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Ukraine's economy: the economic situation and outlook

Background

The lost 1990s

The situation of the Ukrainian economy today is extremely fragile. To some extent this fragility is a result of the lost years of the 1990s, during which little restructuring of the economy took place, the oligarch economy developed, living standards plummeted and the size of the Ukrainian economy shrank.

One of the distinguishing features of Ukraine's economy in the 1990s was that, unlike the economies of the Central European New EU Member States, there was no fundamental reform undertaken, institutions remained unchanged and often the same people who were in charge when Ukraine was part of the Soviet Union remained in power in the Ukrainian economy. Ukraine therefore lost the opportunity to undertake a fundamental reform of the state.

The decline in Ukraine's economy between independence and 1998 was brutal. In 1998 Ukraine's GDP was only 40% of the size that it was at independence. While much Soviet industry was lost, the rise of the oligarch state, with massive corruption between the oligarchs and the government, effectively prevented the rise of new business. Ukraine's uncertain relationship with the expanding European Union also meant that trade with the EU grew only relatively slowly.

Table 1: Real Economic Growth in Ukraine and Poland 1990-1999: % year on year

	1990	1991	1992	1993	1994	1995	1996	1997	1998	1999
UKR	-4.0	-8.7	-9.9	-14.2	-22.9	-12.2	-10.0	-3.0	-1.9	-0.2
PL		-7.0	2.6	3.8	5.2	7.0	6.1	6.9	4.8	4.1

Source: State Statistics Committee of Ukraine and EUROSTAT

While in other European countries in the 1990s, economic reform was progressing partly thanks to large inflows of foreign direct investment, in Ukraine uneconomic capacity was being lost and oligarchic practice meant that reform was not carried out and monopolistic situations were being created for the benefit of the financial integrated groups (FIGs).

The recovery in the early years of this century

This situation of rapid economic decline ended with the reforms which were necessary to meet the challenges of the 1998 financial crisis. The reforms carried out at that time included devaluing the hyrvnya, consolidating the budget with the aim of producing a budget surplus, an anti-inflation policy and a determination to defend budget and other financial constraints.

These reforms did indeed put Ukraine onto an economic growth path which saw average annual real growth rise by 7.5% per year between 2000 and 2007, or roughly by 80% in eight years. During these years there was a real decline in poverty in Ukraine, though average incomes remained of course at a low level relative to Ukraine's western neighbours.

Table 2: Key macro-economic data, 2000-2008

	2001	2002	2003	2004	2005	2006	2007	2008
Real GDP %	9.2	5.2	9.6	12.1	2.7	7.3	7.6	2.3
GDP/capita $	785	883	1053	1371	1830	2282	3035	-
FDI ($ mill)	769	698	1411	1711	7533	5740	9221	11659
Current account %GDP	3.7	7.5	5.8	10.6	2.9	-1.5	-3.7	-6.9
Private consumption (real)	9.0	9.5	11.5	13.1	16.6	15.9	17.1	-
CPI (end year)	6.1	-0.6	8.2	12.3	10.3	11.6	16.6	22.8
Ave. monthly earnings% change	-	20.9	22.9	27.9	36.4	29.7	29.3	-
Exports(%yr on yr)			10.3	21.3	-12.2	-5.6	3.2	0.1
Imports(% yr on yr)			16.4	15.5	6.4	6.8	19.9	6.1
External debt (%GDP)	-	-	47.5	47.1	45.3	50.4	58.6	72.0

Source: EBRD Transition Report; IMF

The drivers of this growth were essentially:

- the devaluation
- a strong demand for metals combined with high prices at the end of this period
- cheap energy until 2005
- buoyant exports with significant terms of trade gains
- buoyant domestic consumption, especially towards the end of the period.

Table 2 gives data for the main macroeconomic variables during this growth period. Apart from the overall real growth rate, growth in foreign direct investment from 2005 and in GDP per capita have both been very strong. More worrying trends however saw inflation rising strongly towards the end of the period as were also the current account balance and the size of foreign debt. These three indicators point to overheating in the economy, to the strong growth in private consumption towards the end of the period and to the underpinning of growth through the import of foreign capital.

An important element of the current crises is that though there have been signs of overheating for a long time and no adequate policies to counter it, nevertheless the downturn in the economy came very suddenly and very brutally in the middle of 2008. The first half of 2008 was marked by the achievement of membership in the World Trade Organisation, strongly rising prices for metals and strong external demand for Ukrainian exports. The hryvnia was strengthening against the dollar throughout 2008 until mid-July, and indeed even at the end of August it was stronger against the dollar than it was in January 2008. The collapse of the economy then came suddenly in September 2008 and by the end of the year Ukraine was in recession with a complete loss of confidence both domestically and abroad.

While the hyrvnia was still strong against the US dollar in the early part of 2008 and inflation was well above 20% year to year, Ukrainian competitiveness was sinking fast. The extremely high level of inflation was on the one hand due to certain supply side influences such as the rise in food prices (50% of the average household budget!) and energy price rises to industry and, on the other, to a wage-price spiral that had set in from 2004 onwards. Real wages growth peaked in January 2006 at over 30% year on year but at the beginning of 2008 was still running at around 20%.

<u>The origin of the current financial and economic crises</u>

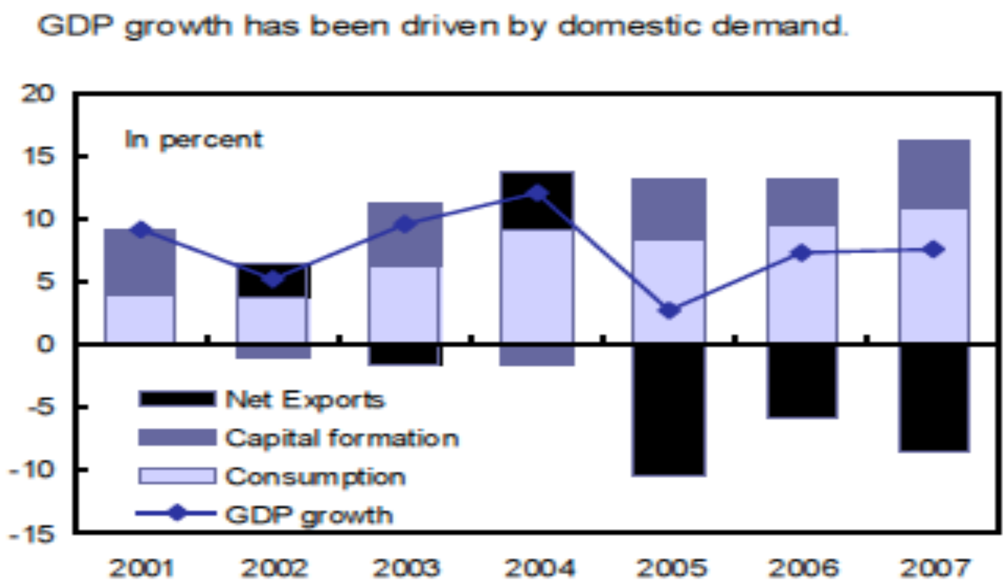
The origins of the current financial and economic crises in Ukraine can be found in the lost years of the 1990s and in today's global recession but also in the errors of economic policy since the turn-of-the-century.

1. *The consumption and real estate bubble*

Figure 1 shows the components of growth of GDP in the period 2001-2007. This diagram illustrates the way in which consumption rose extremely strongly from 2003 onwards, net exports becoming a strong drag on growth from 2005 on, and how investment remained at a level, which was too low for a rapidly developing economy.

Table 2 shows how real private consumption accelerated in the years after 2001 - indeed in quarter 1-2008, private consumption grew in real terms by 20% year-on-year! The CPI deflator rose over the same period to reach an estimated 22.8% at the end of 2008. The growth rate of imports increased, though erratically, over the same period but exploded towards the end of the period, while the current account deficit as a percentage of GDP in 2008 is estimated at around 7%.

Fig. 1: Components of growth in Ukraine (IMF)



All of this demonstrates how the government allowed a bubble of private consumption to develop, some of it backed by a very large increase in the prices of real estate. This was financed by a major expansion of credit in the economy. By mid-2008 credit growth was expanding year-on-year by around 70% according to the IMF. A considerable part of credit growth in recent years has been borrowings in foreign currencies, especially the Swiss franc and the euro on which interest rates were very low compared to domestic Ukrainian rates.

It was obvious that at some stage this bubble would burst and over the last year there has been a discussion about whether the landing would be hard or soft. The landing has been very hard because of:

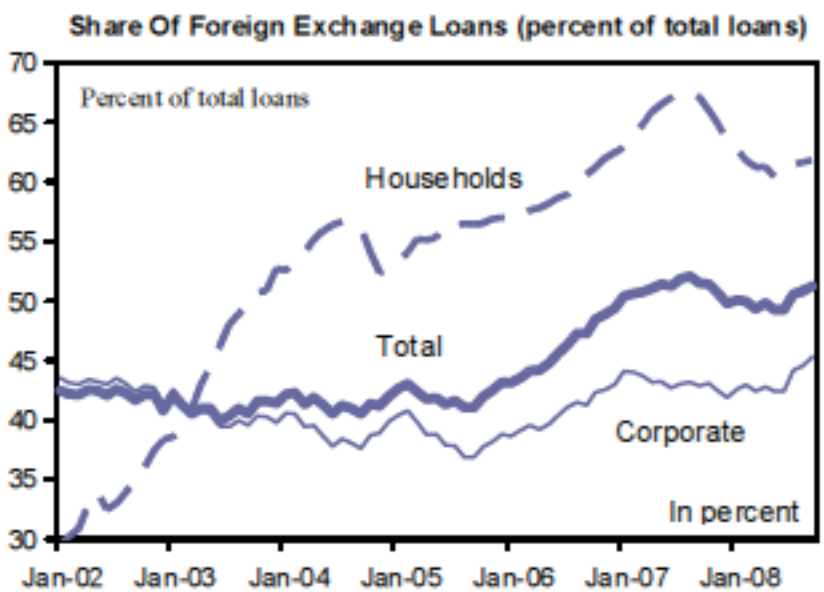
- the extremely high level of borrowing in foreign exchange, the withdrawal of funds by foreign investors leading to very severe problems in the banking sector combined with the rapid weakening of the hryvnia
- the subsequent reduction in bank lending to business
- the dramatic fall in demand for Ukraine's exports,

- the resulting loss of confidence in the Ukrainian economy which is affecting foreign investment, both direct and portfolio, and raising the cost of borrowing.

2. *Foreign borrowings and the exchange rate risk*

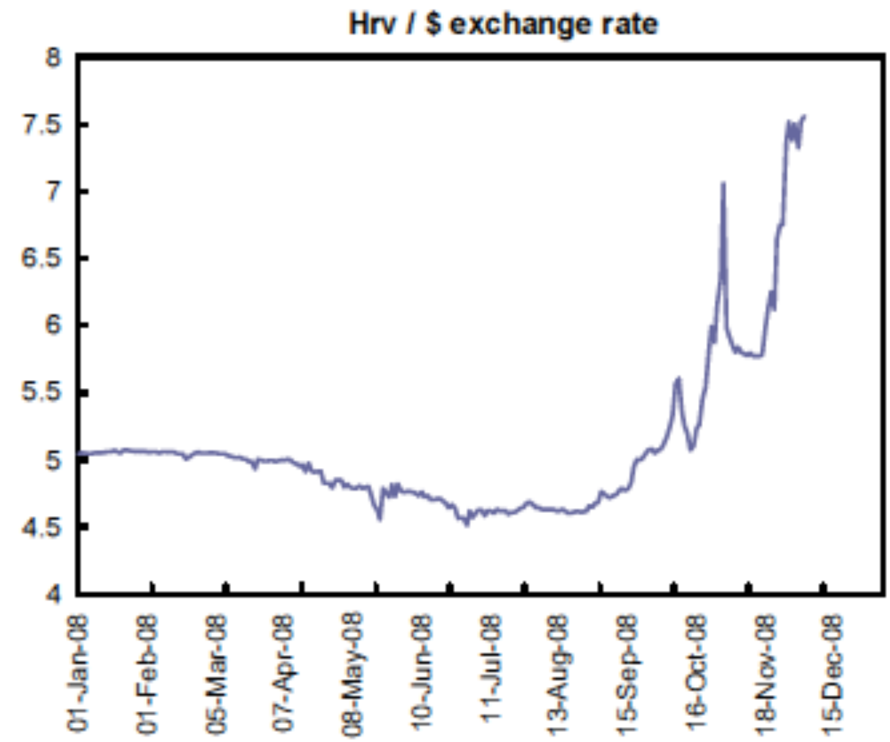
The boom in domestic demand was partly financed by excessive borrowings in foreign currencies. The strength of the hryvnia and low interest rates in hard currency compared to domestic interest rates encouraged many consumers and banks to borrow in foreign currencies. Foreign exchange was a large part of booming real estate market in Ukraine. As confidence in emerging markets suddenly fell away in the second half of 2008, Ukraine could not defend the currency peg with the dollar and the hryvnia devalued sharply, leaving consumers and banks unable to service their loans or at very least having to curtail their expenditure. Figure 2 shows the very high and increasing level of foreign currency loans as a percentage of total loans. By the beginning of 2008 around 70% of household borrowing and 50% of company borrowing were in foreign exchange loans.

Fig. 2 Share of loans denominated in foreign exchange (IMF)



The exchange rate against the dollar fell from around 4.8 hryvnia in August 2008 to just under 8 hryvnia at the end of the year. The end of the boom in metal exports and prices, combined with rising energy prices led to a rapid acceleration in the current account deficit while towards the end of the year the Central Bank's attempt to meet outflows of deposits by injecting hryvnia, some of which leaked into foreign exchange, has further weakened the currency (figure 3).

Figure 3: Hyrvnia exchange rate against US$ Jan-Dec. 2008 (IMF)



3. The Banking problem

It became clear from the late summer of 2008 that Ukraine's banks were under extreme pressure as the currency depreciated and as both domestic and foreign currency deposits declined. The fact that a smaller proportion of Ukraine's banks are owned by foreign institutions than in many other countries in the region also made them more susceptible to damage.

During the period of rapid bank expansion, credit growth soared and the loan to deposit ratio reached 140%. Foreign currency inflows were used for corporate loans and long term retail loans, leading to a high exchange risk. These borrowings were often not hedged. An additional problem was that as credit growth rose dramatically, short term foreign currency funds were used to make long-term domestic retail loans, leading to major maturity mismatches.

As output has plunged and unemployment has risen the risk of default on bank loans has increased sharply, putting the banks under further strain.

It became clear that these different factors made a recapitalisation of the banks an urgent necessity, as their capital was being wiped out by the depreciation of the hryvnia and the slowing of growth.

In December 2008 the IMF calculated that a capital injection of around 8% of 2008 GDP was necessary to return the banks to a minimum capital adequacy ratio. The larger banks will be able to raise much of this capital themselves, but smaller national banks may well need state help.

In this situation the government had little alternative than to turn to the IMF and the IMF agreed to a US$16.4 billion standby arrangement in early November.

4. Fiscal policy and political governance

Ukraine's underlying fiscal position has been rather strong. It has one of the lowest debt to GDP ratios in Europe: on the IMF public sector net debt definition, Ukraine's public-sector debt was only 9.2% in 2008 having come down from 23% in 2004 (however roughly half of the public-sector gross debt is exposed to exchange rate risk). Thanks to buoyant tax incomes, the public-sector deficit has been kept at or below 2% of GDP over the last four years. In spite of this the fiscal stance has been expansionary with very generous funding of social spending.

High social spending is partly a result of need but also of electoral competition between parties or even factions within parties. While the achievements of the Orange Revolution are considerable in the area of democracy and fundamental freedoms, political competition has meant that in financial and economic policy, governments have been profligate trying to buy the votes of certain groups in society. Governments appeared to be happy to float along on the crest of the wave created by booming metal exports, without making any policy provisions for an inevitable downturn in the economy.

Extreme political competition still dominates the Ukrainian Parliament and there is no obvious sign that this will end soon. Today, within a year of the presidential election, the competition between the Prime Minister and the President has become extremely intense and extremely negative both for the image of Ukraine's economy and for economic policy itself. This makes sensible policy-making extremely difficult. Partly as a result of these disputes the IMF has not yet agreed to release the second tranche of its loan to Ukraine.

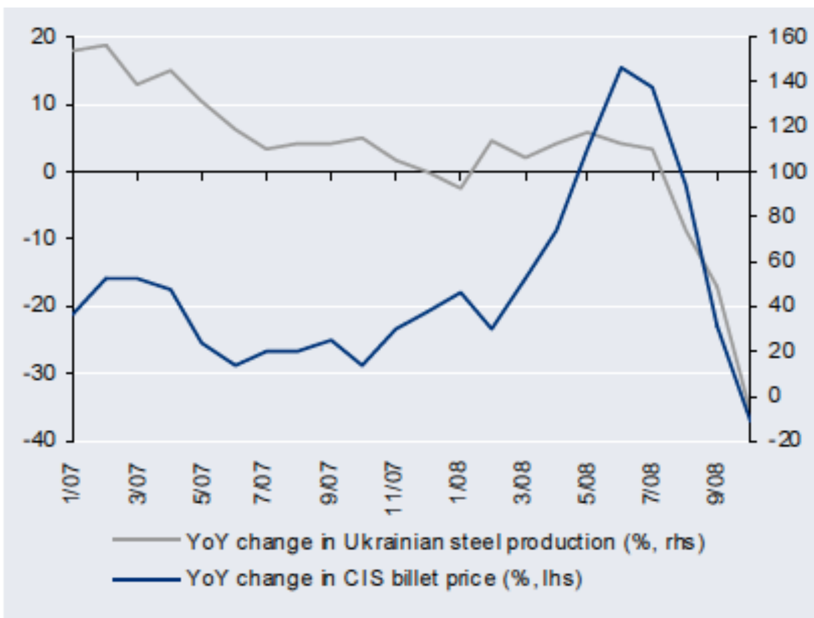
5. The performance of Ukraine's exports and the terms of trade

Ukraine's post-2000 boom was partly based on the rapid expansion of exports and improving terms of trade. Metal products, especially steel, were in high demand as world expansion got underway, especially in the economies of Southeast Asia. Ferrous metal products grew to dominate Ukraine's exports, making up something like 40% of the total. From January to September 2008 the value of exports of ferrous metals including steel rose 56% over the previous year. Steel prices rose extremely strongly in the first half of 2008, helping to keep Ukraine's trade deficit from becoming an imminent danger (see figure 4).

The market deterioration came extremely swiftly. The demand for steel abroad evaporated as world recession took hold while the steel price, which In June 2008 was still around 15% higher than a year earlier, fell precipitously so that by October 2008 it had fallen about 35% compared to a year earlier.

At the end of 2008 Ukraine was therefore hit by a devastating decline in demand for its main export and a severe reversal in its terms of trade.

Figure 4: steel production and steel prices, 2007-2008 (ING)

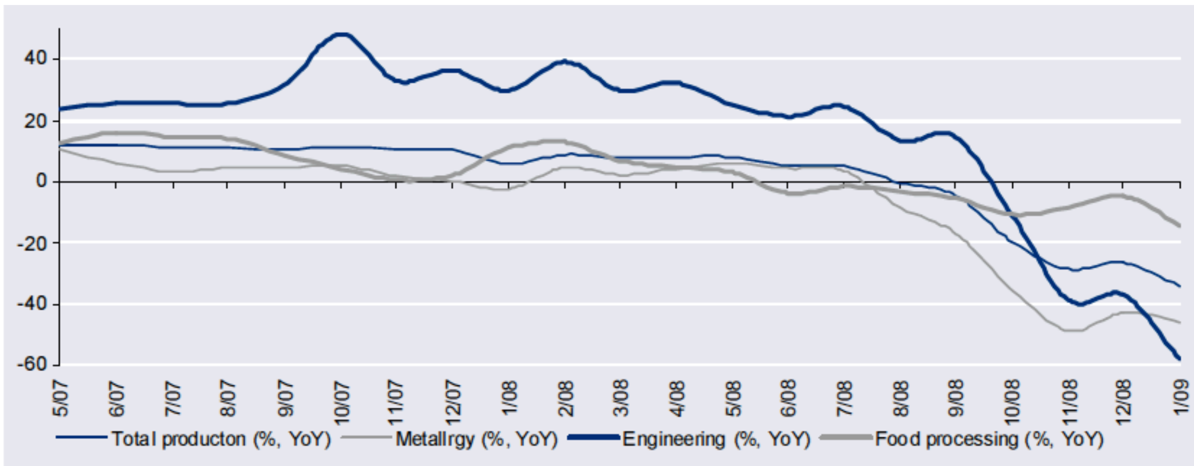


Source: State Statistics Committee, Bloomberg, ING

6. *The impact on output*

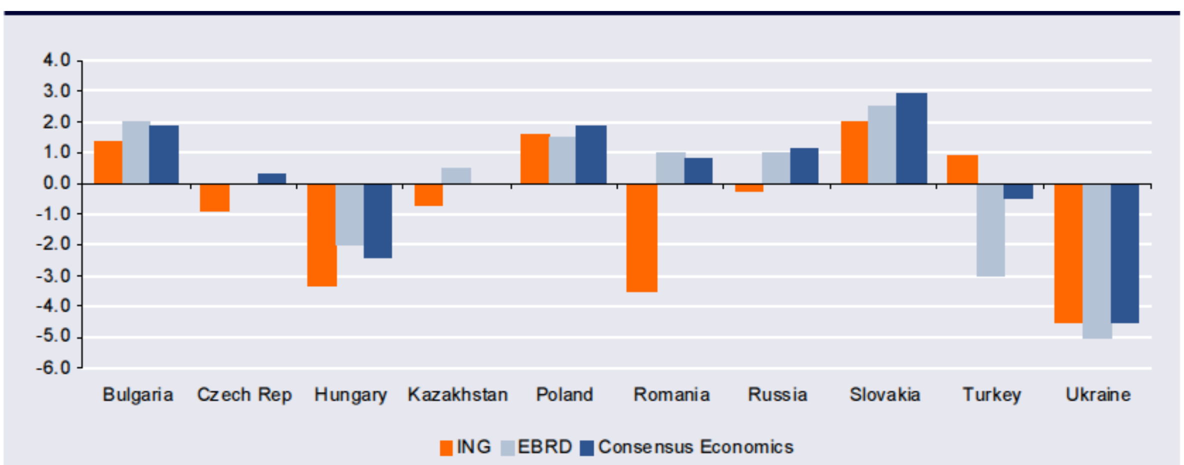
The sudden evaporation of demand for exports coupled with the demise of the banks and their retrenchment in credit markets, led to an extreme decline in output, which occurred also very suddenly. Steel production fell 17% in September year-on-year but by 35.6% in October. Steel led the slump in industrial output which declined by 19.3% year-on-year in October 2008. In the same month engineering output fell by 11.2% mainly caused by the banks inability to make loans for cars and other retail purchases. By January 2009 total production was down around 35% on July 2008 (figure 5).

Figure 5: Industrial production 5/07-1/09



Source: NBU, Reuters, ING

Figure 6: growth forecasts for emerging economies in 2009 (ING)



Source: ING, EBRD, Consensus Economics

In 2008 economic growth is still expected to be positive (+2%) thanks to the rapid expansion in the first half of the year. However the rapid decline at the end of the year is likely to continue, leading to a sharp fall in output in 2009 (figure 6).

In spite of the fact that the elasticity of unemployment with respect to economic output is probably lower in Ukraine than in some West European countries, nevertheless unemployment will surely rise strongly from roughly 6% (ILO) to perhaps over 9% by the end of 2009. In a country which is relatively poor with an imperfect social security system, rising unemployment will mean real hardship to many families.

7. Loss of confidence and the rise in specific country risk

The sudden deterioration in Ukraine's economic performance added to the already strong loss of confidence of investors in emerging economies. The result has been that Ukraine has been downgraded by certain of the major credit rating agencies, cannot raise new capital on international markets while spreads on existing loans have risen sharply.

This loss of confidence has made it extremely difficult not only for the state, but especially for the banks and corporate businesses to raise funds on international markets. Funding roll-over of loans to corporates on maturity will therefore be extremely difficult and, if at all possible, very expensive. The rumours of state default will also not help to calm the fears of investors.

The loss of confidence in Ukraine will clearly affect the flow of foreign direct investment to the country, in a situation where world FDI is liable to stagnate or decline. This is extremely unfortunate because FDI is necessary to modernise the economy.

Continuing political uncertainty, especially in this election year, will only increase the confidence problem for Ukraine.

Structural problems

Structural reforms, aiming at the modernisation of Ukraine's economy, were obviously neglected in the 1990s, except in a negative sense as much old, redundant capacity went out of production.

However during the period of rapid growth after 2000, some key structural reforms did not make much progress. The oligarchic, insider economy remained very much intact until the Orange Revolution. In 2005 the new President and his government did attempt to reduce corruption in public procurement and other areas. A symbolic act at this time was the reprivatisation of Kryvorizhstal, the largest steel plant in Ukraine, for $4.8bn. This had previously been sold by the Government for only $800,000 to a relative of the president. However, while undoubtedly the attitude to brazen corruption between the private sector and government has become more severe, the position of the oligarchs remain strong as does their capacity to prevent competition in their areas of activity.

1. Ukraine and EBRD transition indicators

The EBRD 'transition indicators' give a good general idea of progress in reforming the structure of transition economies.[1]

The latest estimates of these indicators published in November 2008 show that the EU's new member states in Central Eastern Europe generally have 4 or 4+ for each of them. This is true for instance for Estonia which has 4 throughout apart from infrastructure reform where it has 3+. Poland, as Ukraine's neighbour in the West, has 3+ for large-scale privatisation, for competition policy and infrastructure, and 4 for the other indicators.

Ukraine scores better than one might expect. It scores 4 for small privatisation and price liberalisation and 4+ for trade and the foreign exchange system. It however scores very badly in governance and enterprise restructuring, in competition policy and infrastructure, and these are key areas for future development.

These general statements can be unpacked to give a short list of key structural reforms which will be necessary if Ukraine is to recover strongly from the current recession and achieve substantial growth rates over the medium term future. This list is by no means exhaustive but includes:

- the business environment
- competition, state aid, and public procurement
- corruption
- energy
- agriculture

2. the business environment

The poor business environment in Ukraine, characterised by a high level of bureaucracy, is a major brake on recovery and future growth. The World Bank's 'Doing Business 2009' survey places Ukraine 145th out of 181 countries, which are surveyed. This puts the ease of doing business in Ukraine below that of Russia and Moldova in the neighbourhood but also worse than Syria and Rwanda. In dealing with construction permits Ukraine is 179th. In the world and on paying taxes it is 180th.. It also ranks particularly badly as far as 'investor protection', 'registering property' and 'closing a business' are concerned. The

[1] They have been calculated over the last 15 years for all of the countries of central and eastern Europe and the Central Asian economies. They rate progress in structural reform on a scale 1 to 4+, where 1 represents the state of the centrally planned economy and 4+ that of a modern industrialised market economy. These rankings are given across around 10 indicators, grouped under the headings enterprises, markets and trade, financial institutions, and infrastructure (see EBRD Transition Report, November 2008.

only categories in which Ukraine ranked in the first 50 countries in the survey were in ‘enforcing contracts’ and ‘getting credit’.

Worse still Ukraine has not been improving its performance over recent years and actually turned in a relatively worse performance in 2009 than in 2008.

The difficulty of working in Ukraine is well-known to domestic and foreign investors. It impacts both negatively, holding back the development of Ukraine's economy. This again is connected to the political situation in Ukraine, where it is very difficult to tackle serious problems in a very fundamental and long-term way. But without improvement here, the future for new dynamic business looks bleak.

The difficult business environment is combined in the minds of investors with other serious problems such as corruption and the problems of the judiciary to ensure that the risk premium on an investment is extremely large; or put another way, only projects with a very high profitability, which incorporates this risk premium will be considered by foreign investors.

3. Competition, state aid and public procurement

Competition policy and the control of state aids were of course non-existent problems in the period of central planning. Unfortunately with independence, there was no systematic effort to introduce a modern policy in these areas. As the insider economy developed, it was not at all in the interests of the oligarchs to favour a policy which would limit their manipulation of the market. The same argument applies to state aids. The financially integrated groups, which had close relations with the government and many representatives as members of the parliament were able to attract state aids in a variety of forms for their own enterprises. Urgent action in both these areas is necessary if Ukraine is going to be able to implement the new Association Agreement with the European Union.

Public procurement has been an even more difficult area. The changes which have taken place have made public procurement less transparent and more open to corruption than it was before. This has happened in spite of a major effort from the international community to help Ukraine introduce modern transparent legislation in this area.

4. Corruption

On the corruption perceptions index of Transparency International, Ukraine ranks 134th out of 180 countries, equal with Pakistan but still better than Russia.

There are many levels of corruption in Ukraine. The close relationship of the financially integrated groups with the government and parliament ensured that there would be a high level of large scale corruption. The sale of the

Kryvorizhstal steel works, mentioned above, was one of the most obvious examples of such political, large scale corruption.

However corruption exists at all levels in Ukraine. Corrupt practices in the administration are widespread, especially concerning the issuing of permits and licences. Combined with the very bureaucratic rules concerning much administration, corruption makes running a business very difficult, especially for foreigners.

While some progress was made in fighting large scale corruption early in the first Orange Government, these efforts appear to have waned as the political situation has become more complex.

5. *Energy*

The low energy prices which prevailed until 2005 in industry (and still exist as far as consumers are concerned) also reduced incentives to use energy more efficiently. Ukraine therefore remained one of the least efficient users of energy in the world. With increases in energy prices to business after 2005 there was some improvement in energy efficiency in industry and the move to full energy pricing has pushed some companies to the edge of bankruptcy. Full price push through to consumers is planned for 2010-11.

Subsidised prices of energy imports from Russia also created the scope for corruption and rent seeking. The case of the totally non-transparent gas trader RosUkrEnergo was raised again in the latest gas negotiation with Russia and once again it was resolved to eliminate the company from the gas trade between the two countries. In spite of the high level of profitability of the company, its added value has never been obvious.

The scope for increased energy production in Ukraine and especially for energy saving is considerable. This very important area of policy was dealt with in JMWEN-SIDA paper 13b.

6. *Agriculture*

In agriculture too, an extremely promising sector of Ukrainian activity in the future, little progress was made in the creation of a real land market, which would allow efficient farmers to expand their holdings. The liberalisation of sales of state held land has been put off as part of the ongoing political battle in Kyiv. The government introduced measures to limit exports in some years in an attempt to keep down the rate of inflation. These restrictions reduced incentives in agriculture to increase efficiency and output. They have however since been lifted.

The future of the Ukrainian economy

1. The IMF programme

A US$16.4 billion two-year stand-by credit for Ukraine was decided by the IMF in early November. The key conditions attached to this credit were:

- Adoption of a flexible exchange rate system, with targeted intervention
- Early recapitalisation of the banks and tighter supervision
- Fiscal policy prudence, including a phased increase in energy tariffs
- Tight monetary policy

The aims of this programme are fairly obvious:

- to stabilise the exchange rate
- to keep bank lending to business going to avoid a more serious downturn
- to avoid a more serious fiscal deficit at a time when spending on the social safety net is liable to rise

The aims of this programme are attainable – inflation down to 17% by end 2009 and a sharp fall in the current account deficit from 7% of GDP down to 2% by 2010. By 2011, the Fund estimates Ukraine could be back on its long term growth path of 5-6% annually.

2. Politics and the economy

The economic situation of Ukraine has deteriorated seriously since the agreement with the IMF was made. As a consequence, some changes in the programme will be necessary. However already the IMF has postponed release of the second tranche of its loan with disagreement still on both monetary and fiscal policy. The resignation of the finance minister of Ukraine has also not increased the confidence of the IMF in Ukraine's ability to meet the conditions attached to the loan. The danger is that the IMF delay of the payment of the second and possible subsequent tranches of the loan will lead to both severe financial pain but also a loss of reputation for Ukraine.

Ukraine's financial and economic problems are partly homemade and partly a result of the world crisis. There is obviously little that the Government can do to solve the latter problem. However the homemade problems need to be tackled systematically by a secure government. Unfortunately this is a most unlikely event in Ukraine and it is almost certain that the current struggle between the President and the Prime Minister, with a strong opposition keen to take over power, is the situation which will last until the Presidential elections at the end of 2009.

Poor Government is probably the most important domestic factor which has produced the depth of the current recession (although Ukraine does not have a monopoly of poor government). The one ray of hope is that the severity of the recession forced politicians to behave more reasonably at least until the IMF programme was agreed. It is unlikely that this brief unity of purpose will persist as the world begins to recover from the crisis. Sensible government appears to be produced only in quite desperate situations and does not last for long.

3. *The medium-term outlook*

The medium-term outlook for the Ukrainian economy depends very much on the speed and magnitude of the world recovery. Unfortunately it is still too early to say when the recovery will begin. Much of 2010 may be flat as far as world economic growth is concerned. The recovery may also be slower than normal owing to the large financing requirements of governments. This would be bad news for Ukraine's very open economy, as it would mean that demand for Ukraine's metals and semi-manufactures would only recover slowly. Living standards would also only recover gradually from the shock that they have felt in recent months.

However there are reasons to be more positive in the medium-term.

Ukraine has become more competitive through the devaluation of the Hryvnia, which does not help much today when world demand is flat, but which should put Ukraine in a good position when the recovery starts.

If the IMF programme is adhered to, some other positive advantages will accrue to Ukraine. The full pass through of energy prices will obviously negatively affect household budgets, but it will create a situation in which energy saving is given a major economic boost, leading to higher energy saving investment and lower imports of oil and gas.

In spite of higher energy prices, inflation should fall to single figures over the next three years, bringing a degree of stability to investment which has been missing in the past few years.

But undoubtedly the most promising development will be Ukraine's integration with the European Union, realised through the negotiation of the Association Agreement. The Association Agreement will introduce new market economy regulation into Ukraine. If properly implemented, this will help to make Ukraine an attractive home for FDI, with a much improved business environment and less scope for corruption. Above all it will help to re-establish Ukraine's reputation as a reliable partner and reduce country risk, leading to lower borrowing costs for companies and the State.

The implications for SIDA

The general point has to be that any assistance to Ukraine in the future will be extremely valuable, given the shortage of budget funds which is bound to arise as tax revenues fall and expenditure on the social system and in bank rescues increases.

On the other hand, assistance may be made more difficult during the financial and economic crises because the necessary matching national budgetary funding may not materialise.

In terms of SIDA's programming for Ukrainian assistance, it is obvious that the area of governance is crucial to the future development of Ukraine, of its integration with the European Union, and its general credibility with foreign investors. It is unlikely that SIDA can do very much to reform Ukraine's political system. However SIDA can help in the parliament by providing assistance to the Committee on European Integration, which is under-resourced. At Government level SIDA could help the new Coordination Bureau for European and Euro-Atlantic Integration.

More specifically, there is obviously little that SIDA can do in the short-term to help Ukraine emerge from the current recession. However there are two areas in which foreign (and SIDA) assistance would be of value:

- In determining what supervisory changes are necessary to ensure that the specifically Ukrainian elements in the crisis do not reoccur
- In helping to solve the medium-term structural problems, some of which have been dealt with in this paper

I am not sure whether there is specific Swedish advice which can be given on the first of these two elements. It is almost certain that advice will be given by the IMF and other financial organisations. It is however completely possible that SIDA can mobilise very specific technical assistance in a particular element of this complex.

On the second of these issues, there is clearly a great deal which SIDA is doing and can do in the future to help resolve some of the medium-term structural problems. Considering the two assistance sectors which SIDA has chosen to specialise in, the energy economy area is obviously one which is of vital economic interest to Ukraine. But beyond this the development of new sources of energy, both fossil and renewable, can make a major difference to Ukraine's current account over the medium and long-term. There are already officials in the Ukrainian government working on these issues, who are very keen to develop cooperation with the EU member states, which have experience in these fields.

As far as governance is concerned, there is a plethora of needs in Ukraine. If one of the keys to reaching a strong medium-term economic growth path is accelerating European Union integration, then helping to build a strong coordination institution, to strengthen the EU units and building competence in the line ministries, and to ensure a stream of knowledgeable young people coming out of university into government would also be extremely valuable.

In my view it is crucial that the financially integrated groups, led by their oligarchs, support the European integration of Ukraine. Once this support is firm, then many of the political problems for European integration may become less serious and the parliament as a whole would be likely to become a supporter of this process. It would therefore be interesting for SIDA to build on the programmes which it has already run to promote business involvement in European integration, by devising a high-level programme in which Swedish and perhaps other European business people could work together with staff at the highest level in the FIGs. There is every reason to believe that the long-term future of these groups lies in managing multinational enterprises at the European level. This will be made considerably easier if there is rapid progress with Ukraine's integration with the Union. In this area SIDA could be an innovator, because to date many assistance programmes have considered it politically difficult to work with the oligarchs.

A further area in which Ukraine has proved to be extremely weak is that of external communication with key countries and institutions abroad. This was extremely clear in the gas dispute with Russia, when European Union member states basically received only communication from Russia and nothing from Ukraine, with the result that in many countries the press attributed the problem to Ukraine and exonerated Russia from blame. The same is true in external communication on economic matters. While at present the situation makes it difficult to find positive news to communicate, having little or no communication when world growth starts again will mean that Ukraine does not appear as a positive location for international investment in the world's media. Therefore any assistance which SIDA could give, either in the general area of providing information for foreign consumption, or in the specific area of providing economic news internationally, would help in Ukraine's economic recovery from the current recession.