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# UKRAINE ON THE INTERNATIONAL MARKETS: PROBLEMS AND PROSPECTS

**After Ukraine declared its independence, one of its priority tasks became the integration into the world economy. However, Ukraine came up against unusually tough competition on the international markets, while the process of its entrance onto the world economic stage was rather painful for the country's weak economy.**

**The delay in implementing market reforms and the overly slow restructuring of industry led to the deterioration of Ukraine's foreign trade structure. As opposed to the countries of Central and Eastern Europe, Ukraine has remained an exporter of mostly raw materials and semi-finished products without being able to increase its share of goods with a high added value within the overall export structure.**

**The geographic diversification of Ukraine's foreign trade is being achieved gradually, as well as the strengthening of its position on new markets. This often takes place under the influence of external factors, rather than as a result of the implementation of a well thought-out foreign economic strategy. The overall result is that today, Ukraine's main trade partners remain countries of the CIS (above all, Russia).**

**The strategic significance of foreign trade for Ukraine lies in that the modernisation of the economy, the attraction of large-scale foreign investments and the implementation of new technologies are possible only under conditions of the formation of a stable economic system in the country which would be open to the outside world, and Ukraine's organic inclusion in the system of international division of labour.**

**An important factor is the existence of hundreds of enterprises in Ukraine oriented toward foreign markets. For decades, not only large industrial giants, but entire industrial branches (ship-building, rocket construction, military-industrial complex, metallurgy, chemical industry) were deeply integrated in the system of industrial co-operation with the republics of the USSR and socialist countries. After the collapse of the USSR, these branches lost access to traditional markets, that is why huge production capacities went unused under lower demand conditions. The reorientation of these excessive capacities toward other types of production proved ineffective (as the attempts to convert the military-industrial complex demonstrate), while their shrinkage is causing social problems. The renewal of broken co-operative ties and the entry into new markets seems to be more productive, including doing so together with former partners.**

**Despite an enduring and deep economic crisis, preconditions continue to exist in Ukraine for the creation of a competitive economy and the strengthening of its position on international markets — these preconditions are, above all, the country's rich natural resources, convenient geographic position, a qualified and relatively cheap labour force, the potential of the military-industrial complex, high technologies, science, and a relatively effective educational system.**

**Nevertheless, foreign trade turnover has been decreasing over the last three years. Import and export structures alike are deteriorating. Industrial exports of individual branches are ineffective, and often loss-making (as in the metallurgy complex in 1997-1999). The domination of raw materials in Ukraine's export makes it vulnerable to price fluctuations on the world market.**

**The high energy consumption of branches oriented toward export (metallurgy, chemical industry) leads to the dependence of exports on import supplies of energy, prevents export revenues from being used for technological renewal of industry, and reinforces dependence on Russia.**

**Ukraine is unreasonably losing its traditional (and geographically proximate) markets, and moving its production into new markets too slowly.**

**Reasons exist for asserting that the potential for the extensive development of exports has already nearly been exhausted. Quality changes need to be implemented — above all, re-orienting the structure of exports toward increasing the share of finished products in the overall export volume; increasing the effectiveness of export operations; renewing the country's presence on traditional markets and strengthening its position on new prospective markets; improving the state regulation of foreign economic activity.**

**The aim of this UCEPS analytical report is to point out the basic problem areas regarding the development of Ukraine's foreign trade, determine its structural priorities, and substantiate the means for improving the mechanisms of Ukraine's foreign economic activity. This analytical report is comprised of three sections.**

***In the first section*** the principal indicators of Ukraine's foreign trade are analysed. Ukraine's place in the world economy, the role of foreign trade in the development of the national economy, and the main characteristics of Ukraine's export potential are determined. The geographic and commodity structure of foreign trade, and Ukraine's presence on the service and capital markets are analysed. The most troubling tendencies and imbalances will become apparent on the basis of the analysis made; comparative assessments are provided.

***In the second section*** the main internal and external factors influencing the development of Ukraine's foreign trade are analysed. More attention is given to factors which, if taken into account, would make it possible to effectively utilise Ukraine's competitive advantages, and available export potential.

***In the third section*** concrete mechanisms and ways for expanding Ukraine's presence on international markets are proposed. Increasing the competitiveness of the country's economy, decreasing the volumes of loss-making exports, improving the mechanisms of state regulation of economic activities, and bringing the country's legislation closer to GATT/WTO norms are proposed as the main priorities.

# 1. THE CURRENT STATE OF UKRAINE'S FOREIGN TRADE

In this section, the current state of Ukraine's foreign trade, its position in world trade, and individual components of the country's export potential are analysed. The structure of the exports of goods and services is analysed in terms of geographic and commodity dimensions. A brief characterisation of Ukraine's export position is given according to individual types of industrial and agricultural products, along with an analysis of the structure of the export of services, and Ukraine's participation in the international flow of capital.

## UKRAINE'S POSITION IN WORLD TRADE

The liberalisation process, which began developing in world trade after the Second World War, led to a sharp increase in trade volumes. According to WTO information, after 1950, world export volumes grew 18-fold, while production increased only 6.5 times during the same period. Likewise, world exports of industrial goods increased 34-fold, while industrial production increased nine-fold.

A significant increase in the dependence on foreign trade can be observed in a majority of countries. In the mid-'90s, the share of foreign trade in the U.S. GDP comprised 24% (in 1950 — 9%), in France — 43% (and 23%, respectively), in Germany — 46% (27%), Great Britain — 57% (30%)[1]. A similar situation can be observed in Ukraine: Ukraine's export share grew from 24% of GDP in 1992 to 42% in 1999. However, as opposed to other leading countries, in Ukraine, the growth of this indicator over the last several years was not a result of the export *volume* increase. At the same time, Ukraine retains significant export potential which is supported by the data presented below.

**Ukraine is among European leaders in terms of the reserves and extraction of mineral resources and raw material.** Over 200 types of mineral resources were discovered in Ukraine, and nearly 20 thousand deposits have been found. Covering only 0.4% of the earth's dry land and with only 0.8% of the world's total population, Ukraine produces up to 5% of the world's raw minerals and mineral products. Raw minerals extracted in Ukraine are valued at $15 billion[2].

**Ukraine possesses significant potential for international specialisation within the branches of the agro-industrial complex.** Ukraine has over 25% of the world's most fertile black soil, as well as climatic conditions conducive to agricultural production. The completion of reform of land ownership in agriculture, and technological re-equipment will lead to a growth in agricultural production. Even today, large food industry enterprises have been seriously modernised and

[1] Financial Times, Trade Compass, World Trade Analyses database, Global Import/Export, 1999.

[2] Chepizhko V. Land caretakers are 80 years old. — *Uryadovyi Kuryer*, February 7, 1998, p.8.

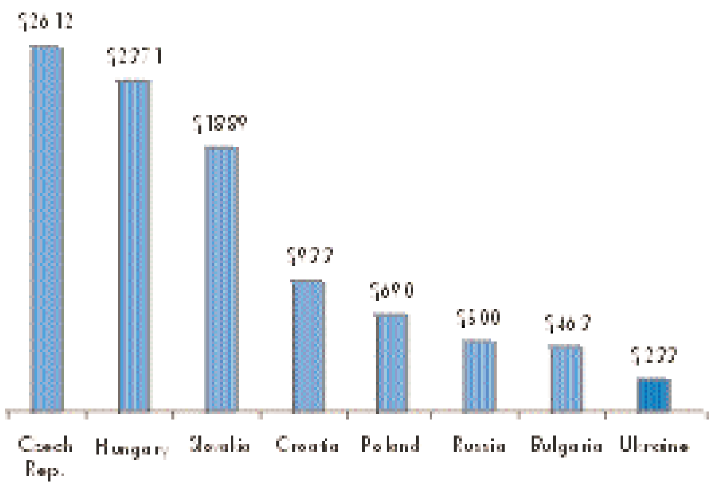
are generating production that meets world quality standards.

**Ukraine has significant potential in the area of the export of services.** It is the world largest transporter of natural gas and has a gas transport system with a high transit capacity — 290 billion cubic meters of intake and nearly 170 billion cubic meters of outlet capacity a year[3]. Almost 97% of Russian gas is transported to Europe over Ukraine's territory. In the next 3-5 years, Ukraine has the possibility of becoming the European major distributor of electricity, natural gas, oil and petroleum products, and not only those supplied from Russia, but from countries of the Caspian region and Central Asia. Ukraine has significant unexploited potential for developing tourist industry. With the shorelines of two seas in the subtropical zone, mountains, a large number of rivers, lakes and forests, Ukraine is a country where tourism can be ensured year-round[4]: recreation, sightseeing, sports (mountain climbing, skiing, sailing), and hunting. A convenient geographic location, and infrastructure of railways, sea lanes, motorways, and air routes connect Ukraine with many countries the world over.

**Ukraine has significant potential in high-tech industry branches[5].** Ukraine occupies a reputable position among the world leaders (after the U.S., Russia, France, and China) in the space sector. This is supported by the fact of Ukraine's participation in a number of international projects: Sea Launch; the construction of the International Space Station; the modernisation of the intercontinental ballistic missile SS-18 (Satan) together with the Russian Federation; the launching, together with Brazil and Italy, of the modernised rocket carrier Cyclone-4 from the Brazilian space launch pad, etc. Ukraine is also one of the nine countries of the world able to design and build military transport aircraft. Its aircraft industry occupies a strong position in the construction of heavy cargo planes. Ukraine inherited from the USSR ship-building facilities which were considered to have one of the most powerful production capacities in Europe. Today, Ukraine's ship-building branch has over 100 plants, including 11 large shipyards. Ukraine has had considerable successes in the arms exports and military-technical services: starting with 1997, Ukraine has solidly held a position among the top ten world exporters in this area[6].

**Nevertheless, despite its high export potential, Ukraine's exploiting of that potential is ineffective, as compared with other countries.** Thus, based on its per capita export volumes, Ukraine yields not only to developed countries, but also to most countries of Central and Eastern Europe (*Diagr. "Per capita exports of goods in 1999"*).

**Per capita exports of goods in 1999[7]**




**As the Diagram demonstrates, Ukraine's per capita export volumes are three times lower than Poland's, and ten times lower than Hungary's. Clearly, such low indicators do not correspond to Ukraine's export potential, and indicate the need for more effective utilisation of that potential in order to increase Ukraine's influence on world economic processes.**

## DYNAMICS OF UKRAINE'S FOREIGN TRADE

The liberalisation of Ukraine's foreign trade, started in 1994, created preconditions for increasing the exports of goods and services. If Ukraine's export volumes are compared with its GDP, exports increased noticeably over the next

[3] Budzyshen L. Gas — the foundation for strategic partnership. — *Uryadovyi Kuryer*, July 3, 1999, p.3.

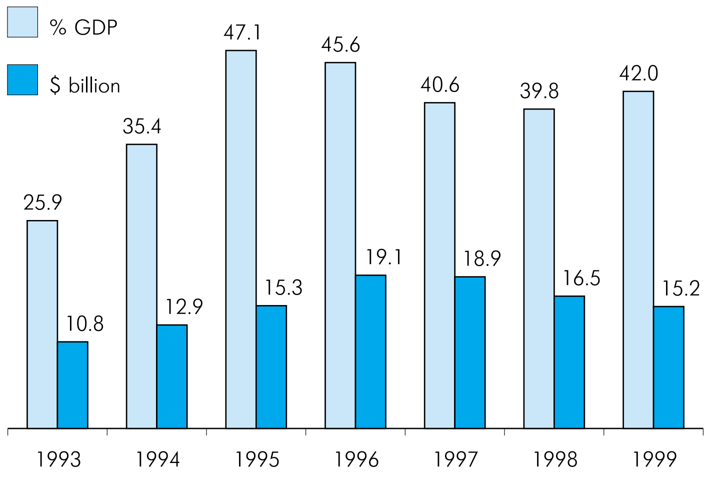
[4] On Ukraine's territory, there are over 70,000 rivers and streams, while 14% of its territory is covered by forest.

[5] For greater detail, see: Ukraine's international image: myths and realities. Analytical report of the Ukrainian Centre for Economic and Political Studies. — *National Security and Defence*, 2000, No.3, pp.33-36.

[6] These issues are examined in greater detail in the article by V.Badrak "Ukraine on the international arms markets". The article can be found in this issue of the magazine.

[7] Calculated on the basis of data from the EBRD, Reuters, and the national statistics of the mentioned countries.

**Exports of goods and services**[8]




two years (*Diagr. "Exports of goods and services"*).

However, at least two important developments are worth noting. In the first place, export growth took place against the background of a decrease in real GDP[9] and internal consumption. Therefore, the country's export potential continued to increasingly lose its internal economic basis. In the second place, as early as 1997, an export *value* decrease could be observed — this bears witness to a mostly export-oriented production growth crisis. The situation was complicated by the world financial-economic crisis of 1997-1999, which led to:

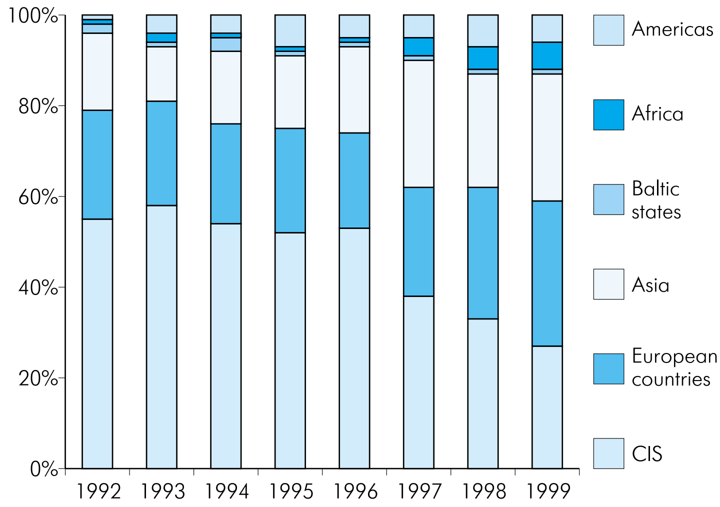
- a substantial decrease in demand on international markets for the principal articles of Ukraine's export, especially for its metallurgical produce;
- a significant decrease in demand for Ukrainian exports on the part of Ukraine's main trade partner — Russia[10];
- administrative control over the currency market, which affected the dynamics of Ukraine's foreign trade;
- the decrease in the export potential of many exporting manufacturers as a result of the domestic financial crisis.

The negative dynamics of exports over the 1997-1999 period can also be explained by the extremely unfavourable structure of Ukraine's foreign trade.

## GEOGRAPHIC STRUCTURE OF UKRAINE'S FOREIGN TRADE

During the '90s, a significant geographic reorientation of Ukraine's foreign trade took place — from the countries of the former USSR to other regions. As compared with 1992, the share of exports to CIS countries decreased by nearly half (*Diagr. "Geographic structure of goods exports"*).

**Geographic structure of goods exports**[11]**,**
% of overall exports




Along with the decrease in exports to the countries of the former USSR, an increase in exports to other countries is taking place. In 1999, the main importers of Ukrainian goods outside of the CIS were China (6.3%), Turkey (5.8%), Germany (4.8%), and Italy (4%) (*Table "Geographic structure of goods exports"*).

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[8] Calculated according to the data of the Ministry of Economy and State Statistics Committee of Ukraine.

[9] Real GDP decreased by 42% in 1993-1999.

[10] The decrease in the competitiveness of Ukrainian producers (as compared to their Russian counterparts) took place as a result of a substantial price increase in the Hryvnia as against the Russian rouble: the rouble as compared to the U.S. dollar became nearly four times "cheaper", while the Hryvnia devaluated only two-fold.

[11] Calculated according to the data of the Ministry of Economy and State Statistics Committee of Ukraine.

**Geographic structure of goods exports,** % of overall exports

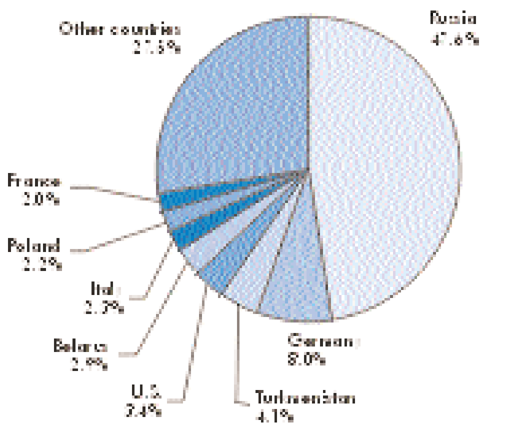
| | 1992 | 1993 | 1994 | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|---|---|---|
| **CIS** | **55.5** | **58.8** | **54.7** | **52.0** | **52.5** | **39.2** | **33.3** | **29.5** |
| Russia | 41.3 | 45.3 | 39.6 | 43.4 | 39.0 | 26.2 | 23.0 | 20.7 |
| Belarus | 5.2 | 4.5 | 5.3 | 3.7 | 5.1 | 5.8 | 4.3 | 3.0 |
| Uzbekistan | 1.7 | 1.2 | 0.7 | 0.8 | 1.2 | 1.7 | 2.8 | 0.7 |
| **Baltic states** | **1.7** | **1.4** | **3.0** | **1.7** | **1.8** | **1.6** | **1.8** | **1.4** |
| **Europe** | **23.9** | **23.1** | **21.5** | **22.8** | **21.4** | **24.2** | **29.8** | **31.3** |
| Germany | 1.9 | 2.2 | 2.8 | 4.1 | 2.9 | 4.0 | 5.1 | 4.8 |
| Italy | 1.8 | 1.8 | 1.9 | 1.5 | 2.4 | 2.8 | 4.4 | 4.0 |
| Poland | 1.2 | 1.6 | 1.3 | 1.1 | 2.4 | 2.7 | 2.5 | 2.6 |
| Bulgaria | 4.6 | 1.8 | 1.3 | 1.7 | 1.0 | 1.1 | 1.6 | 2.5 |
| Hungary | 1.9 | 2.3 | 1.7 | 1.5 | 2.3 | 2.2 | 2.1 | 2.4 |
| Slovakia | | 0.6 | 1.2 | 1.3 | 1.5 | 2.0 | 1.9 | 1.7 |
| Czech Republic | | 1.0 | 1.2 | 0.6 | 1.0 | 1.2 | 1.4 | 1.2 |
| Austria | 0.6 | 2.6 | 1.7 | 1.5 | 0.7 | 0.8 | 1.1 | 1.2 |
| Great Britain | 0.3 | 0.5 | 0.7 | 2.0 | 0.8 | 0.6 | 0.9 | 0.9 |
| **Asia** | **17.2** | **11.9** | **15.2** | **15.2** | **18.6** | **26.9** | **23.7** | **27.5** |
| China | 9.8 | 3.5 | 4.9 | 3.4 | 5.4 | 7.7 | 5.8 | 6.3 |
| Turkey | 4.0 | 1.8 | 1.1 | 1.7 | 2.9 | 4.7 | 5.5 | 5.8 |
| India | 0.4 | 0.8 | 0.5 | 1.3 | 0.6 | 1.6 | 1.1 | 1.5 |
| Pakistan | | | | | 0.1 | 1.3 | 1.5 | 1.6 |
| **Africa** | **0.9** | **1.7** | **1.2** | **1.6** | **1.3** | **3.3** | **4.4** | **5.3** |
| Egypt | 0.3 | 0.9 | 0.6 | 0.6 | 0.7 | 1.3 | 1.5 | 1.5 |
| **Americas** | **0.8** | **3.0** | **4.2** | **6.4** | **4.2** | **4.6** | **6.8** | **6.0** |
| United States | 0.4 | 2.1 | 3.5 | 4.8 | 2.5 | 2.1 | 4.0 | 3.8 |
| **Australia and Oceania** | **0.0** | **0.1** | **0.3** | **0.2** | **0.1** | **0.1** | **0.1** | **0.4** |

The largest drop in exports (more than two-fold) took place with respect to Russia (by $3.2 billion) and Belarus (by $377 million).

## GEOGRAPHIC STRUCTURE OF GOODS IMPORTS

An analysis of the structure of Ukraine's imports (*Diagr. "Share of Ukraine's principal trade partners in imports of goods in 1999"*) points to the need to diversify imports, inasmuch as the share

**Share of Ukraine's principal trade partners in imports of goods in 1999**

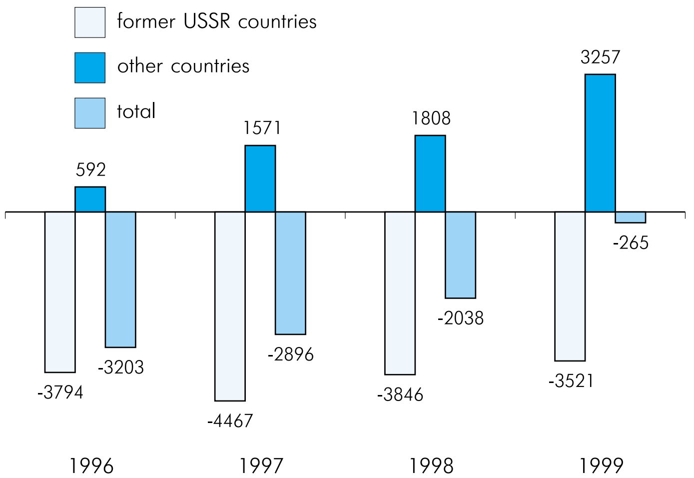



of only one country — Russia — approaches nearly half of all imports. Thus, Ukraine's economy remains critically dependent on the internal processes in the neighbouring country.

## FOREIGN TRADE BALANCE OF GOODS

The trade balance with the countries of the former USSR is experiencing an increasing deficit, while a positive foreign trade balance is on the rise with other countries (*Diagr. "Foreign trade balance of goods"*). However, the positive

**Foreign trade balance of goods**[12], $ million




aspect of this process should not be exaggerated — a decrease in negative balance was achieved as a result of imports decrease outrunning exports decrease, rather than an exports increase.

**A significant share of currency revenues ($3.0-3.2 billion), obtained from moving domestic goods into Western markets, is spent to pay for energy resources supplied from Russia. In this way, currency incomes which could be directed toward economic modernisation are actually "burnt" in the ineffective, energy consuming economy of Ukraine.**

## PRINCIPAL IMPORTERS OF UKRAINIAN GOODS

Over the last four years, a stable group of Ukraine's principal trade partners has formed to which over 50% of Ukraine's overall exports goes (*Table "Main consumers of Ukrainian goods"*). Over the last several years, the list is headed by Russia and China: their imports of Ukrainian goods in 1999 amounted to $2.4 billion and $730 million, respectively.

Ukrainian exports to Turkey, Germany, Italy, and the U.S. are growing — over the 1996-1999 period, these countries steadily climbed to the top of the rating list of countries — importers of Ukrainian goods. The table also demonstrates the **gradual decrease of Ukraine's presence on the markets of Poland** (by 16.9% over a three-year period) **and Belarus** (by 52.2% for the same period).

The decrease in the share of principal trade partners in the overall volume of exports (from 62.4% to 51%) took place as a result of decrease in the exports of goods to Russia — by $3.2 billion (over a three-year period).


**Main consumers of Ukrainian goods**

| 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|
| 1. Russia | 1. Russia | 1. Russia | 1. Russia |
| 2. China | 2. China | 2. China | 2. China |
| 3. Belarus | 3. Belarus | 3. Turkey | 3. Turkey |
| 4. Germany | 4. Turkey | 4. Germany | 4. Germany |
| 5. Turkey | 5. Germany | 5. Italy | 5. Italy |
| 6. U.S. | 6. Italy | 6. Belarus | 6. U.S. |
| 7. Poland | 7. Poland | 7. U.S. | 7. Belarus |
| 8. Italy | 8. U.S. | 8. Poland | 8. Poland |
| **Share of eight countries in the overall exports of goods** | | | |
| 62.4% | 56.0% | 54.5% | 51.0% |

[12] Hereinafter, we refer to the data of the State Statistics Committee of Ukraine: "Statistical yearbook of Ukraine", "Foreign trade of Ukraine", "Foreign trade in goods " (for 1994-1998), and "Foreign trade in goods in 1999".

## TRADE WITH PRIORITY FOREIGN POLITICAL PARTNERS

The priority directions of Ukraine's foreign policy are defined by a deepening of co-operation with the European Union, Russia, and the United States. The data presented in the *Table* below demonstrate that the exports of goods to those countries in 1996-1999 decreased noticeably (by $2.59 billion).

| | 1996 | 1997 | 1998 | 1999 | 1999/1996 |
|---|---|---|---|---|---|
| **Russia, $ million** | 5577.4 | 3723.0 | 2905.0 | 2396.4 | -3181.0 |
| % of overall export | 38.7% | 26.2% | 23.0% | 20.7% | |
| **EU, $ million** | 1596.4 | 1757.1 | 2119.3 | 2118.5 | 522.1 |
| % of overall export | 11.1% | 12.3% | 16.8% | 18.3% | |
| **U.S., $ million** | 376.3 | 300.4 | 500.2 | 435.9 | 59.6 |
| % of overall export | 2.6% | 2.1% | 4.0% | 3.8% | |
| **Total, $ million** | **7550.1** | **5780.5** | **5524.5** | **4950.8** | **-2599.3** |
| % of overall export | 52.4% | 40.6% | 43.7% | 42.7% | |

The main factor causing the decrease in export supplies was the shrinkage in trade relations with Russia (by $3.2 billion). The comparatively insignificant (by $582 million) increase in exports to EU countries and the U.S. only partly compensated for this decline.

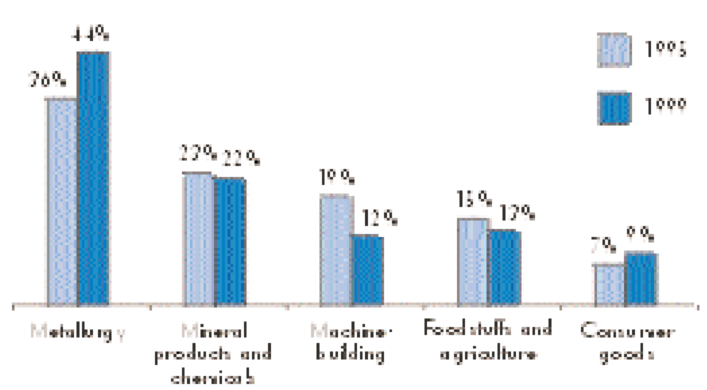
**Thus, during the years of independence, a significant geographic diversification took place in Ukraine's exports which, generally speaking, is a positive factor. However, the decline in exports to CIS countries (above all, to Russia), was not compensated for by the increase in exports to new markets.**

## STRUCTURE OF GOODS EXPORTS

The structure of Ukraine's goods exports demonstrates country's inability to solve the problem of its economy's structural imbalances that were created within the framework of the former USSR. As the Diagram *"Structure of goods exports"* shows, the dominant export positions are held by metallurgical production (44% of overall exports), mineral products and chemicals (22%), while the share of machine-building amounts to only 12%.

Moreover, over the 1995-1999 period, the structure of the exports of goods significantly worsened: the share of metallurgical production grew by 8%, while the share of machine-building production decreased by 7%.

**Structure of goods exports,**
% of overall exports




**Ukraine's foreign trade remains too sensitive to external factors. In the first place, the basis for Ukraine's exports is comprised of the types of goods that tend to experience significant fluctuations in demand as well as unusually tough price competition on international markets[13]. Secondly, Ukraine's main export-oriented branches[14] continue to consume very large amounts of energy resources, making them critically dependent on energy imports. These factors limit the possibilities for increasing exports at the expense of a devalued national currency — the potentially significant positive effect of a devalued Hryvnia gives way to the increased prices for imported energy resources used in the production of exports of goods.**

## COMPARATIVE ASSESSMENTS

As compared to the countries of Central Europe, Ukraine's export trade structure looks extremely unfavourable. In the first place, the exports of raw materials and goods with a low

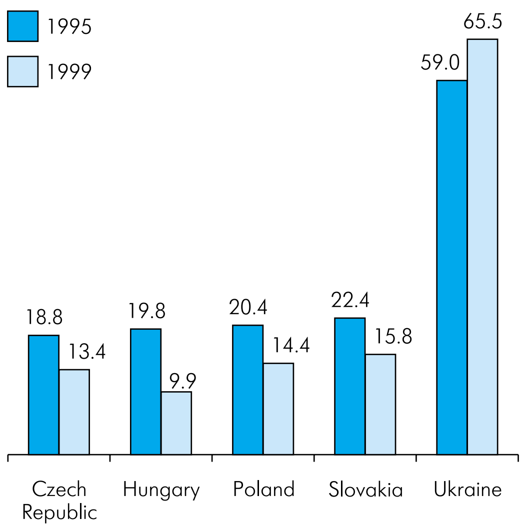
[13] As a result of this, it is namely on the markets of the metallurgical complex, chemical industry, foodstuffs, and textile industry that protectionist measures are applied most often.

[14] Metallurgical and chemical production in 1999 accounted for 51% of overall export. Within the self-production structure of these branches, the share of expenditures for energy approaches 50-70%.

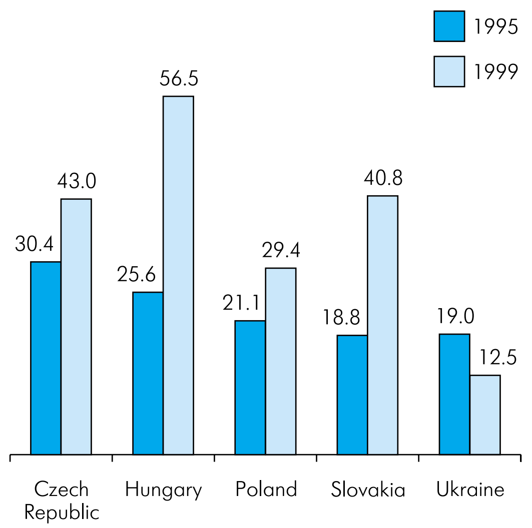
added value from Ukraine (as a percent of overall export) are 4-10 times larger than the same indicator for the Czech Republic, Hungary, and Poland (*Diagr."Exports of mineral products, chemicals, and metallurgical production" and "Exports of machine-building production"*)[15]. Secondly, the exports of machine-building production from Slovakia's (18.8%) and Poland's (21.1%). Therefore, **as opposed to neighbouring countries, Ukraine has not shifted its trade from raw materials and semi-finished goods to the goods with a high added value.**

The share of machine-building production within Ukraine's import structure continues to

**Exports of mineral products, chemicals, and metallurgical production,** % of overall exports

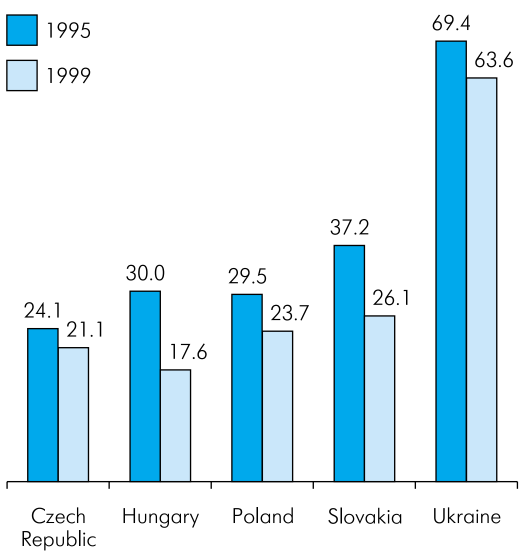



**Exports of machine-building production,** % of overall exports

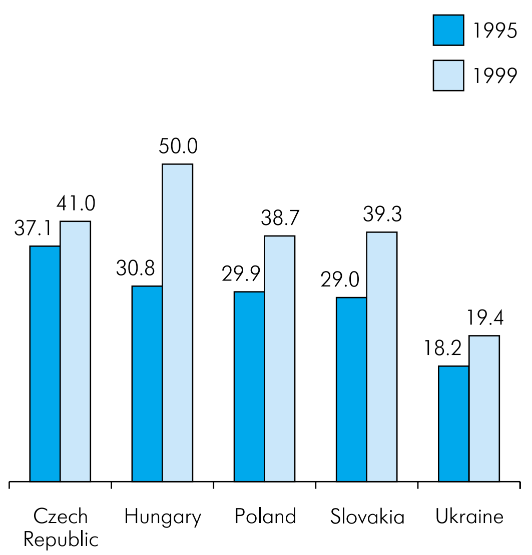



Ukraine are 2-5 times lower than that from the countries of Central Europe. It is worth noting that in 1995, the share of machine-building production within Ukraine's export structure (19%) was approximately in the same position as decline, and in 1999, was 2-3 times lower than in Central European countries (*Diagr. "Imports of mineral products, chemicals, and metallurgical production" and "Imports of machine-building production"*)[16]. This negatively influences Ukraine's

**Imports of mineral products, chemicals, and metallurgical production,** % of overall imports




**Imports of machine-building production,** % of overall imports




[15] Shyrmer Ya. et al. — Foreign trade and currency rate policy in Ukraine, May, 2000, p.7.

[16] Ibid.

export potential, since it is namely the imports of new equipment and technology that make it possible to modernise domestic exporter enterprises.

In general, the comparative analysis demonstrates the **phenomenon of Ukraine's strategically inconvenient export trade structure.** The conclusion drawn is supported by the analysis of Ukraine's principal export product line groups.

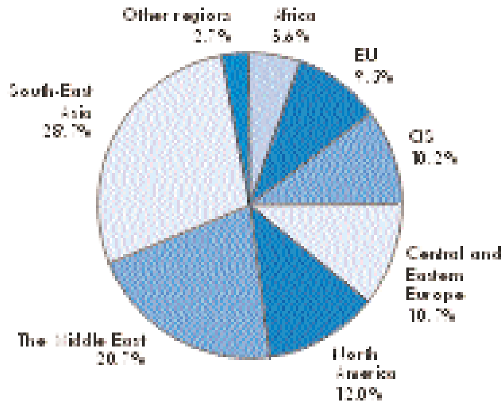
## EXPORT OF INDUSTRIAL PRODUCTS

The production of the metallurgical complex, chemical industry, and machine-building occupies the leading positions among Ukraine's export product groups, accounting for 78% of the overall exports of goods. The indicators and tendencies of the development of the above-mentioned branches are presented below.

***Metallurgy.*** The export of metallurgical production is one of the principal sources of currency flow into Ukraine (40%)[17]. To a large extent, the export of this production depends on foreign market conditions, competitor activities, and protectionist measures applied by importers. Efforts to broaden exports by way of lowering prices provoke anti-dumping proceedings against domestic exporters, and lead to a decrease in the profitability of metallurgical production exports. For instance, in 1999, the physical volume of metal exports grew by 26.5%, while in value terms, its exports decreased by 7.5%. Therefore, **the development of export in the metallurgical branch is, in many instances, not oriented toward economic efficiency, but toward retaining a position on foreign markets with the goal of obtaining currency incomes at any price.**

The geographic structure of the exports of metallurgical production demonstrates its non-correspondence with Ukraine's integration priorities with respect to the European Union, as EU member countries today consume less than 10% of Ukraine's overall export volume (*Diagr. "Geographic structure of the exports of metallurgical production for the 1st quarter of 2000"*).

**Geographic structure of the exports of metallurgical production for the 1st quarter of 2000,**
% of overall volume




***Chemical industry.*** Exports of chemical products amount to approximately 10% of entire goods exports. The main trading articles remain fertilisers and products of non-organic chemistry — which amount to about 65% of entire chemistry exports.

A decrease in the exports of chemical goods has been taking place over the last three years, due to unfavourable world market situation. In 1999 only exports of these products decreased by 15.3% (almost by $200 mln.) as compared to 1998. Furthermore, the increase in chemical products exports is being stalled as a result of its high level of energy consumption, dependence on raw material imports (especially oil and stirol) and environmental damage. Only the inertia of demand in the countries of the former USSR which were unable to find alternative chemical production supply sources makes this sector more or less stable.

***Machine-building.*** The share of machine-building within Ukraine's industrial production structure in 1992-1999 decreased three-fold, which had a negative impact on the exports of machine-building production (its share within the 1999 export structure amounted to only 12%). The main reasons for this are, firstly, the disruption of co-operative ties with the countries of the former USSR and the former Council for

[17] Given this fact, Ukraine exports production with a low level of processing (raw materials and semi-finished goods comprise more than half of metallurgical production exports), which lowers the potential for currency proceeds.

Mutual Economic Assistance (Comecon) and, secondly, the relative rise in prices for energy and materials, which made Ukraine's machine-building enterprises non-competitive.

Under such unfavourable conditions, Ukraine demonstrated an ability to effectively participate in large international projects in high-tech branches, and namely: the production of rockets and space equipment, heavy aircraft manufacture, and ship-building[18]. At the same time, these branches are not leaders in Ukraine's present-day economy and, respectively, do not determine the character and tendencies of Ukraine's export. **Taking into consideration the low competitiveness of production of Ukraine's machine-building, and also the decreasing expenditures on innovation, without necessary state support, it is difficult to speak about the prospects for strengthening Ukraine's position on the international high-tech markets.**

## EXPORTS OF AGRICULTURAL PRODUCTS

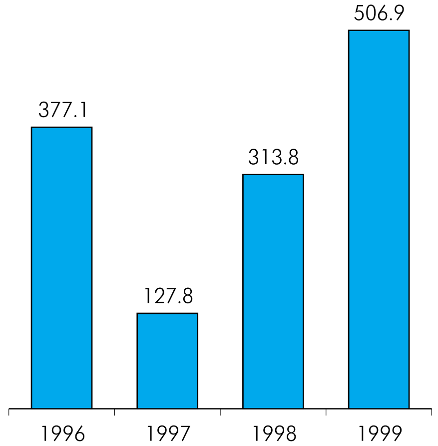
Given the favourable natural-climatic conditions, the development of the agro-industrial complex's exports potential seems undoubtful. The utilisation of this potential depends on the success of the present-day economic reforms in the agricultural sector. Data is presented below with respect to the export of grain, sugar, meat, and sunflower seeds and oil, that is, those goods that comprise close to 70% of agricultural exports.

***Grain.*** Starting in 1998, grain exports grew 1.5-2.5 times yearly (*Diagr. "Grain exports"*). The main grain consumers continue to be the countries of the former USSR — Belarus (35-40% of grain exports), the Baltic states, and also Turkey, Israel, and Iran. Nevertheless, in 2000, for the first time in the last several years, a grain deficit can be observed on the domestic grain market; respectively, exports are on the decline. This took place, among other reasons, due to the fact that in the 1998/1999 season, 5.5 million tons of grain were earmarked for exports out of a low harvest of 26.5 million tons. $507 million worth of grain was sold, which was 60% more than the same indicator for the previous season.

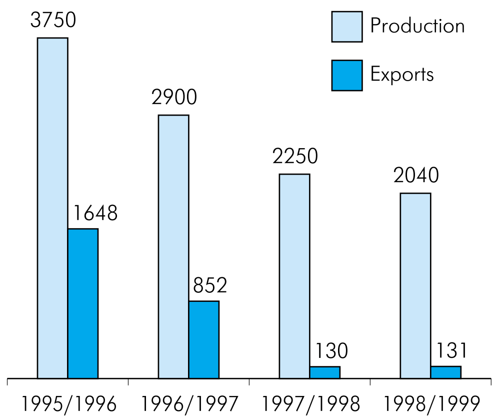
As a result of the low grain harvest over the last years, the increase in export supplies, and the cessation of interventions by the State Committee for Material Reserves of Ukraine on the domestic market, local authorities were forced to compensate for the grain deficit by importing grain. If Turkey was one of Ukraine's main grain importers in 1999, in 2000, Ukraine was already importing grain from Turkey. Furthermore, grain is being purchased from Kazakhstan, Argentina, the Czech Republic, Croatia, and other countries[19]. In this way, **as a result of the ineffective state regulation of relations in the agro-industrial complex, Ukraine is losing foreign markets, and is transforming from a grain exporter to a grain importer.**

***Sugar.*** Ukraine firmly maintained a leading position in the production of beet sugar as early as 7-10 years ago. For example, in the 1993/1994 season (with a production volume of 4.13 million of tons), Ukraine was the third largest beet sugar producer in Europe, after Germany and France. Nevertheless, over the next several years, sugar production rapidly decreased (*Diagr. "Sugar production and exports in Ukraine"*), so that in the 1998/1999 season, Ukraine fell to sixth position (2.04 million of tons). While Ukraine produced

**Grain exports,**
$ million




**Sugar production and exports in Ukraine,**
thousand of tons




[18] Ukraine's international image: myths and realities. Analytical report of the Ukrainian Center for Economic and Political Studies. — *National Security and Defense*, 2000, No.3, p.34.

[19] This leads to an increase in bread prices on the domestic market. See: Guzhva A. Seven days without bread lines. — *Segodnia*, May 17, 2000, p.8.

over 10% of the world's beet sugar in the 1993/1994 season, and almost 4% of the overall volume of the world's sugar, in the 1998/1999 season, these indicators fell to 5.5% and 1.5%, respectively.

The high prime cost of Ukrainian production, in conjunction with world over-production and high supplies of sugar[20], make it impossible to increase sugar exports. As a result, as compared to the 1995/1996 season, last season, Ukraine lost close to $500 million[21] — this amount can be compared to the yearly arms export volume. **Ukraine has already lost its position as a European leader in the production of beet sugar, as well as markets for this production in the CIS countries and, above all, Russia.**

***Sunflower seeds and oil.*** The production of sunflower seeds in the 1999/2000 season amounts to 2.7 million of tons, which is 13% higher than last year's indicator. Still, this is 9% lower than the record level achieved in 1995.

The situation on the Ukrainian sunflower market changed substantially after the introduction of a 23% export duty in 1999. After this event, exports decreased by almost 90% as compared with 1998. Clearly, as a result, Ukraine is losing its former sunflower seed markets. Expectations for higher oil export volumes appeared unjustified[22]. Correspondingly, it was not possible to compensate for a decrease in currency revenues from the exports of sunflower seeds. It is especially worth noting that domestic solvent demand for sunflower seeds is limited, which is demonstrated by the fact that 800 thousand of tons of sunflower seeds were not consumed on the domestic market.

**Thus, the absence of prior calculations and forecasts for the development of events (at least for mid-term prospects), as well as ineffective state regulation of export operations, led to Ukraine's loss of markets for this production, a decrease of currency proceeds and, as a result, a decrease in budget incomes**[23].

***Meat.*** Russia remains the main importer of Ukrainian meat: 97-98% of all meat exports from Ukraine goes to Russia. As the Table *"Meat exports from Ukraine"* shows, from 1995-1998, exports of this product have been decreasing. The situation got especially complicated in 1998, when the Russian rouble "collapsed", and the financial crisis broke out.

**Meat exports from Ukraine,** thousand of tons

| | 1995 | 1996 | 1997 | 1998 | 1999 |
|---|---|---|---|---|---|
| **All meat,** | **213** | **210** | **175** | **100** | **140** |
| Of which: beef | 206 | 190 | 164 | 97 | 130 |
| pork | 3.2 | 8.8 | 7.7 | 0.8 | 4.5 |

Although physical volumes of meat exports to Russia grew by 40% in 1999, currency revenues from export increased by only 5%, as a result of meat price dropping. Furthermore, in 1999, large "humanitarian" supplies of European and American meat were made to the Russian market, which decreased demand for Ukrainian production. **In this way, the orientation of meat export supplies to Russia alone makes Ukrainian exports critically dependent on the development of events in Russia.**

## EXPORT OF SERVICES

Over the recent years, the export of services became one of the important factors for the dynamic development of foreign trade in the world. According to balance of payments data, export of services brings 16-17% of Ukraine's foreign currency revenues, which is close to the lower limit of this indicator for the majority of European countries (14-28%).

In 1999, Ukraine exported and imported services to and from more than 150 countries;

[20] For the 2000/2001 season, the supply for sugar in the world is forecast to be at the level of 165 million tons, while consumption will only be at the level of 130 million tons. Transitional reserves for the 1999/2000 season amounted to 31 million tons.

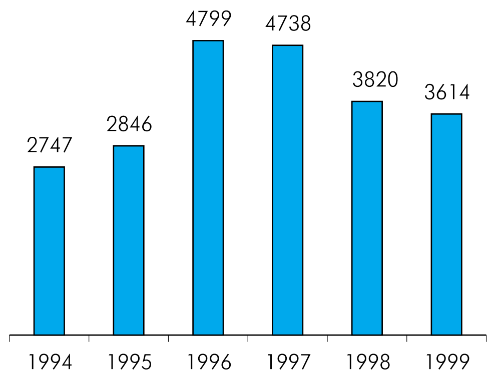
[21] Ukraine experienced significant losses due to the incomplete implementation of agreements with Russia regarding the supplies of sugar in 1996-1998 according to set quotas.

[22] In 1999, prices for different types of oil (sunflower, soybean, rape seed) declined by 34-40%.

[23] Ineffective mechanisms of state regulation of export operations are discussed in the article by V.Kramer "Exports of Ukrainian scrap metal: the experience of state regulation". The article is published in this issue of the magazine.

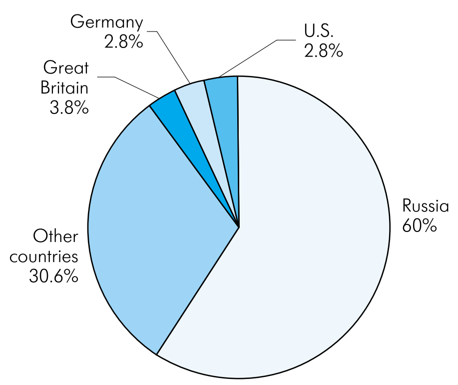
the export of services amounted to nearly $3.7 billion. However, there are reasons to assert that the potential for the export of services is far from utilised to the fullest extent possible. Beginning in 1997, there has been a tendency towards a decline in the export of services[24] (*Diagr. "Export of services"*).

**Export of services,** $ million




Regional breakdown of the export of services is presented in Diagram *"Regional structure of export of services in 1999"*.

**Regional structure of export of services in 1999,** % of overall volume




As compared to 1998, in 1999, the export of services decreased by $206 million. Services export to the countries of the former USSR dropped by $97 million, including by $81 million — to Russia. There were $109 million worth less of services provided to the countries of the "far abroad". This occurred as a result of the decline of services export to Ukraine's large trade partners: China (by 41%), Germany (23%), the U.S. (22%), Turkey (19%), and other countries.

The largest share in the overall export of services (85%) falls on transport services (*Diagr. "Structure of export of services in 1999"*). The transit of Russian energy resources comprises nearly 60% ($1.8 billion) of all transport services export. However, prospects for the transport of Russian energy resources are threatened by the Russian projects of alternate routes for transporting gas and oil, bypassing Ukraine's territory. That's why **maintaining and developing transit possibilities depend on a well thought-out tariff policy for Ukraine, as well as success in the implementation of the project for the transit of Caspian oil.**

Ukraine holds a weak position on the market of **construction services**, whose export amounted to $34.6 million in 1999, or 1.1% of overall export of services[25].

Despite large export supplies of machines and equipment (including arms) in the Soviet times, the export of **overhaul services** amounts to only $120 million, or 3.2% of overall export of services.

Taking into account the favourable geographic, climate and cultural factors, one could expect significant (worth billions) incomes from tourism (the **export of tourist services**). However, income from this type of services amounts to a negligible sum — close to $80 million.

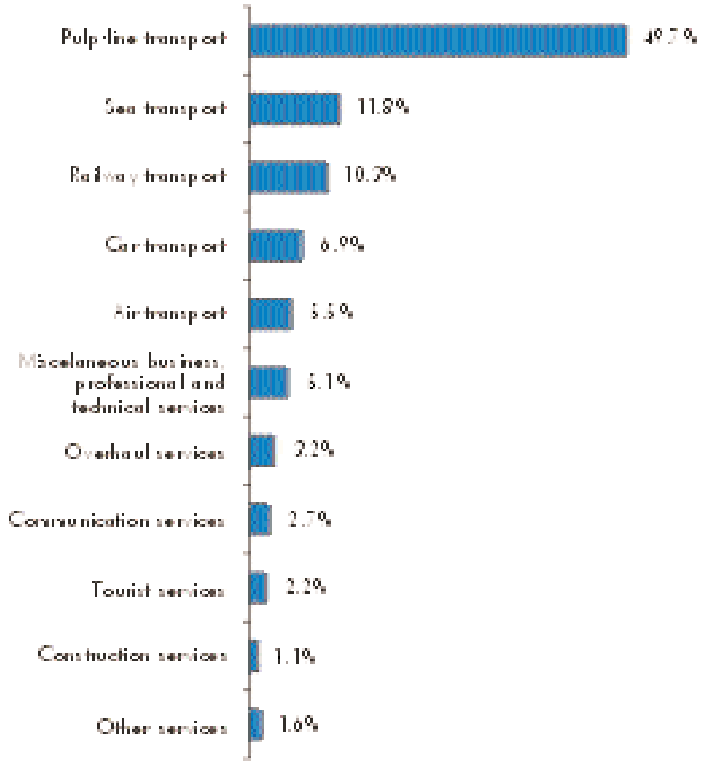
Existing problems in the information technology branch impact the volumes of **computer services** exported from Ukraine — in 1999, exports in this area amounted to only $4 million (0.1% of overall export of services). UCEPS experts believe that Ukraine has huge potential, and the necessary preconditions for a more dynamic development of this kind of services[26].

[24] The growth in the export of services in 1996 (by nearly $2 billion) took place as a result of an increase in tariffs for the transit of Russian gas. Accordingly, lowering these tariffs led to a decrease in the export of services in 1998.

[25] During the Soviet times, more than half of the Soviet experts that worked in Iraq were from Ukraine; Ukraine accounted for more than 60% of completed work. See: Honcharenko O. Myths of Ukraine's diplomacy. — *Zerkalo Nedeli*, July 17, 1999, p.3.

[26] In 1985, India exported $760 thousand worth of software, while in 1998, that figure had grown to $1.8 billion. The reason for such a sharp increase (apart from cheap labour) was the state support of export. In 1985, privileges were legislatively provided for software designers: investments in this branch and the export of software products were not imposed with direct taxes.

**Structure of export of services in 1999,** % of overall volume




Ukraine is virtually not represented on the international market of technologies — **licensing services** amount to only $3.9 million, or 0.1% of overall services export[27].

**In general, export of services at this time has a one-sided character (the transit of Russian energy resources). At the same time, Ukraine does not sufficiently utilise its existing potential and favourable conditions for increasing its export of services to different markets, and above all, to the CIS countries and Asia**[28].

## UKRAINE ON THE INTERNATIONAL MARKETS OF CAPITAL

**According to official statistics, Ukraine makes virtually no investments in the economies of other countries** — in 1999, Ukrainian investors officially invested only $9.6 million in foreign economies (in general, during the years of independence — only $100 million). **UCEPS experts believe that official data are probably understated and in no way correspond to reality.** More or less accurate information with respect to the flow of capital from Ukraine is unavailable. At the same time, the amount of currency that has been illegally transferred outside of Ukraine's territory and placed in foreign bank accounts is estimated at $20 billion, as a minimum[29]. As far as current export-import operations are concerned, as of April 1, 2000, the amount of currency not repatriated to Ukraine made $1.5 billion, or 17% of the entire currency turnover of the country[30]. These money create jobs in other countries while Ukraine is making considerable efforts to get a much smaller credit sum from the IMF. **That's why it can be said with certainty that over the last ten years, Ukraine has been a relatively large exporter of capital.**

It is worth noting that up to September, 1998, foreign loans were actively taken in order to cover the payment balance deficit[31]. These loans were consumed ("eaten up"), rather than used for investing in the real economy, which is why foreign debts increased quickly. The ineffective foreign loan policy, the creation of domestic financial "pyramids", and the slow implementation of market reforms led to the financial crisis in Ukraine (which, up to that time, was still aggravated by the crisis in neighbouring Russia). The National Bank and Government of Ukraine introduced a tough currency control regime in order to stabilise the situation; this led to a drop in export-import operations and, as a result, caused an outflow of capital from Ukraine, and a decrease in direct foreign investments.

At present, the overwhelming majority of the restrictions placed on currency operations in 1998 has been abolished[32], and a "floating" currency rate regime has been established. Nevertheless, **currency regulation in Ukraine remains ineffective. The revaluation of Hryvnia taking place during 2000 is not stimulating Ukrainian exports.**


[27] World turnover in the trade of license products amounts to nearly $30 billion a year. The value of the products manufactured under foreign licenses is estimated at $330-400 billion.

[28] These issues are examined in detail in an article by UCEPS expert: Saprykin V. Ukraine-Iraq: to trade, or not to trade. The article is published in this issue of the magazine.

[29] Melnyk M. Power and corruption in Ukraine: who will take the upper hand? — *National Security and Defence*, 2000, No.5, p.71.

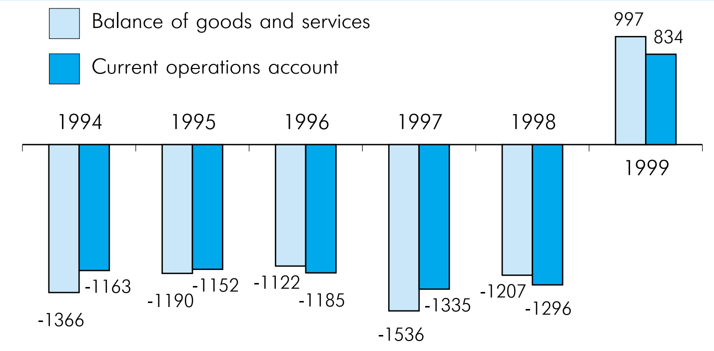
[30] Interfax-Ukraine, May 10, 2000.

[31] Mostly short-term (portfolio) loans at high interest rates.

[32] Only the norm with respect to the obligatory sale of 50% currency proceeds from export operations is still effective.

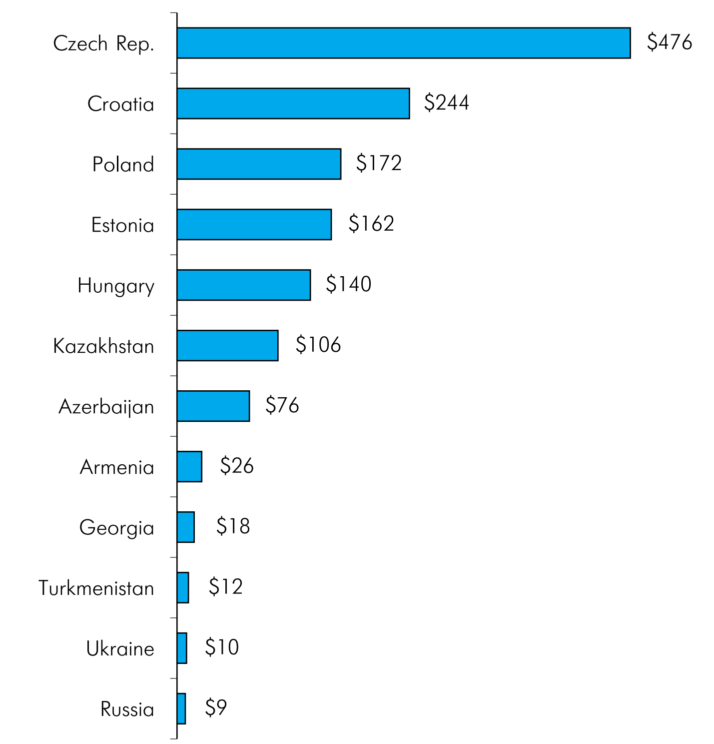
It is worth noting that **in 1999, a positive balance of payments was achieved in Ukraine for the first time** (*Diagr. "Balance of goods and services and current operations account"*). This occurred, in the first place, as a result of the more rapid decrease in imports as compared with exports; anyway, the need for foreign borrowing decreased.

**Balance of goods and services and current operations account, $ million**




**Foreign direct investments** into Ukraine over the years of its independence amounted to $3.2 billion — this is only $60 per capita. In 1999, the amount of foreign direct investments (net) into Ukraine decreased one and a half times, as compared with the previous year, amounting to $437 million — this is less than $10 per capita (*Diagr. "Direct per capita foreign investments in 1999"*).

**Direct per capita foreign investments in 1999**[33]




Ukraine's share in the overall volume of direct foreign investments in the Central and Eastern Europe amounts to only 2.6%. For comparison: this indicator for Poland is 38.8%, for the Czech Republic — 28.8%. The presented figures demonstrate the unfavourable investment climate in Ukraine.

**Foreign direct investments should also be seen as a factor for increasing export potential, since investments mean new equipment, new technologies, and better-qualified management.** Furthermore, it is much easier for a foreign investor to move products manufactured in Ukraine on the markets of foreign countries, including his own.

**Analysis shows that Ukraine has a weak connection to the international flow of capital. On the one hand, foreign direct investments keep off the Ukrainian economy due to the significant risk of investing[34], while on the other hand, officially stated Ukrainian investments into the economies of other countries are very insignificant. The reasons, preventing direct investments into Ukraine, simultaneously lead to the outflow of domestic capital abroad (both through legal and illegal channels). Therefore, having no money for the development of its economy, Ukraine continues crediting countries wealthier than itself.**

[33] Koluneev Yu. Eurobank in 2000: some results and lessons. — *Zerkalo nedeli*, May, 20, 2000, p.10

[34] These issues are analysed in greater detail in previous issues of this magazine. See: Administrative reform in Ukraine: will the closed circle be broken? Analytical report of the Ukrainian Centre for Economic and Political Studies. — *National Security and Defence*, 2000, No.5, p.10.

## CONCLUSIONS

**Despite a powerful export potential, Ukraine's utilisation of that potential is ineffective. The export share of Ukraine's GDP has reached 42%. However the increase in exports occurred against the background of a decreased real GDP and domestic consumption. That's why the country's export potential is increasingly losing its domestic economic base. A drop in export volumes can be observed starting in 1997, which bears witness to a crisis in the export-oriented industry.**

**Based on per capita export volumes, Ukraine is lagging far behind not only the developed countries, but also behind most countries of Central and Eastern Europe. This demonstrates the need for more effective utilisation of the export potential in order to increase Ukraine's influence on world economic processes.**

**In the '90s, a significant geographic re-orientation of Ukraine's foreign trade occurred — from countries of the former USSR, to other regions, which is a generally positive factor. However, the decrease of exports to CIS countries (above all, to Russia) was not compensated by an increase of exports to new markets. Furthermore, the positive balance of trade with Western countries is not being used to modernise production, but mainly to purchase Russian energy resources.**

**In 1999, Ukraine's principal trade partners were Russia, China, Turkey, Germany, Italy, the U.S., Belarus, and Poland — it is namely in this order that these countries are listed as the main consumers of Ukrainian goods. Exports of domestic products to Turkey, Germany, Italy, and the U.S. are increasing. A noticeable decrease in Ukraine's presence on the Polish and Belorussian markets can be observed.**

**The commodity structure of Ukraine's export is extremely unfavourable. It demonstrates the state's inability to overcome the economy's structural imbalances that were formed within the former USSR. Metallurgical production (44% of overall exports), mineral products and chemicals (22%) maintain the dominant export positions, while the share of machine-building accounts for only 12% of overall exports. As opposed to Central European countries, Ukraine was unable to move from trading in raw materials and semi-finished products to trading in goods with a high added value.**

**Ukraine's foreign trade remains extremely sensitive to external factors since the characteristics of Ukraine's exports are: the low level of differentiation of the export of goods and services; the concentration on non-dynamic and protectionist international markets; an unusually large dependence on an unstable price situation for raw materials and goods with a low level of processing.**

**The main export-oriented branches remain too energy-consuming which makes them critically dependent on energy-suppliers and limits the possibilities to increase exports at the expense of national currency devaluation.**

**The export of *metallurgy products* is vulnerable to price fluctuations on world markets, as well as to a significant share of production with a low level of processing, and to a low economic efficiency. The export of metal products is often oriented toward gaining a position on foreign markets with the goal of ensuring currency incomes at any price, rather than economic efficiency.**

**Exports of *chemical products* continue to decrease due to unfavourable world market situation. Furthermore, exports of chemical products are being impeded by their high consumption of energy and environmental factors. Only the inertia of demand from the countries of the former USSR, which are the main consumers of Ukrainian chemical products, makes this sector more or less stable.**

**The share of *machine-building* within the country's import structure continues to decrease. This negatively influences Ukraine's export potential, and makes it impossible to modernise export-oriented enterprises.**

**The development of export potential in the *agro-industrial complex* (AIC) will depend on the success of the current economic reforms in the agricultural sector. As a result of the state's inef-**

fective regulation of relations within the AIC (including regulation of agricultural exports), Ukraine is losing its foreign markets. Ukraine has already lost its position as a European leader in the production of beet sugar, as well as its markets in the CIS countries, especially Russia; Ukraine is gradually transforming into a grain importer; the country is losing its sunflower seed markets as well. The orientation of meat exports to Russia only makes Ukraine's export critically dependent on the development of events in that country.

The *export of services* is one-sided (the transit of Russian energy resources). Ukraine is not using its possibilities to enter the most dynamic markets of services — the tourism business and the information technologies market. Ukraine's usage of opportunities to export services to the CIS and Asian markets is also ineffective.

*Currency regulation of export activities* remains ineffective in Ukraine. The revaluation of Hryvnia in 2000 is not stimulating exports of domestic products.

According to official statistics, Ukraine makes virtually no investments into the economies of other countries. However, it can be said with certainty, that *Ukraine has been an exporter of capital over the last ten years*. The reasons that are impeding foreign investments into Ukraine simultaneously lead to the outflow of domestic capital abroad. Having no financial resources for the development of economy, Ukraine continues crediting the rich countries.

# 2. FACTORS THAT INFLUENCE UKRAINE'S FOREIGN TRADE

Ukraine's foreign trade is developing under the influence of a set of internal and external factors of both positive and negative character. The analysis undertaken by UCEPS experts shows that today the influence of the negative factors prevails. Therefore, the main task of Ukraine's foreign trade policy is finding regulatory mechanisms that would lead to strengthening of positive factors, and bring the influence of the negative ones to minimum.

This section contains an analysis of the principal factors that influence the exploiting of the country's export potential. In our view, it is worth taking them into consideration when determining the possible directions of Ukraine's foreign economic policy.

## 2.1 FACTORS THAT NEGATIVELY INFLUENCE UKRAINE'S FOREIGN TRADE

This sub-section analyses the main internal and external factors impeding the exploiting of Ukraine's export potential, and negatively influencing the development of its foreign trade.

### 2.1.1 INTERNAL NEGATIVE FACTORS

The main internal factors that affect the development of Ukraine's foreign trade are:

- **the low competitiveness** of significant number of exporting enterprises — this concerns their technological level, the quality of goods (services), the technology of export operations, the commercial terms of contracts, and also the amounts of financial resources which support foreign trade activities;
- **the underdeveloped base institutions of market economy,** due to the low effectiveness of privatisation and anti-monopoly regulation; this results in the overly slow formation of effective private owners capable of withstanding tough conditions of international competition;
- **the imperfect mechanisms of state regulation** — an irrational export policy, the inability to correctly define structural development priorities, the tax policy tending to confiscate profits, the overly restrictive cash and credit policy which, taken altogether, deprives enterprises of circulating assets and investment resources for the modernisation of production and improving management; the currency policy, which creates additional risks for exporters; the absence of stable (and transparent) rules of state export regulation, which would minimise enterprise expenditures on foreign trade operations;
- **the underdeveloped market infrastructure supporting export** — above all, the system of financing, export insurance, viable mechanisms for the promotion of goods on international markets, the application of off-set schemes, reliable technical service, etc.

## Low competitiveness

UCEPS experts believe that the low competitiveness of producers of goods and services is a *crucial* factor that impedes the effective promotion of Ukrainian goods on the international markets. This factor is above all the result of the absence of an effective competitive environment in Ukraine, which could stimulate the creation of new competitive businesses. The seriousness of this problem is once again illustrated by the data of the most authoritative international rating of competitiveness, the World Economic Forum in Davos, provided in the Table.

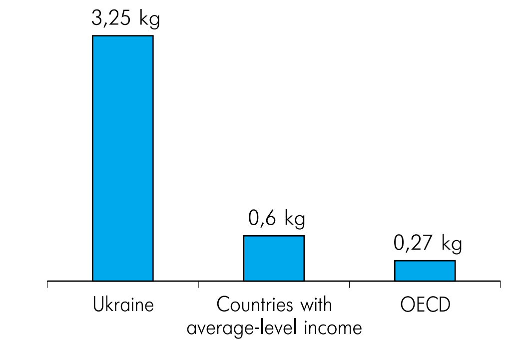
**Competitiveness rating 1999**
(in parenthesis — 1998 rating)[35]

| | | | |
|---|---|---|---|
| 1 (1) | Singapore | 24 (27) | Belgium |
| 2 (3) | U.S. | 25 (24) | Germany |
| 3 (2) | Hong Kong | 38 (43) | Hungary |
| 4 (6) | Taiwan | 39 (35) | The Czech Rep. |
| 5 (5) | Canada | 43 (49) | Poland |
| 6 (8) | Switzerland | 44 (40) | Turkey |
| 7 (10) | Luxembourg | 45 (48) | Slovakia |
| 8 (4) | Great Britain | 56 (...) | Bulgaria |
| 9 (7) | The Netherlands | 57 (51) | Zimbabwe |
| 10 (11) | Ireland | **58 (53)** | **Ukraine** |
| 23 (22) | France | 59 (52) | Russia |

UCEPS experts believe that the next to last place occupied by Ukraine in the overall rating, generally reflects the real state of affairs and the structural distortions and imbalances that are characteristic of Ukraine's economy.

**The competitiveness of Ukraine's production is limited by an ineffective industrial production structure[36], and the high prime cost of most types of export production.** *In the first place*, Ukrainian production consumes an unusually high level of energy resulting from the depletion of the country's basic assets, and obsolete technologies. Per U.S. dollar of its GDP, Ukraine spends almost 5.5 times more on energy resources than the countries of Central and Eastern Europe, and 12 times more when compared with the countries within the Organisation of Economic Co-operation and Development (*Diagr. "GDP energy consumption"*). *Secondly*, existing production capacities are often standing idle because of limited domestic demand, which increases conditionally continuous enterprise expenditures per unit of production[37]. *Thirdly*, a significant share of large enterprises maintains mobilisation facilities and many objects of the social sphere on its balance (kindergartens, dwelling-houses, hospitals, sanatoriums, etc.) — this also increases the prime costs for end production.


**GDP energy consumption,**
oil equivalent expenditures per $1 of GDP




As a result of high prime costs, **prices for separate types of Ukrainian goods are 30-70% higher than international market prices.** According to data of the former Ministry of Foreign Economic Relations and Trade, prices on the domestic market for hot-rolled sheet metal were 20-41% higher than export prices, for round billet — by 30-50%, for ammonia — by 67%, for carbamide — by 88%. Export of production is usually loss-making; supply prices at the level of Ukrainian domestic market complicate marketing of production even on rather stable markets of the countries of the former USSR.

The decline in the competitiveness of Ukraine's producers on the international markets is, to a large extent, caused by the **sharp decrease**

[35] Global Competitiveness Report 1999. — World Economic Forum, 13 July 1999.

[36] In Ukrainian industry, the share of "heavy" branches (power engineering, fuel industry, ferrous metallurgy) increased to 56.5% in 1999, as opposed to 19.7% in 1990. During this period, the share of machine-building, light and food industries fell from 62.3% to 27.5%.

[37] Production capacities for the output of metal cutting machine tools are loaded at only a 9% level, forging presses — by 7%, tractors — by 6%, footwear — by almost 10%.

**in financing of scientific research and technological designing** over the last ten years. The financing of science from the state budget is at a catastrophically low level (in 1999, close to 0.22% of GDP — this is lower by a factor than in developed countries). The level of expenditures for one scientist in Ukraine is 10-15 times lower than in the U.S., France, Germany, Great Britain, and Japan. According to expert assessments, Ukraine spends only $3 per capita for the development of priority information technologies, while the same figure for Poland is $28, and in the U.S. — $250. The orientation toward financing small research projects with an implementation period of 1-2 years leads to a decrease of knowledge-intensive production, and **the collapse of scientific structures capable of developing world class breakthrough technology.** The situation also becomes more complicated by the fact that from the period starting in 1991, Ukraine saw the emigration


of tens of thousands of highly qualified scientists; this process continues today.

The problems of enterprise competitiveness are made worse by the **imperfect schemes for financing export now in effect**. High interest rates on Ukraine's credits market[38], and limited access to long-term credit schemes[39] hinder the modernisation of production and management, and the introduction of up-to-date international marketing plans. The absence of developed schemes for financing exports (effective in most countries of the world) deprives exporters of circulating assets, and does not make it possible to perform export supplies of sophisticated production lines, machinery, and equipment of a comparatively high value. In most instances, such supplies cannot be delivered at all if foreign buyers are not offered convenient terms (credit, joint production, and other off-set schemes). Ukrainian exporters, therefore, are limited with respect to their abilities to offer foreign buyers commercial credits, and leasing of goods. At the same time, leasing is one of the main forms for making sales on the international market of aircraft, ships, and other equipment.

One of the problems of the low competitiveness of Ukrainian exporters is that **powerful Western transnational corporations (TNC) compete on the promising and most dynamic segments of the world market**[40]. In Ukraine, the process of creating TNCs is at the outset — this limits the access of the country's national producers to attractive foreign markets. Even in those branches where Ukraine can claim competitive production (for example, the AN-70 aeroplane), huge competitive pressure can be felt from powerful TNCs (in the case of the AN-70, from Boeing and Airbus Industry), which also find corresponding political support on the part of influential governments.

Production competitiveness also depends on the effectiveness of enterprise management. In most instances, it does not correspond to modern management standards — **the policy of prompt adapting to present-day conditions and demands of the market takes precedence over the development of long-term strategy.** Although many enterprises have marketing divisions, they have not yet been able to apply true marketing strategies, characteristic of Western firms. The absence of active mechanisms for moving production into foreign markets, and the limited means of influence on the intentions of potential buyers (not only purely economic, but also political, diplomatic, and other means for supporting exporters) demonstrate the low effectiveness of activity in this area in Ukraine. The absence of an extended network of sales and service centres outside Ukraine does not make it possible to react quickly to the needs of the buyers (consumers)[41], and does not provide Ukrainian exporters with competitive advantages.

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[38] The average monthly bank credit rate in 1999 in Ukraine was 4.5% — this indicator can be compared with the six-month bank interest rates of developed countries. Therefore, financial resources for Ukrainian exporters are 6-10 times more expensive than for their competitors in developed countries.

[39] Almost 2/3 of credits are issued by Ukrainian banks with a repayment period of one year. As a result of high credit risks, and unclear mortgage rules, banks avoid giving credits for a period of over one-two years.

[40] TNCs are responsible for up to 60% of world trade turnover, while 1/3 of that turnover takes place within TNCs themselves.

[41] The standard is rendering the services (of buyers of equipment) over a 24-48 hour period after receiving the corresponding order. Ukrainian suppliers that don't have corresponding "commercial presence points" abroad find it difficult to satisfy such demands.

After the break-up of the USSR, Ukraine lost the vast experience in the organisation of work on foreign markets, which the experts of former specialised foreign trade associations had. This concerns the movement of goods into foreign markets under various off-set schemes, which are more productive than traditional export supplies, especially when potential buyers have limited currency reserves.

**Ukraine cannot dispel its image as a country with unstable economy, high level of corruption and bureaucratic interference in the economy — this negatively influences the process of accepting Ukraine as a reliable partner**. Ukrainian exporters have a hard time competing with companies of foreign countries with stable economies, and better developed contract law and judicial systems, where, in general, the business ethics stands at a much higher level.


Therefore, the priority task of Ukraine's foreign trade policy should become **the implementation of a set of measures (possibly, within the framework of a special national programme), directed at increasing the competitiveness of Ukrainian producers.**

**These measures should encompass institutional, infrastructural, financial, information mechanisms, and new PR-technologies.**

## Underdevelopment of base market economy institutions

An important trait of Ukraine's foreign trade remains the significant (and not always effective) influence on the part of the state on export-import operations. Starting with 1994, important steps were taken in the direction of liberalising this sphere. However, **the role of market institutions in the regulation of Ukraine's foreign trade remains weak; the bodies of state management[42] retain effective mechanisms of influence on the conditions of foreign trade activity. State bodies have not yet managed to create conditions which would lead to an increase in the competitiveness of national business in general; priority is often given to the creation of artificial advantages for individual businesses.**

This problem is reinforced by the **low effectiveness of conducted privatisation.** In the majority of cases, it did not lead to the creation of real owners, that is, of solvent strategic investors, oriented toward long-term prospects, and prepared to invest significant amounts of their money into the development of production; an owner that has experience in the organisation of effective marketing and management.

**Countless bureaucratic mechanisms are still in place that limit the ability of new businesses to enter the market**, **where those businesses could bring more effective technologies of production and management.** The international experience of the countries of East Asia after World War II convincingly demonstrated that a high level of competitiveness on the domestic market is a precondition for effective activity on foreign markets.

It is difficult for Ukrainian exporting enterprises to work out effective strategies for entering foreign markets and achieve tangible results under conditions of **undefined ownership rules and basis for conducting business**, especially given the absence of market-oriented Land and Civil Codes in the country.

**The weakness of the banking and insurance systems is characteristic for Ukraine.** The mechanisms for providing guarantees and insurance of export supplies are undeveloped — this increases the risks of foreign economic activities. Specialised state-controlled institutions for the financing and insurance of export credits exist in developed countries[43]. The plan for providing state credit guarantees in Ukraine turned out to be ineffective: according to expert assessments, unpaid credits provided under Government guarantees amounted to over $2.5 billion.

[42] The Cabinet of Ministers, the Ministry of Economy, the State Customs Service, the State Tax Administration, and other state bodies of Ukraine.

[43] Examples are the Department for Guaranteeing Export Credits (Great Britain), the Export-Import Bank (U.S.), companies that conduct foreign trade operations: *COFACE* (France), *Hermes* (Germany), and others.

The absence of the necessary support (organisational, information, infrastructure) limits the export from Ukraine of financial, telecommunication, information[44], and business services, international tourism services[45], and services in the field of education and health care. Given **the unsatisfactory protection of intellectual property in Ukraine,** and the extremely low level of remuneration of scientists, it is also difficult to expect an increase in the export of sci-tech services. Often, sci-tech products are sold for next to nothing, although the commercial effect of their introduction might generate hundreds of millions of U.S. dollars. The export of services in such sectors as military-technical or construction services (the construction of facilities abroad), is being held back by the absence of active marketing strategies, and the necessary political and diplomatic support for the efforts of Ukrainian companies.

**Therefore, tangible positive developments within the system of export activity in Ukraine are connected, in the first place, with the increased pace of economic market reforms; and secondly, — with the creation of specialised market institutions that would service foreign economic activity.**

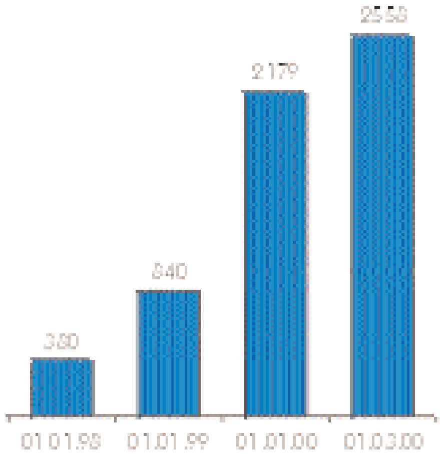
## Imperfect mechanisms of state regulation

**Export policy.** The absence of well-grounded priorities is intrinsic to export policy (with respect to both the commodity and geographic structures), as well as effective mechanisms of state influence (primarily of a market, rather than an administrative character) that could ensure the implementation of defined priorities. As Section 1 shows, the country's export structure is characterised by its orientation toward relatively non-dynamic, unstable, and overly competitive markets, which creates inconvenient trade conditions (the metals and semi-finished chemical products markets). At the same time, virtually no attempts for entering the most capacious world markets are visible, such as the information technologies market (valued at $600 billion), telecommunications (with a yearly turnover of around $600 billion), pharmaceutical products, etc.

On the other hand, Ukraine often loses opportunities for entering regional markets, especially in developing countries. A typical example is the inability (unwillingness?) to exploit rather favourable opportunities for entering the Iraqi market offered by the UN "Oil for Food" programme for two years running.

**Tax policy.** The absence of a Tax Code, designed to replace hundreds of effective taxation acts (that often contradict one another) does not encourage the efficient operation of export enterprises. The development of export is also hindered by significant distortions in the tax structure itself. The mechanism of exporter VAT compensation remains ineffective, resulting in constantly growing budget arrears owed to manufacturers (above all, to exporters) (*Diagr. "State budget arrears with regard to VAT compensation"*).

**State budget arrears with regard to VAT compensation**[46]**,** UAH million




Over the 1998-2000 period, arrears increased by 6.7 times, and reached UAH 2.56 billion — this decreases the already small amounts of circulating assets which are so badly needed by enterprises for increasing exports. Therefore, **the mechanism of VAT compensation to exporters requires improvement.**

**Currency regulation.** Ineffective currency regulation is impeding the growth of export. Despite the National Bank and Government of Ukraine promises to maintain the declared currency corridor, it was not possible to do so in 1999. This reflects the unstable and unpre-

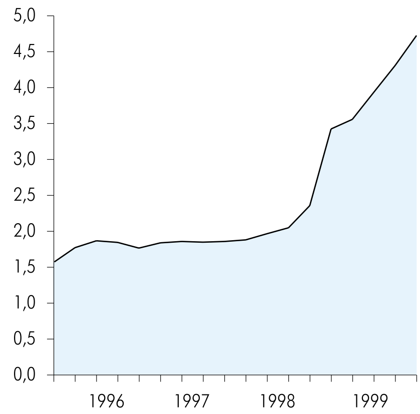
[44] The number of Internet users world-wide has already topped 260 million; in 2002, this number is expected to reach 490 million, by 2005 — 765 million. Today, there are 110 million Internet users in the U.S., in Japan — 18 million, Great Britain — 14 million, Canada — 13.3 million, Germany — 12.3 million, Australia — 6.8 million, Brazil — 6.8 million, France — 6.7 million, China — 6.3 million. In Ukraine, according to expert assessments, there are only 20-25 thousand registered users. According to UN data, there are 3.73 times fewer WEB-sites per every one million persons in Ukraine than in Russia; 37 times fewer than in Slovenia; 41 times fewer than in Estonia.

[45] Within Ukraine's services export structure, international tourism services amount to only 2.2%, while in the world as a whole — over 32%. Over the last 17 years, the volumes of transport services in the world doubled (these services amount to 85% of Ukraine's services exports); at the same time, banking, insurance, communications, information, and consulting services increased by 4.5 times world-wide, while within Ukraine's export structure, they are almost unnoticeable.

[46] According to the Ministry of Economy of Ukraine data.

dictable nature of the Hryvnia's exchange rate fluctuations (*Diagr."Nominal exchange rate of the national currency"*).

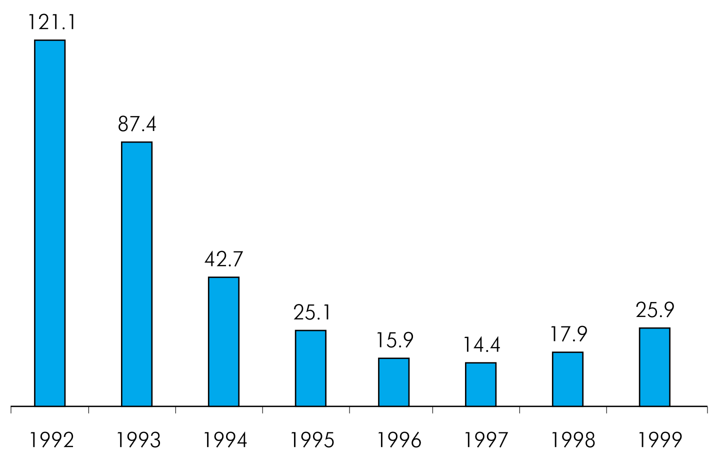
**Nominal exchange rate of the national currency[47], UAH/$**




As the Diagram shows, the periods of the Hryvnia's rapid (and relatively significant) devaluation were followed by periods of its long-term growth against the U.S. dollar. This creates additional currency risks for export-import operation participants.

If the real exchange rate is assessed taking inflation into account (*Diagr. "Real exchange rate of the national currency"*), then up to the middle of 1998, a revaluation (increase in price) of the Hryvnia took place. In general, during the 1992-1999 period, the Hryvnia became five times more expensive, which negatively influenced the competitiveness of Ukrainian exports.

**Real exchange rate of the national currency[48],**
UAH/$, June, 1992 = 100




It is worth noting that after a significant devaluation of the Hryvnia following the financial crisis (August-September, 1998), in 2000, the tendency of real Hryvnia revaluation returned, which is not a good development for Ukrainian exporters. **Such a currency regulation policy seems unreasonable for Ukraine[49]. It does not encourage exports, but provokes uncertainty and raises risks.**

**Foreign trade conditions.** For Ukrainian exporters, the main problem is the **existence of significant covert (tacit) export restrictions** — so-called operational, or non-tariff expenditures in foreign trade. A survey of 21 exporting enterprises showed that in Ukraine, operational

costs amount to nearly 40% of profits (in developed countries — 3-5%). Such large expenses are related to a poorly devised tax system, bureaucratic interference, unstable legislation, the low quality of customs service operations, and barriers resulting form banking sector deficiencies[50].

The significance of tacit restrictions is demonstrated by foreign rating agency assessments. As the Table *"Efficiency of state governance"* shows, Ukraine is among the "leaders" in so-called "unregulated" payments (that is, bribes), and its organised crime level (which forces businesses to bear large additional costs)[51].

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[47] Foreign exchange. — *Ukrainian economic trends*, December, 1999, p.84.

[48] Ibid. The "real exchange rate" is assumed as the nominal cash exchange rate multiplied by the ratio of price levels in the U.S. and Ukraine.

[49] The experience of Poland and Hungary (the most successful transition economies) shows that preference should be given to a moderate regular devaluation of the national currency, for the sake of maintaining its real rate relatively stable.

[50] Sirmer J. et al. — Foreign trade and the currency rate policy in Ukraine, May 2000, p.7.

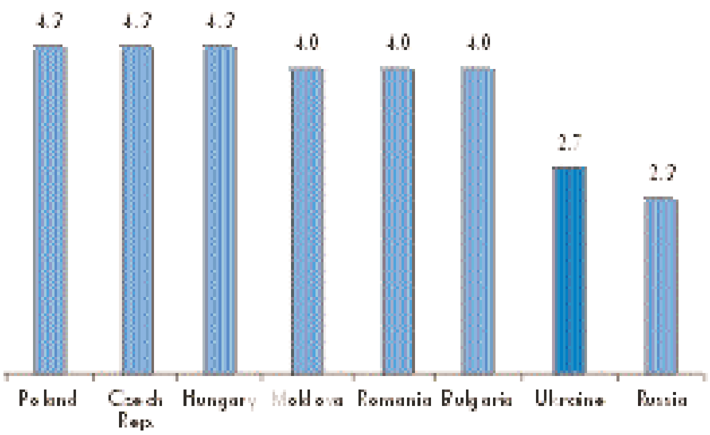
[51] The ghost of Europe. — The Agency of Humanitarian Technologies, 2000.

**Efficiency of state governance**

| Rating position | "Unregulated payments are widely spread" | "Organised crime forces businesses to bear large costs" | "Tax evasion flourishes" |
|---|---|---|---|
| 49 | Venezuela | Slovakia | Brazil |
| 50 | Vietnam | Russia | Greece |
| 51 | The Philippines | **Ukraine** | Italy |
| 52 | Indonesia | South Africa | Russia |
| 53 | **Ukraine** | Columbia | **Ukraine** |

Those restrictions, along with the obligatory 50% sale requirement of export currency proceeds, considerably limit the level of liberalisation of trade and currency regulations in Ukraine, thought to be among the lowest in Europe (*Diagr. "EBRD currency and trade liberalisation index"*).

**EBRD currency and trade liberalisation index**[52]




**The domestic producers protection policy** takes on distorted forms in Ukraine, and violates the rules of competition. For this reason, granting privileges does not always lead to an increase in the competitiveness of domestic production. A vivid example is the situation with *AvtoZAZ-Daewoo* JV. Despite significant tax relief (provided by a special law) and limitations of a clearly non-market character, its production found no demand in Ukraine and abroad. As a result, bankruptcy proceedings were initiated against this enterprise. Unlike East Asian countries, which once demonstrated effective models of export-oriented development, in Ukraine, state support is not used to stimulate the development of export potential, but to grant unjustified, one-sided privileges to individual businesses the expediency of which are not properly substantiated.

Thus, **regulatory mechanisms used in Ukraine's foreign economic activity are distorting the economic environment of working companies. This impedes the development of export potential.**

An important negative factor is **the state's inability to guarantee the strict observance of contractual commitments in foreign economic activity**. In the first place, this refers to services export — the transit of Russian gas via Ukraine's territory. In the long run, the unauthorised siphoning of gas, and the constant accumulation of debts to Russian suppliers creates the threat of Ukraine losing its position as a world leader in the transit of energy resources[53].

**The national law's non-compliance with international intellectual rights protection criteria** limits Ukraine's possibilities for participating in international projects. Ukraine cannot effectively use available potential for software export, since "pirate" products comprise over 90% of Ukraine's market in this area. For the same reason, foreign companies refrain from investing in high-tech projects in Ukraine, which also limits the growth of the country's export potential.

Therefore, **the priorities of legislative support for foreign economic activity include the creation of control mechanisms over the observance of contractual commitments, and guaranteeing the protection of intellectual property rights.**

[52] EBRD report on the situation in transition economies, 1999.

[53] Russia intends to cut the volume of gas pumped via Ukraine by 2/3 before 2008 by using pipelines bypassing Ukraine: the Yamal - Europe gas pipeline (30 Bcm of gas a year), the Baltic gas pipeline (up to 30 Bcm), and the "Blue stream" on the Black Sea bed (16 Bcm, under construction). According to UCEPS expert estimates, implementation of all of these plans is unlikely to occur, especially in the short run, given the deficit of funds experienced by Russia.

**The information support** of export needs to be improved radically. In Ukraine, there is no system of information support, which is why exporters lack information concerning the specific details of trade operations on individual markets, legislation of importer countries, business reputation of potential partners, their solvency, etc. The experience of Ukraine's trade missions abroad shows that the scanty resources allocated by the state for their maintenance[54] make it impossible to resolve the problem of information support for exporters. Furthermore, in Ukraine, even limited (fragmentary, outdated) information for exporters is often viewed as a paid service. For comparison: in the U.S., Japan, and the EU countries, powerful public information systems exist, providing exporters with various data free of charge, or on preferential terms.


The information problem has another dimension: the dissemination of information regarding Ukrainian enterprise capabilities is an important element of marketing and PR technologies. Unfortunately, the lack of financial resources (experienced by both the state and enterprises) does not allow for the proper performance of such work.

## 2.1.2 EXTERNAL NEGATIVE FACTORS

The main external factors that complicate the activity of Ukrainian exporters include:

- **the considerable toughening of international competition** over the last 7-10 years, characteristic of the new stage in world economic development;
- **rapid increase of consumer demands** regarding technological level and quality of goods, conditioned by scientific-and-technological progress, and the new possibilities in the exchange of information on the international level;
- **the transfer from simple, to more refined forms of protectionism,** the active use of political mechanisms on the part of influential countries for supporting their exporters;
- **ineffectiveness of Ukraine's policy regarding international economic integration.**

### Toughening of international competition

The liberalisation of international trade after the end of the Uruguay Round of GATT talks, the accelerated development of information technologies, and the financial strengthening of TNCs, not only encouraged the competitiveness of many countries, but also led to **tougher international competition** on the world's main commodity markets. The entry of new competitors from developing countries (China, India, Thailand, etc.) into the machinery and equipment markets leads to a sharpening of competition, and the exclusion of post-Soviet country enterprises that clearly lag behind their fast-growing competitors[55]. Recently, another factor has appeared: stronger foreign market competition with Russia and other post-Soviet countries (this refers to the supply of steel and other ferrous metal products, which dominate Ukraine's exports).

### Rapid increase of consumer demands regarding technological level and quality of goods

This trend makes price a less important factor; the level of production competitiveness becomes increasingly dependent on the rate of technological innovation quality guarantees. For Ukraine, with its relatively outdated technological base, such a shift in priorities creates quite a problem. Ukraine lost a significant share of its scientific and technological potential over the last 10 years, thereby making it nearly impossi-

[54] Such missions often employ only two, or three specialists.

[55] One example is the loss of the foreign machine tools and durable consumer goods markets (photo cameras, washing machines, TV sets, radio sets, etc.) after 1990.

ble for the country to compensate for those losses under its own power[56].

**Successful adaptation for new international market demands is impossible, if the present dominant policy of current adaptation in Ukraine continues. Without the development of long-term strategies for the development of export potential (both at a national, and export enterprise level), Ukraine will continue losing its position on international markets of high added value goods.**

## Foreign country protectionism policies

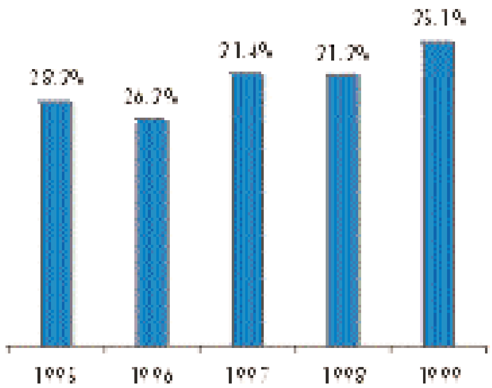
Influential Western countries pursue state protectionism policies, often resorting to political pressure on competitors, above all, on the arms and hi-tech markets (aircraft, NPP equipment[57], etc). This limits Ukrainian producer access to international markets. Ukraine's Government has no effective tools for influencing these processes, and does not render proper assistance to domestic companies competing to win serious international contracts[58].

The EU applies the practice of the so-called **"voluntary" limitation of Ukrainian exports** in such sectors as trade in steel and clothes, despite the WTO prohibition against such actions.

The main trade partner of Ukraine — **Russia — is also pursuing a protectionism policy with respect to the import of Ukrainian goods**. From May 15, 1997, Russia unilaterally introduced a uniform customs duty in the amount of 25% for imported white sugar. This practically blocked sugar supplies from Ukraine, since after the duty was imposed, it became non-competitive on the Russian market[59]. Furthermore, quantitative limitations were introduced for alcohol imports.

Foreign countries are also using **more refined forms of protectionism, aimed at discriminating against Ukrainian exporters**, through the use of various technical, environmental, sanitary, and other standards and norms, making product certification procedures more complex, setting requirements regarding the forms and methods of sales and technical services; they apply the mechanisms of initiating anti-dumping proceedings[60], making charges that exports are subsidised with the aim of imposing anti-dumping (*Diagr. "Share of Ukraine's export goods subject to anti-dumping proceedings"*) and compensatory duties against exporters, artificially decreasing their competitiveness.

**Share of Ukraine's exports subject to anti-dumping proceedings[61]**




In connection with the absence of internationally recognised accounting standards, and chronic non-payments in Ukraine, the actual cost of produced goods is distorted, which gives foreign partners reasons for charging Ukrainian producers with dumping. Furthermore, because Ukraine is categorised as a country without a market economy, this raises the anti-dumping margin from the minimum level (no more than 10%) to 125%, which closes relevant markets for at least five years.

[56] According to expert estimates, under conditions of the tremendous growth in knowledge-intensive hylology programmes, Ukraine lags at least five years behind the world level for every year lost in this area. See: Haiduchenko A., Kostina E. One year lost means at least five years of lagging behind the world level for Ukraine's powder metallurgy. — *Metal*, 2000, No.2, p.16.

[57] In its time, Ukraine's refusal (under U.S. pressure) from participating, jointly with Russia, in the Busher project in Iran became widely known. Within the framework of this project, Ukraine's *Turboatom* company was supposed to manufacture turbines for the nuclear power station. Direct losses from the company's refusal to participate amounted to $5.1 million; total losses are estimated at $50 million. Furthermore, Ukraine lost a chance to participate in China's and India's NPP construction projects.

[58] General Director of the *Motor Sich* company V.Bohuslayev stated that Ukraine "has virtually no intergovernmental agreements for large-scale projects in the aircraft industry sector and engine building". He is certain that large projects require "political and diplomatic support on foreign markets". See: UNIAN, May 30, 2000.

[59] In addition, despite the Ukrainian-Russian agreement for the duty-free supply of 600 thousand tons of Ukrainian sugar to the Russian Federation in 1998, delays in implementing quota mechanisms led to the actual exclusion of Ukrainian suppliers from the market: in 1998, only 100 thousand tons of sugar were supplied to Russia.

[60] 13 countries have initiated anti-dumping proceedings against Ukraine, encompassing 26 commodity groups: iron bars, rolled sheet, rods, ferroalloys, aluminium, nitrogenous fertilisers, etc. According to expert assessments, starting from 1992, losses from anti-dumping proceedings against Ukrainian enterprises amounted to $1.0-1.5 billion. Anti-dumping proceedings are underway in the U.S., EU, Thailand, Taiwan, Indonesia, Venezuela, the Philippines, India, Egypt, Chile, Mexico, Columbia, and South Africa.

[61] State Customs Service of Ukraine data.

Some other political mechanisms are also applied to bar Ukrainian goods from "undesirable" international markets. They include a rather free interpretation of international export control procedures, an introduction of additional conditions for developing relations

(with NATO and the EU), and for obtaining credits from international financial institutions.

**For the development of exports and increasing its presence on world markets, Ukraine should pursue a more aggressive policy (and use available political and diplomatic means), intended to remove explicit and implicit protective measures applied to Ukrainian exporters.**

### Ineffectiveness of Ukraine's policy regarding international economic integration

**Ukraine's weak integration into international economic structures, and especially its lack of participation in some of them, considerably limit its presence on international markets of primary importance to Ukraine.**

Ukraine's **non-participation in the WTO system** makes it impossible for the country to employ international trade regulation mechanisms, including those for settling trade disputes. Ukraine cannot fully exploit the advantages of lowering export barriers because it has not been unconditionally granted most favoured nation status. Special rules are applied to Ukraine in resolving trade disputes and defining framework conditions for anti-dumping proceedings. Ukraine's accession to the WTO is hampered by a number of factors; they include non-tariff import limitations, large state subsidies (especially in agriculture), non-transparent and unstable regulatory mechanisms, and the Government's excessive interference in the country's economy and trade[62].

Recent years have seen **disintegration in economic relations with Russia**, manifested in Ukraine's accelerated loss of Russian markets. According to the estimates provided by the former State Standardisation Committee and State Customs Service of Ukraine, in 1999 alone, losses in separate commodity groups amounted to: ferrous metals — $153 million; ferrous metal products — $120 million; power engineering equipment — $117 million; rubber and rubber articles — $47 million; electrical machines and equipment — $44.5 million; non-organic chemical products — $34 million; salt, sulphur, lime and cement — $26.5 million; land vehicles — $24 million; alcoholic beverages and soft drinks — $21.5 million; rolling stock — $20 million; meat and meat by-products — $18 million; meat and fish products — $6.5 million; aircraft — $6 million; pharmaceuticals — $5.5 million.

**Integrational processes within the CIS are clearly ineffective**, because of the different interests of participating countries, and a large difference in the levels of their economic development. For instance, Russia appears unprepared for the introduction of a free trade zone within the CIS, as it would lose $300-1000 million a year as a result, and if shadow turnover is taken into account — up to $2 billion. For this reason, Russia insists on retaining exemptions from, and temporary limitations on free trade procedures, including with respect to articles vital to Ukraine (foodstuffs, textiles, metal products). The Russian Federation also opposes the cancellation of duties on oil and gas exports, which are critically important for Ukraine.

**Ukraine also failed to achieve noticeable success in the direction of EU integration.** The EU Partnership and Co-operation Agreement signed in June, 1994, did not liberalise Ukraine's access to the EU market in such sensitive sectors as textiles, metallurgy[63], and the agricultural market. EU common strategy toward Ukraine (December, 1999) put off the issue of a free trade zone between Ukraine and the EU. In such a situation, the accession of Poland, the Czech Republic, Hungary, Slovenia, and Estonia to the EU can raise additional barriers for Ukraine.

[62] Agricultural aspects of Ukraine's membership in the WTO. — German advisory group at the Government of Ukraine, April, 2000.

[63] Supplies are regulated by separate agreements.

Ukrainian exporters make inadequate use of the EU preference system (APS) (by less than 50%). This is not only caused by the complexity of the technical procedure of its use; the main items of Ukraine's export often fall under exceptions within this system, or the preferences are so insignificant, that the costs spent on obtaining them would not be repaid[64].

Therefore, **the negative factors that influence Ukraine's foreign trade are mainly the result of the low pace of economic reform in Ukraine — this could not but affect its participation in the international division of labour. Under conditions of tough international market competition, the gap between Ukraine and leading countries is growing; stronger competitors are drastically forcing Ukraine out into the camp of third world.**

## 2.2 FACTORS THAT POSITIVELY INFLUENCE UKRAINE'S FOREIGN TRADE

Analysis shows that negative factors, unfortunately, prevail over those favourable to Ukraine's foreign economic activity. However, it would be unjust not to take notice of positive developments. This sub-section provides an analysis of the basic internal and external factors that favour the exploitation of Ukraine's export potential, and positively impact the development of foreign trade.

### 2.2.1 INTERNAL POSITIVE FACTORS

Such factors arise as a result of the accumulation of managerial experience and partial adaptation of the economy to the new environment, formed after the collapse of the command economy system. Exploitation of the positive factors will aid the development of foreign trade, and encourage positive qualitative changes.

**The general tendency of economic growth, and the appearance of "growth points" in specific sectors**[65]. After 10 years of economic decline, and extremely difficult conditions for business, there are reasons for stating that the low point of transformational setbacks has been left behind. The beginning of economic growth, no matter how unstable and insignificant it may be, will enhance Ukraine's potential for participating in the international division of labour and world trade.

Despite the evident deficiencies and erroneous decisions, **Ukraine gained some positive experience in regulating foreign economic activity. Today, state structures and export enterprises employ far more qualified specialists** than 8-10 years ago. As opposed to the 1997-1999 period, high-ranking officials refrain from making announcements regarding Ukraine's strategic partnership with different countries; **instead of unrealistic political declarations, the Government now pays greater attention to the economic aspects of Ukraine's foreign policy**. The Ministry of Economy is centred on making forecasts and calculations regarding the economic returns of significant foreign economic decisions (one example is the assessment of the consequences of Ukraine joining the WTO system).

Over the years of independence, many higher educational establishments in the capital and regions opened departments where specialists in foreign economic relations and foreign trade are trained. Apart from practical experience, this will encourage the **strengthening of economic pragmatism in the management of Ukraine's foreign economic activity, and more effective forecasting and planning of export-import operations.** Random surveys of exporting enterprises show that in many cases managers pay much more attention to the working out of long-term development strategies than they did 4-5 years ago.

Another positive factor is the creation of exporter councils and associations as a **precondition for better co-ordinated export policies** (such co-ordination is important, since in many cases,

[64] The development of Ukraine's foreign trade and competitiveness in trade with the European Union. — German advisory group at the Government of Ukraine, December 1999, p.47.

[65] In the 1st quarter of 2000, production was growing at a faster pace in sectors characterised by rapid capital turnover: food (32%) and light (30%) industries. Also, growth was recorded in services (telecommunications services, the Internet).

Ukrainian producers compete with one another on international markets). For developing recommendations regarding the state's promotion of exports, the Council of Ukrainian exporters has been established under the Prime Minister of Ukraine. However, during the two years of its existence, it convened only once (in November, 1999), which proves that the effectiveness of this potentially important body is low. Public organisations — councils and associations within separate export branches — are also being established[66].

**Positive changes are seen in the tactics of Ukrainian enterprises competing to gain profitable contracts**. For instance, Ukraine's oil and gas sector enterprises, in joining forces with Turkish partners, won tenders for the construction of two gas supply pipeline branches over Turkish territory worth $190 million. The Ministry of Foreign Affairs is taking concrete steps to ensure the appearance of Ukrainian producers on the Iraqi market[67].

**Positive developments are taking place in legislative regulation of foreign economic activity.** At the end of 1998, the Verkhovna Rada adopted the **Anti-dumping Code of Ukraine.** This document, encompassing six separate laws, is entirely in line with Ukraine's international commitments, and presents a commonly accepted means for protecting the domestic market. The Anti-dumping Code makes it possible to not only take measures for protecting national manufacturers against import supplies that damage the national economy, but also apply more effective mechanisms for protecting domestic exporters.

The Government of Ukraine has approved **"Regulations for investigating facts of discriminatory and/or unfriendly actions of other states, customs unions, and economic groups with respect to the legitimate rights and interests of Ukrainian entities of foreign economic activity"**[68]. This document defines as "discriminatory" those actions that put Ukrainian entities of foreign economic activity into a worse position when compared to foreign businesses. It determines procedures to be applied by the Ukrainian side, and the mechanisms of interaction with competent bodies of foreign countries. This regulatory act will encourage the improvement of Ukraine's image and the activity of Ukrainian entities of foreign economic activity on international markets, and strengthen the protection of their interests against outside threats.

**The national regulatory-legislative base is gradually being harmonised with international law.** Foreign economic regulatory procedures in separate sectors are evidently being liberalised. As far as direct (explicit) export restrictions (quotas, tariffs, licences) are concerned, Ukraine's economy can be assumed to be quite open even today. The list of goods exportable by businesses without strict state control has been considerably shortened. Whereas at the end of 1993 almost 70% of goods exported from Ukraine fell under legislative acts that restricted free foreign trade, today, the majority of direct restrictions on export operations (export duties, obligatory licensing, export quotas) have been cancelled[69].

**Tariffs are being gradually reduced** in Ukraine: the weighted average industrial goods tariff has been reduced to 5.48%[70]. However, some restrictions on foreign trade still exist. For instance, tariffs for the export of livestock and

[66] The Council of Ukrainian producers and exporters of ferrous metals, the Council of Ukrainian producers and exporters of bituminous coal, the Association "Council of Ukrainian suppliers and oil refiners, importers of petroleum products", the Council of Ukrainian producers and exporters of non-ferrous metals, the Ukrainian association of ferroalloy manufacturers, the National association of sugar manufacturers of Ukraine, the Co-ordinating council of Ukrainian exporters of iron ore products, the All-Ukrainian association of oil suppliers, the Association of scrap metal exporters.

[67] UCEPS experts advocated the expediency of Ukraine's participation in the UN programme "Oil for Food" for Iraq as early as 1998.

[68] The Cabinet of Ministers of Ukraine Resolution No.2120 of November 22, 1999.

[69] The procedure of foreign trade contract registration have been streamlined, the terms of document execution, and the list of indicative prices of export products, have been shortened.

[70] Weighted average tariff for agricultural produce and foodstuffs amounts to 25.4%. As of April 1, 2000, the weighted average tariff for the entire nomenclature of goods was equal to 7.14%, arithmetic mean customs tariff — 9.96%.

hides of big cattle remain[71]; an export duty (23%) was introduced for some kinds of oil-plant seed; a law prohibiting non-ferrous scrap metal export was adopted, etc.[72]

In separate sectors, more flexible methods of regulating foreign economic activity are being introduced. This particularly refers to the **transport tariff policy**. For example, rail and port tariffs on cargo movement and handling were reduced by 20-30%. According to experts, tariffs on Ukrainian railways are 1.7 times lower than cargo tariffs in Russia or Belarus. Given the transit potential of Ukraine, such measures will encourage the growth of services export.

Customs control procedures on Ukraine's borders are also gradually being simplified: at present, around 100 **reduced control checkpoints operate on the state border** with Romania, Poland, Slovakia, Hungary, and Moldova. This cuts carrier costs, and raises Ukraine's competitiveness as an exporter of transportation services.

Important measures are being taken for **overcoming the present incompatibility of the national telecommunications system with those of other countries**. These measures encompass the introduction of new digital automatic telephone exchanges, expansion of fibre optic lines, development of cellular communication networks, Internet, etc. This opens new prospects for Ukraine's access to the international telecommunications and information services markets.

**Ukraine's Government has taken a decision on creating a mechanism of export and credit risk insurance**[73]. This will reduce risks for the state when guaranteeing the repayment of foreign credits, raise borrower responsibility, and improve control over the execution of credit agreement terms.

### 2.2.2 EXTERNAL POSITIVE FACTORS

Certain external factors exert some positive, although at times, contradictory influence. Above all, one should note the possibilities presented by the qualitatively new level of **world economic globalisation, liberalisation of trade on the goods, services, technologies, capital, and labour markets.** Eight rounds of talks on world trade liberalisation have been held within the GATT/WTO framework. This aided the development of regional free trade (first in Europe, later — in North America), and the liberalisation of trade in some developing countries and transition economies. For example, over a 50 year period, industrial goods import tariffs in developed countries were cut by 90% (reaching 4%, on average)[74]. This creates better prospects for entering international markets.

Ukraine, being outside the WTO, **does not have altogether bad prospects for entering individual markets, and even those where protective measures are applied.** In 2000, domestic textile producers were allowed to raise textile supplies to EU countries by 30-50% (depending on the category)[75]. According to experts, as a result of those supplies alone, Ukrainian exports could increase by $140-145 million. Mutual understanding has been reached with the EU regarding the need to promptly execute a new long-term agreement (possibly to come into effect starting in 2001) on trade in textiles and clothes, possibly on a quota-free basis[76].

[71] Consistent attempts by the Government to convince the Verkhovna Rada of Ukraine of the need for removing those duties have failed to bring a positive result thus far.

[72] As was shown in Section 1 (with the example of the 23% sunflower seed export duty), such restrictions are sometimes introduced without due calculation of their possible results, which leads to a decrease in currency proceeds, on the one hand, and to overstocking of the domestic market due to the absence of solvent demand, on the other. This problem is analysed by V.Kramer in the article "Export of scrap metal: the experience of state regulation". The article is presented in this issue of the magazine.

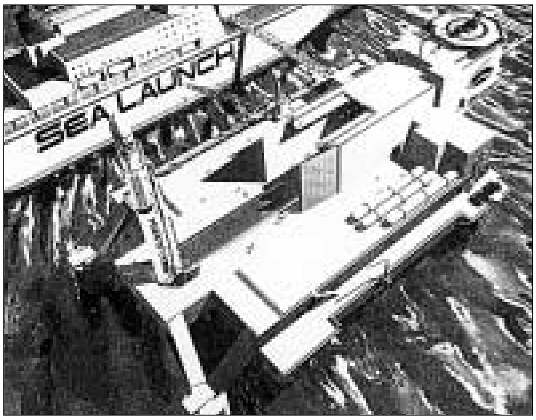
[73] The Cabinet of Ministers of Ukraine Resolution No.120 of August, 17, 1998.

[74] However, non-tariff trade restrictions remained; moreover — they were tightened.

[75] UNIAN, June 2, 2000.

[76] Ibid.

External factors encourage the economic modernisation and expansion of Ukraine's export potential by attracting foreign investments, advanced foreign experience, and the possibilities offered by international co-operation. Given the scanty budget allocations on Ukraine's science and technology sector, **it is international scientific and technological co-operation, and the acquisition of new technologies that should be viewed as a realistic mechanism for raising the competitiveness of Ukraine's manufacturers.** According to survey results[77], economists of the Harvard Business School argue that the effectiveness of acquiring a patent per $1 of investments is 3-5 times higher than the financing of independent scientific research. Furthermore, the acquisition of up-to-date technologies (licences, patents) allows for the release of funds very much needed for the priority sectors of science and technology. With those factors in mind, one can hardly overestimate the importance of **Ukraine's participation in large-scale international projects related to the introduction of truly high technologies.** The pioneers on this path are the *Pivdenne Design Bureau* and the *Pivdenmash Production Association*, which participate in the Sea Launch joint project. The total value of the project is estimated at $2 billion, one launch of a rocket carrier — at around $70 million.




Of extreme importance for Ukraine are the projects regarding **international transport corridors** over its territory. EU experts forecast that by 2005, cargo traffic along the Eurasian transport corridor via Ukraine's territory will reach 20 million tons a year.

Among other external factors favourable to Ukraine, emphasis should be placed on the **increased demand for food in the CIS (Russia, Azerbaijan, Belarus, Kazalkhstan), and price increases on the world metals markets**. This last tendency is related to the restoration of production in South-east Asia, and an increase in the EU metal consumption.

This may seem strange, but **some unfavourable tendencies can bring positive results**. For example, a tougher Russian position regarding debt payments and timely settlements for current supplies of imported energy resources objectively encourages energy conservation and the introduction of new technologies in Ukraine. This will enable Ukrainian producers to reduce production costs and thereby raise the competitiveness of production on foreign markets. Furthermore, a greater share of currency proceeds (over $3 billion of such proceeds are now used to pay for Russian energy resources) will possibly be used for modernising the production of export enterprises.

UCEPS experts believe that the **present positive factors by themselves will not ensure the desired pace of export growth, let alone qualitative changes in Ukraine's foreign trade structure. Overall success will, to a large extent, depend on such important preconditions as the development and implementation of the state strategy for the accelerated development of high-tech industries, and in-depth reforms in Ukraine.**

[77] The American model of the "new" economy is spread to other countries. — *International Commerce Information Bulletin*, April 13, 2000 (after the Business Week publication).

## CONCLUSIONS

The analysis performed shows that the development of Ukraine's foreign trade is presently dominated by negative factors. The factors conducive for exploiting Ukraine's export potential are few, although their role is gradually increasing.

The low competitiveness of Ukrainian production can be assumed to be the most important negative factor. This factor is becoming a serious problem under conditions of the continued globalisation of the world economy and tough international competition related to this process.

The analysis demonstrates the weak role of market institutions in regulating Ukraine's foreign trade, and the inappropriate mechanisms for regulating its market. The state retains administrative-bureaucratic influence and control over export operations, with export limitations being the main problem for exporters. The policy of domestic producer protection takes on distorted forms in Ukraine, which does not encourage Ukrainian exporter competitiveness on international markets.

The set of factors that negatively impact the development of Ukraine's foreign trade is conditioned, first of all, by Ukraine's low pace of economic transformation, affecting the potential of the country's participation in the international division of labour. As a result, Ukraine has established itself on international markets as a supplier of raw materials, semi-finished goods, and products with a low added value.

Absence of proper (organisational, information) support limits Ukraine's exports of financial, telecommunication, information, business services, international tourism services, education and health care. Insufficient level of intellectual property rights protection and extremely low salaries of scientists hamper the expanding of scientific and technical services export.

The inconsistency of national law regime to the international criteria of intellectual property rights protection limits Ukraine's opportunities to participate in large-scale international projects. Banking and insurance system institutions remain weak. The mechanisms of providing the guarantees and insurance of export supplies are undeveloped that increases the risks for foreign economic activity.

UCEPS experts believe that present positive factors of influence per se are not conducive to the desired levels of export increase as well as to quality changes in Ukraine's foreign trade.

An important task of Ukraine's foreign economic policy should be the strengthening of positive factors, including: expanding economic "growth points"; raising the efficiency of foreign economic activity regulation on the basis of applying experience gained, as well as quality professional training; harmonising the national regulatory-legislative base with international law; the consistent liberalisation of foreign economic activities; deepening of negotiation process as for Ukraine's co-operation with international integration unions; implementation of an agressive export policy including use of political, diplomatic, and other factors.

# 3. CONCLUSIONS AND PROPOSALS

**The main problem of Ukraine's foreign trade is the low competitiveness of those international market sectors of goods and services that are undergoing the most dynamic development, and determining the future of the world economy.** Goods with an insignificant level of added value and a low share of high technology dominate Ukraine's present-day export. Ukraine's image is increasingly becoming that of a supplier of semi-finished goods which are produced by branches consuming much capital, energy, materials, and labour (mostly by work requiring mid-level qualifications), and characterised by a low level of environmental safety. This vector for increasing exports contradicts the structural priorities of Ukraine's economic development. Under conditions of limited domestic demand, export growth over the last years has started to become the catalyst for the economy's structural simplification. Based on this, the following **strategic goals of Ukraine's foreign trade policy can be defined**:

- the development of the country's export potential, based on such points of reference of national economy's international specialisation that would become organically united with the directions of structural economic changes convenient for Ukraine (while maintaining a balance between domestic and foreign demand for Ukrainian goods and services);

- the restructuring of export, and bringing it closer to the proportions that are characteristic of those in developed countries; giving priority to sectors that influence the future of the world economy: electronics (including microelectronics); the equipment of new (untraditional) types of power engineering, and the production and processing of new types of materials with predetermined properties; biotechnology; a substantial increase in the export of international tourism, science and technology, engineering, consulting, and educational services; the sale of licenses for patented designs and know-how;

- the creation of competitive, financially powerful transnational corporations; the mastering of global marketing and investment strategies, as well as the forms and methods for large-scale international co-operation projects, by Ukrainian companies;

- the diversification of the geographic foreign trade structure directed toward removing the over-dependence on individual countries (markets), and increasing the level of Ukraine's economic security;

- ensuring a stable balance between exports and imports, as well as Ukraine's trade and current payment balances as a precondition for removing the country's one-sided dependence on the inflow of foreign capital and credits.

**Ukraine's strategic goal should continue to be its foreign trade policy oriented toward increasing exports. However, the model for such a policy needs substantial changes. The continuation of today's policy is without prospects, where export increases are the result of "pushing" abroad production that has no domestic market (due to limited solvent demand). This is all the more the case when this automatically leads to an increase in energy resource imports. Ukraine's foreign trade strategy should be defined with the following in mind:**

(1) more active use of political, diplomatic, and other measures for breaking down the barriers on the path of Ukraine's exporters entering foreign trade markets;

(2) countering discriminatory measures applied by Ukraine's trade partners by improving the regulatory-legislative base and mechanisms for providing consulting, information, legal, and other forms of state support to exporters;

(3) the co-ordination of acceptable conditions for Ukraine regarding its entry into the WTO (proceeding from its long-term national interests), as well as the conditions for joining international integration unions (EU, CIS, etc.). Such conditions should provide for the consistent liberalisation of import, while retaining the possibility for the limited use of protective meas-

ures by Ukraine on the basis of applicable and transparent procedures, and by observing conditions and limitations for transition economies set by GATT/WTO, as well as for those instances where showing flagrant disturbances of payment balances, or stability on domestic commodity markets.

**An effective strategy for developing an economy open to the outside world lays the foundation for the establishing a system of market institutions based on strategically effective privatisation (including foreign investor participation), and the formation of a truly competitive domestic market environment for Ukraine.** Only then will it be possible to draw domestic and foreign capital into Ukraine's economy, which is a prerequisite for developing the country's export potential, introducing new production technologies, and improving exporter market competitiveness.

**Ukraine's export policy should not be oriented toward intensifying export by *sharply* devaluating the national currency.** Given Ukraine's critical dependence on energy imports (primarily from Russia), and continued expectations of high inflation, this can, above all, result in the destabilisation of Ukraine's financial system, as well as the unwelcome encouraging of accelerated raw material and semi-finished goods exports, where there is a high level of price competition.

Presented below are UCEPS proposals for strengthening Ukraine's presence on foreign markets. The proposals contain measures for improving the functioning of export-import mechanisms and attainment of priority geo-economic targets in Ukraine's foreign trade development.

## IMPROVEMENT OF EXPORT-IMPORT MECHANISMS

**1. The revision of Ukraine's legislation governing foreign economic activity**; the introduction of changes ensuring the implementation of the above-mentioned strategic priorities, and the adaptation of national legislation to WTO norms. These steps should be taken simultaneously with the intensification of talks on Ukraine's membership in WTO.

**2. The development and implementation of a national programme for raising the competitiveness of producers within sectors vital to Ukraine; the creation of complexes of technologically interrelated and internationally competitive production facilities capable of ensuring the exports of goods, as well as science and technology, engineering, educational, information, and other services.** Such a programme should contain the following priorities:

- Within the existing complex "*ore mining - ferrous metallurgy - heavy machine-building*" — orientation toward the export of quality rolled steel, metal-intensive products, including vehicles (especially vessels), excavators, metal-cutting machine tools, equipment sets, such as mining, power engineering, metallurgical and chemical equipment; making optimal use of demand on developing markets.

- The development of a complex of competitive production facilities on the basis of the domestic agro-industrial complex, export specialisation according to separate types of *agricultural produce* (grain, oil seed), *processing and food industry sectors* (meat products, some types of dairy products, vegetable oil, sugar, confectionery products, alcoholic beverages and soft drinks), *agricultural machinery*, and *food industry equipment*.

- The development of a special, foreign market-oriented complex of production facilities, for the production of *missile and aviation equipment* (especially transport aircraft building); support of the *military-industrial complex*, primarily in directions that have good prospects for entering foreign markets even today (*armour, air defence, small arms, combat engineering equipment*).

- The creation of a new production complex based on branches related to mining *rare-earth metals*, the development of *microelectronics* (including the area involving the use of new space technologies), the production of *computers, household electronic equipment, and other appliances*; the attraction of foreign capital into this complex with the aim of accelerating modernisation and creating new production facilities.

- The formation of a *new technology-intensive complex based on production facilities directly connected with the implementation of advanced scientific projects, together with the institutions of the National Academy of Sciences and leading Ukrainian universities* — in the powder metallurgy, welding equipment, new high quality materials sectors, etc. The organisational forms for the development of such a complex could include (a) a network of technoparks and technopolises, created with the participation of foreign capital; (b) the involvement of Ukraine's leading scientific institutions in international research and technological programmes, particularly within the EU framework.

- The significant *expansion and modernisation of Ukraine's transport complex and transport infrastructure* for East-West and North-South transit. This refers to all kinds of transit, including pipeline, rail, motor, sea, and air transport.


- The creation of a complex of *international tourism* in Ukraine, supported by the broad participation of foreign capital in infrastructure development.

**3. Raising export enterprise competitiveness by creating marketing and service networks on priority external markets.** Such networks should employ the capital and marketing potential of powerful local companies and banks, which are well aware of the market situation, and have established commercial relations. The state could initiate this process by establishing **trading houses, business-centres and technical centres** on joint-stock basis in co-operation with Ukrainian commercial organisations and banking institutions on its most important markets.

**4. The acquisition of foreign licences for up-to-date technologies (know-how), machinery, equipment and instruments** in order to create new competitive domestic production facilities. UCEPS experts believe that in order to achieve this, **the State Innovation Fund of Ukraine should be transformed into a joint-stock commercial entity** with the participation of Ukrainian state and private capital.

**5. More active introduction of international standards, norms and certification procedures,** in order to ensure the compliance of domestic goods and services with international standards, the development and implementation of a corresponding national programme; reduction, to a reasonable minimum level, of the list of goods subject to obligatory export certification; introducing measures ensuring Ukrainian certificate recognition outside Ukraine.

**6. The application of political, diplomatic and legislative measures intended to encourage Ukraine's participation in large-scale international co-operation projects (industrial, science and technology, scientific-production)** in sectors of primary importance for the national economy. Priority should be given to (a) restoring co-operative ties with Russia, (b) joining international programmes undertaken by the EU, (c) participating in regional and global co-operation projects (in the rocket and space sector, computerised information networks, telecommunications, power engineering, agro-industrial sector, health care, environmental protection, the development of international transport corridors, and solving of fundamental scientific problems).

**7. The accelerated computerisation of Ukraine's economy and foreign economic relations at different hierarchical levels.** In this respect, the following steps would be helpful:

- the creation of a comprehensive information system in the area of foreign economic activity and state monitoring of export-import operations;

- the creation of a single database for tenders held in foreign countries; developing measures for state information support of Ukrainian enterprises participating in international tenders;

- the introduction of international bookkeeping and statistical accounting standards into business practice;

- encouraging access to international information networks for entities engaged in foreign economic activity (for example, by exempting computer sales and Internet services from VAT, and exempting the imports of related parts and unique equipment from import duties).

**8. The improvement of financial mechanisms for regulating exporter activity.** This envisages the following steps:

**a) developing a mechanism for formalising the state's obligations regarding VAT repayment to exporters in the form of bonds (certificates), as a guarantee for obtaining credits**. Implementing such a mechanism will (a) increase circulating assets of export enterprises that can be channelled toward production renovation (expansion); (b) allow exporters to obtain credits necessary for developing production; (c) extend the VAT repayment term for enterprises without withdrawing their circulating assets;

**b) implementing a mechanism for extending export credits through the National Bank of Ukraine rediscount of bank bills.** This will increase exporter circulating assets and encourage export industry growth.

**9. The conclusion of international agreements for joint control over transit cargoes and Ukraine joining the International convention for the co-ordination of border cargo control terms**, signed in Geneva in 1982. This will raise Ukraine's competitiveness on the transport service markets.

## ATTAINMENT OF PRIORITY GEO-ECONOMIC TARGETS IN FOREIGN TRADE DEVELOPMENT

UCEPS experts propose possible targets for strengthening Ukraine's positions on the CIS, European (above all, EU and CEFTA), Asian, African, and the Americas markets.

### CIS

In its relations with CIS countries, Ukraine's principal position should be advocating **the establishment of free trade procedures within the CIS based on GATT/WTO norms and principles, without any exceptions.** Given the effective arrangements on bilateral trade exemptions, parties should undertake their formalisation, and gradually remove them over a given transitional period (through negotiations and consultations). The duration of such transitional period may differ from country to country (or groups of countries), depending on the depth of economic reforms and the foreign economic policy of the particular state (or group of states).

In order to make the best possible use of the advantages offered by industrial co-operation (in accordance with Ashghabat Agreement terms), and for restoring lost markets in CIS countries, it appears necessary to **review the volume and nomenclature of goods, and expand the list of branches that could participate in industrial co-operation.**

**Solving the pressing problems in bilateral economic relations with Russia should become a priority task of Ukraine's foreign economic policy. The Russian government should be advised of the inadmissibility of unilaterally implementing protec-**

**tionist measures** in violation of previously reached agreements and signed bilateral treaties, such as the Free Trade Agreement.

An important target of Ukraine's foreign trade is **the expansion of its presence in Transcaucasia and Central Asia**. Ukraine's active participation in creating the Transcaucasian transport corridor, concluding separate co-operation agreements in specific sectors, such as transport, supply of oil, gas, cotton, etc., would be helpful in this respect. Ukraine also has realistic chances for **increasing its export of services to CIS** taking part in the building and reconstruction of industrial projects, pipelines, routes of communication, and the granting of prospecting and transit services.

UCEPS experts believe in the good prospects that Ukraine has for **interregional co-operation with CIS,** foremost, by intensifying Ukraine's regional state administration efforts in establishing trading houses in the most attractive regions of partner countries. This would encourage the expansion of trade and economic co-operation at the regional level, including on consignment terms.

### European countries

In order to expand Ukraine's presence on European markets, and foremost, on the EU and CEFTA markets, the following steps should be taken:

- **the process of executing Ukraine's commitments under the effective Partnership and Co-operation Agreement with the EU** (of June 16, 1994) **should be accelerated.** Without this, Ukraine would have no basis for raising the matter of a free trade zone and its associated membership in the EU;

- together with institutional and structural reforms, **Ukraine should seek recognition as a country with a market economy, beginning with recognition of its separate sectors as those operating mainly on market principles.** This will improve the overall climate of economic co-operation, and help to avoid anti-dumping proceedings being initiated against Ukrainian producers exporting their produce to EU markets;

- a new agreement should be concluded between Ukraine and the EU regarding the textiles trade in 2000-2002, stipulating significant expansion, or complete cancellation of quotas;

- in order to avoid anti-dumping and other protective measures applied by the EU, the validity term of the Agreement between the European Union and Ukraine's Government on establishing a system of double-checking regarding Ukraine's export of steel-casting products to the EU, without quantitative limitations, should be extended;

- Ukraine's efforts to join CEFTA should be intensified, first of all, through negotiations and consultations with the countries of this region regarding mutual trade liberalisation.

**The strategic target in trade development with European countries should be increasing the sale of finished goods and high-tech products.**

### Asian and African countries

Many Asian and African countries have embarked on the path of industrialisation, which requires large material resources (machinery, equipment, rolled stock), as well as designing and construction services. That's why UCEPS experts believe the markets of the Middle East, Africa, and some countries within Asia and the Pacific region (China, Vietnam, Laos) to be **the most promising for the marketing of rolled stock and Ukraine's machine-building sector production, and for offering scientific and technological as well as construction services.** In those countries, Ukraine could actively participate in constructing infrastructure objects: bridges, motorways, viaducts, seaports, air terminals, railways, large power engineering and industrial projects.

Good prospects also exist for expanding co-operation with Asian and African countries in the military-technical sector, **the joint implementation of Ukrainian technologies, and the country's further establishment on national and regional markets.**

The creation of favourable conditions for entering the markets of those countries depends critically on the state's support of Ukrainian exporters. This refers to the conclusion of international economic and scientific and technological co-operation agreements, double taxation relief, and the protection of investments; the establishment of Ukrainian trading houses and representative offices of Ukrainian companies in those countries; the introduction of an effective system of double insurance for foreign economic risks in Ukraine.

### The Americas

The priority task for Ukraine **on the U.S. market** is the restoration of lost markets, and finding new ones. In order to accomplish this task, the following is required:

- granting Ukraine most favoured nation status on a permanent and unconditional basis, which is likely to occur automatically after Ukraine's accession to the WTO (U.S. support of those efforts is of primary importance); extending the term of the General System of Preferences, and its application to the main items of Ukraine's export;

- revising the old and preventing the new anti-dumping processes regarding goods of Ukrainian origin;

- more active co-operation in individual hi-tech sectors, encouraged by the expansion of collaboration in the field of product standardisation and implementation of a more effective system of intellectual property protection in Ukraine;

- amicably resolving problems arising with some American investors in Ukraine, etc.

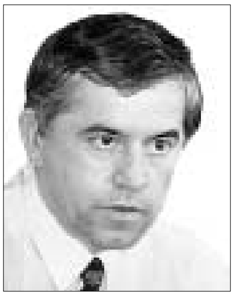
Promising directions of entering **markets of Latin American countries** are: prospecting services, and the design and construction of oil, gas and power engineering projects. Given the relatively low solvency of Latin American countries, Ukraine's machine-building sector production may appear competitive on many markets in that region (on the basis of price/quality criteria). Strengthening Ukraine's position on Latin American markets will require the same steps as for Asian and African countries.

**UCEPS experts believe that successfully attaining the indicated targets in Ukraine's foreign trade policy will be possible only within the overall context of channelling economic transformation toward the modernisation and accelerated innovative development of the national economy.**

# DEVELOPMENT OF UKRAINE'S EXPORT POTENTIAL: AN EXPERT VIEW

Why is Ukraine's representation on international markets so weak? What impedes fully employing existing export potential? What direction should Ukraine move in, in order to expand its international market presence, and raise its foreign trade effectiveness? While analysing different aspects of those problems when preparing its analytical report "Ukraine on international markets: problems and prospects", UCEPS experts turned to Ukrainian and Western experts in order to compare their own conclusions with the views of others.

**Andriy Honcharuk,**
Deputy Minister of Economy of Ukraine



**Anatoliy Kinakh,**
President, Ukrainian Union of Industrialists and Businessmen, People's Deputy of Ukraine

**Oleksiy Plotnikov,**
Professor, Ph.D. (Economics)

**Janusz Szyrmer,**
Executive Director of the Project for Macroeconomic Reform, Harvard Institute for International Development, Professor

UCEPS experts proposed that the participants answer the following questions:

**1. What is your assessment of Ukraine's current foreign trade situation?**

**2. What factors impede the development of the country's export potential and lead to the loss of Ukraine's position on the international markets?**

**3. What should be the main priorities, strategic targets and urgent steps aimed at strengthening Ukraine's international market position?**

Below, we present the answers to those questions, along with the conclusions drawn from the results of this round table by correspondence. In our view, they deserve attention, as they contain proposals regarding urgent steps and strategic targets aimed at strengthening Ukraine's position on the international markets.

## UKRAINE'S CURRENT FOREIGN TRADE SITUATION

**Andriy Honcharuk.** The importance of foreign trade for the development of Ukrainian economy is well known. It is enough to say that today, export volumes amount to 36.4% of GDP (in 1993, this indicator was 14.9%).

After the foreign trade liberalisation policy began being pursued starting in the second half of 1994, positive tendencies within this branch became evident. In the 1995-1997 timeframe, foreign trade turnover increased by 38.9%; of that, exports increased by 47%, imports — by 31.5%. The higher rate of exports growth, as compared to imports, improved the foreign trade balance: the 1995 deficit of $1.2 billion was followed by a $249 million surplus in 1996, and $424 million in 1997. The tendency toward a positive balance persisted in the subsequent years (1998 — $350.7 million, 1999 — $2.3 billion).

However, in 1998-1999, a number of objective and subjective factors brought about negative tendencies in foreign economic activity.

After the period of foreign trade decrease, this year saw the branch stabilising. Over the first quarter of 2000, Ukraine's foreign trade turnover in goods and services reached $7.9 billion, which is 20.3% higher than for the same period last year. Especially positive is the increase in Ukraine's exports — $3.9 billion, or 17.3% more than in the first quarter of 1999; of that, goods exports grew by 24.1%.

Such a significant increase in goods exports over the indicated period is primarily related to increased exports of aluminium and related products (1.8 times); fertilisers (1.6 times); ferrous metals (1.5 times); machinery and equipment (1.2 times). The growth in overall volumes was a result of the favourable world market situation, especially for metal products, which account for more than a third of the country's export potential.

Despite all of this, **we cannot be satisfied with the present export structure, because it does not correspond to our economy's potential, especially with respect to the sale of finished products.** Today, each country is trying to develop its export structure on the basis of selling engineered products, high technologies, services, etc. If we compare the export structure of the not so distant past (in Soviet times), when 30-35% of all exports fell on engineered products, with the present 9.1%, we see that long-term possibilities exist for improving this indicator.

Goods and services import volumes rose by 23.4% in the first quarter of this year, exceeding $4 billion. **The optimal import structure remains, where more than 85% falls on raw materials, and industrial and technical products.**

A positive development is that the increase in the import of goods in 2000 is related to larger supplies of technological products of an industrial designation, such as machinery and equipment (1.4 times); plastics and plastic articles (1.4 times); vehicles and aircraft (1.3 times); mineral products (1.2 times).

Another important tendency of the first quarter of 2000 is the improvement of trade with Russia, particularly the increase in export supplies. Exports of goods and services to Russia in the first quarter of 2000 amounted to $1.1 billion — 16.8% higher than for the same period in 1999. This demonstrates the animation of Russian economy to a certain extent, which remains Ukraine's main trade partner.

**Ukrainian production is present on all of the world's regional markets.** In the overall volume of goods exports, the country's export share to the CIS is 34.5%, to European countries — 31.3%, Asia — 21.4%, the Americas — 7.8%.

Over the recent years, the goal was to diversify the markets. The current year is not exception: while in the first quarter of 1999, the CIS share was 50.2% of total turnover, in the first quarter of 2000, that number fell to 47.3%; of that, the share of exports to the CIS fell from 36.1% to 34.5%.

Ukraine's foreign trade turnover with other countries, including trade in goods and services, amounted to $4.2 billion, and grew by 27.2%, as compared with the same period in 1999.

The general development of the recent economic situation in Ukraine and on foreign markets gives grounds for expecting that until the end of 2000, positive trends seen in the first quarter will persist. The steady growth in export-oriented industries continues, a favourable situation exists on the metal and chemicals markets, prospects exist for increasing engineered products exports. Some forecasts predict that exports will grow by 4-6% by the end of the year, and that the foreign trade balance surplus will persist.

**At present, the executive branch is taking measures for creating favourable conditions for domestic business export activities.** Tax obstacles for exports have been virtually removed, registration and licensing procedures streamlined, measures are being taken to prevent anti-dumping proceedings against Ukrainian manufacturers, negotiations are underway to cancel trade restrictions with individual countries, especially Russia, practical steps are being taken to increase quotas for the export of textiles, rolled metal, and other products to the EU markets.

**Anatoliy Kinakh.** Today, Ukraine's foreign trade turnover does not correspond to the country's economic potential. It is constantly decreasing, its structure is getting worse; the primary export items are raw materials, rather than high-tech goods. The main factors for this situation are: the absence of economically grounded programme that clearly defines the priorities and directions for the development of Ukraine's export potential; the poor use of information regarding expansion possibilities for domestic goods markets; the state's passivity in implementing various cross-border economic projects; the inadequate work of responsible state agencies aimed at accelerating Ukraine's entry into European and world economic structures, such as CEFTA.

**Due to the lack of co-ordination between the Ministry of Foreign Affairs of Ukraine and economic block state structures, Ukraine is losing its traditional markets in Central and Eastern Europe, South America, the Middle East and, unfortunately, in the countries of the former Soviet Union.**

The integration of Ukraine's economy into the European economic space is impeded by the delay in the process of Ukraine becoming an associate member of the EU, and its recognition as a country with a transition market economy. Delays in those issues are caused, foremost, by the passivity of our missions attached to those international organisations. This was once again revealed during the Belgian visit of a delegation from the Ukrainian

Union of Industrialists and Businessmen, and in negotiations with representatives of those organisations.

**Oleksiy Plotnikov.** The current state with Ukraine's foreign trade generally corresponds to the overall state of the national economy. The fact that for many years unfinished goods (ferrous metals and chemicals) have comprised 50% of Ukraine's exports is very disturbing. Such an indicator is typical for developing countries, but is not characteristic for one with ambitions of becoming a "European nation". Undoubtedly, the export structure problem cannot be solved all at once, but **the very fact that unfinished goods have been dominant for so long is proof of the absence of any steps by the state aimed at implementing structural reforms in the country's domestic industry, and raising the competitiveness of finished products**. It's hard to say namely whose interests are the reasons behind the perseverance of unfinished goods as the principal type of product within the export structure, but this situation clearly shows either inability, or reluctance to take serious steps toward improving the situation in the national economy.

As far as the country's import structure is concerned, the domination of energy resources is determined by national realities, which are difficult to change quickly. This export item is, and will remain, an objective phenomenon for some time to come. But if one looks at another import item — "machinery and equipment" — the conclusion will be different. This indicator shows that the use of domestic equipment is very limited within the country. And this is another problem of the market transformation of the national economy branches.

**State regulation of foreign economic activity generally meets Ukraine's current requirements. There is quite a convenient balance between the model of strict state regimentation**

**and the model of complete openness, without any state influence on foreign economic activity.**

**Janusz Szyrmer.** Foreign trade is traditionally considered an important indicator of a country's economic performance. Export not only provides foreign currency, thus supporting the national currency, but also promotes competition on domestic markets. Import, in its turn, not only diversifies the consumer goods basket for the population, but also allows access to new production and management technologies. Furthermore, foreign trade allows for the utilisation of the country's potential in specific sectors, while relying on others, for the production of various necessary items.

**Unfortunately, the dynamics of Ukraine's foreign trade structure shows no signs of proper exploiting the country's foreign trade potential. In 1997-1999, both Ukraine's export and import decreased, in dollar terms. This occurred primarily as a result of the decline in commodity trade with the countries of the former Soviet Union.** Although Russia remains Ukraine's main trade partner, there is a positive tendency toward the re-orientation of export and import flows and the diversification of trade partners. At present, Ukraine is trading with Europe more actively than before. At the same time, within the 1994-1999 time-frame, total exports to the former Soviet Union decreased by 29%, primarily due to a decrease of exports to Russia. On the one hand, this was the result of weaknesses in both countries' economies; on the other hand, such a situation is conditioned by constant trade restrictions imposed by the Russian Government in order to reduce Ukraine's exports. Most experts tend to view trade relations between Russia and Ukraine as a "trade war".

The geographic structure of imports is more stable, due to Ukraine's considerable dependence on Russian energy resources. In 1997-1999, Russia's share in the country's import was a little below 50%. Europe was and remains another large trade partner for Ukraine in terms of import.

The analysis of Ukraine's foreign commodity trade structure demonstrates the basic problems that exist in this sector. Foremost, its imports are totally dominated by natural (energy) resources. The situation is particularly complicated by the fact that more than 40% of Ukraine's exports in 1999 fell on metal, and that metallurgy is an energy-consuming branch. Finished products account for a small share of total exports, with the exception of machinery and equipment. Furthermore, the share of machines and equipment in total exports has fallen, and in 1999, comprised only 12%, as against 18% in 1995. There were no significant overall changes in trade structure for several years. This means that **no considerable changes in Ukraine's industry structure have taken place since it declared independence.**

The comparative analysis of Ukraine and other East European countries shows that Ukraine significantly differs from its East European neighbours by export structure and its dynamics. Ukraine exports three times more mineral resources, chemicals and metals than other East European countries (percentages in overall export structures are compared). Moreover, in Ukraine, their share is increasing. On the other hand, exports of machinery and equipment, not to mention production goods, are rather low, if compared to other East European countries.

As far as state regulation of foreign economic activity is concerned, direct trade restrictions, such as tariffs and quotas, are few, and cannot be viewed as a serious obstacle to trade. According to the Ministry of Economy of Ukraine, as of April 1, 2000, the average weighted tariff for the entire commodity nomenclature was close to 7%. The analysis performed by the Harvard Institute for International Development proves that **Ukraine's export has been considerably liberalised over the recent years.**

## FACTORS IMPEDING THE DEVELOPMENT OF UKRAINE'S EXPORT POTENTIAL AND AFFECTING THE LOSS OF ITS POSITION ON THE INTERNATIONAL MARKETS

**Andriy Honcharuk.** Among the reasons that led to a decrease in Ukraine's foreign trade in 1998-1999, the following should be emphasised.

The August (1998) financial-economic crisis in Russia, which led to a sharp reduction of trade in Russia and in other CIS countries. As CIS countries account for almost half of Ukraine's foreign trade turnover, Ukraine could not but feel the effects of the crisis in the post-Soviet space.

The regional financial crisis in South-east Asia, which led to a significant reduction of demand in the countries whose economies previously were the most dynamic economies in the world, and consumed the basic items of Ukraine's exports. The financial crisis engendered a trade market crisis, caused a sharp price reduction, and turned countries-importers of Ukraine's products into exporters of similar products. That is, the decrease in demand on the Asian markets was accompanied by increased competition on Third World country markets.

The situation on Ukraine's traditional export markets worsened considerably. This resulted in anti-dumping proceedings against Ukrainian metal suppliers in the U.S., Canada, Latin America, and Western Europe.

The situation on foreign high-tech export product markets was also unfavourable. This sector long remained without investments and the stimulating effect of domestic demand.

**Anatoliy Kinakh.** The development of a foreign economic strategy is affected by the following factors:

- instability of the legislative base;
- existing tariff barriers, sometimes applied without economic substantiation and consideration of domestic manufacturer interests;
- lack of mechanisms for the practical implementation of signed co-operation agreements in the area of the mutual recognition of certification results;
- ineffective protection of domestic manufacturers and support of their export efforts;
- lack of mechanisms for the financial support of export-import transactions through crediting and insurance of export credits, and the activity of relevant institutions that could verify the credibility and reliability of trade partners and banking institutions taking part in such transactions.

**Oleksiy Plotnikov.** This may not seem so obvious, but the absence of feasible market reform results in Ukraine directly hinders the development of the country's export. **When the national economy is on the decline, and it continues for unbelievably long time, then export potential cannot develop by itself.**

The absence of practical market reform results over the entire period of its independence led to Ukraine's loss of markets it once had in the period of co-operation within the Soviet Union, and its failure to find new ones. The technological level of Ukraine's industry is such that there can hardly be any expansion in the diversity of competitive goods. The state has no resources for technological re-equipment, and serious foreign investments are difficult to expect.

Foreign capital is in no hurry to flow to Ukraine for obvious reasons. In mid-May, 2000, *The Economist Intelligence Unit* published rating of "business attractiveness", its so-called "Business Environment Rankings". Among 60 countries mentioned in the publication, Ukraine occupies 57th place, despite the fact that Central and Eastern Europe is considered to be the most lucrative region for doing business over the next five years. On the other hand, the question of whether foreign capital is interested in the development of Ukraine's export potential is a rather ambiguous one.

One should realistically assess the stance of international financial institutions that link the possibility of foreign financial resources coming to Ukraine with the actual ceasing of production that is competitive on foreign markets. Of course, this has nothing to do with ferrous metals, or chemicals.

**Janusz Szyrmer.** In Ukraine, there are many indirect restrictions which impact the intensity of trade relations. As far as demand is concerned, it should be noted that **the main reason**

**for the underdevelopment of trade lies in the insufficient competitiveness of Ukrainian products.** This problem goes beyond the Government's direct authority, and it is only time and market mechanisms that will be conducive to the establishment of competitive enterprises. At this point, one may only refer to the devotion of Ukraine's Government to the course of economic reform as a prerequisite for the removal of these obstacles.

Meanwhile, on the supply-side there are more factors that influence the behaviour of exporters. Firstly, this is the instability of Ukraine's legislation, including the tax system, which raises the risks and costs of foreign economic transactions. Secondly, the underdeveloped finance sector is unable to manage all risks that arise within foreign trade. Thirdly, there is inconsistency between Ukraine's currency exchange rate and trade policy. **Maintaining a stable currency exchange rate at any cost reduces the profitability and efficiency of export operations. Such an effect was clearly seen when currency purchase restrictions were in force.**

Experts from Harvard Institute for International Development assessed the value of exporter transaction costs caused by such restrictions. Although this assessment fails to take most restrictions into account, the obtained figure is 9% of monthly enterprise turnover, and approximately 40% of their monthly profits. Even when the limited nature of these calculations is considered, this figure is shocking.

The main factors that limit the development of Ukraine's export include:

- the low competitiveness of Ukrainian goods;
- the low level of the financial sector's development (this primarily refers to bank guarantees and insurance), which makes foreign economic activities more risky;
- unstable legislation, including the tax system;
- the low market institution development level and observance of contractual commitments;
- complicated customs procedures;
- the economy's overall non-transparency.

## THE MAIN PRIORITIES, STRATEGIC TARGETS AND URGENT STEPS AIMED AT STRENGTHENING UKRAINE'S INTERNATIONAL MARKET POSITION

**Andriy Honcharuk.** Over the recent years, much has been done to support Ukraine's export and create conditions for its structural optimisation.

Given the development of negative trends in the finance and economic spheres, a set of measures has been worked out capable of maintaining the presence of Ukrainian goods on foreign markets. Those measures do not require state funds, and won't lead to a reduction of state budget revenues. Such measures for supporting Ukraine's exporters could include:

- formalisation of the state's obligations regarding VAT repayments in the form of bonds or certificates, which would serve as collateral for obtaining credits;
- granting manufacturers the right to use a part of currency proceeds for promoting exports;
- identification of mechanisms that would allow enterprises to write-off bad debts which cannot be returned to foreign partners;
- defining the list of articles to which streamlined foreign trade contract prolongation and settlement term extension procedures should apply;
- conclusion of inter-bank agreements with CIS and East European countries for long-term contract crediting, using national currencies, etc.

World experience shows that another means for promoting export is the process of creating the unions, associations and other kinds of groups of manufacturers and businessmen. This process is conditioned by a number of reasons, among them: the strict antimonopoly law, a sharp rise in product differentiation, and an increased role of non-price competition under the influence of the technological revolution, the emergence of new forms of market regulation on a state monopoly basis, etc.

Under the present world commodities markets situation, the issue of regulating export parameters by balancing its structure is important.

That's why the Council of Ukrainian exporters has been established under the Cabinet of Ministers of Ukraine, which united the directors of the largest exporting enterprises and authorised commercial banks.

The establishment of the Council of Ukrainian exporters makes it possible to work out recommendations regarding the improvement of current legislation for promoting exports, and establishing interaction in separate industry sectors with the aim of pursuing a uniform price policy on external markets. This will allow for predicting the volumes and nomenclatures of export-oriented production, taking into account the saturation the domestic market, and avoid competition between Ukrainian producers on foreign markets.

The Council of Ukrainian exporters held its first meeting, chaired by the First Vice Premier of Ukraine. Its second meeting is scheduled for late June, 2000.

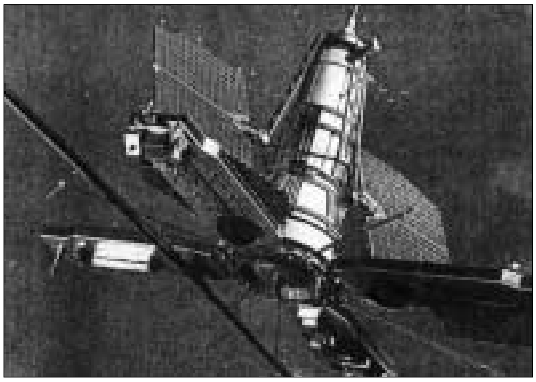
Today, it can be stated that the Council helps to establish permanent contacts between exporting enterprises and executive authorities. This will allow for prompt and economically-grounded decision-making to the benefit of both the enterprises and the state, and encourage the effective implementation of measures provided in the Programme for product export stimulation, including hi-tech products. This Programme is now being developed, with the participation of the Ministry of Economy, and other central executive authorities.

**Anatoliy Kinakh.** In order to continue implementing the course announced by the President of Ukraine toward the economic prioritisation of foreign policy, intensification of foreign economic relations, and creation of attractive investment climate in Ukraine, relevant Ukrainian ministries and agencies should work out a programme and arrange a number of events for introducing Ukraine's economic potential and possible directions of co-operation to foreign partners, along with the possibilities for attracting foreign investments into the most important sectors of the economy, and participation in privatisation.

The importance of revising previously signed intergovernmental and inter-ministry economic agreements should be stressed, with the aim that they take concrete actions and find new, untraditional forms of co-operation, in order to encourage their implementation by business entities.

Solving the aforesaid problems would make possible the quickest radical shift in Ukraine's foreign economic activity, and strengthen its economic potential and prestige on the international scene.

**Oleksiy Plotnikov.** In the first place, presently competitive production should be supported and promoted. Ukraine is quite competitive in the transport aircraft industry, power engineering industry, some areas of the military-industrial complex (such as electronic surveillance systems, etc). This list is short, but



it should be expanded, and no efforts be spared for the state to retain its positions in the branches indicated above.

The geographic-economic points of reference of the state must be clearly determined. The ill-fated "multi-vectored policy" does not help to strengthen Ukraine's position on the international markets. **One can set global tasks of "conquering markets, from Northern Europe to New Zealand", but should not forget what Ukraine is, given its current status and potential, and what this potential is capable of.** If Ukraine targets exclusively CIS markets, a relevant export structure will be needed, along with the measures and mechanisms for its support. If Ukraine looks at the markets of the developed countries, entirely different parameters will be necessary. One cannot develop an export-oriented industry while aiming at "exports" in general.

Again, the whole set of impediments for the development of economic activity in the country affects export potential. Economic legislation effective in Ukraine cannot be viewed as conducive to the development of the national economy and, consequently, of the country's export potential. This primarily refers to tax legislation, legislative support for foreign and domestic investments, the development of free economic zones.

**Janusz Szyrmer.** Raising Ukraine's competitiveness on the world market will require:

- the implementation of new production and management technologies, the development of new financial strategies;
- the formation of a stable and transparent legislative system;
- the effective enforcement of contractual commitments;
- a consistent, transparent and predictable Government policy;
- the abolition of a controlled currency exchange rate;
- clear and inexpensive customs procedures.

On the other hand, Ukrainian production should be globally accepted. For instance, import limitations, such as quotas on Ukrainian textiles, should be cancelled.

**The polled experts believe that the structure and dynamics of foreign trade do not correspond to our country's export potential. The structure of exports is dominated by raw materials and unfinished goods, imports are overwhelmed by energy resources; the share of engineered products is low. The structure of foreign trade is deteriorating every year. The polled experts note that state regulation of foreign economic activity has been significantly liberalised in recent years but, on the other hand, export is impeded by significant non-trade (non-tariff) limitations.**

**Among the basic factors that hinder the development of the country's export potential, they named: the instability of the legislative base; complex tax procedures; underdevelopment of the financial sector and market institutions.**

**The experts suggest that the main priority in the development of Ukraine's export potential and the expansion of its presence on international markets should be raising the competitiveness of Ukrainian products.**

**Such a conclusion is reiterated by the results of three expert polls conducted by UCEPS in Poland, Russia, and among Western experts working in Ukraine[1].**

**Experts assess Ukraine's position on most international markets to be generally low, and that it reflects present-day realities** (*see Diagram*).

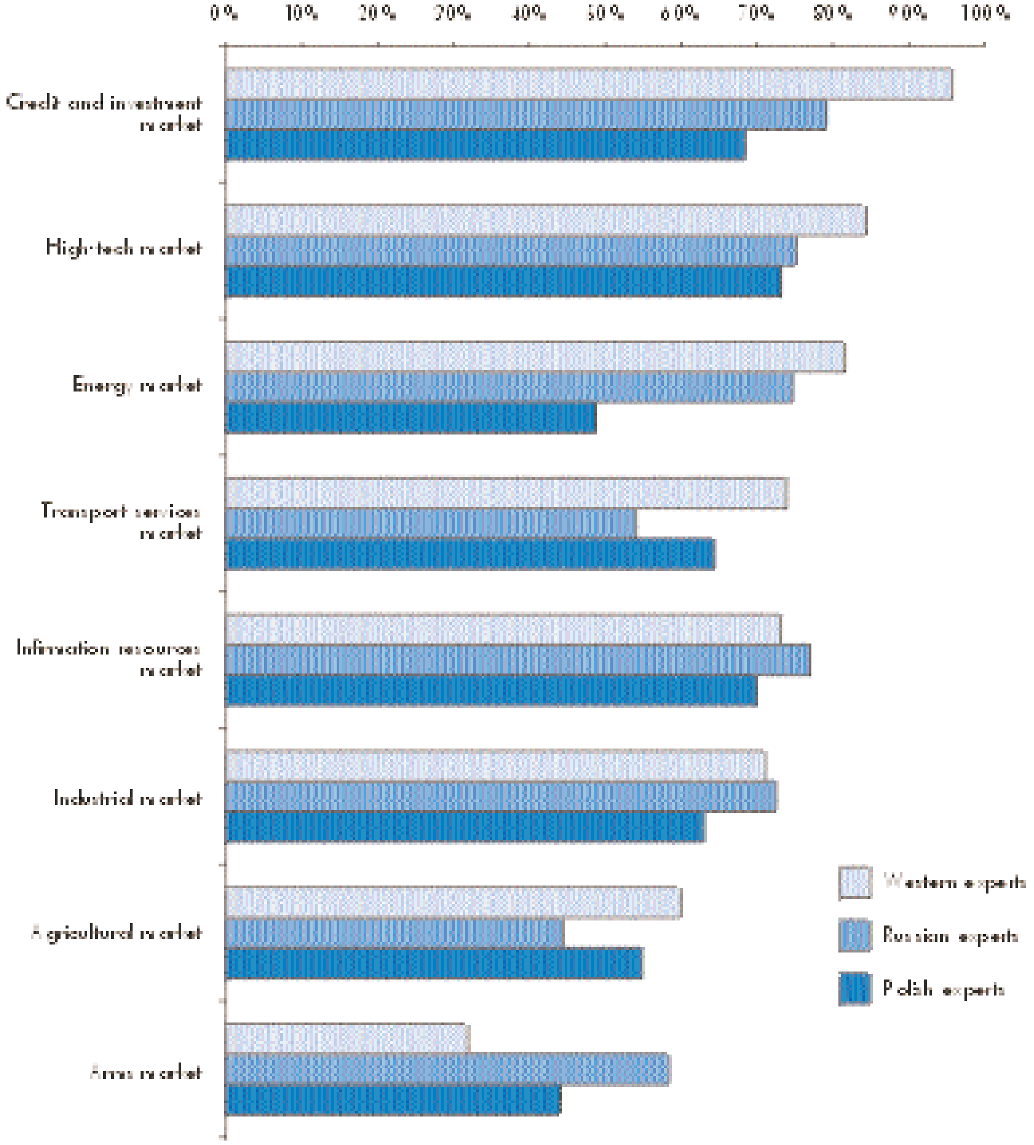
When assessing Ukraine's influence on the credit and investment markets, 94% of **western experts** said it was minimal, or insignificant; with respect to the energy market, the share of such assessments amounted to 81%; the hi-tech market — 83%; transportation services — 74%; information resources — 73%; industrial products — 71%; agricultural produce market — 60%. Western experts only noted Ukraine's success on the arms market.

**Polish experts** believe that Ukraine's presence is insignificant on the hi-tech market (74% of those polled consider Ukraine's influence minimal, or insignificant), on the information resources market (70%), credit and investment (69%), transportation services (64%), industrial products (63%), agricultural produce (55%).

**Russian experts** assess Ukraine's influence, as minimal, or insignificant on the credit and investment markets (79% of those polled), high technologies (75%), energy resources (74%), industrial products (72%), information resources (72%), and arms (58%).

[1] In each case, 100 representatives of presidential and governmental structures, members of parliaments, international financial institutions, influential bankers and businessmen working with Ukrainian partners, and foreign economy experts were polled. One block of questions was related to the assessment of Ukraine as an entity of the world economy. The results of those polls were analysed in detail in the National Security and Defence magazine, 2000, No.3, pp.2-44,53-68.

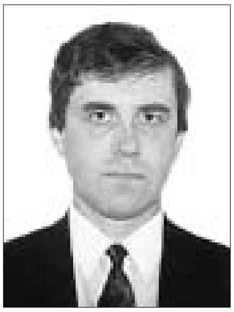
**Ukraine's influence on international markets is "minimal", or "insignificant",** % of the polled




Polish experts give a higher mark to Ukraine's position on the market of energy resources (25% assesses Ukraine's influence as "significant" or "noticeable", another 21% — as "medium"). This is evidently related to the perception of Ukraine as a large exporter of gas, oil, and coal.

**UCEPS experts express their warm gratitude to experts who took part in this discussion. Their thoughts and concrete proposals appear to be reasonable, and they were taken into account when finalising the UCEPS analytical report.**

# UKRAINE'S EXPORT POTENTIAL: THE PRIORITIES OF INTEGRATION



*Volodymyr SIDENKO,*
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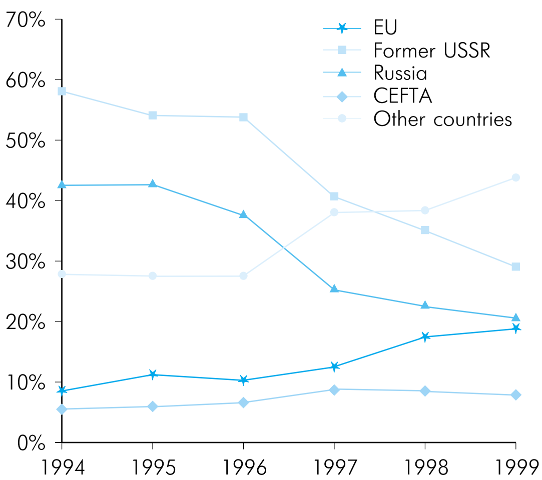
A characteristic trait of Ukraine's export policy remains its inconsistency with the foreign policy priorities announced by the state: integration with the European Union, a deepening of co-operation with Russia and with the U.S. This is demonstrated by the analysis of the geographic structure of Ukraine's exports of goods. In 1999, only 18.3% of goods exported from Ukraine were supplied to EU member countries (while there was a general tendency toward an increase in the EU share)[1], and the share of the former USSR amounted to 29.5%, this figure decreasing substantially (*Diagr. "Geographic structure of Ukraine's exports of goods"*).

**Geographic structure of Ukraine's exports of goods**




It is worth noting that among the countries of the former USSR, exports to Russia are dominant, amounting to 20.7% of Ukraine's overall exports, or 74% of the country's exports to the CIS. Therefore, **it is namely "the other countries of the world" that presently make Ukraine's primary and most dynamic export market.**

In relations with Russia, there is a tendency to lose markets, which leads to the overall process of economic disintegration. Other countries of the former USSR, including CIS member countries, and also CEFTA member countries (Poland, Slovakia, Slovenia, Romania, Hungary, and the Czech Republic) play an insignificant role in Ukraine's export. If one is to add that in 1999, 48% of Ukraine's export to EU member countries went to only two countries (Germany and Italy), while for most other EU countries Ukraine is an insignificant economic partner, then the following general conclusion becomes evident: **Ukraine's present-day geographic structure of export supplies reflects the lack of clarity and the weakness in the country's realistic integration strategy with respect to both the EU and CIS. Evidently, there is an inconsistency between political declarations regarding Ukraine's European vector of integration, on the one hand, and the actual practice of development of Ukraine's foreign trade, on the other.**

The main reasons for such a state of affairs can be characterised in the following way.

**In the first place**, Ukraine is primarily an exporter of ferrous metallurgy production and

[1] It is worth noting that mutual trade between EU member countries accounts for around 63% of their foreign trade turnover over the last several years. Within the structure of Poland's and Hungary's exports on the threshold of 1998-1999, exports to EU member countries amounted to more than 70%.

other products with a low added value, and is little noticed on high-tech markets. This makes Ukraine a nearly unpromising partner for regional integration both in the West and East alike. It is namely the high-tech branches and technically complex industries that involve international co-operation, and are the main spheres of integration in the modern world economy.

Furthermore, the EU history shows that namely coal mining and metallurgy (as was the case with the European Coal and Steel Community), atomic energy (Euroatom), and later on, a single agricultural policy — that is, the sectors important for Ukraine's economy — were the basis upon which the integration of Western European countries took place. These branches were paid primary attention with regard to mutual international regulation, because they contained the largest problems for member countries. **At present, the entry of new competitors into this supra-national regulated sector can lead to negative consequences for maintaining a balance on the single EU market.**

**Secondly**, the high level of monopolisation of many markets in Ukraine is paradoxically combined with the absence of powerful transnational corporations (TNC) with global strategies of marketing and foreign investment. But it is the TNCs that have long been the main carriers (subjects) of international integration processes. **No government intentions (declarations, strategies, programmes) can compensate for the absence of the basic mechanism of integration related to TNC activities.** Today, Ukrainian companies are by a factor behind leading European TNCs, given the formers' financial and organisational potential of competitiveness. And this cannot but limit Ukraine's presence on the EU market.

**Thirdly**, the overall institutional conditions of Ukraine's foreign economic activity are characterised by contradictions, instability, and a low level of fitness for implementing large-scale and technically complex projects of international co-operation. Under these conditions, the more complex the object of trade is, the more problems the exporters experience. Possibly as a result of this, being a raw materials exporter is the simplest way out. However, the export of raw materials, or semi-finished goods demands the formation of developed international regulatory bodies to a far lesser extent and, therefore, does not actively engender relations of an integrational nature.

Therefore, **it is necessary to clearly understand which branches and industries of the national economy will become the forces behind the European vector of development, when declaring the priority of Ukraine's integration into the EU.** The naive belief in agreements reached on a governmental level regarding the conditions for integration into the EU is insufficient, because this is, above all, an integration of markets, with mutual activities of the governments of different countries following as a result.

Given the indicated factors, **it is of the utmost importance that Ukraine defines its realistic economic (and not only political and ideological) potential for international integration activities, according to possible scenarios**. For this, one of the most important criteria in decision-making should be the present-day and prospective state of the country's export potential. Below, individual features of the integration process are outlined according to three principal directions.

## INTEGRATION INTO THE EUROPEAN UNION

Present-day practical actions in this direction require the understanding that in order to achieve the end goal, Ukraine needs to undergo a long period of adaptation to the EU institutional requirements, even under the conditions of the radical and effective implementation of structural reforms. **A more realistic and achievable task appears to be the creation of a free trade zone with the EU.** All the more so, as this step can be co-ordinated with the Russian vector of co-operation, if Russia also enters this "expanded European free trade zone".

At the same time, it is worth noting that, given Ukraine's technological lag behind the EU, lifting economic barriers is not likely to give Ukrainian exporters unquestionable advantages. Undoubtedly, in separate sectors that today come under the EU protectionist measures (agriculture, textiles, ferrous metallurgy), trade expansion will be a positive development even for a short-term period. The prospects for machine-building and instrument engineering are more problematic. **Many Ukrainian enterprises outperformed by more powerful European companies will inevitably be liquidated, given the much higher level of competitive pressure on the EU internal market.**

Naturally, the expansion of European companies on the Ukrainian market under free trade conditions could also have a significant positive effect, in the form of the spread of high technology. However, **from the point of view of national economic security, the above-indicated factors favour a very careful approach to the idea of creating a free trade zone in relations with the EU until Ukraine achieves substantial progress in structural reforms on the microeconomic level, with the emergence of strong companies in various sectors, capable of competing on an international level.**

## CREATING A FREE TRADE ZONE WITHIN THE CIS

Despite all of the advantages this possibility presents for Ukraine, today, this looks problematic given Russia's very low interest in it. However, the Russian position can change under the influence of the generally positive economic development of that country over the last year. Should this pattern continue, Russia could become interested in expanding its market frontiers for the growing national companies, willing to compete internationally.

This scenario presents Ukrainian exporters with the possibility of making certain economic gains as a result of easier access to the Russian market. However, the overall differences in the pace and scale of economic transformation between Ukraine and Russia means that Ukraine should approach the situation with a certain degree of caution (as in the case with the EU), as **free trade always favours more powerful and competitive companies.**

The task of rapid liberalisation of trade with Russia can, in principle, be achieved by Ukraine entering the Customs Union of Russia, Belarus, Kazakhstan, Kirghizstan, and Tadjikistan. This would immediately allow for the introduction of a regime of completely free trade (without exceptions, or restrictions) in the relations with the members of the Customs Union. This is one of the main goals that Ukraine is pursuing in its relations with countries of the CIS, and its Economic Union in general. With respect to Russia, the following possible positive economic effects might be noted:

- restrictions on access to imported energy resources would be removed, and the possibility created for obtaining energy resources on equal footing with Russian enterprises; this would signify the effect of the removal of actual oil and gas supply quotas within the framework of international agreements, and the effect of removing export duties for energy resources;

- the possibility would emerge for significantly improving conditions for the transit of energy resources obtained from third countries,

such as Kazakhstan and Turkmenistan, over Russian territory;

- a noticeable improvement would occur in the conditions for supplying the Russian market with Ukrainian goods (sugar, alcoholic beverages), whose exports were seriously damaged by Russia's application of quantitative restrictions;

- better conditions for implementation of international co-operation projects as a result of lowered transaction costs, and the creation of better conditions for implementing the principles set down in the Ashghabat agreements;

- from a longer-term perspective, the possible slowing down and removal of the negative pattern of losing markets in the Customs Union member countries. Those countries are now creating alternative enterprises and an alternative transit infrastructure, which is not in line with the interests of Ukraine's exporters.

However, **the possible political consequences of membership in the Customs Union of "the five" do not make this choice very promising for Ukraine.**

## CHANGING THE FOCUS FROM REGIONAL, TO GLOBAL INTEGRATION

Under certain conditions, this alternative can become the principal one for Ukraine. When compared with the regional group integration scenario, this one envisages a generally slower pace of trade liberalisation, and fewer obligations with respect to the international (supra-national) regulation of economic relations. **It is also more convenient from the perspective of the ideology of Ukraine's "multi-vectored" approach, which currently coincides with the country's current geographic structure of exports. However, prospects for this choice will depend on the possibility of creating strong companies in Ukraine with global marketing strategies. And this scenario can become not an alternative, but a supplement to an effective regional integration strategy, all the more because the economic openness of the regional integrated groups is turning into one of the main principles underlying the new system of global economic regulation.**

# CHANGES ON THE WORLD ALUMINIUM MARKET: UKRAINE'S PROSPECTS

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The world aluminium market presents a vivid example of the oligopoly of the "seller's market": product prices, the volumes and conditions for supplies are determined by several large producers in the U.S., Western Europe, and Eurasia. Likewise, price formation, the requirements for supplying raw materials, and the destination of goods and money flows within the branch also depend on the will of the main producers.

Ukraine participates in this division of labour, above all, as a producer of basic raw material for the production of aluminium — alumina. The capacity of the *Mykolayiv Alumina Plant* (*MAP*), the producer of this raw material, amounts to 1,100 thousand tons a year — one of the largest production capacities in the world, and the largest in the CIS. The *Zaporizhsky Aluminium Plant*, which last year produced only 112.4 thousand tons of aluminium, needs large investments for modernisation to keep up with the world giants in this branch (whose capacities reach one million tons a year), is not capable of substantially influencing the situation on the market and, therefore, is considered to be less lucrative than *MAP*.

That's why the desire of financial-industrial groups and "oligarchs" from the near and far abroad to establish control over the Ukrainian alumina plant is understandable. Especially active were Russian (or those connected to Russian businessmen and politicians) companies: *MAP* covers 25% of the needs of Russian aluminium producers. Control over the plant would allow these producers to occupy a more confident position on the international aluminium markets, determine prices and markets.

At the end of March, 2000, the "war" for possession of *MAP* ended with its privatisation. Its 30% share block was acquired for UAH 547.2 million, with a long-term commitment on the part of *Ukrainian Aluminium Ltd*, 75% of whose authorised capital belongs to members of the Ukrainian project of the joint company *Siberian Aluminium*, which took over control of 66% of *MAP* shares. At the beginning of April 2000, the strategic alliance between *Siberian Aluminium* and the group Siberian Oil became known, as well as the creation of the Transnational Corporation (TNC) *Russian Aluminium*, which now controls up to 10% of the world production of this metal.

Therefore, from now on *MAP* will operate on the aluminium market within the framework of the newly created TNC. What are the consequences of these developments for Ukraine?

## THE WORLD ALUMINIUM MARKET

Perhaps everyone recalls the historical anecdote about how, in the 19th Century, aluminium tableware was more expensive than its golden counterpart. Nevertheless, around 100 years ago, a relatively inexpensive method for extracting aluminium was discovered (electrolytic) making it possible to produce aluminium industrially.

The large energy consumption and need for raw materials — bauxite and alumina — determined the economic expediency of creating only large enterprises with their location near electric power stations. That's why the number of major aluminium producers in the world is limited, and they are all monopolists: in the U.S. — *Alcoa* (74% of the national market) and *Reynolds Metals* (over 25%), in Canada — *Alcan* (over 70%), in Germany — *VAW* (virtually 100%), France — *Pechiney*[1] (100%), Switzerland — the *Alusuisse Lonza Group*, Norway — *Norsk Hydro*. These companies produce more than half of the world's aluminium, with the result that they can dictate their conditions to other market participants.

The price for aluminium is traditionally determined on the London Metal Exchange by way of negotiations between the consumers and producers of aluminium and raw materials. The main parameters are determined by the five largest aluminium producers, with the American giant *Alcoa* playing first fiddle in the process. Prices are determined every autumn; negotiations are held to find partners, the price, and conditions for supplying aluminium (as well as alumina) for the following year.

In recent times, there has been a tendency for the merger of the main aluminium producers. *Alcoa* has intentions to buy controlling interest of the *Reynolds Metals* company, which will allow it to control 99.5% of production of primary aluminium in the U.S., 16% of world aluminium production, and 38% of alumina production. *Alcan*, in its turn, is joining forces with European allies. This company announced plans to merge with the French *Pechiney* and the *Swiss Alusuisse* companies, after which the new corporation, *APA*, will control 15% of world aluminium production, and 22% of alumina[2].

The increased pace of goods and money flows (as a result of the globalisation of information, new technologies, access to many markets simultaneously), and the globalisation of capital and stock markets presents a challenge to the traditionally "slow" industrial branches. Today, as never before, profitability and effectiveness depend on the optimal allocation of resources, the acquisition and analysis of information, and the approval and implementation of decisions. As a result, large industrial companies in Western countries are forming groups that are capable of reacting flexibly to the market situation, and achieving not only a lowering of prime costs resulting from savings made on large-scale production, but also creating new and occupying existing niches in the international trade, by joint efforts of capital (especially banking capital), manufacturers, and suppliers of information (including those who gain information through industrial espionage).

**The world's primary aluminium production capacities** (1999, thousand of tons)[3]

| | |
|---|---|
| North America[4] | 6691 |
| Latin America | 2285 |
| Western Europe[5] | 3802 |
| Eastern Europe, | 4116 |
| Including: Russia | 3149 |
| **Ukraine** | **112** |
| Asia | 5159 |
| Africa | 1242 |
| Australia, Oceania, South-east Asia | 2113 |
| **World total** | **25408** |
| Primary aluminium used for further processing | 10861 |
| Primary aluminium offered on free market | 14547 |

[1] It is namely this company that constructed *MAP* in 1985. As a result, *MAP* is a relatively new enterprise, attractive for investors.

[2] Panina N. Russian Aluminium comes up in the world. — *Tribuna*, April 20, 2000, p.5.

[3] Maslov H. The promising alliance. — *Stolichnye Novosti*, May 23-29, 2000, p.5

[4] Mainly the U.S. and Canada.

[5] Mainly Germany, France, Switzerland, Norway.

Characteristic of this sector is **the creation of vertically integrated corporations, whose idea is to control the maximum number of technical links, from raw material to finished goods (in order to lower taxation costs, streamline the supply of parts, etc.), as well as merge enterprises within a branch, with the goal of optimising goods and cash flows, re-dividing markets, and improving management.**

The activities of South Korea, Japan, the U.S., Germany, France, and other industrially developed countries can serve as examples in this respect. Thus, recently in France, a merger of defence industry enterprises took place: the merger of the *Aerospatiale* and *Dassault*, with the goal of creating "industrial centres of gravity"(especially in the aerospace sector) based on the examples of Great Britain, Germany and Italy[6]. As a result of similar large enterprise mergers in the U.S. in late '80s — early '90s, the country's arms exports doubled.

**Therefore, the main present-day strategy of industrially developed countries is: (1) the optimisation and expansion of production, the creation of vertically integrated structures with a well-defined mechanisms for approving and implementing decisions; (2) governmental control over corporations (including with respect to price formation); and (3) ensuring their foreign interests through governmental levers[7].**

The prospect of uniting the world's aluminium giants is part of the global process which is now dominating industrial relations. Moreover, the rapid development of the aerospace industry, shipbuilding, and the increased use of aluminium in some light industry sectors are increasing the demand for high-tech grades of aluminium. This is forcing producers to invest large sums in modernisation of production, and to optimise its structure.

Taking the above-listed factors into account, the atomism of production, and the war between the "oligarchs", which up until recently were characteristics of the Russian aluminium sector, made Russia non-competitive on the world markets (although the hypothetically combined production capacities of Russian enterprises allow the Russian Federation to compete for 10-14% of world aluminium volumes and thus, enable it to compete as equal with Western companies). As a result, the "reconciliation of oligarchs" in April, 2000, between A.Chubais and O.Deripaska on one side, and B.Berezovsky and V.Abramovich on the other, when they agreed about the creation of a single aluminium concern, *Russian Aluminium* (that united the production of bauxite, alumina, aluminium, electric power stations and banks), appears to have been a completely logical and timely step to take.

Ukrainian *MAP* played rather significant part in the creation of this concern. Russian capacities supply only up to 40% of the needs of the aluminium giants for alumina. The rest comes from the far (Australia) and near (Ukraine, Kazakhstan) abroad. *MAP* satisfies 25% of the needs of Russian producers[8]. Therefore, whoever controls *MAP* controls a significant share of the CIS alumina market. And whoever controls alumina can dictate conditions to aluminium producers. As a result of *Siberian Aluminium* acquiring 66% of *MAP* shares, the latter's alliance with its largest competitors — the companies of B.Berezovsky and V.Abramovich — has become possible.

Now the management of *Russian Aluminium* is giving assurances that the need for strengthening its own market position will lead to the modernisation of its enterprises, including *MAP*. Should such plans become implemented, *MAP* will receive a stable market for its production, and investments sufficient for modernising production.

**Therefore, the market situation in the aluminium branch (as in other sectors of industry) is unfavourable for small enterprises acting on their own. The norm has become the merger of such enterprises and the battle of so created large corporations for the markets and price formation. That's why *MAP* incorporation in the powerful Russian TNC is an inevitable and positive devel-**

6 Lozovytskyi O. Reform of the armed forces in France as the most important result of the development of the European-wide security system. — *Liudyna i Polityka*, 2000, No.2, pp.37-38.

7 In virtually all Western countries, special councils for economic security exist which are called upon to co-ordinate the actions of state structures, optimise the activity of the public sector, and provide consulting services regarding the intensification of the work of the domestic private sector.

8 More than 90% of its production goes for export, as Ukraine's consumption of alumina is very insignificant.

**opment. Given the absence of Western investors' interest in *MAP*, an alternative would have been "picking up the crumbs" from the tables of the largest, with the corresponding uncertainty regarding payments, markets, as well as tax revenues from *MAP*. However, did *MAP* and the entire branch win out in the union with a concrete investor, that is, with *Siberian Aluminium* of the joint company *Russian Aluminium*?**

## CONSEQUENCES AND LESSONS OF THE ALUMINIUM BRANCH PRIVATISATION

It is probably not worth going into the details of *MAP* privatisation and analysing the actions of the main players involved. There has enough been written about this in the Ukrainian, Russian, and Western press. **Instead, it is worth emphasising individual characteristics of the privatisation of the Ukrainian aluminium sector which make it unique in Ukraine, and which are worth applying to the privatisation of other large enterprises.**

Above all, for the first time in Ukraine, the shameful practice of selling industrial giants in small blocks of shares for almost nothing has been overcome. The price of the block (30% of shares), offered by the tender winner, was UAH 547.2 million (nearly $100 million)[9]. By the way, the starting price for the block of shares was determined by the State Property Fund of Ukraine to be only UAH 113 million, while the Government of V.Pustovoytenko drafted a plan that envisaged revenues in the amount of UAH 190 million, and that for the sale of 50% of *MAP* shares. Such financial injection in the period of payments of billions-worth foreign and domestic debts is of advantage for Ukrainian budget.

Secondly, the example of privatisation in the aluminium sector can be useful for other branches with similar features. For Ukraine, those features are:

1) dominance of export-import operations in enterprise activities;

2) production utilising mostly imported raw materials;

3) evident gap between domestic and export prices for enterprise production.

That is, the discussion concerns enterprises that are oriented toward export, and are more integrated with international, rather than domestic goods and financial flows. These are industries which are still "alive" and will soon face large-scale privatisation.

It is worth emphasising the need for leaving at blocking interest of 25% +1 share in state ownership. The sale of 100% of the shares of such enterprises will cause the state's inability to maintain control over goods and financial flows, and take timely measures for protecting Ukraine's budgetary interests. This will result in the transfer of enterprise operations to tolling schemes (taxed under lower rates) with irreversible negative consequences, and especially:

1) a significant decrease in sales volumes which, in the end result, will lead to a decrease in the country's GDP;

2) non-accrual of VAT and, as a result, the appearance of debts payable from the state budget;

3) shrinkage of revenues in the form of enterprise profit tax, as a result of the substantial narrowing of the tax base.

Therefore, **it is worth retaining state control over the activities of such enterprises by leaving a blocking interest in those enterprises under the state's ownership, in order to ensure budget revenues for a 3-5 year transition period**. This will not only allow for the budget to remain afloat, but lead to a conscious capitalisation of enterprises, which will make it possible to sell the state-owned interest for a higher price (after the end of the three-year transition period[10]).

These measures need to be legislatively grounded. **Privatisation laws should undergo significant amendments.** In particular, a transparent procedure should be established, providing for the privatisation on a competitive basis, making contracts with investors, the mechanisms for avoiding unfair conduct by investors (the prohibition of privatisation of enterprises by offshore companies, defining the term of "industrial investor" to mean one that has substantial experience in the certain branch), demands concerning the investor's solvency, a list of possible investment obligations, and mechanisms of inevitable accountability (up to contract termination) for investor's default. It is also worth adopting a

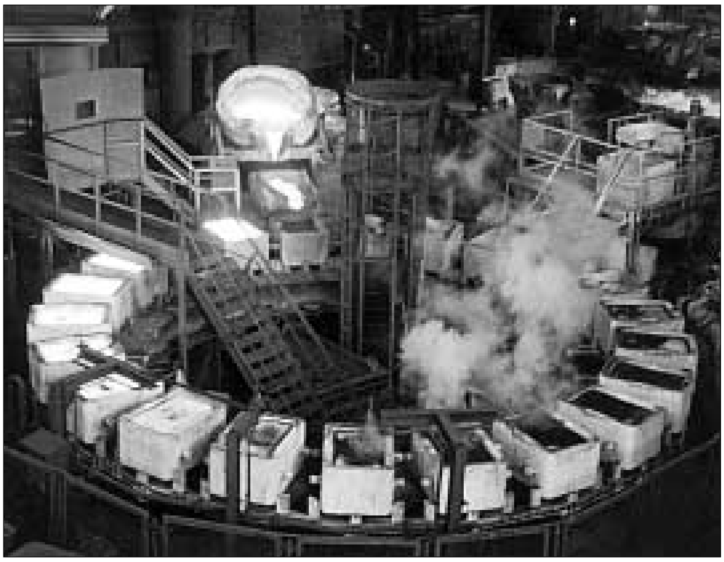
[9] In the middle of May, 2000, when this material was being prepared, investors had already paid 30% of the agreed sum to the state budget.

[10] Italy, among other countries, had a similar experience, where an attempt had been made to sell 100% of enterprise shares. Heavy economic losses forced the country's government to radically reassess the approaches to and methods of privatisation, including making participation in the privatisation process more difficult by adding more qualifying requirements and investment conditions.

law limiting tolling operations. This would allow for both an increase in tax revenues to the budget, and ensure larger profits for enterprises pressed to accept tolling schemes.

**Privatisation in Ukraine should not be confined to the sale of "strategic" blocks of shares. The secondary stock market should be supported by the offer of smaller blocks of shares. This will attract medium-size investors to Ukraine, who are aware of portfolio investments, and capable of reviving the stock markets which, in turn, will encourage Ukraine's earlier participation in the global stock market and investment process.**

On the other hand, in Ukraine's metallurgical sector the number of enterprises whose ownership remains with the workers (such as the *Metallurgical Plant named after Illych* — 40% of its authorised fund belongs to the working collective, and its performance level is quite good) function effectively. Such companies should be retained as "public" ones, while offering small blocks of shares to individuals and legal entities with limited financial resources.



This condition was met at *MAP*. Moreover, the investor took an obligation to expand alumina production capacities, and build a new aluminium plant. As far as additional alumina capacities are concerned, the representatives of *Siberian Aluminium* publicly announced that prior to the end of 2000, *MAP* will raise its output capacities by 15%, and later, its alumina output is to reach 1.3 million tons. Presently, the enterprise has no tax and wage arrears, and wages have increased 1.5 times, on average[11]. The construction of the enterprise's aluminium plant with a production capacity of at least 100 thousand tons of aluminium a year will imply for the Russian side an expansion of the new production capacities of enterprises, while for Ukraine — domestic capacities for producing this strategic metal (critically important for the aerospace industry, and some other sectors). Given the mutual benefits offered by this project, its implementation may occur even before 2002, stipulated in the agreement.

**The newly established corporation, of which *MAP* is a part, intends to reject the previously existent tolling scheme, loss-making for raw material producers, that channels enterprise profits to offshore companies** (*see Scheme*). Starting in January, 2000, Russia limited cross-border tolling operations, and completely cancelled such operations on the domestic market. This kind of the Russian Government's policy is supposed to increase tax revenues, but this development favours Ukraine as well: the sale of alumina for *MAP* is far more profitable than processing tolling raw materials (especially at discount prices, as was the case between July and November, 1999)[12].

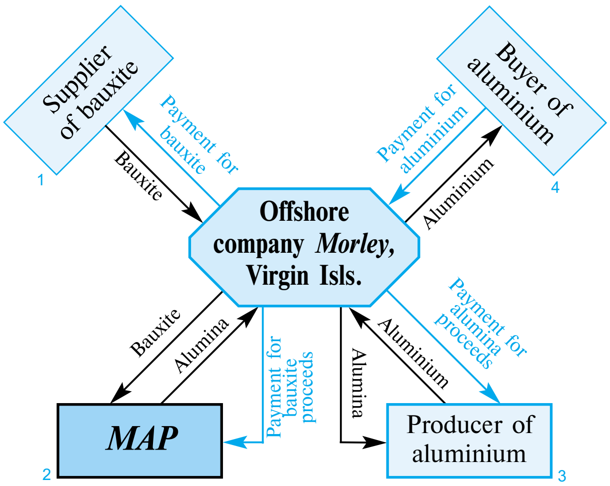
Finally, the emergence of a Russian industrial investor on Ukraine's market with vast experience in this sector, will improve Ukraine's reputation which is still unattractive for investing, given successful fulfilment of contract commitments. *MAP* looks to be more of an exception than the rule in Ukrainian industry. It was constructed relatively recently, and employs know-how that has not yet become obsolete. Furthermore, *MAP* produces 25% of all alumina manufactured in the CIS. All this makes it extremely attractive for investors — a feature shared by only few Ukrainian enterprises, especially in the metallurgy sector. However, **"expensive" privatisation, the involvement of privatised enterprises in the world division of labour, the attraction of investors prepared to invest in production — all these are targets that should be set when privatising every enterprise. In any event, Ukrainian enterprises should not be sold for a song to persons of dubious repute.**

Active actions of Russian investors can help to give a real start to investing in Ukraine. **Improvement of the investment climate requires the alteration of tax and budget policies, and the completion of administrative reform. If**

[11] Someone is already answering for alumina. — *Kievski Teregraf*, May 25, 2000, p.3.

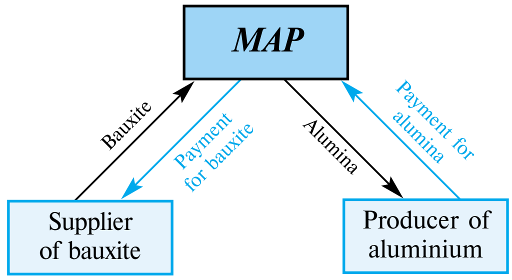
[12] O.Deripaska, who chairs *Siberian Aluminium*, consciously rejected tolling schemes in 1999. He believes that the equity capital of *Siberian Aluminium* is enough to pay for everything, including raw materials.

**The scheme of withdrawing profits from the *MAP* under a tolling scheme[13]**




Price of one ton of alumina (manufactured from raw material obtained on tolling terms) — $82. Amount of alumina sold — $90 million. Therefore, profits from the sale of alumina are hidden in the profits from aluminium sales. The offshore company is on velvet at the expense of the *MAP*. Profit tax revenues are down, transactions with tolling raw materials are not subject to VAT, production volumes fall, leading to a decrease in Ukraine's GDP.

**The new scheme of domestic production and sale of finished products**




Price of one ton of alumina (at the London Metal Exchange) — $200-230. Amount of alumina sold — $220-250 million. Profitability of basic production is provided at a level of 8-15%. Profits remain at *MAP*, with a corresponding increase in tax revenues. Sales are rising, leading to an increase in Ukraine's GDP.

**Western countries are truly interested in Ukraine not being swallowed by Russia, initiatives from the U.S. and EU countries can be expected that encourage investments by big business into Ukraine's economy.** On the other hand, should the Russian projects succeed, there will then be grounds for improving Ukraine's image as a country where privatisation was unsuccessful.

**In general, the consequences of *MAP* privatisation for Ukraine were:**

- the creation of a precedent for the sale of a large share block of a big company for a high price to an industrial investor (experienced in the branch, and willing to expand production, rather than export profits);
- the retention of a government-controlled share block (25%+1 share) of one of the largest enterprises, which ensures control over the strategic development of the enterprise, and helps to receive incomes into the state budget in the form of dividends;
- the creation of the possibility for expanding the national production of the strategic material — aluminium, which is necessary for priority branches of domestic industry (aircraft industry, ship-building, space industry, and also for construction and light industry sectors);
- the creation of a basis for improving Ukraine's reputation and investment attractiveness, which will lead to foreign investments (from both the near and far abroad alike).

**Furthermore, this agreement, if successfully exploited by the Ukrainian side, can become the basis for far-reaching positive developments in relations between Ukraine and Russia.**

[13] This scheme was effective during July - November, 1999 and was in line with the Law "On Operations with tolling Raw Materials in Foreign Economic Relations".

## CONSEQUENCES FOR UKRAINIAN-RUSSIAN CO-OPERATION

Clearly, for a "big economy" (the aluminium branch unquestionably belongs to just such an economy, given its monopolistic nature and the importance of this branch for the state) the political process plays a significant role — and vice versa. That's why the issue of the political climate in the countries where economic operations are undertaken by respective enterprises is extremely important for the stability of foreign markets and tax revenues from exporters.

Experts foresee the possibility of a serious revision of Ukrainian-Russian relations following the election of the President of the Russian Federation V.Putin. Large-scale changes in the groups and spheres of influence are taking place in Russia, as well as in the methods and mechanisms of activity. Furthermore, according to many Russian businessmen, they are feeling "the pinch" in Russia, so they begin looking at other countries as possible territories for expansion.

Greater pressure can be expected on Ukraine, so as to acquire (through different means of pressure) shares of the largest Ukrainian enterprises. This particularly concerns enterprises that were part of mutual production complexes along with Russian enterprises during the times of the USSR.

Ukrainian businesses will unlikely be able to refuse "partners" foisted upon them. **The danger exists that the new owners will conduct a policy of freezing the activities of their acquired businesses on the territory of Ukraine with the goal of removing competitors, and obtaining additional possibilities to move Russian goods into Ukraine (as into other countries)**. Without the investment of substantial funds into the economy of Ukraine, and without long-term obligations, these new owners will not feel themselves related to their acquired businesses, and will be able to determine their fate according to their own judgement.

While assessing the high probability of Russian "oligarchs" to take part in privatisation in Ukraine, on the one hand, and the danger of the appearance of illegal "privatisers", on the other, **it becomes necessary to admit into Ukraine only those Russian investors (and only on those terms) that are in line with Ukraine's national interests. This process requires establishing ties with the "new wave" of young, pragmatic modern-like Russian businessmen and politicians, who adhere to the European model of doing business, fulfil their commitments and place their stake on**

**the modernisation and expansion of production**, as with *MAP*, rather than on intrigues, corruption, personal benefits and the sell-out of assets and goods at dumping prices. However, relations with this "new wave" of businessmen should be established conditional on participation in long-term projects and counter-protection of the interests of Ukrainian and Russian business.

In this way, it would be possible to achieve **the creation of a powerful political-economic Ukrainian-Russian lobby interested in the stability of partner relations between the two countries and preservation of the status quo and, consequently, secure the interstate relations against disturbances, personal ambitions and other problems of the "transitional period" on the highest level.**

Unfortunately, the relations among the authorities within both Russia and Ukraine are still in the state of formation. That's why exploiting the positive results of Ukraine's "first serious privatisation agreement" will depend on many factors. In the first place, this is the far-sightedness and the efficiency of the Ukrainian authorities, and their ability to maintain dialogue on an equal footing with their Russian counterparts.

The initiation of such a dialogue will require the accomplishment of the following tasks:

- the diversification of energy sources;
- the repayment (restructuring) of debts for Russian gas to avoid Russian pressure;
- the accomplishment of a transparent and thought-out large-scale privatisation (to attract sufficient funds, enter contracts with industrial investors, and work out proper investment commitments);
- the stabilisation of the political situation (lowering of political risks and easing extra foreign pressure on Ukraine because of the ambitions of its politicians);
- the promotion of joint projects involving Ukrainian and Europe-oriented Russian businesses, and the encouragement of Ukrainian investments into Russia;
- the effectiveness of state control over the fulfilment of investor obligations, the establishment of legal and economic mechanisms providing for the inevitable responsibility in the event of default.

In any event, the authorities must be governed exclusively by Ukraine's interests.

**Therefore, in the event the Ukrainian authorities make the best use of the results of privatisation, it will be possible to say that the *MAP* project:**

- **facilitated the restoration of industrial relations with the CIS on the basis of economic expediency and civilised partnership (rather than administrative economy or ambitions of the "big brother");**
- **linked the long-term interests of Ukrainian and Russian authorities and businesses, which may serve as a basis for forming a lobby interested in the stability of relations between the two countries;**
- **has shown that the Russian capital is ready to participate in large-scale privatisation of Ukrainian industrial facilities and, therefore, Western investors should be more active, if they are willing to acquire shares of the leading Ukrainian enterprises.**

**Therefore, thanks to a favourable market situation and the far-sighted actions of politicians and officials, Ukraine managed to strengthen its positions on the aluminium market, become involved in the international division of labour, create a precedent of "expensive" large-scale privatisation, and mark the way for the establishment of more civilised relations with Russia.**

**Stable markets for alumina and the construction of a new aluminium plant will create new jobs in Ukraine and increase state budget tax revenues. Furthermore, the results of privatisation will guarantee the steady development of the sectors critically dependent on aluminium: aerospace industry, ship-building, other high-tech branches. This, in turn, will make Ukraine's participation in international projects, such as the AN-70, or Sea Launch, more effective, and improve Ukraine's chances for participating in other similar projects.**

**The results of MAP privatisation should be used throughout Ukraine's metallurgical branch. The metallurgical sector should be oriented not toward trade in low-quality semi-finished goods at dumping prices, but toward the supply of raw materials for industrial enterprises within the framework of large projects in machine-building, ship-building, aerospace, and other sectors. Only then will we see Ukraine returning to the ranks of civilised and developed countries.**

# UKRAINE ON THE WORLD ARMS MARKET

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The world arms market is characterised not only by purely economic, but also by political and technological factors. Only those countries that are politically influential and possess hi-tech and science-intensive industries can achieve success in the arms trade. That's why Ukraine's status as a player in the international arms market is critically important for the country's image and for the consolidation of its economic security.

Ukraine's presence on the world arms market is conditioned, foremost, by the heritage of the USSR, which used to spend unlimited funds on the arms race. After the break-up of the Soviet Union, Ukraine inherited nearly 30% of the latter's military-industrial complex, in particular, a significant theoretical and practical base within sectors where Soviet science was ahead of its Western counterpart[1]. That's why, despite the economic crisis and industrial decline, the defence sector has retained its leading position in many directions.

To a certain extent, this was a result of Ukraine's attempts to occupy its niche on the world arms market. The first arms contracts reanimated a number of defence sector enterprises. That's why some of Ukraine's "generals of the military-industrial complex" spoke of Ukraine's "destiny" as an arms seller. At the same time, Ukraine objectively has fewer possibilities on the arms market than its closest competitor — Russia, which inherited some 60% of the Soviet military-industrial complex.

## WORLD ARMS MARKET: PRESENT-DAY TRENDS

An analysis of the international arms market reveals a number of tendencies that will impact the future of Ukraine's arms business. First of all, the market is gradually becoming narrower. The dynamics of contracts signed in 1996-1998 makes it possible to predict a further decrease in world arms exports in 1999-2000 by approximately 5%, as compared to 1997-1998[2].

The gap between 4-5 leading countries and all other arms exporters is widening. For example, the U.S. in 1998 alone increased arms exports to developing countries by $2 billion, as compared to 1997[3].

Defence expenditures in the majority of Third World countries, which are the main importers of Ukrainian weapon systems, are gradually decreasing. Pakistan, Ukraine's main partner in the field of military and technical co-operation, cut military spendings in 1999/2000[4]; Turkey, when announcing a tender for the purchase of 12 corvettes (valued at nearly $1.5 billion) in May, 2000, said that this project will be financed at the expense of exporters crediting, and not out of the state budget[5].

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[1] Production of homing missile warheads, radio detection stations, surveying systems, aircraft and missile homing systems, etc.

[2] Report of the International Institute for Strategic Studies. — MTC, No.52, December 27-31, 1999.

[3] INFO-TASS, VEGA base, August 9, 1999.

[4] *Jane's Defence Weekly*, June 16, 1999, vol.31, No.24, p.28.

[5] UNIAN, May 29, 2000.

Demand for outdated hardware from the stockpiles is falling. For this reason, Ukraine does not take part in a number of promising tenders, such as for the re-armament of the Republic of South Africa[6].

The methods of transferring defence and dual-use products to customers are changing. Increasingly more countries are beginning to favour the use of off-set schemes, related with the purchase of technologies and beginning production on their own territories.

Structural changes are taking place in arms supplies: after the latest NATO operations in the Balkans, a steady growth has been observed in the demand for air defence systems and combat aircraft[7].

Finally, another noticeable tendency is the sharpening of competition between former socialist countries, conditioned by the existence of production facilities and stockpiles of similar weapons systems. The creation of the Russian-Belorussian Union also poses a danger of tougher competition for Ukraine.

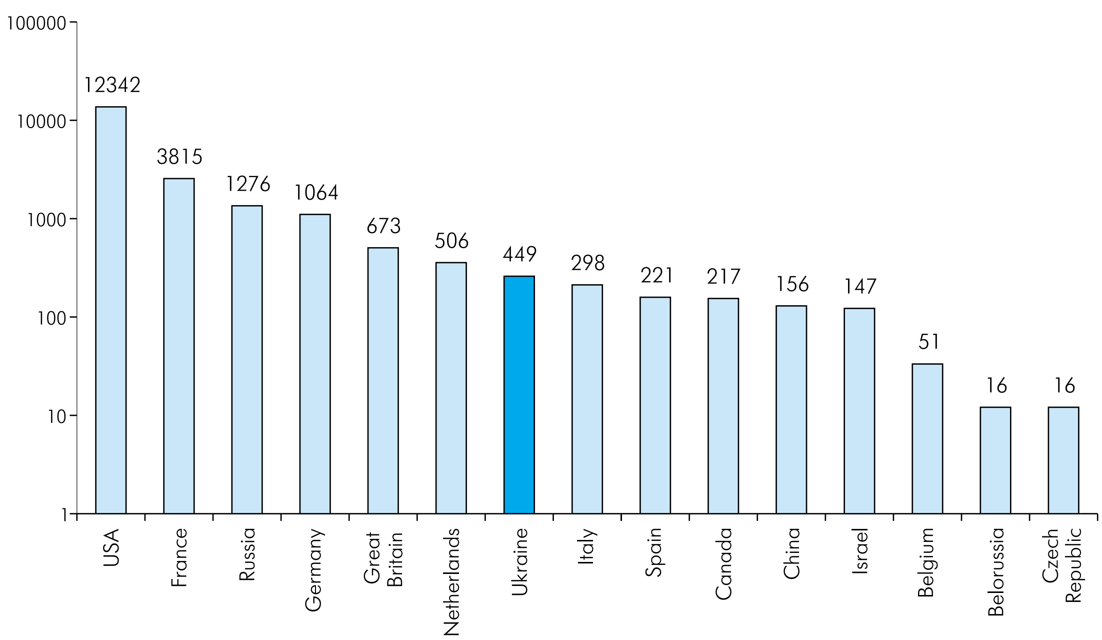
**The world arms market, therefore, is changing rather quickly, with market competition becoming stronger. The list of the world's main arms exporters and importers is virtually unchanged** (*Diagr. "Arms exports in 1998" and "Arms imports in 1998"*)[8].

**As is clear from the Diagram, Ukraine lags behind the group of arms export leaders, but retains a weighty position in the second echelon of exporters.**

## UKRAINE ON REGIONAL ARMS MARKETS

Ukraine is unevenly represented on the regional arms markets. This is primarily due to the strict division of the market, which is the reason that underlies the strong competition between new producers attempting to re-divide this market[9]. Secondly, Ukraine has a closed cycle of production only in limited number of weapons systems production. This complicates the promotion of production and makes domestic enterprises dependent on the final manufacturer. According to the Director General of the *State Company Ukrspetsexport* V.Malev, this limits Ukraine's possibilities on the market and makes it "competitive only where it is able to comprehensively represent the national producer, from designing to manufacturing, as the example of radar equipment demonstrates"[10].

**Arms exports in 1998,** $ mln.




6 UNIAN, June 25, 1999.

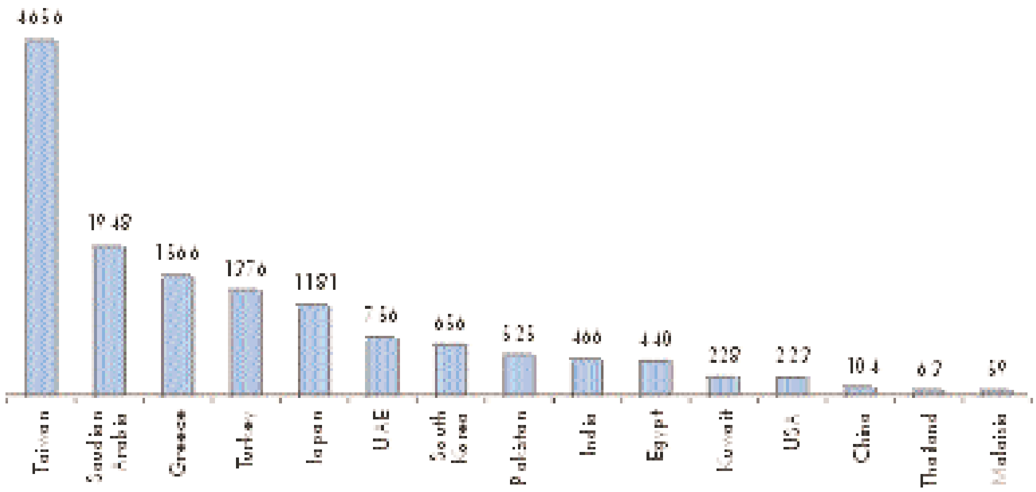
7 Arms export. — AST Centre, March-April, 1999, No.2(12), p.2,36.

8 SIPRI Yearbook 1999, Armament, Disarmament & International Security. — New York, Oxford, 1999, p.424.

9 During the "cold war" period, the world arms market was strictly divided between the USSR and developed Western countries.

10 UNIAN, September, 14, 2000.

**Arms imports in 1998,** $ mln.




**Ukraine's limited capabilities of manufacturing end products of a military designation affects the volumes of arms sales.** Ukraine neither manufactures, nor sells new combat aircraft, which account for some 50% of the entire market, or submarines (14% of all deals). Helicopter sales, where Ukraine is the engine supplier, comprise only 14% of world exports[11].

At the same time, the country's efforts on the arms market brought some positive results. While earlier, sales of tanks and other military equipment to Pakistan formed the basis for Ukraine's arms exports, in 1999, the situation improved, with a shift to a more balanced distribution of Ukraine's exports and supplies to other regions: North and Central Africa, and South Asia. *Ukrspetsexport* alone performed arms export and import operations with over 30 countries in 1999[12]. Furthermore, whereas before, the lion's share of exports fell on *Ukrspetsexport*'s subsidiary, the *Progres* firm, which serviced the Pakistani tank contract, presently, the share of other intermediaries in the defence business is as large as that of the *Progres* firm. Experts believe that the completion of the Pakistani tank contract in 1999 will not lead to a decrease in Ukraine's arms exports in 2000, nor will it affect its presence on the world arms market[13].

**The volumes of Ukraine's exports are rising.** While in 1997, *Ukrspetsexport* (together with its subsidiaries) earned $148 million (out of a $186.7 million planned), in 1998, this figure reached almost $300 million[14]. According to the State Export Control Service of Ukraine, the backlog of orders for Ukrainian arms increased by 50% in 1999. Trade indicators with CIS countries, including Russia, also improved[15].

In contrast to the leading Western manufacturers of weapon systems, **Ukraine lays down no political conditions for potential customers, which gives it an advantage over other exporters.** This leads to positive results. For instance, having experienced pressure from the U.S. (the delivery of 28 modernised F-16 air-

[11] Another 11% falls on the exports of armour, 10% — on missile equipment; artillery and C³I systems account for 2% each. — *Russian-Ukrainian Bulletin,* 2000, No.5, p.50.

[12] Industrial Ukraine. — IDET-99, p.3.

[13] UNIAN, January 17, 2000.

[14] Sputai G. Armour for export. — *Kievsky Telegraf*, May 15, 2000.

[15] Badrak V. Sensitive trade: hopes that come true. — *Russian-Ukrainian Bulletin*, 2000, No.5, p.45.

craft was embargoed in 1995[16]) and France (a month-long delay in the delivery of eight modernised Mirage-III and Mirage-V fighters, and an Agosta-class submarine[17]), Pakistan demonstrates a preference for co-operating with Ukraine, or China (which is also unwilling to put forth political demands in its arms trade).

**Experts name Ukraine's reluctance to employ barter, off-set, and leasing schemes among the factors that impede Ukraine's possibilities on the arms market[18]. Furthermore, Ukraine does not trade in licences, which also limits its potential on international markets.**

## Markets of European countries

On the European markets, Ukraine has had more failures than successes. This development is a logical one, given the scientific and industrial development levels of leading Western countries, and the integration of the majority of post-socialist countries into Western European structures, which has led the governments of those countries to support Western projects.

The promotion of military products onto the European markets is limited by the latter's self-sufficiency, i.e., the existence of production capacities for satisfying the majority of defence requirements. The policy of protecting domestic manufacturers in European countries should also be taken into account. That's why **Ukraine's ability to offer competitive military (dual-use) production by itself does not mean that European countries are prepared to import such products.** A demonstrative example of attitude towards Ukraine, as a potential competitor, is the denial of its membership in the European Space Agency, disregarding (or, rather, regarding) the fact that Ukraine is one of the world's most powerful space systems manufacturers.

Today, Ukraine's military and technical co-operation with European countries has more to do with tenders and joint projects, rather than direct products supplies. A showy example is the joint Ukrainian-French-Czech project for the modernisation of the T-72 tank, which laid the groundwork for co-operation between Ukraine and France[19]. Few Ukrainian defence industry enterprises supply production directly to the European markets. In 1999, the *Sumy Scientific-production Association named after Frunze* exported military products and services to France, Great Britain, the Netherlands and Austria; the state company *More Production Association of Feodosiya* — to Greece and Turkey; *Topaz Open Joint-stock Company* — to Denmark; *Motor-Sich Open Joint-stock Company of Zaporizhia* — to the Czech Republic, Ireland, Bulgaria; the State Company *Tasko-export* — to the Czech Republic, Slovakia, Slovenia, Bulgaria and Poland[20]. A promising (for Ukraine) tender for the supply of at least 250 tanks to Greece is now underway.

At the same time, growing interest in Ukraine by some European countries is evident. This interest is confirmed by a number of pres-

tigious contracts, either entered into, or negotiated. For instance, *Ukrspetsexport* entered a $97-million contract for the supply of two air cushion landing vessels of the Zubr type to Greece[21]. At the end of 1999, a contract was signed between the *Kharkiv Design Bureau named after Morozov* and *Swiss Ordnance Enterprise Corp.* for the joint manufacture of a test 120-mm NATO standard tank cannon[22].

In May, 2000, negotiations were held between representatives of Ukrainian defence business circles and the management of the influential *Association Francais Conversion* (*AFC*), where the French side reaffirmed its desire to co-operate with Ukraine within the framework of projects for designing and mo-

[16] Novosti news agency, August 25, 1999.

[17] ITAR-TASS, November 10, 1999.

[18] Sputai G. Armour for export. — *Kievsky Telegraf*, May 15, 2000. p.4.

[19] Interview of General Designer of Ukraine's armour, director of the *Kharkiv Design Bureau named after Morozov*, M.Borysiuk for the Centre for Army, Conversion and Disarmament Studies, April 30, 1999.

[20] Database of the Centre for Army, Conversion and Disarmament Studies.

[21] UNIAN, January 26, 2000.

[22] UNIAN, August 25, 1999.

dernising armour (*SAGEM* and *GIAT Industrie*), the production of sub-calibre projectiles jointly with the Tasko corporation of Ukraine (*GIAT Industrie*), and the modernisation of MIG-29 aircraft and their sale to third countries (*Thomson*)[23].

Good prospects exist for co-operation with Turkey, which is a NATO member, and shows an interest in Ukrainian technologies[24]. Ukraine still has a chance of winning the Turkish tank tender (the production of 1000 modern tanks; project value — $4.0-4.5 billion). In some respects, the Ukrainian tank surpasses those of its Western competitors, particularly based on the results of trials in mountainous terrain and in winter conditions, and in such tests as "serpentine" and "stream crossing"[25]. Ukraine has a chance of winning a tender for the supply of 12 corvettes to Turkey, with the joint construction of the first ship and design by the exporting country (these orders can amount to 25-28% of total project value[26]).

**The main achievement of Ukraine on the European market is its participation in joint projects with NATO countries, where co-operation was not possible just 3-5 years ago. The main disappointment was the refusal of Central and Eastern European countries to utilise the potential of Ukraine's military-industrial complex, particularly for the modernisation of military equipment, for which Ukraine has a strong desire, and into which it invested considerable funds.**

## Middle East and North African markets

Markets of this region offer rather good prospects for Ukraine, since local armies employ many post-Soviet weapon systems (tanks, AAA and SAM systems, anti-missile complexes, tactical missiles, combat planes and transport aircraft). Whereas several years ago, the sale, for the most part, of equipment from Ukraine's MOD arsenals was on the agenda, now the emphasis is on selling new weapons systems[27]. That's why Middle East markets were the first to be targeted by Ukrainian arms sellers, and played an important role in consolidating Ukraine's position on the arms market, in general. For instance, **Yemen** purchased combat aircraft: four SU-22 (1995) and four SU-17 (1996)[28].

Based on 1998 results, **Algeria** became the third largest importer of Ukrainian arms, accounting for 10% of yearly defence export volumes; 90% of Ukraine's entire export to that country was in arms[29].

As of 2000, Ukraine achieved the most noticeable success on the **Iranian** market. The largest deals were the supply of 12 AN-74 air-

craft ($132.9 million), and the construction of a plant for building AN-140 aeroplanes in Iran ($195.2 million)[30]. Furthermore, the execution of a contract for the transfer to Iran of the know-how for the manufacture of the AN-140 began. The first aeroplanes assembled under licence will appear as early as 2000.

In recent years, the *State Company Malyshev Plant* supplied its production to the Middle East, particularly to Iran and Jordan. In 1999, it struck a deal for the supply of 50 newly-made BTR-94 APCs to Jordan, worth nearly $6.5 million[31]. Earlier, they performed Jordan's order for upgrading their ageing British-made Centurion tanks into heavy APCs[32]. During the SOFEX-2000 exhibition, a contract was entered for training 100 specialists at the *State Company Malyshev Plant*. Also, letters of intent were

[23] Versii, May 19, 2000.

[24] UNIAN, May 15, 2000.

[25] Interview of *Progres* Director S.Samoilenko for the Centre for Army, Conversion and Disarmament Studies, April 21, 2000.

[26] Interview of the Chief Designer of the *State Ship-building Research and Design Centre* of Ukraine S.Kryvko for the Centre for Army, Conversion and Disarmament Studies, October 1, 1999.

[27] Some countries in this region showed interest to the new developments of special systems (production of the *Topaz Open JSC*, Donetsk, and the *Iskra factory of Zaporizhia*). Good prospects also exist for the sale of armour, aeroplanes manufactured at the *Antonov Aviation Scientific-technological Complex*, and other up-to-date systems.

[28] Database of the Centre for Army, Conversion and Disarmament Studies.

[29] Ibid.

[30] UNIAN, October 2, 1999.

[31] Versii, May 12, 2000.

[32] UNIAN, May 5, 2000.

signed with some other countries of that region regarding the modernisation of 150 T-72, and the supply of 100 T-84 tanks[33].

Starting in 1999, Ukraine has made attempts to establish military and technical co-operation with **Libya** (after the lifting of UN Security Council sanctions). The *Central Design Bureau Shkhuna Open Joint-stock Company*[34] began operations on the Libyan market; negotiations are underway regarding Ukraine's participation in creating defence ship-building facilities in Libya[35].

**It can be stated that Ukraine found its place on the markets of the Middle East and North Africa. The volumes of military products and services exports remain stable, and military and technical co-operation is undergoing dynamic development.**

## Central African markets

The Central African markets look attractive for Ukraine for a number of reasons. In the first place, their consumption of weapons systems and equipment decommissioned from the Armed Forces of Ukraine is comparatively smooth. Secondly, the Central African region is a traditional area of armed opposition, so, arms trade is on the rise to the south of Sahara. In 1998, it increased almost two-fold — from $991 million to $1.69 billion[36]. The expectation of conflicts makes customers less demanding in their choice of arms suppliers. Thirdly, most Central African countries do not have developed industries, that is why they prefer buying arms, rather than licences. Finally, this region employs even more Soviet-made weapons systems than the Middle East. At the same time, this circumstance causes competition among post-Soviet arms exporters to be especially strong.

Despite tough competition, Ukraine managed to consolidate its positions on the Central African markets. In 1998 alone, Ukrainian manufacturers performed contracts valued in excess of $150 million, and that, in strict observance of international agreements[37]. This is almost one-third of all proceeds obtained by Ukraine from arms deals that year.

Ukraine already has steady customers in Central Africa. For instance, the People's Democratic Republic of **Congo** has been using the services of Ukrainian suppliers for several years now (in 1997-1999, supplies were undertaken by the *Luhansk Machine-tool Building Factory Production Association*). Co-operation with new importers is developing. In 1999, **Angola** acquired special equipment produced in Zaporizhia. According to the *Ukrspetsexport*, in 1998, two unnamed African countries began the execution of two large contracts with Ukrainian suppliers (one of them valued at $132 million)[38].

**In general, within the 1997-1999 timeframe, Ukraine became well established on the Central African market. At the same time, this market is the area of the strongest competition between Ukraine, Russia and Belarus. Russia has more opportunities for political lobbying, and more trade and diplomatic missions. This enables Russia to supply more countries within the region. Ukrainian specialists tie prospects on this market to political decisions on selling a wider range of military equipment.**

## Asian markets

Asia presents the most important market for Ukraine, as many Asian economies are booming now (China, India, Pakistan, etc.). At the same time, increased tension between India and Pakistan steps up arms purchases in other countries of that region.

[33] Ibid.

[34] Base designer of small and medium vessels, patrol and missile ships and boats, small patrol and landing vessels.

[35] UNIAN, November 17, 1999.

[36] Report of the International Institute of Strategic Studies. — MTC, No.52, December 27-31, 1999.

[37] Badrak V. Brilliance and misery of the defence sector. — *Zerkalo Nedeli*, July 17, 1999, p.2.

[38] Database of the Centre for Army, Conversion and Disarmament Studies.

Over the last three years, **Pakistan** has been the largest of Ukraine's partners in the area of military and technical co-operation. It was thanks to the Ukrainian-Pakistani contract for the supply of 320 T-80UD tanks to Islamabad (worth over $650 million) that Ukraine became the ninth largest arms exporter in the world in 1997, and seventh in 1998. During the 1996-2000 timeframe, Ukraine performed Pakistani orders totalling nearly $800 million, while potential orders for the next five years amount to at least $1 billion[39].

Despite the fact that **China** is traditionally Russia's largest partner, supplies of Ukrainian production to the Chinese market are growing. This refers mostly to aeroplanes, parts, and the repair of Soviet-made aviation equipment. In 1997, China purchased 56 air-to-air missiles, electronic countermeasure equipment, and engines for Chinese K-8J trainers[40]. In 1999, the majority of domestic manufacturers of high-tech equipment maintained trade relations with China: The *Artem State Joint-stock Company, Lorta State Company*, *Motor-Sich Open Joint-stock Company, FED State Company*, *Central Design Bureau Arsenal State Company*, etc.

Ukrainian arms sellers' contacts with **India** are on the rise. Recently, Ukraine established a Military Attache office in India, and the *Ukrspetsexport* will establish its representative office there in the near future. In September, 1999, the Director General of the *Ukrspetsexport* V.Malev noted that "Ukraine is set to increase the volumes of arms and military equipment supplies to the Indian market, and is doing this every year"[41]. There is a range of equipment for which even Russian-oriented customers must turn to Ukraine: airplane equipment (produced by the *FED* and *Artem* companies), radar stations (*Iskra*), aircraft engines and parts (*Motor-Sich*), etc.

Ukraine also co-operates with other Asian countries: **Bangladesh** obtained AN-24 aircraft and components supplied by the *FED* factory of Kharkiv; **Sri Lanka** purchased MI-17 and MI-24 helicopters from Ukraine; **Cambodia** acquired 10 million 7.62-mm cartridges. Negotiations between Ukraine and a number of Asian countries are now underway.

**Compared with the first years of independent arms trade, Ukraine not only retained its presence on the Asian markets, but also expanded co-operation with countries traditionally oriented toward Russia. The Asian market offers good prospects for Ukraine, as the tendency toward greater defence spending is constantly on the increase in this region.**

## South-east Asian and Pacific region markets

Ukraine is a newcomer here, but is seeking to become a fully-fledged player on the markets of this region. The South-east Asian and Pacific region markets appeared in the focus of major arms sellers, when it turned out that the financial crisis of 1998 was smaller and shorter than expected[42].

Ukraine is counting on a victory in the **Malaysian** tank project, which provides for the supply of 60-80 vehicles. At the customer's request, Ukrainian T-84 tank was present at the "DSA-2000" international arms exhibition in Kuala-Lumpur.

**Vietnam** is also demonstrating an interest in the development of military and technological co-operation with Ukraine. During the Kyiv visit of the Minister of National Defence of Vietnam in May, 2000, a wide range of issues of co-operation between the two states was discussed. The parties outlined a wide programme of military hardware modernisation: air defence systems, armour, radar stations, etc., for the Vietnamese Armed Forces. Furthermore, starting from September, 2000, 30 Vietnamese servicemen will be trained at Ukrainian military schools[43].

It should be noted that Russia is also targeting the markets of South-east Asia and the Pacific region. It is aggressively lobbying its interests, using political means. For example, during the "DSA-2000" exhibition in Malaysia, Russia's vice premier responsible for the military-industrial complex attended not only the exhibition, but also the ASEAN summit, where he strongly attacked Ukraine[44].

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[39] Expert assessment of the Centre for Army, Conversion and Disarmament Studies.

[40] Kandaurov S. Ukraine expands the range of arms exports. — *Krasnaya Zvezda*, September 25, 1999, p.3.

[41] UNIAN, September 14, 1999.

[42] In 1999, Malaysia's GDP grew by 5.5-6.0%, against the forecasted 2%. — *Aviation Week & Space Technology*, February 21, 2000, vol.152, pp.83-84,86,91.

[43] UNIAN, May 13, 2000.

[44] RosBusinessConsulting, April 4, 2000.

**The results of Ukraine's first efforts on the markets of South-east Asia and the Pacific region give reasons to hope for the consolidation of Ukraine's position on this market, provided there is a consistent marketing policy and adequate political support for Ukrainian exporters.**

## Latin American markets

The market of this region is rather promising, despite its remoteness from Ukraine. Starting from mid-1996, the economies of most countries in this region began seeing economic growth. Experts believe that Ukraine can negotiate contracts not only for the supply of end products, but also for infrastructure building and servicing, as well as personnel training. Prospects also exist for the supply of aircraft and space launch services[45].

Ukraine's successes on this market have been modest so far. Most contracts were entered several years ago, and they mostly provided for equipment supplies from stockpiles, rather than new production. In 1997, the *Ukrspetsexport* entered a contract with **Ecuador** for the supply of Osa AK air defence systems ($64 million), and SU-27 warplanes ($600 million). **Peru** purchased nine AN-32 military transport aircraft and four AN-72A airplanes. In 1999, **Venezuela** ordered a batch of aircraft and border boats from Ukraine[46].

The main problem impeding Ukraine's advance on the Latin American markets is the lack of a consistent marketing strategy. For example, the absence of a Ukrainian exposition at the international exhibition "FIDAE-2000" damaged Ukraine's image as an arms exporter to the region.

**Summing up, it can be stated that Ukraine's presence on Latin American markets remains insignificant, and the country's existing potential for military and technical co-operation remains unclaimed.**

## CIS markets

CIS countries are mainly oriented toward co-operation with Russia. At the same time, geopolitical changes over the recent years give reasons to hope for an increase in orders for Ukraine, provided it proves its political stability. This primarily refers to the Baltic countries, Georgia, Azerbaijan, and possibly Uzbekistan. The main obstacle to activating Ukraine's co-operation with those countries is their limited financial resources, and hopes for military and technical assistance from NATO.

The effective agreements in the field of military and technical co-operation mainly cover the repair of military equipment and the supply of spare parts. In 1997, the *Kyiv Tank Repair Factory* executed a contract for the overhaul and

modernisation of 40 tanks for **Uzbekistan** (contract value — $3.2 million)[47]. Now, Ukraine faces the prospects of losing the market of this country, as Russia's President V.Putin recently proposed that the State Duma ratify the Agreement of military co-operation with Uzbekistan (signed December 11, 1999), which provides for the supply of up-to-date Russian weapon systems[48].

In 1999, Ukraine supplied arms and military equipment (in small quantities) to Azerbaijan, Uzbekistan, Estonia, Turkmenistan, Kazakhstan, Lithuania, Moldova, Latvia, Georgia, Tadjikistan, Kirghizstan, and to Russia itself.

**Russia**, as an importer of Ukrainian military equipment, occupies a special place in the system of Ukraine's arms export. On the one hand, Russia is Ukraine's largest competitor on the world market. On the other hand, it remains

45 Proskurin S., Kablov V. Latin American region of military and technical production: current state and prospects. — *Arsenal*, 1999, No.2, pp.28-29.

46 In particular, the Ukrainian-Venezuelan Trading House submitted to the Ministry of Foreign Economic Relations and Trade of Ukraine an order for 16 AN-26 transport aircraft, 10 AN-24 passenger planes, four AN-32 transport aircraft, four AN-12 transport aircraft, six MI-8 helicopters, 26 border speedboats for the coast guard, six small passenger hydrofoil boats, and military logistic equipment.

47 *Uryadovyi Kuryer*, February 8, 1997.

48 RosBusinessConsulting, May 18, 2000.

the second largest (after Pakistan) importer of Ukraine's military production. Furthermore, co-operation in the field of military and technical co-operation is profitable for both Ukraine and Russia. Useful in this respect will be the recent Resolution of Ukraine's Government that allows more than 60 defence factories to participate in co-operative production throughout the CIS, without obtaining special exporter status[49].

**Experts are convinced that Ukraine should be more aggressive on the CIS market, using political and diplomatic measures.**

## CONCLUSIONS AND FORECASTS

Ukraine is gradually strengthening its position as an arms exporter on the world market.

Noticeable success has been achieved on the markets of Asia, Africa, and the Middle East. Ukraine's presence on the South-east Asian and Pacific region markets is growing. Ukraine was equally successful in presenting its image as a reliable partner in co-operation with Western European countries, although the quantity and amounts of defence contracts with Western European countries have little influence on the volumes of arms exports from Ukraine. The tendency toward Ukraine losing Central and East European markets is disturbing. Such a development is conditioned by the orientation of countries within this region toward integration with European institutions, Ukraine's weak marketing policy, the lack of effective political support for exporters, and the fact that Ukraine lags behind the advanced Western countries in many areas of new weapon systems development.

**An increased demand for licences in countries that previously used to buy weapon systems forces countries trying to retain their leading export positions to invest more into the development of technologies, fundamental research in the defence sector, and modernisation of military-industrial complex production facilities.**

In the present situation, Ukraine has virtually no chances of entering the "big five" of the world's major arms exporters. Its main tasks should be retaining its present position on the world market, increase arms exports, and promptly react to the changing demands of potential customers.

Ukraine is capable of adequately reacting to the new challenges on the arms markets. It possesses the necessary prerequisites for this, including resources. The country's intellectual and scientific and technological potential is adequate for the design of competitive weapon systems, provided that development priorities are defined. Arms trade performances over the last years also proved the competence and professionalism of structures that conduct arms trading on behalf of the state, and the readiness of Ukrainian business to promptly react to the requirements of foreign countries.

**Today, insignificant amounts of money are invested into the development of weapon systems in Ukraine. Without a noticeable increase in R&D investments, and the design of new weapon systems, arms sales will be endangered.**

One of the vulnerable elements of Ukraine's arms trade is the lack of attention to investing in long-term projects. This will affect the future arms export volumes.

**Unless the problems of financing defence system projects are resolved, allocations on R&D, marketing, exhibitions, and information support for exporters are increased, and a system of technology transfer is created, Ukraine can lose significant amounts of arms exports as early as in three-four years.**

[49] UNIAN, June 26, 1999.

# EXPORT OF UKRAINIAN SCRAP METAL: THE EXPERIENCE OF STATE REGULATION

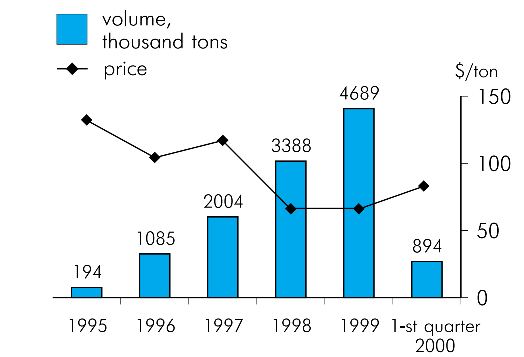
*Veniamin KRAMER,*
*Executive Director, Ukrainian Scrap Metal Association*

The export of scrap metal, as a relatively narrow area of export, is a good example for demonstrating the overall realities and issues concerning the regulation of the export of products from Ukraine. The scrap metal export sector clearly demonstrates the following characteristics: the mutual interdependence of internal and external factors; the ineffectiveness of state regulation, which is oriented toward prohibition (restriction) rather than toward stimulating economic activity; unperfected legislation and excessive permissive powers wielded by the authorities, which creates conditions for bribe-taking and corruption; the absence of strategic planning and forecasting, including in the results of the decisions taken.

## PROBLEMS OF THE DEVELOPMENT OF THE UKRAINIAN SCRAP METAL MARKET

The rapid growth of scrap metal export volumes began in March of 1995[1], when the Government changed the scrap metal export quota and licensing regime. It appeared impossible to stop the increase in scrap metal export against a background of inflation, a declining Hryvnia rate, and the absence of effective regulations and restrictions[2] — the difference in price on the domestic and international markets had already become somewhat too large. Despite measures taken by the state to regulate the scrap metal market, it remains in a "feverish" state. The results of these developments were metallurgical capacities often standing idle, suspicious operations with scrap metal, to put it mildly, and an outflow of significant funds and raw materials abroad (*Diagr. "Exports of scrap metal"*).

**Exports of scrap metal**




The sources for the problems on the Ukrainian scrap metal market are of both an

[1] Up until 1993, strict restrictions existed for the export of scrap metal from Ukraine. Beginning with 1993, a quota was implemented in the amount of 250 thousand tons of ferrous metal scrap. Export was realised through the state foreign trade organisation *Ukrzovnishprom* with all currency funds being transferred to the country's Currency Fund. In 1993, the registration of all scrap metal export contracts with the Ministry of Foreign Economic Relations of Ukraine was implemented, and starting in 1994, indicative prices for the export of scrap appeared. The introduction of price limitations played a positive role, as they corresponded to the European level. After indicative prices were abolished in December of 1996, export prices dropped by 10-12%.

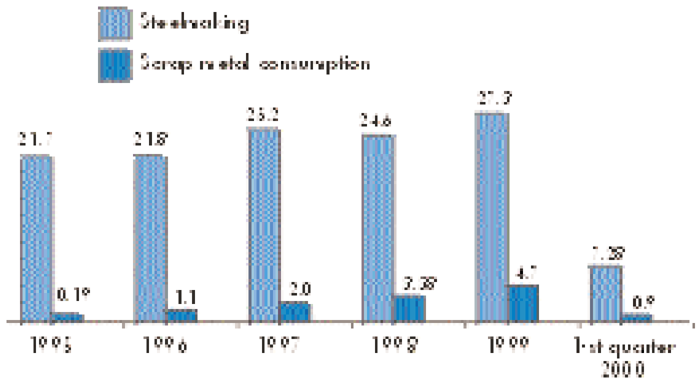
[2] Such barriers as the registration of contracts and price controls were easily overcome by exporters.

objective and subjective character, as well as a clear hierarchy (beginning with the Verkhovna Rada and ending with local administrations and the entities of business activities themselves).

The main **objective** sources of the problem remain the following: the imbalances in the export structure, the consumption and generation of scrap metal; the fluctuation of demand and prices on domestic and foreign markets; the metallurgy sector's sluggishness in adapting to market conditions; the low solvency level of domestic metallurgic enterprises. **Subjective** factors are conditioned by the following: contradictions in the regulatory and legislative base; the inability, and unwillingness on the part of authorities to resolve crucial economic problems; the absence within those structures of strategic planning experience; and also, the ambitions for enrichment both on the part of businesses and some officials on virtually all levels of power.

Complaints of metallurgists with respect to scrap metal deficits, while the volumes of its export are increasing, are justified. The reasons for this, in part, became the imbalances within the structure of domestic and foreign requirements. According to the data of the International Institute of Steel and Iron (IISI), the share of open-hearth smelted steel[3] at Ukrainian enterprises remains the single highest one in the world to date — 48.1%, while the same indicator for Russia is 27.8%, for Romania — 10.5%, for Asian countries — 3.1%, in the countries of Central Europe — 2.8%, and in the rest of the world — 4.6%, while in the countries of NAFTA, the EU, Central and South America, Africa, and the Middle East — 0. At the same time, world volumes of steel smelted in electric furnaces are growing, needing approximately 1.1 tons of scrap metal per one ton of smelted steel, which became the reason behind the continuous growth in demand for scrap metal (*Diagr. "Scrap metal consumption in Ukraine"*).

**Scrap metal consumption in Ukraine,** millions of tons




What could be easier, it would seem, than to determine how much Ukrainian enterprises need and, having so determined, maintain the balance between export and domestic needs. But **up until the beginning of 2000, no one in Ukraine knew how much ferrous scrap metal was necessary for the country's metallurgists. The last time such calculations were made was in the '80s.** It was only at the beginning of 2000 that an accounting of the balance of Ukrainian metallurgical enterprises' scrap metal needs was undertaken as part of a joint effort between the former Ministry of Industrial Policy, the Institute of Economics, and the Ukrainian Scrap Metal Association[4].

Purely commercial motives were among the reasons for the increase in scrap metal exports: low in-country purchase prices, and far higher ones when exporting; and the low payment levels of domestic metallurgists. **A radical re-division of the scrap metal market has taken place over the last decade for which metallurgists proved to be unready.** During Soviet times, almost all scrap metal supplies to metallurgists were made through the state enterprise of the *Vtormet* (secondary metal) system. By 2000, the volume of scrap metal processed at the enterprises formerly belonging to *Vtormet* decreased to 12—15% of the overall volume of scrap metal pro-

[3] The share of scrap metal used at open-hearth furnaces per ton of smelted steel is nearly three times less than for electric furnaces.

[4] Given the indicative plan of the Ministry of Economy of Ukraine for the smelting of steel in 2000 (27.5 million tons), the specific proportion of scrap metal for one ton of steel was allocated as 364.9 kilograms (including 183.1 kilograms of scrap metal supplied by the domestic market, and 181.8 kilograms — generated at metallurgical enterprises themselves).

**Balance of scrap metal demand by Ukrainian enterprises**

| Name of enterprise | Calculation volume of production | | Scrap metal demands | | |
|---|---|---|---|---|---|
| | Steel | All rolled metal | Total | Circulating scrap | Third party deliveries |
| *Makiyevsky* | 840 | 665 | 360 | 238 | 122 |
| *Yenakyivsky* | 1690 | 1480 | 490 | 255 | 235 |
| *Azovstal* | 3640 | 3330 | 1060 | 565 | 495 |
| *Donetsky* | 1225 | 935 | 895 | 185 | 710 |
| *named after Illich* | 4950 | 4320 | 1690 | 840 | 850 |
| *Alchevsky* | 2480 | 1950 | 1120 | 405 | 715 |
| *Kryvorizhstal* | 5290 | 4470 | 1440 | 1100 | 340 |
| *named after Dzerzhinskiy* | 2295 | 2040 | 633 | 270 | 363 |
| *Zaporizhstal* | 3300 | 2745 | 1320 | 785 | 535 |
| *named after Petrovskiy* | 780 | 683 | 105 | 70 | 35 |
| *Dniprospetsstal* | 540 | 350 | 570 | 105 | 465 |
| *Nizsnedneprovky* | 470 | 330 | 330 | 175 | 155 |
| *Kramatorsky* | 20 | 25 | 20.2 | 7 | 13.2 |
| *Kerchensky* | 1.7 | — | 1.8 | — | 1.8 |
| ***Total*** | **27521.7** | **23400** | **10035** | **5000** | **5035** |

cured on the country's domestic market. The main reasons for the decrease are the inability of some members of *Vtormet's* management to work in market economy conditions, and the high level at which national producers are taxed (*Table "Balance of scrap metal demand by Ukrainian enterprises"*).

The new force on the scrap metal market, the owners, simply don't want to give their property (scrap metal) away for nothing, or to wait for years for its payment. As a result, scrap is exported despite administrative barriers. In this regard, this is a very indicative example of the mutual interaction between scrap metal suppliers and consumers during the first four months of 2000. As soon as metallurgical plants sharply raised purchase prices and began paying for scrap metal on time, they became "buried" in scrap metal, and were forced to stop buying. It became clear that many scrap metal suppliers were prepared to even lose some revenues (especially with the non-return of VAT on exports), but to supply scrap metal to domestic enterprises, as long as it was in acceptable amounts and paid for properly!

**The influence of subjective factors with their own hierarchy can be observed on Ukrainian scrap market.** At the top levels of power (the Verkhovna Rada, the Cabinet of Ministers, the central bodies of the executive branch) there appears a multi-layered licensing system in the scrap metal export sphere, as well as the approval of bylaws that distort the essence of legally established rules, which actions only deepen market problems. Judging by the results obtained[5], one of the goals of such actions is the creation of conditions that allow the authorities to obtain "administrative rent".

A clear example of this is the creation of a system of registering export contracts. Its lack of perfection is becoming the reason behind serious damages to domestic exporters for whom it is easier to suffer material losses when agreeing to prices on foreign markets (as a result of the lost opportunity), rather than again experience the "pleasures" of re-registration. The issue should be resolved far more simply and effectively by the customs service — by deducting the difference resulting from the increased contract price, and permitting scrap metal to cross the border. But no — a new permissive document is necessary. The country loses currency income in the amount of tens of millions of dollars a year as a result of this alone.

**Many problems of a subjective character are connected with the imperfect state of the regulatory-legislative base.** Its contradictions allow, for example, the term "export shipment" to be freely interpreted, and applied to all operations with shipments involved with scrap metal within the country[6]. This kind of free interpretation is the basis for planned revenues to the budget in the

[5] The Verkhovna Rada and the Cabinet of Ministers of Ukraine have not approved a single act up until the present date which would directly *stimulate* scrap metal deliveries in Ukraine's metallurgical branch. During the 1997-1999 period, the Government approved nearly 20 resolutions, directives, and other normative acts aimed at placing *restrictions* on the export of scrap metal. However, the desired result was not achieved. In 1999, export grew 1.4 times as compared with 1998, and nearly 2.5 times as compared with 1997.

[6] The resolution of the Cabinet of Ministers of Ukraine No.999 of July 2, 1998, addressed the issue of control over the export of scrap metal shipments, but the obligatory control over any scrap metal operations conducted within the country was not established.

millions from the Ministry of Environmental Protection and the State administration of railway transport of Ukraine for radiological control of "export" scrap metal shipments, and the sky-rocketing tariffs for their transit. And this is only one of many examples of the authorities masterfully putting up barriers on the path of increasing the effectiveness of exporting scrap metal from Ukraine.

**Such barriers are many on the lower levels of the state machinery (local authorities).** The Law "On scrap metal" provides for the right of control over activities concerning scrap metal at the local level. Suffice it to say that not one legally, or illegally functioning subsidiary (purchasing point) dealing with scrap metal would have been opened without the formal, or informal authorisation from local authorities. Most of accusations regarding criminalising the scrap metal business (especially ferrous scrap) by local authorities would be worth making against themselves — if scrap metal collection points did not purchase that which is stolen with their quiet approval, then there would be no theft.

**Over the last two-three years, regional authorities began paying more attention to the scrap metal market as one of the realistic sources of cash against the background of the overall economic collapse.** At the same time, they gave voice to the interests of large business clans by tightly regulating scrap metal activities on their territories. This became especially clear in the Donetsk, Luhansk, Dnipropetrovsk, and Zaporizhia regions, where restrictions were either officially, or unofficially introduced for the transit of scrap metal outside of these regions, or where the activities of collection points were either halted, or shut down, etc.

This state of affairs was "encouraged" by the Decree of the President of Ukraine on transferring the functions of issuing licenses for the right to work with scrap metal to the Dnipropetrovsk and Donetsk regions (which is not envisaged by the Law "On scrap metal"), and the proposal of the State Committee for Industrial Policy to give all regions in Ukraine this right. As a result, only firms convenient for the local authorities will remain on the scrap metal market. Interregional "wars" will begin for scrap metal, the non-recognition of licenses issued in one region by another, and so on. **This market re-division, and its lack of order will, among other things, lead to a real decrease in the volumes of scrap metal procurements, and will hit the country's metallurgical branch hard.**

The state's introduction of restrictive measures on the scrap metal market directly contradicts the agreement on the trade of some types of steel products signed with the EU. According to that agreement, Ukraine is obligated not to introduce any restrictions on the export of ferrous metals (Trade Nomenclature for Foreign Economic Activities 7204). On the one hand, such a dual position clearly does not work in favour of Ukraine's image. On the other hand, according to experts, from the economic point of view, the given conditions of the Agreement are difficult to see as favourable to Ukraine[7].

## STATE OF THE DOMESTIC MARKET

In the '90s, the volume of smelted steel fell more than two times as compared with the Soviet period, and in 1995, amounted to 21.7 million tons. Likewise, the volume of scrap metal supplies from the domestic market fell approximately 3.0-3.2 times, to 2.84 million tons. During the 1995-1999 period, the total input of scrap metal for the smelting of one ton of steel fell to 340-375 kilograms/ton, or by nearly 10%.

In 2000, the situation with the supply of scrap metal changed sharply for the better. This change was the result of the introduction of a mechanism of a balanced approach to ensuring domestic and foreign scrap metal needs, which was proposed by the Ukrainian Scrap Metal Association, and approved for implementation starting March 1, 2000. The essence of this mechanism is the regulation of the volumes of scrap metal export by the market participants themselves, starting on a voluntary basis with the participation of Ukrainian Scrap Metal Association. The improvement of the situation occurred due to: the persistent and painstaking

[7] In the first place, the quota share of finished rolled steel for export from Ukraine to the EU (as compared with the volumes of smelted steel) is approximately 2.5 times less than for Russia. Secondly, lifting the barriers for scrap metal export was done without a prior evaluation of the domestic stocks and needs. In the third place, it is difficult to understand why a bilateral Agreement in place which the European Union applies to the rest of the world (the prohibition against introducing export restrictions applies to all countries, but not to EU members).

work of Ukrainian Scrap Metal Association and the State Committee for Industrial Policy along with metallurgists; the appearance of real owners on the majority of metallurgical plants; the growth of the rolled metal markets; the introduction of local barriers on the path of scrap metal export. This resulted in the sharp rise of purchase prices for scrap metal during the December, 1999 - April, 2000 period (from 40-50 $/ton to 63-78 $/ton). Virtually all enterprises paid their debts over the latest period. Supplies to plants that exported semi-finished hot- and cold-rolled flat steel articles were especially successful (the *Illich* metallurgical plant, *Zaporizhstal*, *Azovstal*, *Alchevsky* metallurgical plant, and others). The situation is worse on the external long rolled steel market. This results in the lower solvency and the purchase price levels of the *Yenakyivsky* metallurgical plant, the *Makiyevsky* metallurgical plant, and *Kryvorizhstal* producing this rolled steel.

The difference between scrap metal purchase prices and export prices for semi-finished

products of Ukrainian metallurgists is on the level of (or higher than) the same indicators of their Turkish, Italian, Moldavian and Taiwanese colleagues — the main consumers of Ukrainian scrap metal. **These conditions the export of production with a low level of processing, corrupting metallurgists by easy profits, and turning them away from the need to modernise facilities for the production of high quality finished rolled steel.** For example, according to totals for the first quarter of 2000, the share of the export of pig iron, ferrous alloys, ferrous metal scrap, and semi-finished products amounted to 56.9% of the overall export volume of ferrous metallurgy production in Ukraine by tonnage, or 47.8% by value.

**At the end of April - beginning of May, 2000, many plants either halted scrap metal purchases, or sharply decreased their volumes due to an oversupply, while simultaneously decreasing purchase prices. It got to the point that hundreds of wagonloads of scrap metal were left stockpiled on the way to some enterprises.** This forces suppliers to re-orient deliveries toward export (which is fraught with a decrease in export prices and the overburdening of port storage areas), or decrease scrap metal procurement volumes. **Metallurgists were unprepared to agree to the steps being taken by scrap metal suppliers aimed at reasoned purchasing activities. As a result, one can expect a new wave of unbalancing scrap metal market in Ukraine.**

According to Article 9 of the Law "On scrap metal", which came into force in June of 1999, the export of the waste and scrap of non-ferrous metals is prohibited. This prohibition officially remains in force even today. Furthermore, the export of non-ferrous metal scrap continues until now as a result of the Cabinet of Ministers of Ukraine's non-fulfilment of Clause 3, Section V of the indicated Law, which provides for the need to bring regulatory-legislative acts in line with the Law in effect.

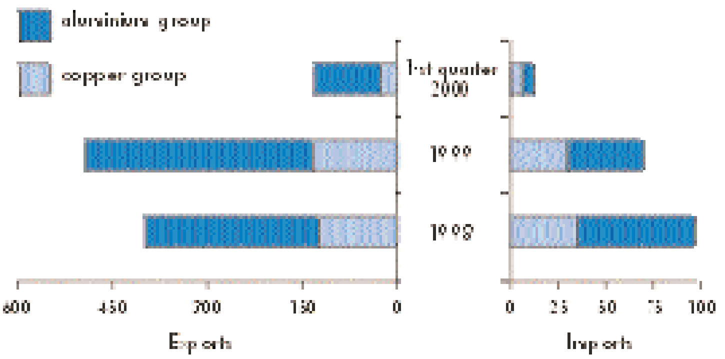
**Scrap is exported abroad through two channels: as ingots for further smelting, or under tolling schemes.** Starting in the summer of 1999, the majority of non-ferrous metal exporters took up the smelting of scrap into ingots and alloys, whose export is not prohibited by the Law. One needs only to show a certificate of quality issued by an authorised laboratory. Unfortunately, within the text of the Law "On scrap metal" (par.2, art.9), a substitution of meanings took place either intentionally, or unintentionally: instead of the words "certificate of quality", it would have been worth writing "certificate of compliance". This would not have changed the practice of "buying" certificates, but it would have at least established a higher legal barrier for their issuance and enhance the efficiency while conducting exports.

The second channel for the export of non-ferrous scrap metal exists within the framework of tolling operations. By exploiting the incompatibility between the Law "On tolling operations" and the Law "On scrap metal", non-ferrous metal is exported in the form of payment for processing just such scrap exported earlier. As if that weren't enough, **some firms, by taking advantage of the absence of the adequate control on the part of the state[8], have become clever enough to sell production abroad as though it was produced of raw materials under tolling agreements** (whose production was paid for by addi-

[8] The State Customs Service, the State Export Control Service, the State Tax Administration of Ukraine.

tional non-ferrous scrap supplies). **In this situation, Ukraine gets back only the revenues from the sale of finished products the volume of which surprisingly coincides with cost estimate of scrap metal exported.** As a result of real operations under tolling schemes, the country should have seen a stream of finished rolled steel gushing in (wire, rods, foil, and so on). However, as the Diagram *"Exports of non-ferrous scrap metals and imports of non-ferrous produce"* shows, this did not happen.

**Exports of non-ferrous scrap metals and imports of non-ferrous produce,** $ million




In 1999, the export of copper scrap decreased by only 17.1% as compared to 1998 volumes. However, the export of partly finished products grew 13 times, while the export of copper alloys more than doubled. As a positive development, it is worth noting the growth of the export of copper products by 116.5%. Also, the import of finished rolled steel into the country dropped by 44% (in value terms). That is, for "some kind of" reasons, the import of finished rolled steel, including that produced under tolling schemes, fell by nearly half in 1999 as compared to 1998 when the export of non-ferrous metals was not yet restricted. In the first quarter of 2000, the export of copper scrap dropped by 40% as compared to the first quarter of 1999 (that is, prior to the adoption of the Law "On scrap metal"). At the same time, the export volumes of partly finished products increased rapidly: unrefined copper — 4.5 times, alloys — eight times. The import of rolled copper decreased by 5%.

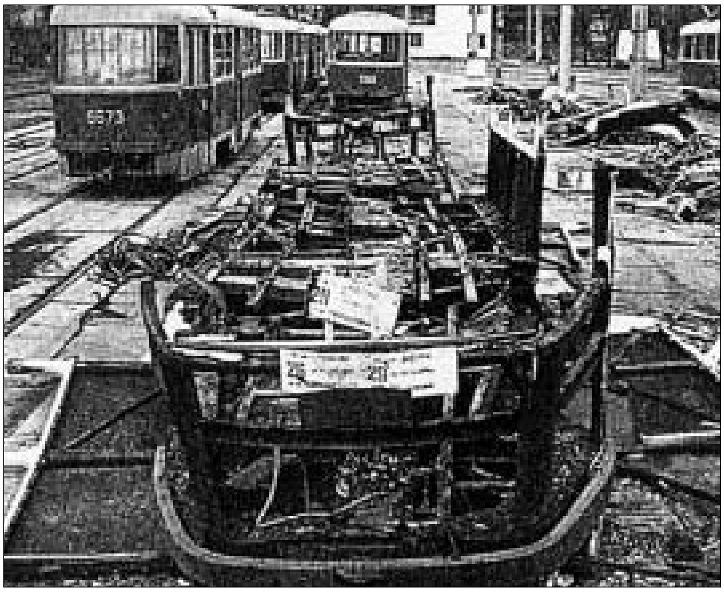
The aluminium group experienced a similar situation: in 1999, the export of aluminium scrap decreased by a total of 24%, but there was a sharp rise in the export of alloys as compared to the indicators for 1998. The export of aluminium scrap in the first quarter of 2000 grew 2.5 times as compared to the first quarter of 1999, while the import of finished aluminium products grew for a total of only 54%. The growth of the export of alloys continued as expected — by 38%. One pleasing development — the export of finished products experienced a nine-fold growth.

## TRADE OF SCRAP METAL ON FOREIGN MARKETS

During the 1995-1999 period, the export of scrap from Ukraine grew from 194 thousand tons to 4.69 million tons (more than 23-fold). If five years ago Moldova was the main consumer of scrap metal, then in 1999, 60% of all supplies were made to Turkey, 10% — to Italy, 6.4% — to Egypt (the remainder — to Moldova, South Korea, Taiwan, and other countries). In the first quarter of 2000, the difficult situation in Turkey, the growth of the economy of South-east Asia, and the strengthening of Ukraine's position in Egypt caused re-distribution of the volumes of deliveries: to Turkey — 37.2%, Egypt — 16.2%, Taiwan — 14.5%, the remainder — above all, to Italy, South Korea, and Moldova (*Table "Geographic export structure"*).

**Geographic export structure,** thousands of tons

| Destination country | 1995 | 1996 | 1997 | 1998 | 1999 | 1-st quarter 2000 |
|---|---|---|---|---|---|---|
| Turkey | 8,78 | 115,49 | 1306 | 2084,8 | 2817,9 | 333,3 |
| Italy | 7,56 | 20,83 | 78,1 | 396,3 | 468,7 | 114,6 |
| South Korea | 14,1 | — | 7,8 | 208,7 | 226,6 | 61,8 |
| Moldova | 21,17 | 732,11 | 275,9 | 145,9 | 285,1 | 58,7 |
| Germany | 3,52 | 18,74 | 106,8 | 82,2 | 23,6 | 11,9 |
| Cyprus | — | 10,89 | 6,8 | 69,5 | 45,8 | — |
| Slovakia | 4,39 | 8 | 17,3 | 56,8 | 50,4 | 8,9 |
| Spain | n.a. | n.a. | 5,2 | 39,3 | 52,6 | 7,3 |
| Switzerland | 18,21 | 10 | 4,4 | 22,4 | 1,7 | — |
| Poland | n.a. | n.a. | 11,8 | 18 | 70,4 | 11,2 |
| Egypt | n.a. | n.a. | n.a. | n.a | 301,8 | 144,8 |
| Greece | 31,6 | 59 | 106,8 | 82,2 | 81,9 | 7,9 |
| Taiwan | — | — | — | — | 211,7 | 129,4 |



Up until 1997, the state regulated the scrap metal export price policy by introducing indicative prices. After they were removed in December, 1996, the customs service began using reference prices for scrap metal export, which were established monthly by *Derzhzovnishinform* (State Foreign Information). At the same time, not a single scrap metal contract is accepted for registration without an official expert evaluation by the above-mentioned organ, or an expert organisation under the State Committee for Industrial Policy — *Ukrpromzovnishexpertiza* (Ukrainian Industrial Foreign Expertise). Unfortunately, such expert evaluations are valid for one-two months only; that is, almost the amount of time needed to register the contract and prepare the shipment for export. Over the last 10-11 months, an exporter has the right to export scrap metal at one and the same price, according to the law. An analysis of scrap metal export price conditions for the first quarter of 2000 demonstrates what that leads to. An analysis of customs statistics for January supplies made it possible to determine the typical price for one ton of exported scrap metal under FOB conditions — $62.56, and in February, approximately $65. However, already in March, when scrap metal was being shipped for export under re-registered contracts, the average price grew to $74.82. It is worth noting that the foreign market in the January-March, 2000, allowed to realistically sell scrap metal for $80-87 to Turkey, Egypt, and Europe, and for $95-100 — to South Korea, Taiwan, and other countries of South-east Asia[9].

**The above-given data demonstrate the low effectiveness of both the existing price control system, as well as the export contract registration system.** Tenders are increasingly being used in world practice, announced by metallurgical companies 3-4 months prior to the supply of the entire scrap metal shipment. This practice makes it possible to form stable prices, while the parties to the contract are insured against their fluctuation for that period. And this is how it goes up until the final transaction. Ukraine's system of registering exports has no room within such a market mechanism, resulting in losses for both businessmen and the state alike.

**In general, scrap metal export will continue to be a stable and reliable source of income, given the continued growth of steel production in the world[10].** Ukraine needs to determine the amounts of the potential scrap metal generation, as well as the need for scrap metal on the part of the domestic metal which, in its turn, will depend on its own strategies for development. Based on preliminary assessments, Ukraine's potential stock of metal is around 400-450 million tons. Given the present volumes of rolled steel domestic consumption and export, the overall balance of the potential of scrap generation will remain negative. It is worth adding that the country exports around 75% of all produced volumes of the overall amount of rolled steel yearly, which undermines the source of the subsequent scrap generation process in the country. Furthermore, the progressive growth of the manufacturing an exports of semi-finished products automatically decreases the volume of the country's scrap generation at metallurgical enterprises by several hundred thousand tons a year.

[9] According to customs statistics, the average price for one ton of scrap metal exported to South Korea and Taiwan amounted to $61.8 and $58.8, which demonstrates either the concealment of income by exporters, or the inadequate price control practised when declaring export shipments of scrap metal at customs.

[10] According to IISI data, in 1997, 799 million tons of steel were smelted in the world. The volume of scrap metal consumption amounted to 356.3 million tons, including in the countries of the former USSR — 32.7 million tons. The import level reached 52.1 million tons (including the EU that imported 22.8 million tons, Asian countries —- 13.5 million tons, Turkey — 7.2 million tons). Among the main importers of scrap metal in the world were the countries of Asia — 56.9 million tons (including Japan — 24.7 million tons, South Korea — 13.7 million tons, China — 6 million tons), followed by the EU — 52 million tons, Turkey — 8 millions tons. In 2000, with the forecasted smelting of steel in the amount of around 803 million tons, scrap metal needs will reach 423 million tons, which will be covered 56.6% by domestic supplies and the waste of own production (239.5 million tons), leaving 183.5 million tons that need to be imported.

## CONCLUSIONS

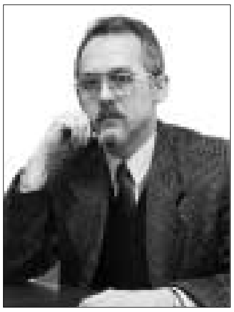
**Given the strategic importance of this resource for Ukraine, the state should establish order in the sphere of ferrous metal export. The basis for doing so should be the following: a strategy for the development of the metallurgical branch, its scrap metal supply needs, and an assessment of the scrap generation potential. With that in place, it is necessary to create a policy for supporting the balance between domestic needs and foreign demand. Latest practice demonstrates that the involvement of non-governmental organisations (the Ukrainian Union of Producers and Businessmen, the Ukrainian Association for Black Metallurgy, the Ukrainian Scrap Metal Association) in the formulation and implementation of such a policy, and in the improvement of the regulatory-legal basis, as well as tight co-operation with them, leads to the increased effectiveness of the indicated measures.**

**The export of ferrous metal scrap will remain a stable and reliable source of income for Ukraine, given the continued growth of metallurgical production in the world. The state cannot be uninterested in effectively taking advantage of this segment of the market, and increasing the returns from its functioning. The factors that impede this process are structural, price, and regulatory imbalances on the domestic and foreign markets, as well as the inadequate, superfluous over-regulation on the part of the state system of control over the activities of domestic businesses.**

**In order to limit the export of non-ferrous scrap out of the country, the following is necessary: (a) introduce changes to the Law "On tolling operations" and amendments to the Law "On scrap metal" with the regimentation of conditions for the export of ingots and alloys produced from non-ferrous scrap metal; (b) strengthen control over the import of finished products manufactured under tolling schemes; (c) spread the practice of registering contracts for the export of scrap, ingots, and alloys produced from non-ferrous metals.**

**Finally, it is necessary to introduce realistic corrective measures into the current normative base that regulates conditions for business activities concerning scrap metal. It remains very important to balance the optimal choice of priorities with the goal of achieving a tolerable compromise of interests of absolutely all participants of the Ukrainian scrap metal market.**

# UKRAINE - IRAQ: TO TRADE, OR NOT TO TRADE?[1]



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The analysis of the political and economic situation in and around Iraq shows that Saddam Hussein's regime is firmly in place despite the economic sanctions imposed by the UN. The UN humanitarian programme "Oil for Food" for Iraq is marginally effective, since it does not satisfy even the minimum requirements of the Iraqi population's primary needs. The U.S. tough stance allows for little hope that UN sanctions will be cancelled any time soon. Nevertheless, removing sanctions is possible, and very necessary. In this connection, and considering the fact that political and economic preconditions have matured for mutually beneficial economic co-operation between Iraq and Ukraine, the latter should join the UN programme. Despite significant differences between Iraq and Ukraine, the two countries may well be able to develop mutually beneficial trade relations.

## THE UNHAPPY BIRTHDAY

Saddam Hussein was born on April 28, 1937, in a small village near the town of Tikrit, 130 km from Baghdad. This year, the main Iraqi holiday will last for two weeks. A grand celebration is expected, involving a symphony orchestra and festive concerts throughout Iraq. Despite two lost wars, and the inestimable miseries of the Iraqi people who are suffering from a lack of food and medicines as a result of international economic sanctions provoked by the Iraqi leader's aggressive policies, Saddam Hussein's regime is entering the new century with strength to spare.

Saddam Hussein occupies every one of the country's supreme posts. He is the President, the head of the executive branch, the Chairman of the Revolutionary Command Council, the Supreme Commander-in-Chief, the General Secretary of the regional leadership of the Party of Arab Socialist Revival.

"Soul and blood for Saddam!", chant Iraqis. They love their leader, just as the Soviet people used to love theirs, despite the reprisals, and the political and economic repression of dissidents.

The phenomenon of Stalin's adherent — Saddam Hussein — for a European, lies in the paradox of the broad support that he enjoys in the Arab world, despite the establishment of a dictatorial regime in Iraq, and its aggressive policy toward neighbouring states, as well as many other countries. According to the results of a poll conducted in 1999 among readers of Arab newspapers, Saddam Hussein was named among the most prominent political figures of the 20th century who has influenced the course of history.

[1] The article was published on April 29, 2000 in *Zerkalo Nedeli*. Here, we present a short version.

For the West, Saddam Hussein is an aggressive and absolutely merciless dictator; for the Third World, he is a defender of the oppressed and least privileged, the leader of the only country capable of "opposing the imperialist West, fighting imperialism, Zionism, and the rich oil monarchies of the Gulf". Saddam Hussein attained the position of Iraq's official "Fuhrer" and "invincible Arab leader" by following Stalin's lead in removing real and potential rivals, forming conditional unions that are later conveniently broken when necessary. Neither Iranian leader Ayatollah Khomeini, nor U.S. President George Bush, both of whom fought Iraq, managed to defeat him, although both were obsessed by a desire to overthrow Saddam Hussein's dictatorial regime. These two wars only placed the Iraqi leader in the focus of attention in the Arab world. The UN strict economic sanctions in no way damaged the dictatorial regime. They only managed to hit the Iraqi people.

His ability to move craftily between the geopolitical interests of the Great Powers (the USSR, the U.S., China, France, and Germany had a hand in this knot), interaction with oil-rich Arab countries on an "as-needed" basis, and speculation on the pan-Arabic idea, will allow Saddam Hussein to continue his impetuous political career in the new century.

## IRAQ - UKRAINE: PARALLELS

After nearly 10 years of economic transformation, Iraq and Ukraine have been set back by many years, although the reasons behind this for both countries were different. There are many similar problems in the development of the two states, which maintain virtually no political and economic relations. **An assessment of the degree of Iraq's economic collapse and poverty demonstrates that Ukraine has a good deal of room left to fall.**

According to *The Economist's* 2000 forecast, Iraq's per capita GDP will amount to $313; inflation will run at 110%; its population - 23.6 million (in Ukraine, per capita GDP is forecasted to be $590, inflation — 20%, its population — 49.5 million).

Sharp decline in Iraq's industrial production was caused by a decade of international sanctions (in Ukraine — due to disruption of economic ties after the collapse of the Soviet Union). Iraq, being the world's largest oil exporter, suffers regular power cuts (up to 14 hours a day). Power cuts often take place in Ukraine as well.

The standard of living in Iraq fell dramatically: the monthly average salary amounts to $5-15, while prior to the blockade, it was close to $400 (in Ukraine, salaries remained at the 1989 level of $35). Iraqi public servants are paid close to $2.5 a month. The majority of the country's engineers and scholars left their jobs and, just as in Ukraine, became engaged in retail trading. Iraq's public health situation is disastrous: every month, 6000 children die due to the shortage of food and medicines.

Like Ukraine, Iraq is experiencing a high level of crime, smuggling and prostitution. The fierce war being fought against crime and

corruption (the most of socially dangerous crimes are punished by death penalty), as a rule, fails to reach the higher circles. **The fight against embezzlement is stimulated in what appears to be an unusual manner: according to a presidential decree, ministers get 10% of funds stolen earlier and returned to the treasury, individuals who report on embezzlers get 5%, while those who give the location of stolen cash get 3%.**

Unemployment and emigration levels are high: over a ten-year period, 1.5 million people left the country. The school education level has fallen sharply; schools often lack not only textbooks, but blackboards as well.

And what is Iraq building? What is its national idea? Saddam Hussein believes that "Arab socialism is more complicated and complex than the typical capitalism and communism... We have a socialist and a private sector... Our choice is more complicated, because an easy decision is not always the right one". The Iraqi national idea is based on the upsurge of the Arab identity and on the "challenge to the West's wealth and arrogance". Each nation has the right to choose its own path, with history being the only judge. Without assessing Iraqi spiritual values, one can state that their very existence help Iraqis, at the very least, to overcome their present problems.

The depth of the problems and the levels of democracy in the two countries are beyond comparison. Ukraine is a European state. There is not much in common between Iraq and Ukraine, but today, we have an opportunity to solve many economic problems by acting together.

## "CORRUPT" SANCTIONS

It has always been assumed that individual leaders or social groups can make mistakes, but never a people, or those who express the will of the international community. Alas! The 20th century has thrown this postulate out. **Fatal mistakes were made by peoples who accepted the ideas of national socialism and bolshevism, with millions of lives being paid as the price for doing so. The century, now in its twilight, has shown that the international community, represented by the body of the UN (which some world leaders have managed to lead by the nose), can also make mistakes. And the cost of those mistakes is the same — hundreds of thousands of lives.**

The imposition of economic sanctions on Iraq after its Kuwaiti occupation was intended to deter Baghdad, force it to give up its weapons of mass destruction development programme, and control Iraq's capital flows. However, the international community should now admit that the UN humanitarian programme for Iraq "Oil for food" has failed to achieve its goal. Even if the programme is implemented to its fullest extent, which is being opposed by the U.S. and Great Britain (explaining the delay in the execution of previously entered contracts resulting from Iraq's alleged use of imported goods for military purposes), will not satisfy the minimum requirements of Iraqis, who have no share of the guilt for what is occurring in the country.

As a result of the international economic blockade, 1,227,000 Iraqis died from diseases and hunger over the last 10 years, among them — nearly 500,000 children under five years of age. Iraq's starving population needs urgent assistance (medicines and food) from the international community.

Russia, France, China, Canada and Ukraine all speak out in favour of easing, or relieving economic sanctions imposed against Iraq. However, there is no reason to hope that the U.S. will agree to removing them completely in the near future as long as Hussein remains in power.

## IRAQ IS NOW READY TO TRADE WITH UKRAINE

Above all, Iraq means oil. The country has the world's second largest oil reserves. After sanctions are removed, Iraq will be able to produce up to 110 million tons of oil [a year], and after renovating and rebuilding the oil industry infrastructure, extraction levels could double.

Iraq began exporting its oil under the UN "Oil for food" programme on December 10, 1996. Over three six-month periods, Iraq was allowed to sell $2 billion worth of oil. For the fourth and fifth periods, the UN Security Council raised this amount to $5.2 billion. For the sixth period, the Iraqi quota was raised by $3 billion due to a fall in oil prices; in the seventh period, all restrictions on oil extractions were removed. By April 17, 2000, Iraq had exported more than 230 million tons of oil worth $25.8 billion under the UN programme. The money obtained from the oil sales was used to purchase food and medicines (over $6 billion worth), different types of equipment ($3 billion), make reparation payments to Kuwait (nearly $7.3 billion), and provide support for the UN programme.

Today, more than 900 contracts worth $1.7 billion are being blocked by the U.S. and Great Britain based on allegations that Iraq can use imported goods for military purposes. Over the 10 years that sanctions have been in place, Iraq lost over $100 billion that it could have made by selling oil on its own.

According to expert estimates, during some phases of the UN programme, up to 60% of Iraqi oil was sold to Russia (presently, this indicator is close to 40%), which then re-exported it to other countries. **The largest consumer of Iraqi oil was the U.S. (up to 30%), which purchased oil mainly through Russian intermedi-**

**aries.** Iraq was the 5th-6th largest supplier of crude oil to the U.S., and its share in overall U.S. exports amounted to 8%. Iraqi oil is purchased by such giants as *Mobil*, *Exxon*, and *Chevron*. The reason for American companies' interest in Iraqi oil is clear: under the UN-approved procedure, lower coefficients are applied to facilitate oil sales as against market oil prices on international exchanges, thereby making it the cheapest oil available. Therefore, despite continued bombing and missile attacks by the U.S. - British air force against Iraq, American refineries expect receiving uninterrupted supplies of Iraqi oil. Significant amounts of oil go to France, China, Spain, Britain, and the Netherlands.

The latest UN Security Council resolutions on Iraq removed restrictions on the volumes of extracted oil, and doubled the amount that Iraq can use to buy spare parts and equipment for restoration of the oil industry. The increase in oil extractions is impeded by the poor condition of oil extracting and transport equipment.

In accordance with the UN mechanism provided for signing contracts under the "Oil for food" programme, Iraq is entitled to choose its suppliers of goods, medicines, equipment, as well as its oil purchasers. **When large contracts are signed (worth millions of dollars), the Iraqi side's choice is dictated by the political attitude of the contracting country toward Iraq, rather than the price offered. For this reason, until recently, Ukraine has had few opportunities to win serious contracts, although it did not even attempt joining the programme.**

Ukraine, as a non-permanent member of the UN Security Council, supports easing economic sanctions against Iraq, whose ineffectiveness has led to supplying its citizens with only 10% of the basic food and medicine requirements. With the active participation of Ukraine's UN representative, a resolution was passed increasing the amount that Iraq is permitted to use to purchase spare parts and equipment for the restoration of its oil industry. At the initiative of Ukraine and Canada, it was decided to establish a group assigned with raising the efficiency of the Security Council sanctions.

Iraqi oil is being sold, and goods necessary for Iraq are being bought according to quotas, or on a competitive basis, for hard currency, all under UN control. This process does not require interstate agreements. Having won a competition, or obtained a supply quota, a company enters a contract that comes into force only after being approved by a special UN commission. The funds obtained in exchange for oil are remitted to UN special accounts, and are later used to pay for the goods and equipment supplied to Iraq under those contracts.

**Iraq imports a wide range of machinery and materials, and even now operates many pieces of equipment manufactured in the former Soviet Union. Iraqi industry needs:** pipes, pipeline equipment and spare parts; pumps, compressors, turbines and their spare parts; fire fighting equipment; special purpose vehicles, excavators, and seagoing tugs; spare parts for drilling equipment; laboratory equipment, chemical agents, cement; electric motors and their spare parts; batteries and cables; steel and black iron bars. In recent years, the largest suppliers of equipment to Iraq were France (contracts concluded in the amount of nearly $90 million), China ($21 million), Italy ($18 million), Russia ($17 million), and Germany ($12 million).

**The number of goods and products supplied to Iraq in exchange for oil lists in the thousands: from grain and food, tea and soap, to most common medicines and medical equipment.** Permanent suppliers of foodstuffs (grain, sugar, rice, infant formulas, vegetable oil) include Australia, France, Sri Lanka (tea) and Vietnam. **Ukraine is never on the long list of the programme's participants.**

Within the framework of the UN programme's seventh phase, Russia obtained a quota for purchasing over 20 million tons of oil (company in charge — *Zarubezhneft*), Belarus entered a contract for the supply of 450 MAZ road trains and 10 thousand tyres. Earlier, Russian companies signed contracts for the supply of equipment and materials for increasing oil extraction in Iraq for a total value of $57 million.

**Participation in all three segments of Iraq's programme is economically beneficial to Ukraine:**

this means the supplies of domestic foodstuffs, medicines, and other goods and general purpose equipment to Iraq, the purchase of Iraqi oil for re-export and refining at Ukrainian factories, and supplies of materials and equipment for the oil industry.

**Companies working with Iraqi counterparts are actually out of danger (even in the event of the further aggravation of relations between the U.S. and Iraq), since their business meets the interests of the international community and is conducted under UN control.** Co-operation with Iraq in the oil sector opens up the prospects for access (after sanctions are removed) to Iraq's ruined oil and gas infrastructure for renovation purposes, and the exploration of its fields.

Therefore, after Ukraine was elected as a UN Security Council non-permanent member, a number of its initiatives aimed at easing economic sanctions against Iraq and their partial removal, political and economic prerequisites have formed for developing mutually beneficial economic co-operation between the two countries within the framework of the UN programme.

**Ukraine produces the majority of goods and equipment needed by Iraq. Why not compete for capacious and profitable market, win large orders for domestic enterprises, and create thousands of jobs? The amounts of possible contracts and potential trade volumes will depend entirely on the activity of Ukraine's Foreign Ministry[2] and foreign trade organisations.**

[2] A visit of Ukraine's Deputy Foreign Minister A.Maidannyk to Iraq took place on May 24-26, 2000 on which the issues of bilateral co-operation in the field of trade and economy have been discussed. Ukraine's participation in the implementation of the eighth phase of the UN programme "Oil for Food" was the focus of discussion. This was the first visit of Ukrainian delegation at such a high level.