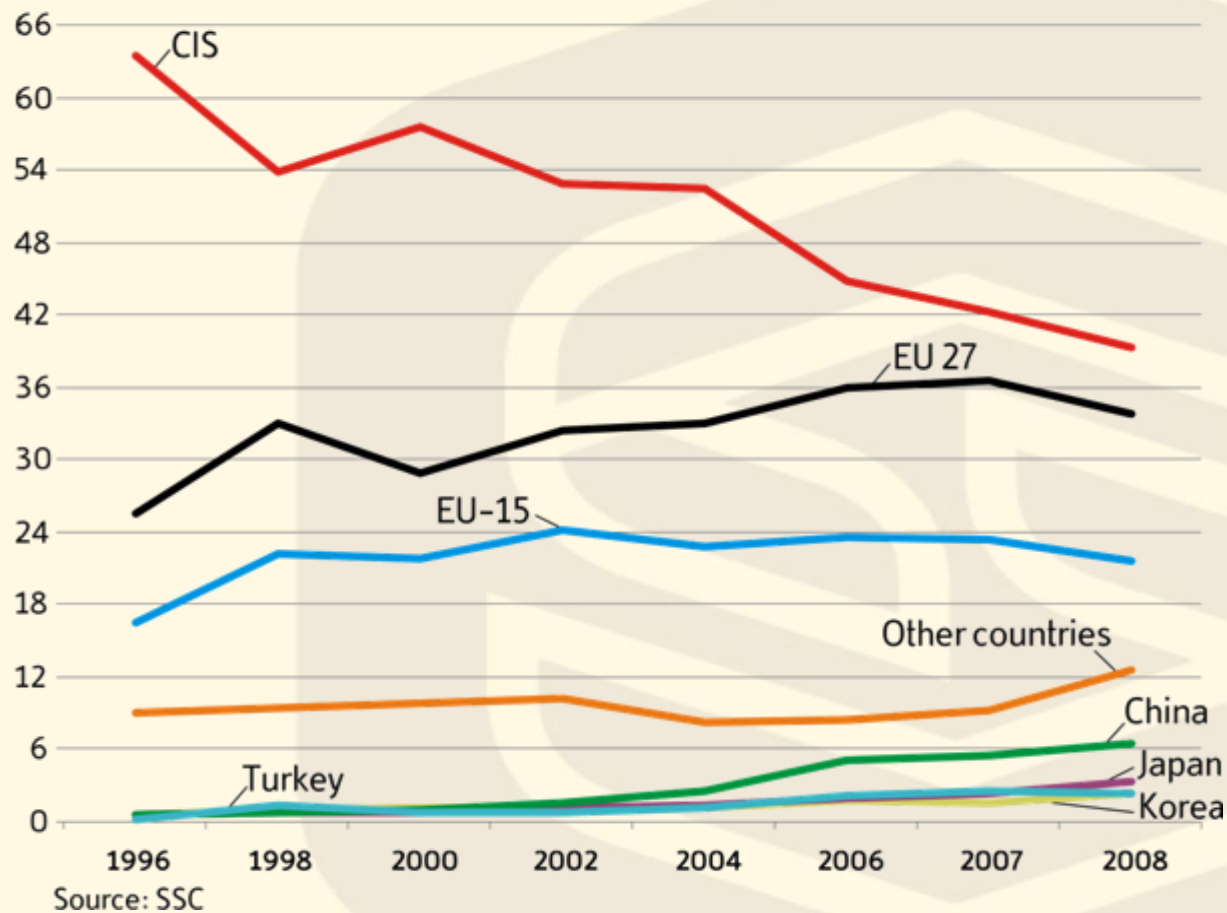
Composition of Export of Ukrainian Goods to the EU-27



Source: SSC

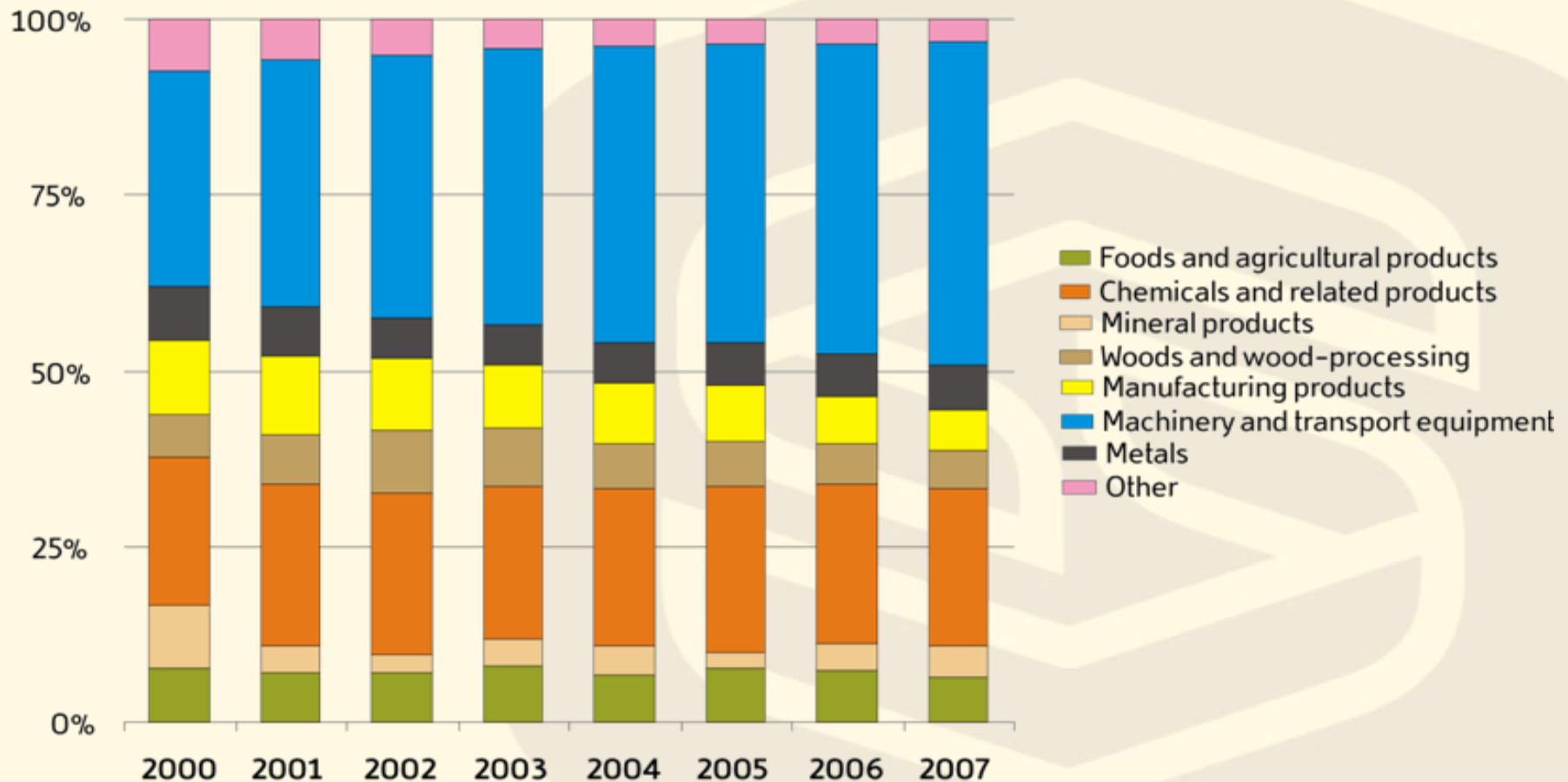
- Furthermore, most Ukrainian exports to the EU have been in low value-added goods, such as metals and mineral products.

Imports of Goods into Ukraine, % of total



- On the import side, the EU has not increased its share in Ukraine's imports.
- The slack by the CIS was taken by other countries, particularly China, Japan Korea, and Turkey.

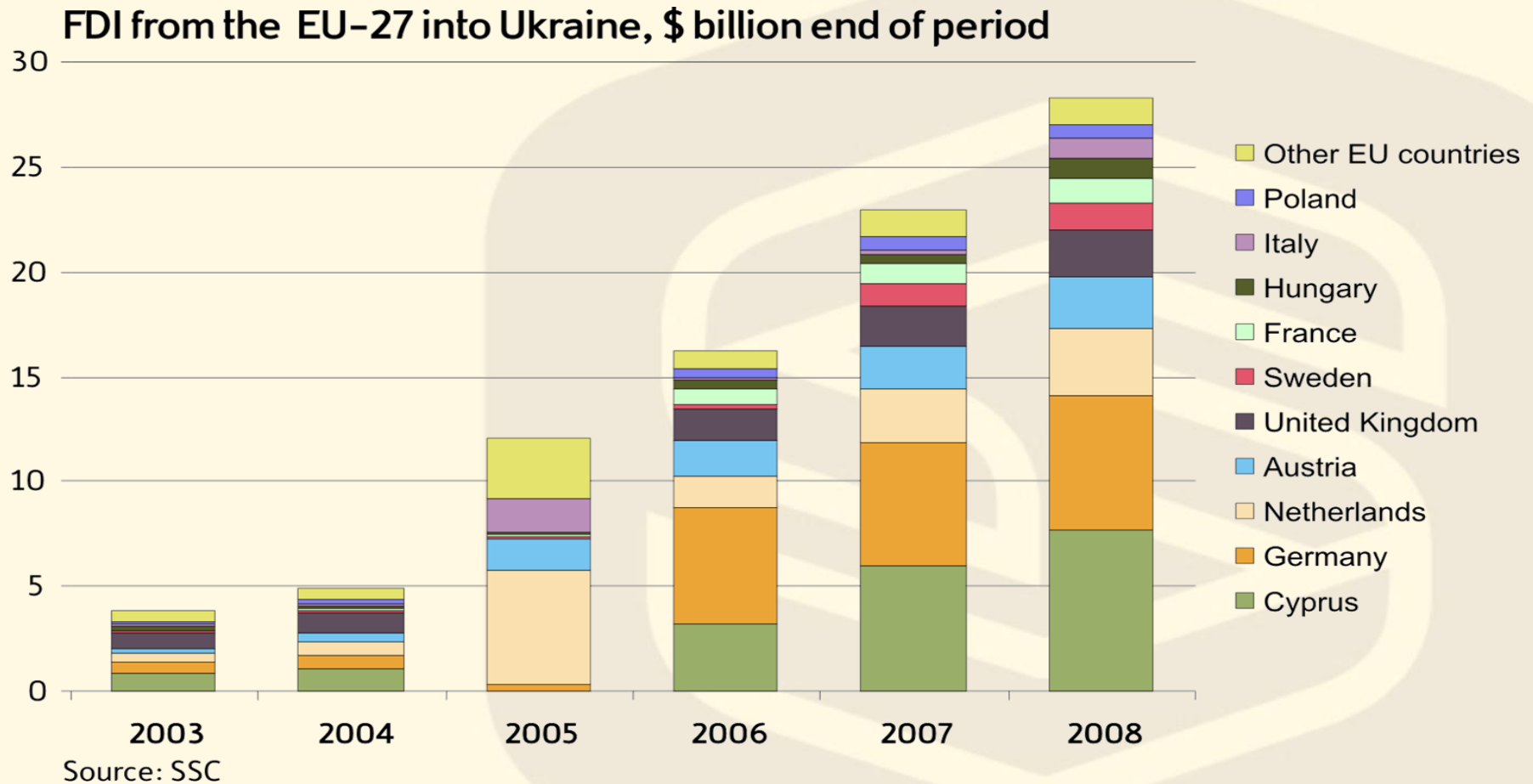
Composition of Ukrainian Imports from the EU-27



Source: SSC

- Contrary to Ukrainian exports, most of Ukraine's import trade with the EU is high value products.

The EU is a major foreign investor in Ukraine



- Contrary to trade, for Ukraine FDIs from Europe are significant.
- About 80% of all FDI into Ukraine originates from EU countries.

Reversing the declining trade patterns with the EU

- The previous slides show that a FTA is now essential to reverse the declining trading between Ukraine and the EU.
- But the simple elimination of tariffs and other quantitative restrictions would have only modest economic benefits for Ukraine and would have minimum benefits for the EU.
- However, Ukraine would benefit significantly from an **Enhanced** FTA with well-design agreements on competitiveness and other improvements in the business environment.
- Such agreement could play the same "motivating" role for implementing economic reforms in Ukraine that EU membership had on countries such as Bulgarian and Romania.
- Close cooperation with the EU is the most feasible way to support institutional development in Ukraine and established a modern system of private and intellectual property rights protection.
- These reforms would encourage further growth in FDIs and would place Ukraine is the "supply chain" for Europe.

Benefits of a FTA to the EU

In the Short-term

- In the foreseeable future, the main benefits for EU are in the risk and stability areas:
- In the near future, the EU will be dependent on energy resources from Russia and Central Asia - also through Russia: in this situation the EU needs a more integrated, stable and prosperous Ukraine to improve security in the transportation of this energy to Europe.
- The EU has already made major FDI in Ukraine. A more stable and prosperous Ukraine is also desirable to achieve high and sustainable returns on these FDI investments, including in the banking sector.
- Ukraine has a considerable potential to become an efficient low-cost link in the supply chain of European producers: it could boost efficiency of the EU supply chains. This will help to cut production costs in the EU and enable it to better compete with other regions.
- In a short time, by 2007 Ukraine became the 13th largest trade partner for EU exports – on par with Australia, India, Brazil and Mexico.

Benefits of a FTA to the EU

In the Longer-term

In a more distant future, Ukraine can be a “major” economic partner of the EU with high potential for EU exporters for the following reasons:

- Large potential market of 45 million people, one of the largest populations in Europe. To realize this market potential, Ukraine will need to increase its purchasing power, which a FTA would support.
- Highly educated labour force (almost 76% university enrolment, one of the highest in Europe- UNESCO) with high technology potential.
- Low wages (averaging about 1/3 of wages in Central Europe)
- Proximity to and bordering the EU with low transportation costs.
- Great agricultural potential with very fertile soil.
- Reasonable infrastructure.
- Despite political difficulties, Ukraine is the only post-Soviet country (in addition to the Baltic states) that is rated by Freedom House as a free country.

GDP Growth and Ukraine's Investment Climate

- Ukraine will need to improve the quality of its business environment not only to realize the potential trade benefits for both Ukraine and the EU, but also to overcome the current crisis.
- The current financial crisis will depress GDP growth in Ukraine in the next couple of years.
- The possibility to use fiscal stimulus to revive growth is constrained by the limited availability of foreign long-term loans.
- Therefore, the most realistic option to revive economic growth is to improve the business environment to attract private foreign investments.
- The agenda for reforms is large, as most international such as the World Bank's Report on Doing Business, or the World Economic Forum rate the business environment of Ukraine quite poorly, as shown in the next two tables.

Ukraine – IFC/WB's Ease of Doing Business

UKRAINE		Ukraine	Region	OECD
Ease of Doing Business	145			
Starting a Business	128	10	7.7	5.8
Construction Permits	179	27	22.6	13.4
Employing Workers	100	5.5	8.6	4.9
Registering Property	140			
Getting Credit	28	30	23.6	15.4
Protecting Investors	142	471	257.2	161.5
Paying Taxes	180	1901.7	680.4	56.7
Trading Across Borders	131			
Enforcing Contracts	49	99	47.2	13.4
Closing a Business	143	848	366.8	210.5
		11.5	11.8	17.5
		43.3	26.1	24.4
		3.7	10.2	3.4
		58.4	48.1	45.3

Source: World Bank

- ▶▶ On the quality of the business environment, Ukraine is ranked 145th out of 180 countries in terms of Ease of Doing Business by IFC/WB.
- ▶▶ Domestic and foreign business still face an onerous burden of excessive and costly regulatory, licensing and taxation procedures.

Ukraine–World Ec Forum: International Competitiveness

UKRAINE		Major Competitive Disadvantages
GCI 2008–2009	72	
Basic requirements	86	
1st pillar: Institutions	115	Property rights
2nd pillar: Infrastructure	79	Intellectual property protection
3rd pillar: Macroeconomic stability	91	Judicial independence
4th pillar: Health and primary education	60	Efficiency of legal framework
Efficiency enhancers	58	Transparency of government policymaking
5th pillar: Higher education and training	43	Reliability of police services
6th pillar: Goods market efficiency	103	Ethical behavior of firms
7th pillar: Labor market efficiency	54	Strength of auditing and reporting standards
8th pillar: Financial market sophistication	85	Protection of minority shareholders' interests
9th pillar: Technological readiness	65	
10th pillar: Market size	31	Intensity of local competition
Innovation and sophistication factors	66	Extent and effect of taxation
11th pillar: Business sophistication	80	Total tax rate
12th pillar: Innovation	52	Agricultural policy costs
		Prevalence of trade barriers
		Prevalence of foreign ownership
		Business impact of rules on FDI
		Burden of customs procedures

Source: World Economic Forum

►► The World Economic Forum lists poor institutions, weak judiciary and corruption as major competitive disadvantages of Ukraine.

Ukraine's Business Environment

- Ukraine's competitive disadvantages are systemic and can only be remedied with a strong and broad reform program.
- To attract investments and revive growth, Ukraine needs to pass to the international investment community a strong message that the country is serious about improving its investment climate.
- For this, the country needs to make a quantum jump on economic reforms. That is, the country needs to take some "dramatic" measures to curtail drastically by a set deadline its excessive business regulations, to get rid of corruption in customs administration by bringing outside managers, to deal energetically with its weak judicial system, to improve public governance, etc.
- The measures are well-known. They just need to be implemented expeditiously.
- To improve implementation capacity, the reform of Public Administration should receive high priority.