

# Ukraine's Financial and Political Crisis

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# UKRAINE

## HOW UKRAINE BECAME A MARKET ECONOMY AND DEMOCRACY



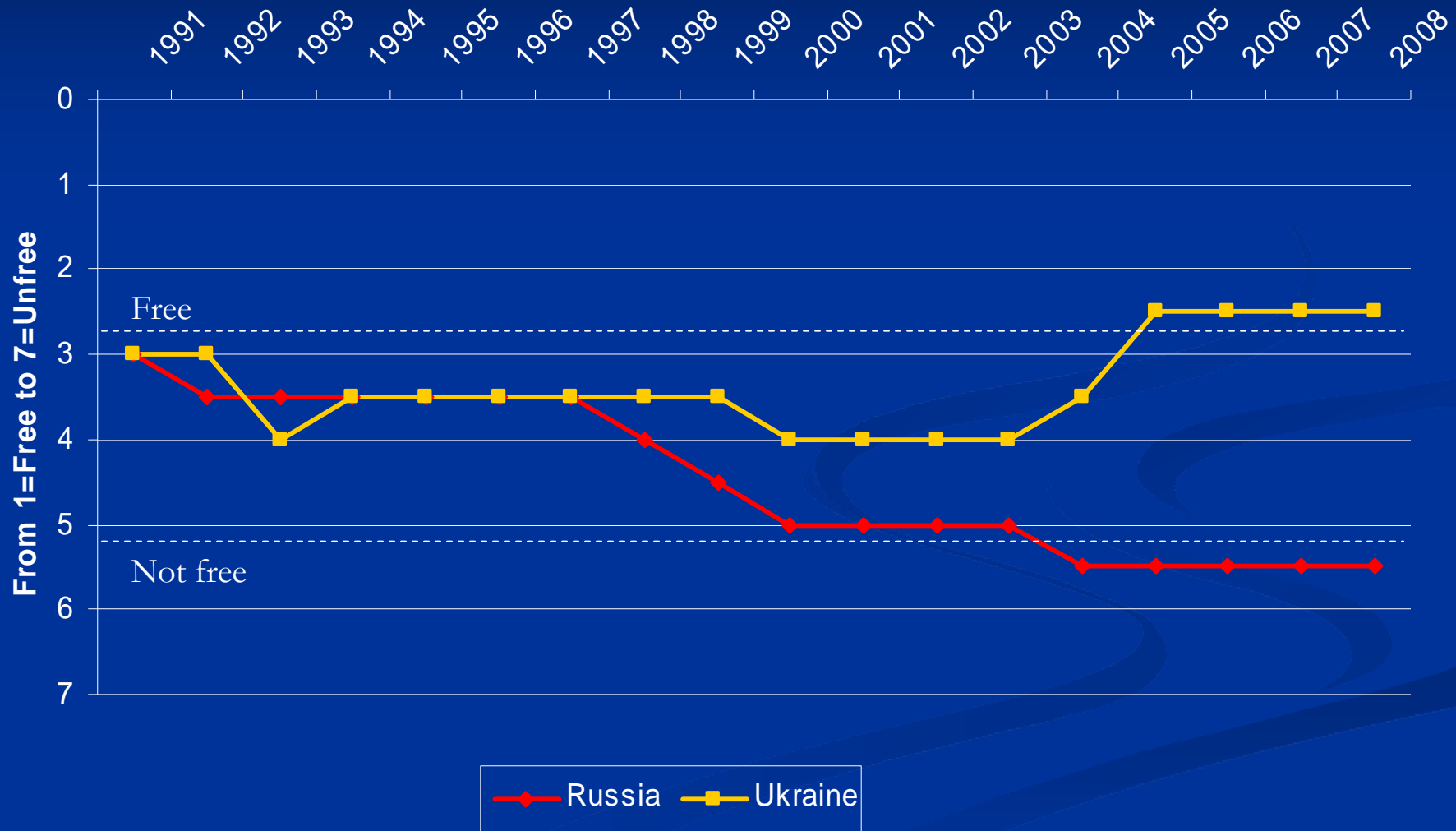
# Theses

1. Democracy, but constitutional reform needed
2. Hard hit by financial crisis: needs international support
3. Ukraine can only turn to the West

# Orange Revolution: Brought Political Freedom

- Freedom of speech, association and media
- Free and fair elections

# Democracy since 2005







# Political Equilibrium: Advantages

- All three major parties are center-right parties
- Big businessmen behind all parties
- Uniquely broad consensus on domestic policy



# Political Equilibrium: Problems

- Nobody can govern: President regularly vetoes decisions by Prime Minister
- Substantial corruption
- Too little legislation and reform
- Constitutional reform is needed

# What to Look for?

- Constitutional change:  
Parliamentary system?
- Presidential elections: The  
earlier the better

# **2. Financial Crisis Hit Hard**

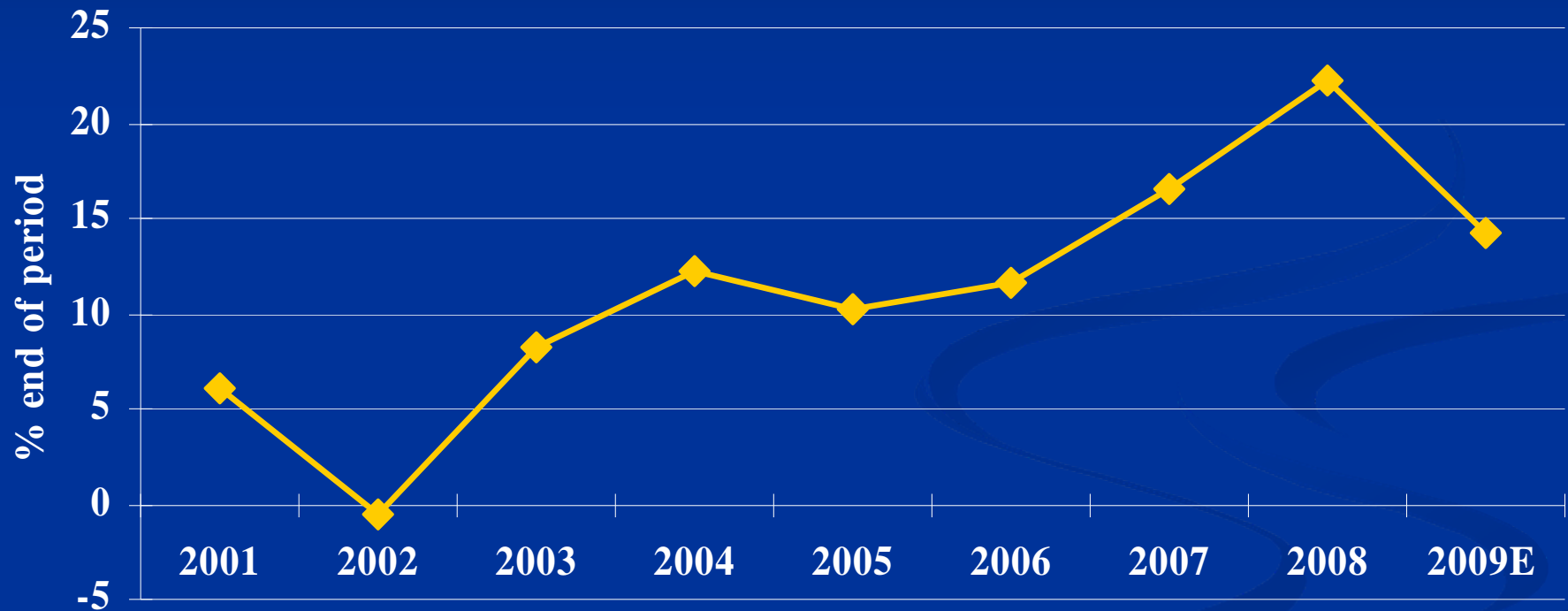
# Why Hit So Hard

1. International finance dried up
2. Collapsing steel industry: 42% of exports
3. Fixed exchange rate with USD
4. Messy politics

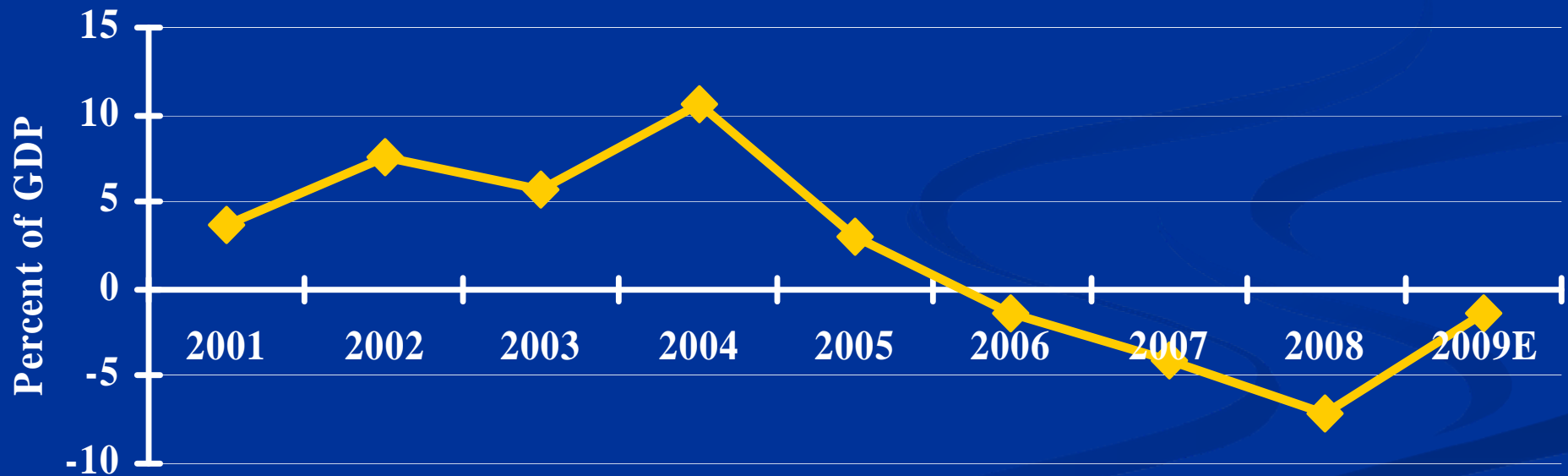
# Excessive Monetary Expansion 40-50% a year



# Inflation Peaked at 31% in May 2008



# Current Account: -7.2% of GDP in 2008 rendered Ukraine vulnerable



# Solution: IMF Program

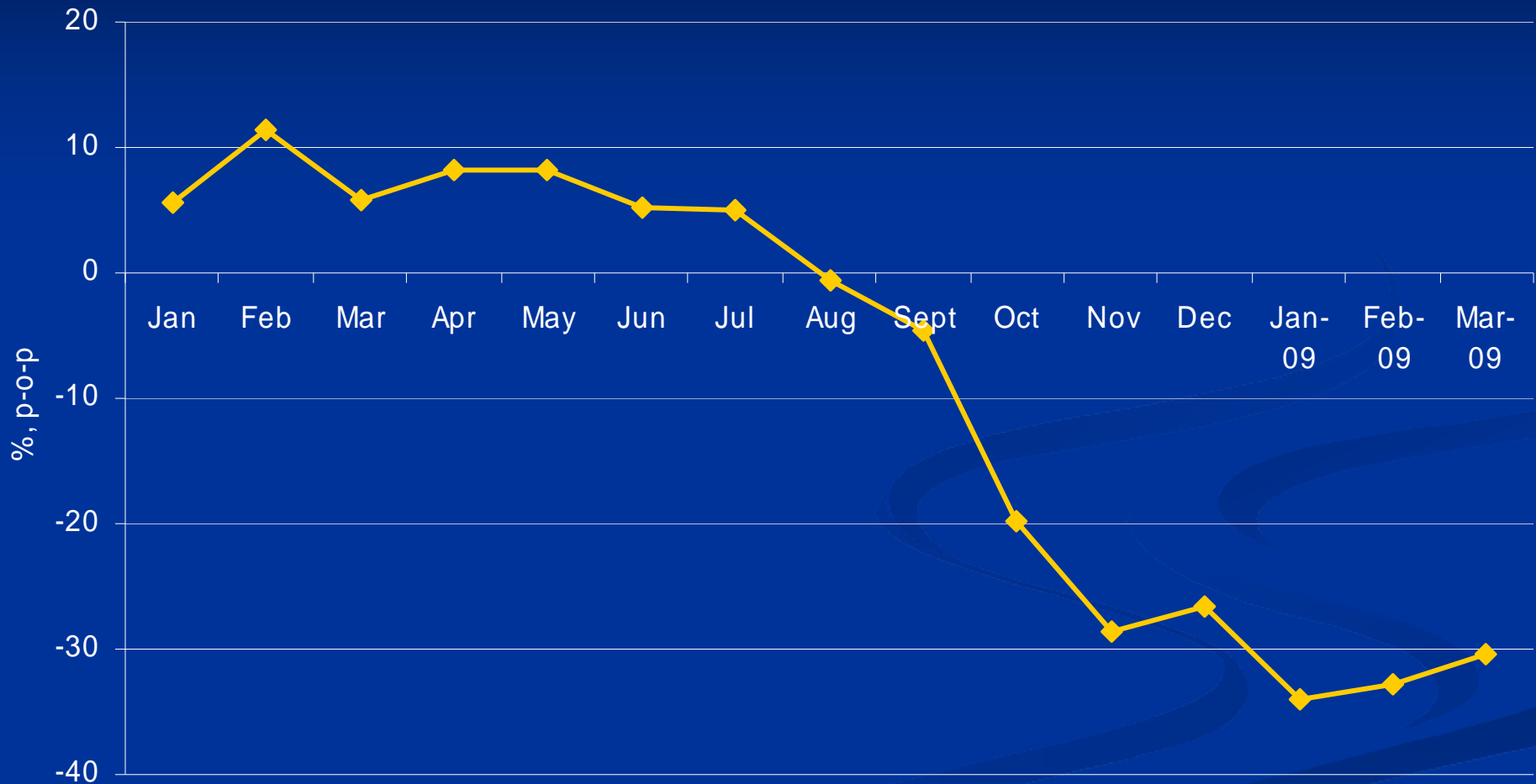
- Concluded in less than 4 weeks
- Substantial financing: \$16.4 billion
- Standard conditions
  - Balanced budget – now -4% of GDP
  - Abandoning peg for floating exchange rate
  - Bank restructuring



# Economic Outcome

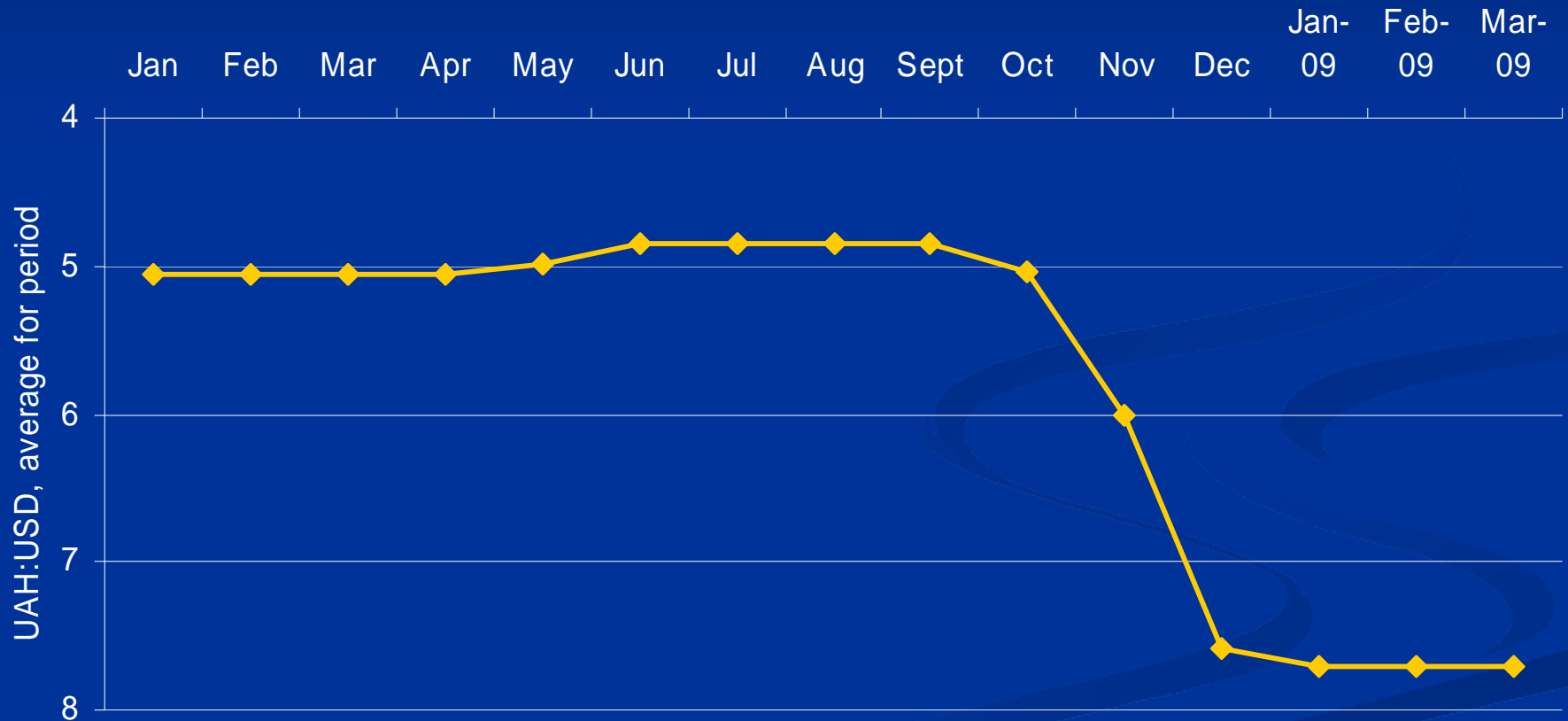
- GDP fell by ca 20% in Q1
- Industrial production plummeted by 32% in Q1 (steel & mining)
- Depreciation of hryvnia by 50%

# Industrial Output Slumps

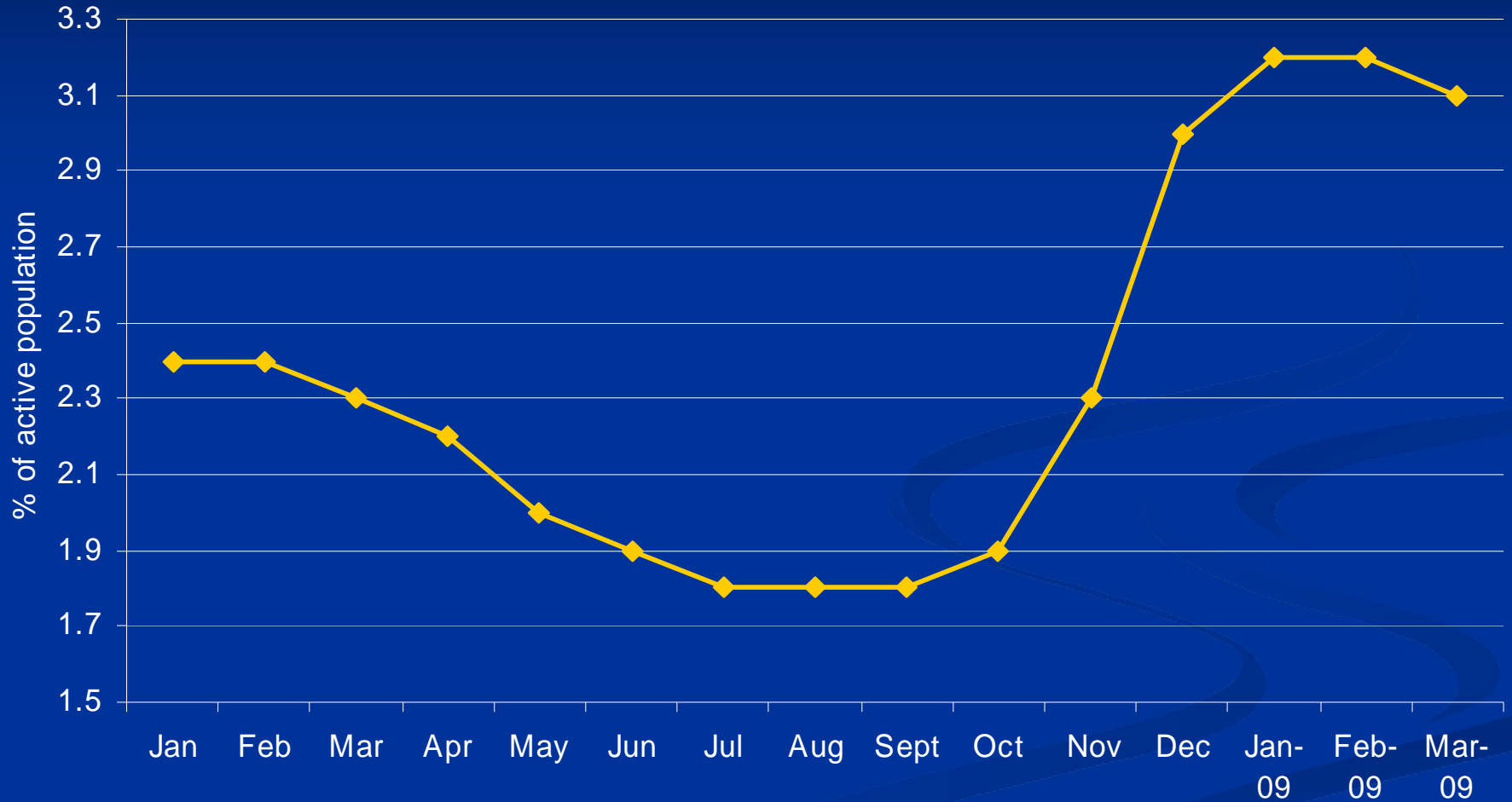


Source: Ukrainian State Committee on Statistics, May 2009

# Exchange Rate Adjusted & Stabilized



# Rising Registered Unemployment



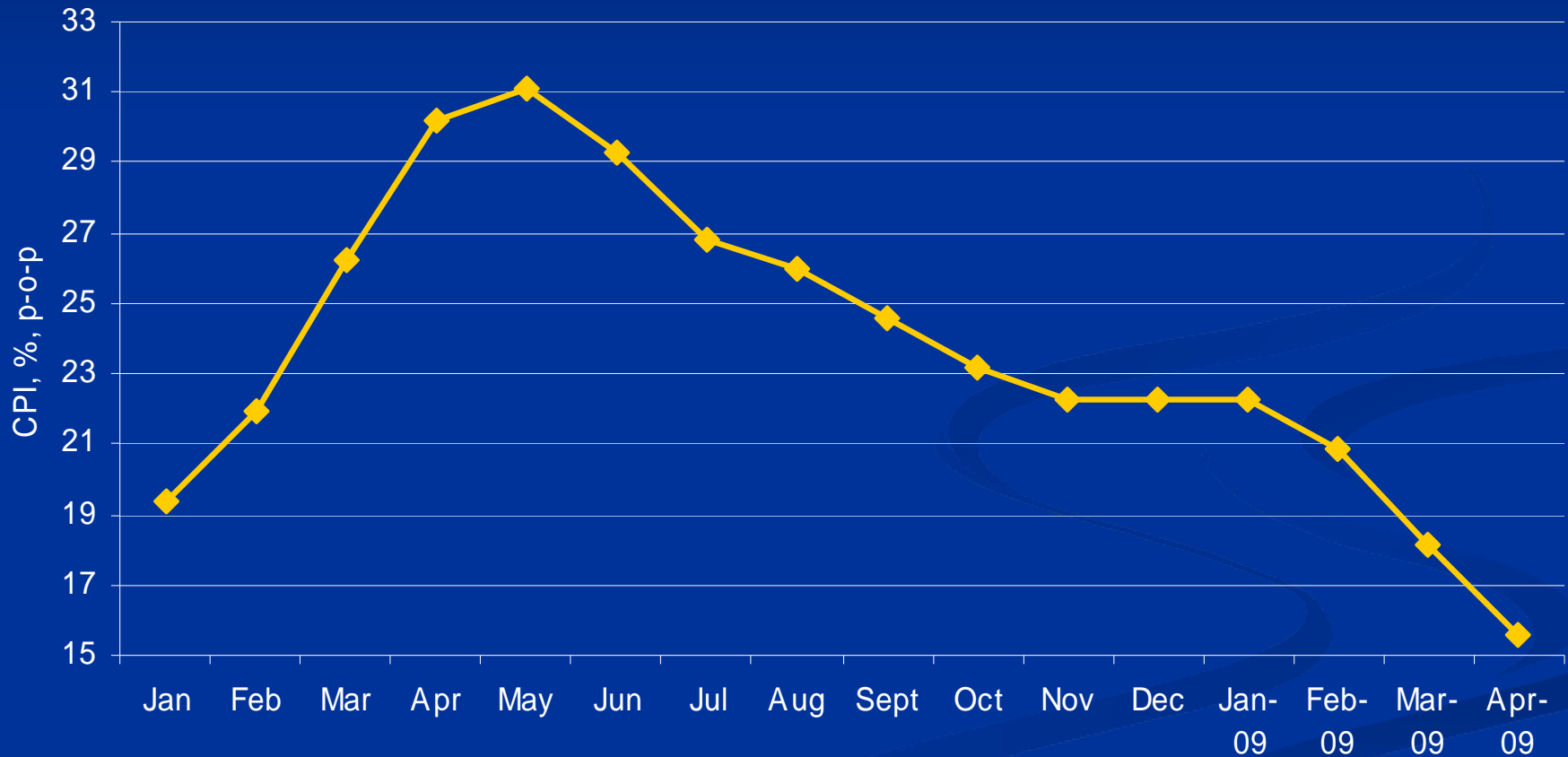
Source: Ukrainian State Committee on Statistics, May 2009

# Has Ukraine Hit an Early Bottom?

- Competitive exchange rate
- Reserves hold: \$25bn end 2009?
- Default unlikely
- Did industrial production bottom out in January?

# Inflation Moderates

## 15.6% in April

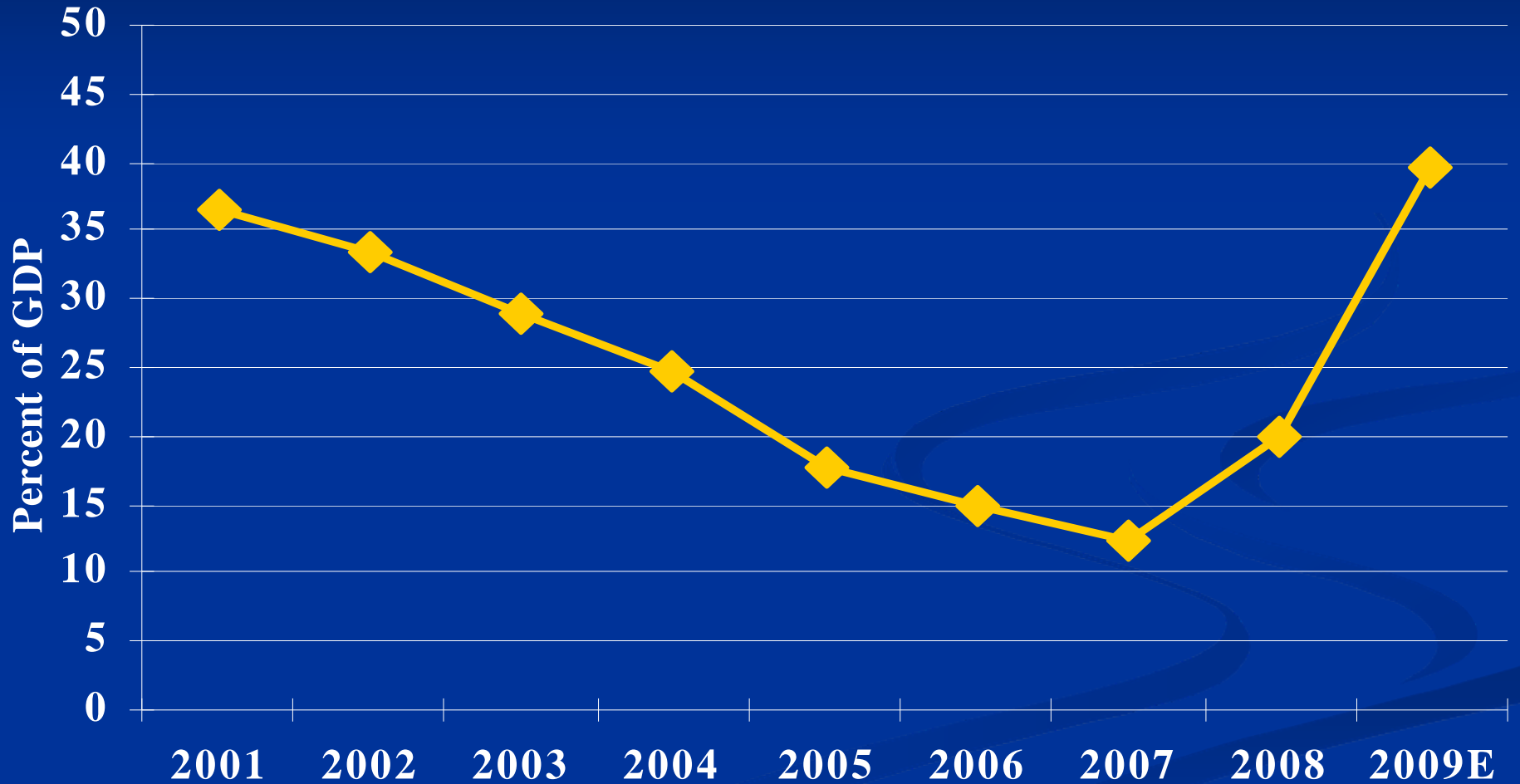


Source: Ukrainian State Committee on Statistics, May 2009

# The Budget Deficit Remains under Control: 4% of GDP in 2009?

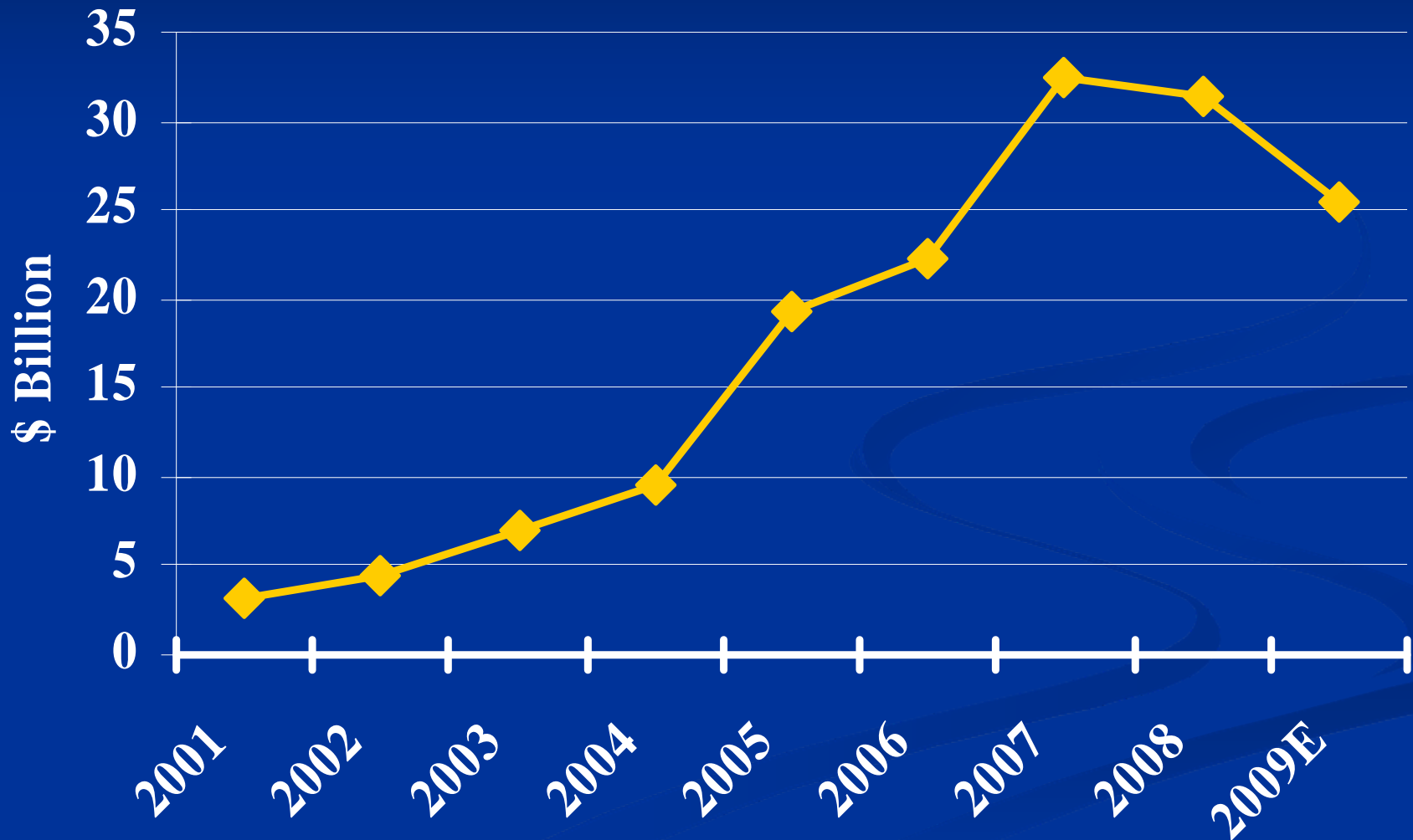


# Public Debt Was Minimal & Rise Tenable





# International Reserves: Falling But Sufficient



Source: Dragon Capital, April 2009

# What to Look for?

- Budget discipline?
- More international financing?

# **3. Ukraine Has Little Choice But Turn to the West**

# The Threat: Putin on Ukraine

- Crimea was simply given to Ukraine by a CPSU Politburo's decision, which was not even supported with appropriate government procedures that are normally applicable to territory transfers.
- Ukraine, in its current form, came to be in Soviet-era days... From Russia the country obtained vast territories in what is now eastern and southern Ukraine...
- If the NATO issue is added there, along with other problems, this may bring into question Ukraine's existence as a sovereign state.

NATO Summit, Bucharest, April 2008

# Russia's Policy on Ukraine

- Minimal official contacts
- Gas wars
- Trade sanctions
- Threats over NATO association
- Anti-Ukrainian propaganda

Entirely hostile, therefore ineffective

# What Can Russia Do?

- War is out of question
- Gas and trade wars do little good
- Passports are allegedly distributed – unlikely to work
- Huge Russian funding for presidential elections is likely

# Putin's Objectives toward Ukraine in Gas War

1. Destabilize Ukraine
2. Arouse a frozen eastern  
Ukraine
3. Let the Ukrainian gas pipeline  
system implode
4. Discredit Ukraine in Europe

# Ukraine's Response

1. Gas for 3 months in storage
2. New pipeline to eastern Ukraine
3. Sufficient technical gas in pipe
4. Gazprom lost its reputation and market



# Tough Gas Negotiations





# After Midnight...





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# Outcome of Gas War

1. No intermediary: Less corruption & less dependence on Russia
2. Long-term agreement
3. Normal prices and tariffs set by formula: more predictable

Victory for Ukraine

# West-orientation of Foreign Policy

1. WTO accession on May 16, 2008, could boost Ukraine's growth by 1-2 % points a year
2. European Association Agreement with EU, including free trade, is likely by 2010
3. National Action Plan with NATO



# What Europe Can Do

1. European Association Agreement
2. Gas cooperation March 23 EU-Ukraine declaration
3. Twinning of government agencies
4. Budget financing
5. 1,000 scholarships

# Political Prospects

- Democracy likely to hold
- The constitutional crisis needs to be solved: European parliamentary system obvious solution
- Political financing drying up with financial crisis: Major positive change

# Economic Prospects

- IMF agreement and international support are vital
- Ukraine is likely to weather the financial crisis
- Corruption must be controlled & hit by crisis
- In the long run: European convergence

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