



## WTO Membership Set for February

Last Wednesday Ukraine overcame the final hurdle to joining the 151-nation World Trade Organisation (WTO), when Vice-Prime Minister Hryhoriy Nemyria negotiated successfully an agreement on export duties with EU Trade Commissioner Peter Mandelson in London. Finalising the agreement paves the way to the formal acceptance of Ukraine's accession request at the next meeting of the WTO general council in Geneva on 5-6 February.

"Today we have achieved a compromise by solving an issue on export duties which has remained a problem since 2006," said Mr Nemyria.

"This is a very historical day, a very important breakthrough, and I want to congratulate the Ukrainian participants in the talks on the results, and all of us – on the compromise," said Mr Mandelson. "Today's agreement clears the way for Ukraine fully to join the world trading system.... This is the first step toward greater Ukrainian integration with the global and the European economy," added the former-British Cabinet Minister.



▲ Vice-Prime Minister Hryhoriy Nemyria brokered an agreement with EU officials, paving the way for Ukraine to join the WTO in February.

Mr Mandelson went on to say that he expected the EU to begin negotiations on establishing a free trade agreement with Ukraine. As with WTO accession, such an agreement is seen as an important stepping stone to eventual EU membership.

The breakthrough delivers on one of the key tenets of BYuT's pre-election "Contract with Investors" and contrasts sharply with the approach of the former-prime minister Viktor Yanukovich, who failed to meet deadline opportunities and put WTO membership on a slow trajectory.

"This is a clear-cut case of delivering on a promise we made to the electorate," said Mr Nemyria, "The old-era of protectionism does not work in today's global economy. Protecting inefficient industry and jobs have been excuses for our oligarch clans for too long. Cynically manipulated import-export restrictions and high tariffs raise the price of goods, restrict choice and ultimately damage job prospects. Joining the WTO will open up markets previously denied to us and supports our goal for a stronger, more transparent economy based upon recognised international rules."

Mr Nemyria also discussed Prime Minister Yulia Tymoshenko's visit to Brussels on 28-29 January. During her visit – her first since becoming prime minister – she will meet with European Commission President Jose Manuel Barroso, EU foreign policy chief Javier Solana and External Relations Commissioner Benita Ferrero-Waldner. Meetings are also scheduled with Mr Mandelson and EU Energy Commissioner Andris Piebalgs.

# Why the Bank Repayments are Affordable

Doom-mongers will tell you that the move by the government to pay back bank deposits, wiped out by hyper-inflation when the Soviet Union disintegrated, is set to heat up Ukraine's economy and tip the inflation scales into recession.

While it is true that there could be as many as 1.2 million savers that could benefit from the government's largesse, the threat of runaway inflation appears over-hyped.



Jitters in the market were sparked by a news release from Standard & Poor's (S&P) Ratings Services, which said: "the decision by the new Ukrainian government to incorporate payouts of "lost savings" liabilities into the 2008 budget, at a cost of just under 3 percent of GDP, will further

stoke demand pressures in an economy that is already overheated."

The total 2008 budget deficit of UAH 18.5 billion equates to an affordable 2.1 percent of GDP which is by no means excessive. Indeed the deficit is only 4.5 percent higher than the UAH 17.7 billion deficit recommended by the previous government.

While inflation peaked at 16.6 percent year-on-year in December 2007, the 2008 budget can hardly be described as an inflationary budget, even when factoring in the pay-outs to savers of \$4 billion. The social spending provisions and payouts are merely evidence of a reallocation of priorities rather than a profligate spending programme.

## Pent-Up Demand

Furthermore, Ukraine's current account deficit, described by S&P as "relatively modest and over-financed by robust FDI," is expected to be propped up further by pent-up foreign direct investment (FDI).

"There are billions of dollars waiting to be invested in the country," said one British entrepreneur brokering deals in Ukraine, "investors have been hanging around in the wings waiting for the new government to take power."

Prime Minister Yulia Tymoshenko and her advisers have stressed repeatedly that the government is able to afford the Oschadbank repayments and point to a thorough analysis that determined the programme affordable.

"I can firmly state that all the payments of devalued deposits were calculated by the Ministry of Economy and Ministry of Finances and underwent all the necessary expertise," said Ms Tymoshenko.

Firm measures were put in place to limit cash withdrawals to UAH 1,000 (nearly \$200). Also, an attractive high interest rate was instigated to incentivise savers to retain their money in the bank.

**"There are billions of dollars waiting to be invested in the country."**



## Curbing Inflation

The government recognises the need to curb inflation. Rises in utility costs and consumer goods, and a currency pegged to the falling US dollar have fuelled the situation, as have the previous government's woeful lack of fiscal control and the cynical dumping of huge amounts of hryvnia into circulation.

In an interview in the Ukrainian Observer, Pavlo Prokopovych, of the Kyiv Economics Institute and the Kyiv School of Economics, said: "The situation is worse in Kyiv, where the rate of inflation surged to 18.7 percent for the first eleven months of 2007. Therefore, one may conclude the government has abused the printing press to finance social expenses."

**"Viktor Pynzenyk built up a track record during his last stint in office in 2005 for prudence."**

Viktor Pynzenyk, the new Finance Minister, will bring a more measured approach to handling the nation's finances. He comes with a reputation for cautious financial management and is well-respected by the international investment community.

In response to the S&P news release, Tim Ash, Managing Director, Emerging Markets, Eastern Europe, Middle-East and Africa, of Bear Stearns investment bank was more sanguine about the country's economic outlook: "It should be noted that the new minister of finance, Viktor Pynzenyk, built up a track record during his last stint in office in 2005 for prudence. He will likely argue that any payments made to savers will be made up for by savings elsewhere in the budget."

Furthermore, doubters need only study the prime minister's impressive track record in raising receipts and tax revenues.

When in government in 2005 the short-lived Tymoshenko-administration increased revenues (according to the Ministry of Finance) to the state budget by 63 percent over the prior year while receipts from state customs increased by 73 percent. Tax receipts from profits grew by 45 percent while VAT receipts leapt 100 percent.

Successful customs duties raising initiatives like "Contraband Stop!" are to be re-introduced and during a recent visit to the Dnipropetrovsk region, Ms Tymoshenko tasked the State Tax Administration and State Customs Service to increase budget earnings from taxes and custom duties twofold.

"People should remember that she was a successful business woman in her own right," said one seasoned Ukraine watcher, "she certainly knows how to maximise returns."

## Privatisation Bonanza

Finally, Ukraine still has some "low-hanging fruit." Whilst ruling out any major re-privatisation programme, the government has made its intentions clear on fresh privatisations. Again, when in



▲ Yulia Tymoshenko with Minister of Finance Viktor Pynzenyk.



office, it is worth remembering that Ms Tymoshenko raised record privatisation receipts with the sale of the Kryvorizhstal steel plant.

Of course, Ukraine is subject to the same vagaries that buffet international markets. Its steel and chemicals industries are dependent on overseas markets and can be impacted by a global slow-down. However, 2007 saw a respectable 7 percent GDP growth rate during a period of political upheaval and FDI growth of 50.3 percent to \$2.5 billion in the first half of 2007, as compared to the same period in 2006.

The country is firmly placed in the "emerging market" category and the new government is indeed shaking-up the status quo. But the environment it is seeking to create has not been seen before in Ukraine – economic vibrancy underpinned by the rule of law.

Stability and predictability are laudable twin goals, but of equal importance – and sadly lacking until now – is the requirement to underpin these with accountability and transparency. This new environment will not be achieved overnight, but the process has already started. By laying these foundations the investment pie that is Ukraine will grow substantially. Perhaps this thinking – more than ever – needs to be considered when evaluating the nation's medium to long-term outlook.

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## Calling on the Kremlin

Prime Minister Yulia Tymoshenko is set to visit Russia in late February. Her visit is aimed at strengthening relations between the two countries. Ms Tymoshenko has made no secret of her desire for a fresh-start relationship with Russia and there have been receptive signals from the Kremlin.



High on the agenda will be energy issues. Ukraine's new premier has long-wanted to broker a more transparent agreement for the supply of natural gas to Ukraine. This includes the removal of intermediary companies.

Currently, the exclusive supplier of natural gas to Ukraine is RosUkrEnergO – the privately owned Swiss company which has been dogged by criticism over its opaque structure and dealings. At one time the company was under investigation by the US Department of Justice.

Under a deal negotiated last December by the outgoing Yanukovich-government, the Russian state gas company Gazprom will sell gas to Ukraine via RosUkrEnergO at \$179.5 per 1,000 cubic metres during 2008. While this is still cheaper than prices paid by other former Soviet-bloc countries, a reduction would be broadly welcomed and may take into account Ukraine's unique position as a transit country for Russian gas headed to lucrative markets in the EU.

The December deal proposed a rise in the transit charge per 1,000 cubic metres from \$1.6 to \$1.7. Yet an audit of the transit charges suggests the \$1.7 charge is still hugely discounted. This, together with a genuine desire to improve relations to the mutual benefit of both countries, gives both parties significant room to manoeuvre.

## New Broom

The new government is completing the process of putting in place the new team to overhaul Ukraine's murky energy sector. Vitaliy Hayduk is being widely tipped to fill the vacant position of



Vice-Prime Minister for Fuel and Energy. Last week Mr Hayduk, who is the co-owner of the Industrial Union of Donbas, announced plans to withdraw from business in order to concentrate solely on politics.

Mr Hayduk is a seasoned politician who served as Vice-Prime Minister for Fuel and Energy in 2002. He is a known opponent of shady intermediaries in the energy sector and in 2006 reportedly turned down the Vice-Prime Minister post because of his concerns over the January 2006 gas deal.

## A Solid Team

The new Minister of Fuel and Energy, Yuriy Prodan, has spent much of his new tenure working on addressing the issues that have impacted the financial performance of Naftohaz, Ukraine's state gas company. Supporting him is the new head of Naftohaz, Oleg Dubina, a veteran "turn-around" specialist who is expected to put the ailing company on a sound commercial footing. Stripped of industrial gas contracts – placed with UkrGazEnergo – and saddled with discounted transit charges, Naftohaz is deeply unprofitable.

"The profitability of UkrGazEnergo is provided at the expense of Naftohaz," said Mr Prodan recently – a clear indication of his desire to restructure the company.

The business and financial affairs of Naftohaz are currently subject to an investigation headed by First Vice-Prime Minister Oleksandr Turchynov. The findings are due in February.

"If we are to attract foreign investment and find our place in Europe, we must clean up this sector and put our house in order properly," said Mr Turchynov, "transparency and the rule of law must be paramount. It can be the only way we can move forward."



▲ First-Vice Prime Minister Oleksandr Turchynov.

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