

**Igor G. Mantsurov,**

Director-General, Scientific and Research Institute of Economics  
at the Ministry of Economic Development and Trade of Ukraine

**Dmitry I. Mantsurov,**

Deputy Head of the Department, Ministry of Finance of Ukraine

## **POST-WAR SUCCESSFUL REHABILITATION OF UKRAINE IN THE FRAMEWORK OF CONSTITUTIONAL AND INSTITUTIONAL CHANGES**

*АННОТАЦІЯ. У статті розглянуто питання залежності темпів і пропорцій економічного розвитку України від якості суспільних та державних інститутів. Доведено, що суттєве зниження обсягів виробництва протягом 1990–2013 років викликано недосконалою моделлю переходу від адміністративно-командної до ринкової економіки. Розроблено рекомендації, застосування яких, на думку авторів, сприятиме успішному післявоєнному відновленню країни.*

*АННОТАЦИЯ. В статье рассмотрены вопросы зависимости темпов и пропорций экономического развития Украины от качества общественных и государственных институтов. Доказано, что существенное снижение объемов производства в течение 1990–2013 годов вызвано несовершенной моделью перехода от административно — командной к рыночной экономике. Разработаны рекомендации, применение которых, по мнению авторов, будет способствовать успешному послевоенному восстановлению страны.*

*ABSTRACT. The article is devoted to analysis of dependency between economic development growth and proportions and quality of public and state institutions. It is proved that a significant decline of GDP volume during the years 1990–2013 was happened due to imperfect model of transition from a command to a market economy. The substantial recommendations oriented to public and state institutions improvement are formulated. According to the authors, its implementation would contribute significantly to successful post-war reconstruction of the country.*

### **INTRODUCTION**

In August 2014 Ukraine has celebrated the 23rd anniversary of its independence. Unfortunately, this time could be considered as successful, at least from the economic as well as social points of view. Since 1991, Ukraine experienced the longest and one of the deepest declines of GDP among all the transition economies. In particular, the first half of the decade 1991–2000 was marked by the extreme macroeconomic instability and hyperinflation, in the second half of the same decade progress in disinflation and currency stabilization was seriously damaged by the 1998 financial crisis caused by the unsustainable fiscal policy.

Since 2000 the Ukrainian economy entered into a period of growth and relative macroeconomic stability. As a result, in the early 2000s, Ukraine experienced an economic boom with average growth rates of up

to 7 %.<sup>1</sup> However, even this quite rapid and intensive economic growth could not compensate serious decrease of the national economy aggregate indicators during the first decade and, as result, Ukraine experiences the longest and one of the deepest declines of GDP among all the transition economies of the ex-Soviet Union countries except Armenia (- 35 per cent in 2009 in comparison with 2000, see Table 1).

*Table 1*

**SOME INDICATORS OF THE EX-SOVIET COUNTRIES  
DEVELOPMENT IN 1990–2012**

Country	The year of GDP maximum reduction, since year 1990	GDP amount in the year of its maximum reduction, (as a percentage to 1990)	GDP amount growth rate in year 2012 (as a percentage to 1990)	GDP of the country as a share of the World GDP amount, %		Growth rate of the percentage of country GDP to the World amount of GDP (2012to 1990, %)
				1990	2012	
Azerbaijan	1992	79,1 (-21,9)	89,8	0,29	0,9	310,3
Armenia	1992	60,0 (-40,0)	71,7	0,1	0,14	140,0
Byelorussia	1999	80,0 (-20,0)	80,3	0,85	0,78	91,8 (-8,2)
Kazakhstan	1999	77,3 (-22,7)	86,5	1,35	2,65	196,3
Kyrgyzstan	1999	75,0 (-25,0)	92,2	0,12	0,08	66,7 (-33,3)
Moldova	1999	70,6 (-29,4)	88,5	0,18	0,1	55,6 (-44, 4)
Russia	1998	66,9 (-33,1)	73,6	2,55	2,65	103,9 (-21,4)
Tajikistan	1992	74,1 (-25,9)	96,2	0,13	0,09	69,2 (-30,8)
Ukraine	1999	76,2 (-24,8)	65,0	4,04	2,35	58,2 (-41,8)

Source: developed by authors

In addition it is necessary to add that the significant economic growth during the years 2000–2008 was largely driven by particularly favorable external conditions that allowed the country to reap quick wins in the metals and chemicals sectors on the back of the global commodities boom. Soaring steel prices and, for much of the period, cheap natural gas imports from Russia supported significant improvements in the country's terms of trade, while highly liquid international capital markets simultaneously fuelled foreign direct investment (FDI) infows into the country.

Notwithstanding this period of strong growth, the country's weaknesses in terms of institutions' development, governance and business climate remained unaddressed. The absence of major structural reforms, deteriorating investment conditions, and low competitive pressures in the

market created an extremely fragile economy which became heavily dependent on a few commodity-based exports for growth. Not only did this model limit the tremendous entrepreneurial potential of the country's educated workforce, but it also constrained the country's ability to adjust to and benefit from shifting dynamics in the world economy.

The impact of the 2008 global economic crisis illustrated the vulnerability of this model: Ukraine's GDP contracted by almost 15 % in 2009 (versus a 3.7 % average in OECD countries), and was followed by a slow recovery in the ensuing years. The drying up of cross-border capital flows as capital markets became more risk averse, persistently high corruption and poor public management further weakened the country's unsustainable fiscal situation. Amid the current geopolitical crisis, Ukraine's economy is extremely fragile and dependent on significant external support.

The reforms that the former Ukrainian President Yanukovich started introducing immediately after the world economic and finance crisis in 2010 were clearly intended to strengthen what has been known from Russia as 'the vertical of power' and to weaken the key non-presidential institutions of the Ukrainian Parliament and the judiciary. All mentioned above provoked so-called fiasco in Vilnius with following massive protests of the Ukrainian people, President Yanukovich regime collapse, Crimea annexation and Russian invasion into two Eastern provinces of Ukraine.

As a result, top concerns for Ukraine now are the developments in peacekeeping efforts and the state of the global economy together with resolution of the political crisis in the country and problems related to the post-war rehabilitation.

On external side, beyond the Russian aggression, the main risk is a protracted crisis in Europe, leading to lower demand for exports and more difficult access to global capital markets. Domestically, the main risk is a failure to implement macroeconomic rebalancing (preferably anchored in a program with the IMF). Delays in macroeconomic adjustment could mean that the forced adjustment will be much sharper. Ukraine's access to financing is already limited by investor concerns over the sustainability of its macro framework, political and military situation and the poor investment climate.

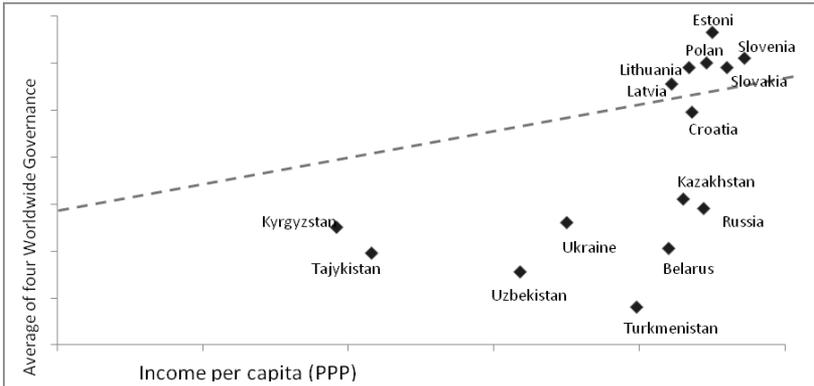
All mentioned above gives a reason to affirm that Ukraine is facing an economic and finance crisis, and the **country needs first of all to make urgent and extensive measures to its institutional system to reverse the progressive crisis of the national economy.** The global economic crisis hit Ukraine very seriously with severe increase of unemployment and decline of the living standard.

## MAIN PART

Central to all these challenges is the imperative to build the more supportive institutional environment based on effective cooperation among all stakeholders. The matrix of improving national institutions, combined with external economic forces, sketch out the framework for the most optimistic scenario of the country's further development.

In its latest outlook on the region, the European Bank for Reconstruction and Development notes: "Economic and political institutions play a key role in defining a country's long-term growth potential. Countries with a stronger institutional environment — effective rule of law, a good business climate, more secure property rights and market-friendly social norms — are better positioned to attract investment, to participate in trade and to utilize physical and human capital more efficiently."<sup>8</sup>

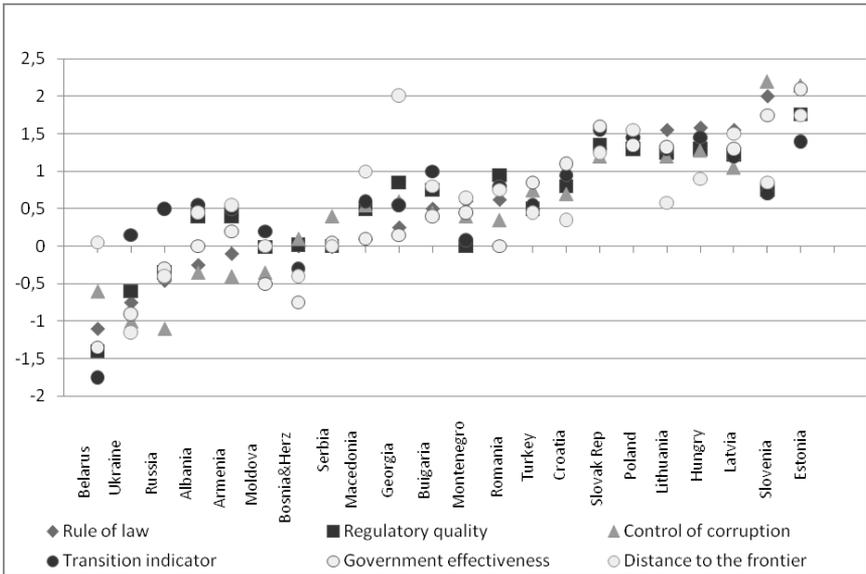
Nonetheless, Ukraine, as well as other post-Soviet countries in Eastern Europe and Eurasia, has weaker institutions than countries with similar levels of economic development. The difference is particularly stark when comparing Ukraine with its neighbors that joined the European Union or even with those that are so far from this process. For instance, Russia and Belarus (see Graph 1).



Graph 1. Correlation between institutional quality and income per capita

Source: EBRD Transition Report 2013: Stuck in Transition? <http://wiiw.ac.at/ebird-transition-report-2013>

More deep analysis of the institutional systems' main components in different countries (e.g. rule of law, transition indicator, regulatory quality, government effectiveness, control of corruption, distance to the frontier) indicates that quality level of all these components in Ukraine is much more lower than in great majority of European countries (see Graph 2).

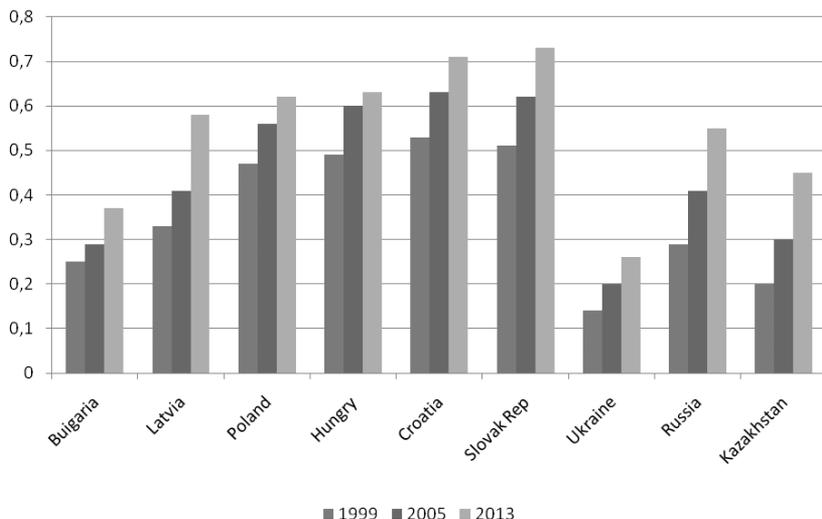


Graph 2. Main components of the national institutional systems

Source: EBRD Transition Report 2013: Stuck in Transition? <http://wiiw.ac.at/ebd-transition-report-2013>

Numerous studies on the links between institutions' quality level and economic growth indicate that there is a high level of correlation between these phenomena. For instance, Acemoglu and Robinson (2012) argue that "the inability of societies to develop effective, low-cost enforcement of contracts *is the most important source of both historical stagnation and contemporary underdevelopment.*"<sup>1</sup> As a result, "a cluster of institutions ensuring secure property rights for a broad cross section of society, which we refer to as institutions of private property, *are essential for investment incentives and successful economic performance*"<sup>1</sup>.

Data of Graph 3 indicate very clearly that the correlation between state institutions' quality level on one hand and economic growth on the other hand is quite high. On the other worlds, institutions' quality level is a crucial factor that determinate economic growth rates and proportions.



Graph 3. GDP per worker as a share of EU 15 average

Source: EBRD Transition Report 2013: Stuck in Transition? <http://wiiw.ac.at/ebird-transition-report-2013>

Taking this into account, authors reached the conclusion that actually the most important priority for post-war reforms would be serious constitutional and institutional changes. Separately it is important to note that after the recent Parliament elections in Ukraine the constitutional majority of democratic forces in the Verkhovna Rada has been created and, as a result, favorable conditions for these constitutional and institutional changes exist.

In order to perform these constitutional and institutional changes, the following extraordinary and immediate measures should be undertaken as soon as possible.

1. Undoubtedly, decisions on those important questions need to be grounded in a broader long-term vision for the country. First of all, following the parliament elections, Ukraine needs to build a broad societal consensus on a compelling modernization strategy (*that never has been developed in Ukraine since the country had obtained the independency 23 years ago*), fostering its long-term economic and social development. Implementing such a strategy is an extremely important task that will take time and can only be carried forward with visionary leadership, wide public support and benefits distributed equally across society.

2. Taking into account that Ukraine has tremendous agricultural potential and could play a critical role in contributing to global food security, it necessary to create conditions that will help to use this potential effectively. Obviously that till now it has not been fully exploited due to depressed farm incomes and a lack of modernization within the sector. The establishment of a legal framework for secure land ownership (which requires corresponding constitutional changes), development of an efficient registration system, and ensuring free and transparent land markets are important elements of a policy framework that could facilitate agricultural development in Ukraine.

3. Ukraine's road safety record remains one of the worst in Europe in terms of road accidents and fatalities. Substantial portions of the network need upgrading to European technical and safety standards (that also require the establishment of a legal framework for secure land and road infrastructure ownership) Improving the efficiency of the transport sector could play a role in raising economic competitiveness.

4. Ukraine is one of the most energy inefficient countries in the region and restructuring and upgrading its energy sector continues to be one of the key development challenges for the newly adopted by the Parliament Government. The sector faces problems maintaining security, reliability and quality of supply due to delays in energy sector reform, poor financial condition of energy sector enterprises, lack of investments, and deferred maintenance in aging infrastructure. These factors threaten the sustainability of economic growth, degrade the environment and increase the cost of social services. Improving them is among Ukraine's top strategic priorities.

5. To support extremely ineffective and corrupt banking industry, the Government and the National Bank of Ukraine as well other financial regulators should pay attention to strengthening the policy and regulatory role of the state in the financial sector, while consolidating state ownership of financial institutions.

6. Beyond formal public service institutions, what is currently lacking is a systemic approach to economic modernization and market-based incentives for innovation. Small and medium-sized firms (SMEs) are playing an important role not only in generating employment, but also in innovation and technology adoption.

Conditions for SMEs are particularly difficult in Ukraine. On indicators that pose important barriers for small enterprises, such as obtaining electricity or paying taxes, Ukraine remains among the worst performers worldwide in the World Bank's Ease of Doing Business Index.<sup>12</sup>

7. Special and immediate attention should be paid by the Government to the IT sector, which according to many stakeholders could become a real backbone of the future Ukrainian economy. While Ukraine has a large pool of highly qualified programmers, many of them have been operating in the shadow economy, providing services for companies elsewhere in the world.

8. The municipal and services sector in Ukraine suffers from decades of underinvestment and poor maintenance. The need to invest in water and wastewater utilities is growing dramatically and the existing low tariff levels are a major limitation to the sustainability of utilities. The need for rehabilitation is exacerbated by the overall high energy consumption in water production and wastewater treatment. Improving service delivery through rehabilitation of infrastructure and promotion of energy efficiency solutions offers the possibility of driving utilities towards financial sustainability while providing improved services.

9. Obviously that Ukraine is facing a health crisis, and the country needs to make urgent and extensive measures to its health system to reverse the progressive deterioration of citizens' health. Crude adult death rates in Ukraine are higher than its immediate neighbors, Moldova and Belarus, and among the highest not only in Europe, but also in the world.

10. Literacy and school enrollment rates are high in Ukraine. However, larger budget allocations to education have not resulted in improvements in the quality of education. Ukraine's priority should be to make better use of the resources allocated for the sector by significantly downsizing the school network to fit the smaller (current and projected) cohorts of students.

11. It is difficult to achieve integrated regional development without partnership and cooperation between community and authorities. The cooperation between local authorities, education, civil society and business will have great importance.

12. It is vitally necessary to improve the instruments for regional economic development, such as cluster development, innovative activity development and technology transfer, rural development as well.

## **OVERALL CONCLUSIONS AND RECOMMENDATIONS**

The analysis presented in this article indicates that Ukraine has the potential to position itself as a key player in tomorrow's global economy. So far, however, Ukraine has largely been a passive and reactive player: growing fast during the global commodities boom of

the early 2000s and then contracting even faster during the downturn period. Its current economic fragility has also made it dependent on external assistance, which has been subject to force geopolitical maneuvering between Russia and the European Union.

External pressures aside, Ukraine now stands at a crossroads with respect to the socio-economic model it chooses and the strength of the social contract that it can establish between the government and society. By building a strong and resilient economy based on transparent institutions, Ukraine can be in a position to define its own destiny. The choice is largely up to the main stakeholders in the Ukrainian economy, who need to find common ground for a strong, forward-looking agenda for the country and its place in the wider region.

Deep constitutional and institutional reforms are the main instruments that Ukrainian stakeholders can use to escape the country's current low equilibrium and kick-start the modernization of the economy. Even while facing the most serious geopolitical confrontation in recent history, Ukraine's capacity to foster strong and agile domestic institutions will define the country's ability to adjust to the changing environment and deliver lasting prosperity to its citizens.

The European Union beyond the financial and organizational support would have to invest in the training of civil servants and judges and support for peaceful civil society initiatives. The EU would have to reconsider its focus on exporting its own regulations and prioritize rebuilding Ukraine's political system instead.

This will help the GoU to prevent the collapse of the national economy and the deep decline of the Ukrainian population living standards.

### **References**

1. *Acemoğlu and J. Robinson* [2012] "Why nations fail: the origins of power, prosperity, and poverty", Crown Business, New York.

2. *Chávez Juárez and I. Soloaga* [2012] "IOP: Stata module to compute different measures of inequality of opportunity for dichotomous, ordered and continuous outcome variables", Statistical Software Components, S457442, Boston College Department of Economics.

3. *Filmer and L. Pritchett* [2001] "Estimating wealth effects without expenditure data — or tears: an application to educational enrollments in states of India", *Demography*, Vol. 38, No. 1, pp. 115-132.

4. *Gennaioli, R. La Porta, F. López-de-Silanes and A. Shleifer* [2013] "Human capital and regional development", *Quarterly Journal of Economics*, Vol. 128, No. 1, pp. 105-164.

5. International Labour Organization [2012] “The youth employment crisis: time for action”, ILO, 101st Session, Report V. A.
6. McKenzie [2005] “Measuring inequality with asset indicators”, Journal of Population Economics, Vol. 18, pp. 229–260.
7. Sahn and D. Stifel [2003] “Exploring alternative measures of welfare in the absence of expenditure data”, Review of Income and Wealth, Vol. 49, pp. 463–489.
8. Shorrocks [2013] “Decomposition procedures for distributional analysis: a unified framework based on the Shapley value”, Journal of Economic Inequality, Vol. 11, No. 1, pp. 99–126.
9. Solt [2009] “Standardizing the World Income Inequality Database”, Social Science Quarterly, Vol. 90, No. 2, pp. 231–242. SWIID Version 4.0, September 2013.
10. EBRD Transition Report 2013: Stuck in Transition? <http://wiiw.ac.at/ebrd-transition-report-2013>
11. Vyas and L. Kumaranayake [2006] “Constructing socio-economic status indices: how to use principal components analysis”, Health Policy Planning, Vol. 21, No. 6, pp. 459–468.
12. World Bank [2012] “Youth unemployment and vocational training”, background paper for the World Development Report 2013.

**Khrapunova Y. V.,**

Post-Graduate Student,  
Scientific and Research Institute

of Economics at the Ministry of Economic Development and Trade of Ukraine

## STATISTICAL EVALUATION OF THE DEMOGRAPHIC EXPANSION

*АНОТАЦІЯ. В останні роки все зростаюча увага приділяється різним аспектам демографічної експансії, яка, думку автора, у деяких країнах суттєво впливає на рівень національної безпеки цих країн. В статті розглянуто наукові підходи до оцінювання демографічної експансії та пропонується авторський підхід до побудови і коректного застосування відповідної системи статистичних показників. За допомогою цієї системи проаналізовано основні соціальні та економічні наслідки процесу нерегульованої міграції в Україну мешканців інших країн протягом останніх 15 років.*

*КЛЮЧОВІ СЛОВА: демографічна статистика, демографічна безпека, демографічна експансія, статистичне оцінювання демографічної експансії, система показників демографічної експансії.*

*АННОТАЦИЯ. В последние годы всевозрастающее внимание уделяется различным аспектам демографической экспансии, которая, по мнению автора, в некоторых странах существенно влияет на уровень нацио-*