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ІМЕНІ ТАРАСА ШЕВЧЕНКА  
ІНСТИТУТ МІЖНАРОДНИХ ВІДНОСИН**

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**Редакційна колегія:**

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<b>Перепелиця Г. М.,</b>	д-р політ. наук, проф.;
<b>Пирожков С. І.,</b>	д-р екон. наук, проф., академік НАН України;
<b>Пузанов І. І.,</b>	д-р екон. наук, проф.;
<b>Рижков М. М.,</b>	д-р політ. наук, проф.;
<b>Рогач О. І.,</b>	д-р екон. наук, проф.;
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<b>Філіпенко А. С.,</b>	д-р екон. наук, проф.;
<b>Фурса С. Я.,</b>	д-р юрид. наук, проф.;
<b>Шемшученко Ю. С.,</b>	д-р юрид. наук, проф., академік НАН України;
<b>Циганов С. А.,</b>	д-р екон. наук, проф.;
<b>Шнирков О. І.,</b>	д-р. екон. наук, проф. (заст. головного редактора).

Відповідальний редактор: **Римська Т.Ю.**

**Адреса редакційної колегії:** 04119, Київ, вул. Мельникова, 36/1,  
Інститут міжнародних відносин; тел. 481-44-14.

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*Garanska I.\**

## THE THEORY OF REFLEXIVITY: A NEW WAY TO ANALYSE FINANCIAL CRISIS

**Resume.** *The purpose of this research is to understand the financial crisis, applying the theory of reflexivity. The theory of reflexivity, which was introduced by George Soros, proposes a different outlook on financial crisis. According to the theory of reflexivity, prior to financial crisis, financial analytics and brokers could not react to the changes in the economy without reflecting their own thoughts, because they are part of the system and they are the participants. Therefore, according to this concept supply and demand curves cannot freely meet at the point of equilibrium, because supply and demand cannot be regarded as separate items. In order to understand the current crisis, a new theory is needed which can look at it from a different perspective. In this article, the world financial crisis of 2008 is regarded through the prism of the theory of reflexivity.*

Current financial crisis cannot be compared to any other crisis that occurred in the past. This crisis is unique due to nowadays globalization, technological progress and expectations of individuals. The world financial crisis has not arisen suddenly and accidentally, it is rather an outcome of malfunctioning economic mechanisms. This study aims to regard current crisis, its causes and consequences with the help of modern economic theory--the theory of reflexivity. Regarding crises in general, many scientists observe and analyze them through the prism of different classical economic theories which lack philosophical components. Modern economists, such as G. Soros, regard crisis from a different point of view.

The followers of classical economics use precise scientific methods to prove the validity of their arguments. In contrast to precise sciences, social sciences also use a philosophical approach to problems. Economics is regarded by many as a social science and can carry a philosophical character in the matter of analyzing world economic crisis. In order to acquire a better understanding of current crisis it is necessary to take into consideration the role that citizens of each country play in this crisis. The citizens of one or another country are the participants of the market and cannot be disregarded during analysis of the economic crisis.

**The main objective** of the paper is to analyze the world financial crisis through the prism of the theory of reflexivity. The theory tells us that we are part of the events that happen and we cannot stand aside, we are the participants and we cannot separate ourselves from the world that we live in, therefore decisions that we make reflect our thoughts and understanding of the crisis. According to the theory of reflexivity, prior to financial crisis, financial analytics and brokers could not react to the changes in the economy without reflecting their own thoughts, because they are part of the system and they are the participants. The theory of reflexivity is a contradiction to the equilibrium theory.

The equilibrium theory tells us that supply equals demand at the point of equilibrium. And in order for the market to come to an equilibrium point, according to this theory, information has

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\* Postgraduate student of the Department of World Economy and International Economic Relations of the Odessa National Mechnikov University

to be clear and easily accessible to the participants of the market and government does not intervene. In other words, the equilibrium theory predicts that the market will reach equilibrium on its own. Regarding the situation through the prism of the theory of reflexivity, the market cannot reach equilibrium without the participants. In classical theories of economics, the supply and demand curves are regarded as given, but according to G. Soros, such situation is not realistic and cannot take place in real life.

Supply and demand have to be formed under a great number of factors; one of the main factors is participants' expectations. Different expectations of market participants resulted in such massive and rapid burst of the crisis. Modern look on the development of the current crisis brings new opportunities to analyze structure and causes of the current crisis. If supply and demand curves are regarded as not given, then the movement of these curves can be regarded as an outcome of the participants' actions. Supply curve and demand curve depend on the results expected by the participants. The expectations of the participants on the other hand depend on information and self measures of the expected market outcome. Every market participant does not have the exact information about the behavior of other participants and expectations of other participants. Entering the market, the participants themselves, create market outcome based on their personal experience and expectations of the outcome. Based on acquired information, which can be either right or wrong, the participants of the market make their decisions.

According to G. Soros, current crisis takes its roots in the US real estate market. Regarding the US real estate market from the point of view of new modern economic theory, the market could not reach equilibrium on its own. The US real estate market started experiencing difficulties after the government provided public with easily acquirable credits on good terms and conditions. Consumers were taught that in case of crisis the market will be able to return to equilibrium on its own. Everyone who received credit expected that in case of a bad outcome, the market will rehabilitate on its own, but consumers' expectations turned out to be not so true. The participants made their choices based on earlier acquired experience, when in case of lack of liquidity the government injected liquid assets using monetary instruments and was able to stabilize the economic situation.

Due to lack of clear information and previous positive credit experience, consumers continued receiving loans expecting a perspective outcome. Positive expectations increased the number of people desiring mortgage during the beginning of crisis. The US citizens spread confidence to foreigners and foreign countries regarding loan policies. Information about positive loan experience had an influence on Ukrainians as well. The real estate market in Ukraine flourished without bad forecast before the breakdown of the crisis. Ukrainians continued receiving mortgage, expecting positive outcome on the real estate market in Ukraine and abroad. Ukraine, being an exporting country expected inflow of capital from abroad. Ukrainian participants of the market expected stable situation on the US market and expected to receive money from abroad that could be later injected into economy in order to stimulate the real estate market in Ukraine. Expectations were navigated towards two aspects at the same time: stable situation on the national market and stable situation abroad.

Range of unreasonable expectations is also shaped by globalization. Capital dependency between countries led to such downfall in expectations by national consumer as well as national seller. Now it is time to regard another part of market relations in which the seller on the real estate market plays an important role. Constructing the price of one square meter, seller expected stable situation on the market, clear information and demand on the supplied good. The seller had certain expectations in mind. Analyzing behavior of a seller through the prism of the equilibrium theory, the optimal price had to be formatted by the market. But it did not, because

the factor of expected result was not taken into consideration, which is also integrated in the formation of price of one square meter.

The hypothesis of one theory contradicts the hypothesis of the other. This principal is rooted in the thinking of G. Soros, he states that the theory of reflexivity contradicts the equilibrium theory and two theories cannot simultaneously co-exist. Attending to the concept of one theory, we automatically reject the possibility of existence of the other theory. The theory of reflexivity analyzes behavior of players on the market, relying on the psychological aspects of their behavior. Each participant will behave depending on available information and on personal intentions and expectations. Each participant wants to maximize most favorable outcome regardless of other's expectations of the market outcome.

In regarding the causes of the crisis, it is worth to note such aspect of the crisis, as globalization which worsened the situation in countries, other than the United States. On the eve of the world financial crisis, based on the estimations made by IMF, the markets of developed countries were fully integrated in the financial globalization and up to 30-50% of national financial markets of developing countries. Uncertainty and inequality of the processes of financial globalization were reflected in the acceleration of structural changes of financial markets, and also in the growing number of mergers and take-overs in the world economy. In conditions of globalization, cyclical processes are not restrained by national borders, their volatility influences most of the countries in the world.

Current stage of globalization has started recently and was engendered by planned politics, partly related to elimination of trade and investment barriers and partly related to establishment of international norms and institutions. Globalization has opened possibilities for exchange of information and capital inflow. Comparing earlier crises and current crisis, a strong interdependency between countries is observed during current crisis. International relations and high level of globalization pushed countries toward close relations, trade and exchange. At the current stage of globalization, countries are closely dependent on each other, which was not the case in the 1930s.

Specificity of globalization is accumulation of financial resources in the developed countries and circulation of cash flow in the center of the world financial system. Until 2009, the US used to be the economic center with the end point of capital flowing there from periphery. However, the world financial crisis demonstrates us the impossibility of this country to restrain crisis and fight with it within the country, not letting it spread out around the globe.

It is also necessary to analyze not only the cause of the crisis, but also its progression. It is wrong not to consider the psychological aspect of crisis. The nation starts to panic. If until the beginning of crisis, expectations of market participants in the US and in Ukraine were positive, during the crisis the situation changes completely. Panic takes control over people and their actions, behavior of people reflects the real situation on the market. The theory of reflexivity cannot be ignored during analysis of current financial crisis. Actions of participants reflect their fear, beliefs and intentions and influence the result. People stop spending money and making investments. People expect improvements and wait for better conditions to invest. Savings increase and inflow of capital to any segment of economy sharply decreases. Investors that have partially invested stop investing due to fear of losing even more than was already invested. At the same time arises the problem of unpaid credits. Inability to payoff mortgage leads to lack of liquidity. The current account deficit that experiences the United States worsens the consequences of the world financial crisis. The theory of reflexivity explains people's behavior and their desire to save more during the crisis. Behavior of market participants is based on intentions of individuals. From G. Soros' point of view, the way to fight the consequences of world financial crisis is to receive help from the government.

Countries should not expect the market to return to equilibrium on its own. Current world financial crisis proves the actuality of the theory of reflexivity and obsolescence of the equilibrium theory. If the market worked according to the equilibrium theory, then by the end of the first wave of crisis, supply and demand curves would have moved towards equilibrium. But reality proves the opposite the market cannot recover on its own. The government needs to play an active role in the formation of market equilibrium and regarding the US market, the government indeed influenced the US financial system. In the pre-crisis times, the US government injected liquidity in the US economy, bringing the market to equilibrium.

The theory of reflexivity cannot predict the outcomes of the current crisis, but it gives us the base to analyze the causes of crisis, participants' behavior during crisis and possible solutions to end the crisis. The theory of reflexivity pushes individuals to reject analyzing crisis through the prism of classical economic theories. The true outcomes of the crisis, we will be able to analyze only after the end of this crisis abroad and in Ukraine. The theory of reflexivity is the theory of the future, in demand, but is not yet as widely spread out as the equilibrium theory. This topic needs further post-crisis analyze, in which it will be possible to analyze the consequences of the government actions, outcomes of the crisis and ways to prevent future crises. The theory of reflexivity has its downfalls, it cannot prevent crisis and it cannot provide the exact answer on how to get out of it, but it can certainly shade light on the evolution of this financial crisis.

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**Doskoch D.\***

## APPLICATION OF KEYNESIANISM IDEAS IN CONDITIONS OF MODERN CRISIS

*The topicality of the explicated material is agreed upon the necessity in finding ways of prevention and counteraction of various crises. The main ideas of keynesianism and possibilities of their introduction on modern stage of economic development have been examined in this article. The Keynes's conception made a significant influence on the economic theory and economic policy development. Governments of many countries put into service this conception, that's why an experience of its application may be helpful in present crisis consequences overcoming.*

**Keywords:** keynesianism, demand, employment, crisis

*Актуальность изложенного в статье материала обусловлена надобностями в определении путей предотвращения и противодействия разнообразным кризисным явлениям. В статье рассматриваются главные идеи кейнсианства и возможности их внедрения на современном этапе экономического развития. Концепция Кейнса произвела значительное влияние на развитие экономической теории и экономической политики, а также была взята на вооружение правительствами многих стран, поэтому опыт её применения может стать полезным в преодолении последствий современного кризиса.*

**Ключевые слова:** кейнсианство, спрос, занятость, кризис.

*Актуальність викладеного у статті матеріалу обумовлена потребами у визначенні шляхів запобігання та протидії різноманітним кризовим явищам. У статті розкладаються основні ідеї кейнсіанства та можливість їх впровадження на сучасному етапі економічного розвитку. Концепція Кейнса справила значний вплив на розвиток економічної теорії та економічної політики, а також була взята на озброєння урядами багатьох країн, тому досвід її застосування може виявитися корисним у подоланні наслідків сучасної кризи.*

**Ключові слова:** кейнсіанство, попит, зайнятість, криза.

From everlasting people faced the crisis phenomena in economy, trying to find out their reasons, to determine them and to prevent or at least to soften their destructive consequences. During the last 40 years financial crises caused nearly 30-40% loses of national financial assets in a number of countries. The recent episode of financial destabilization is a world financial crisis which has begun at the local American mortgage market in 2007 and lasts till now, striking world financial and bank systems.

The crisis expanding now is a unique one according to its scales and global influence. A lot of scientists compare the present crisis with the years of the Great Depression. Some researches

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\* 4th year Student of International Economic Relations Department of the Khmelnytskyi National University

assert that the crisis is even deeper. But in spite of the world community long-term experience in dealing with the financial crises, there are still no universal recipes to prevent or to resist different crises. That means that the theme of the work is urgently actual and needs to be discovered.

The purpose of researching this question is an attempt to find out the alternative methods of overcoming economic crisis consequences. Some specialists consider that the neoliberal world economy development model has exhausted itself, that's why to recover from nowadays recession some other methods, not inherent to neoliberalism conception, should be used. In this article the main ideas of keynesianism and possibility of their application on the modern stage of economic development have been examined.

While considering a world financial crisis, it is necessary to address to the studies of a famous British economist John Maynard Keynes. Keynesian economics played an important role in the development of the western economic theory. It tried to answer a number of difficult questions connected with the crisis of 1930s. Keynes pointed out the number of weak points of bourgeois economic science of his time. He tried to bring new elements in the analysis of the capitalist economy; drew economy nearer to the needs of economic development; marked new tendencies in the capitalist development and proved the necessity of the state to take part in the economic life of the country.

Keynes's conception made considerable influence on development of economic theory and economic policy. The Keynes's ideas were put into service by leading authorities of capitalist countries. Especially it concerns to the theory of national income, theory of cycle, theory of growth and other aspects of macroeconomics. That was the Keynes's theory that initiated wide embodiment of economy government control and working out of concrete methods of such regulation (thatcherism in Great Britain and reaganomics in the USA).

Microeconomic approach dominated in a prekeynesianism political economy that is an economy analysis from the point of separate economic units. Prosperity conditions of a firm were equated with the prosperity terms of nation on the whole, increasing of its national riches.

Keynes extended the research scopes considerably, making an attempt to consider a national capitalist economy on the whole, to operate mainly on modular categories - consumption, accumulation, savings, investments, employment, i.e. by the quantities that determine a level and rates of national income growth. The main in the Keynes's research method was that he aimed to set the correlation of cause and effect, dependences and proportions between them, while analyzing combined national economic quantities. It initiated such direction of economic science, which is nowadays called macroeconomic.

Unlike the theories of Clark, Marshall, Pigou and others, Keynes came to the conclusion, that all vitally important problems of highly developed capitalist society must be searched not in the field of resources offer as the neoclassical economic idea did till now, but in the field of demand which provides realization of these resources. Keynes tried to show that a mechanism of automatic equalization of demand and supply, that a neoclassical theory is based on, is utopia.

Experience of the late 50s showed that anti-crisis measures did not provide the durable raising, high and stable economy growing rates. The American economists came to the conclusion that it was necessary to concentrate attention not on anti-crisis measures, but on growth stimulation measures that would prevent from crises at the same time. Thus, main motive of public economic policy measures direction was changed.

According to the Keynesianism point of view a deficient demand is the main reason of the present crisis. During the last years the production was increasing and volumes of the world trade were the biggest in history. A special increase of mortgage crediting was observed through-



out the countries and turned out to be rather harmful for a bank system. The reasons of the increase were the follows:

- rise in the price of real estate caused by the inflation processes;
- accessible mortgage;
- investment attraction because of the big prices of dwelling.

The further expand of the financial crisis is rather predictable. That's all because of the capital mobility and considerable binding of a great number of countries' economies to the economy of America that have influenced the development of crisis processes in the countries.

The ways out of the crisis proposed by Keynes in the sphere of state regulation would be very useful. From our point of view, Ukraine needs more strict state control. The ideas of liberal market economy are not acceptable for a young country with unstable economic situation and not properly developed entrepreneurship. The system is not powerful enough to be self-controlled. Ukrainian economy depends on metallurgical, extractive industry and reprocessing products export. As a result we have instability at the outer markets. That's why today is the moment for a state to begin to regulate the situation in the country.

Keynes supposed that to solve the problem of market balance we need to turn to the demand sphere. So it is needable to renew the demand on the majority of goods by inducing the population to spend money rather than to save. The population needs to have incomes that can be provided by giving people work. But how to supply people with work when a lot of enterprises that depend on export and can't market their products because they do not have orders from abroad have stopped for today? As for us, it would be reasonable to create a system of state orders and purchases that would form a demand on the products.

Why not start roads building as it was in America during the period of the Great Depression? It would be a good variant for Ukraine. It would solve the problem of employment and rebuilding of the roads<sup>6</sup> state of which leaves much to be desired. At last, Ukraine would have a chance to approve its status of a transitive country situated in the centre of Europe.

Of course, it would be a mistake to affirm that the Keynesian theory is the only right. In fact on verge of 70-80s it and its conception of government economy control met serious tests. Deep world crisis 1974-1975 showed a weakness and vulnerability of Keynesian practical recommendations. But we shouldn't finally reject the ideas of D. Keynes. But what is needable is to synthesize the main Keynesianism and liberal ideas combining freedom, democracy and private property with the institute of state regulation. The governments of entire countries try to take under the control some spheres of economy functioning for the sake of economic recession processes slowdown and softening of their consequences. Ukrainian authorities also try to restrain a cutback of country's economic activity by controlling banks activity. But, possibly, it is worth inculcating such measures that have already proved themselves correct, for example, social works organization, system of the public purchasing and others.

We are certain that present crisis is not the last in the history of mankind. It is possible, that financial crisis of 2008, possibly, will change the contours of modern state economy administration radically. Their essence: strengthening of regulative and consolidating role of the state in many spheres of country vital activity. But that is now that we should do some conclusions and reconsider the aims of development. Presently we can surely speak about simultaneous connection of different crises, as for example, global crisis of liquidity and mortgage crisis in the USA, which influenced other countries. A crisis affected all spheres of human activity that are the basis of the cyclic economy increasing. Consequently, aims of human development should be reinterpreted. The institutes of global economy should be thoroughly reconstructed to coordinate policy. Due to the new values and new aim of civilization it is worth to change the way

of policy realization. The accents should be put on the above national coordination. And only than in the nearest future, if we want to avoid big crises, we would move in the areola of an out of the common triangle of a development balanced in social, ecological and economic spheres. The apexes of this triangle are determined by values, institutes and policy. To do so, we should always remember that the development strategy and economic policy are effective only if they are based on a correct economic theory.

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*Bolba O.\**

## KEYNESIAN APPROACH TO THE WORLD FINANCIAL CRISIS

**Key words:** Keynesian approach, neoliberalism, crisis, aggregate demand, stimulus.

The aim of the following research is the complex analysis of modern neo-Keynesian approach to the world financial crisis, which had negatively influenced the world economics.

The following investigation thematics and necessity of understanding the peculiarities of Keynesian principles and economical laws involves using several methods of scientific research: comparative and elemental analysis, logical synthesis, methods of comparison, grouping of data.

The research realization gave the possibility to see that the following is noteworthy. Many believe that the root cause of the current global economic crisis is the adoption of neoliberalism as the new orthodoxy following the collapse of the dominance of Keynesian economics in 1979. The theoretical foundations of the proposals of the Washington Consensus are the usual analyses advanced by neoliberal economic theory. According to this argument economies are in crisis because of impediments to the free operation of the market. The impediments came from the over inflated interventionist Keynesian state and its expansionary and redistributive policies that deform market data and signals. The solution, according to the neoliberal thinking is the withdrawal of the state from the economy and the reinstatement of the unhindered operation of the market.

Neoliberalism propagated further that the operation of the financial system should be liberated from the state grip and prerogatives and be left to the free operation of the market forces while the interest rate should be determined competitively. Moreover, the withdrawal of the state from the economy required the privatization of all the activities and enterprises that were state-owned and directed, the limitation to a minimum of all state regulations and adequate guarantees for property rights, opening of the economies to liberalise international trade, capital movements and financial activities including the market determination of exchange rate between currencies, and abolition of protectionism.

For over two decades, therefore, neoliberal philosophy turned the global economy into a headless chicken. President Reagan and Prime Minister Thatcher were the prime drivers of the neoliberal philosophy in the 1980s. However, there is a widespread debate regarding whether the neoliberal economic theory promoted development or hindered it especially since the onset of the current global financial crisis in mid 2007. At present many agree that the Washington Consensus and its neoliberal philosophy was a total failure. The neoliberal economic theory led to crises after crises and impoverishment of many both in developed and developing countries.

The financial meltdown caused by excessive greed and speculation and the virtual absence of any meaningful regulatory intervention proved that the free market economy does not have any mechanism to self correct itself. The Keynesian economic theory that markets do not have any automatic mechanism to self correct in the short run is incontestably true now as it was in the 1930s and subsequently.

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\* 4th year student of Department of World Economy International Economic Relations, Institute of International Relations of Kyiv National Taras Shevchenko University

The global economic crisis has shaken the foundation of the free market consensus of the past two decades. Several countries including the United States have embarked on massive fiscal stimulus plans to rescue the financial and the real sectors of the economy. Barack Obama's stimulus package of \$878 billion approved by the government in February 2009 represents the biggest fiscal stimulus ever.

Some of the EU countries have moved beyond fiscal stimulus and nationalized some of their failing banking industries. The current responses of the governments across the globe on the global recession fully recognizes the Keynesian view that markets do not have any automatic mechanism to self correct and that government intervention is necessary to revive the economy. Analysts hope the famous New Keynesian economists such as Paul Krugman, Joseph Stiglitz and Greg Mankiw are behind Obama's stimulus package and advocate for more stimulus than less. The biggest fear at present is not that the stimulus is too big but that it is too little and hence many are not effective. If the multiplier effect fails to raise the current level of spending beyond the \$2 trillion gap in the US consumer demand at present, the Obama stimulus plan may not rescue the US economy from the current recession soon.

Among the emerging economies, China has already begun a massive government spending programmes to compensate for the sharp decline in aggregate demand due to the contraction in global demand for the country's export. Keynesian aggregate demand management has once again become a critical policy instrument for both developed and developing economies.

So, let's consider the topic more profoundly.

Keynesian economics also called Keynesianism and Keynesian Theory is a macroeconomic theory based on the ideas of 20th century British economist John Maynard Keynes. Keynesian economics argues that private sector decisions sometimes lead to inefficient macroeconomic outcomes and therefore, advocates active policy responses by the public sector, including monetary policy actions by the central bank and fiscal policy actions by the government to stabilize output over the business cycle [19].

We should learn from Keynes to focus on the macroproblems of our day. Today's problem is the financial crisis and the resulting great recession. Neither the standard Keynesian policies of decades past nor the monetary policy doctrine of recent years provides useful solutions. Dynamic stochastic general equilibrium theory is part of the crisis wreckage, but turning to old or to New Keynesian theory will be of little use. A balance sheet recession requires that policy address the problems in the private sector's capital as well as its income accounts. We need serious theoretical work on problems of system stability using, for example, agent-based methods. Monetary theory needs to develop an analysis of processes in which intertemporal budget constraints are violated. Network theory will be useful in that quest.

...today we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand. J. M. Keynes (1930) [7].

The most important lesson from the life and work of John Maynard Keynes may be that the macroeconomist should start from the important problems of the day and should face the following questions. (1) How are we to understand what is happening right now? (2) What can be done about it? What is the best policy to follow? (3) Do recent events force us to modify what, today, is widely accepted economic theory? If so, what is wrong and how might we go about arriving at a more satisfying theory?

There are some things that Keynes would not have us do. He would not have us try to deduce how the world works from a small set of doubtful 'axioms' about tastes and technologies.

Thus, what about understanding what is happening?

The important economic problem of today is the ongoing financial crisis centered in the USA and the deepening world-wide recession. What might we learn from Keynes about it?

The current crisis developed in a manner quite contrary to that presupposed by Keynes in the General Theory.

The process leading up to today's American financial crisis had the dollar exchange rate supported by foreign central banks exporting capital to the USA. The Federal Reserve System has not had to defend the dollar (so far). On the contrary, this capital inflow was not even to be discouraged by a Federal Reserve policy of extremely low interest rates. The price elasticity of exports from the countries that prevented the appreciation of their own currencies in this way kept US consumer goods prices from rising. Operating an interest targeting regime keying on the consumer price index (CPI), the Fed was lured into keeping interest rates far too low for far too long. The result was inflation of asset prices combined with a general deterioration of credit quality [10]. This, of course, does not make a Keynesian story.

What then can we learn from Keynes that is relevant to the current crisis? The General Theory is not particularly helpful.

His various papers from the early 1930s are more focused on the financial crisis than the General Theory where the notion has taken over that the real nexus of the problem is the coordination of household saving and business investment.

The Treatise on Money contains a piece of analysis that can be found illuminating. It deals with the financial side of a business downturn. Keynes assumes an initial equilibrium disturbed by a decline in expected future revenues from present capital accumulation. Firms cut back on investment and as activity levels declined direct some part of cash flow to the repayment of trade credit and of bank loans. As short rates decline, banks choose not to relend all these funds but instead to improve their own reserve positions. Thus, the system as a whole shows an increased demand for high-powered money and simultaneously a decrease in the volume of bank money held by the non-bank sector. Keynes's preference for speaking of 'liquidity preference' rather than 'demand for money' becomes understandable in this context since while an increase in liquidity preference does constitute an increase in the demand for outside money it also leads to a decrease in the volume of inside money.

What makes this analysis relevant in today's context is that it describes a process of general deleveraging as part of a business downturn. Causally, in Keynes's theory, it is the decline of investment expectations and the consequent contraction of output that prompts deleveraging. Today, we are faced with the converse problem where the deleveraging that the financial sector is rather desperately trying to carry through has driven the economy into the worst recession since the 1930s. Only a year ago we were still treated to brave protestations from all sorts of sources that the real economy was strong and not much affected by the credit crisis. Yet, it was quite clear that, in a closed system, it is a fallacy of composition to suppose that general deleveraging can take place without a decline in asset prices and excess supply of goods and services in general [9].

Declining investment and increasing saving sounds like a textbook Keynesian recession. This is taking place, moreover, while a great many agents are under severe liquidity constraints. The financial conditions are such as to render the automatic adjustment tendencies of free markets peculiarly ineffective in producing a recovery.

The great weakness of Keynesian income-expenditure analysis is that it fails to deal systematically with the state of balance sheets. This is a balance sheet recession. The trouble starts with the condition of private sector balance sheets, particularly of financial institutions, and this is the problem that must be solved if the recession is to end any time soon.

Japan did try the kind of fiscal policies that were considered conventional Keynesian economics some decades ago. Enormous amounts of money were spent on 'bridges to nowhere' and other, hopefully better motivated, projects until Japan's national debt grew to a size that discouraged any continuation of the policy. All to little apparent avail.



So, the deficit spending will be absorbed into the financial sinkholes in private sector balance sheets and will not become effective until those holes have been filled. If the sinkholes are large, this will take a long, long time. Today, they are enormous. Policy must address both the capital accounts and the income accounts [11]. Nationalisation of the crippling losses of the financial sector—whether or not the financial institutions are nationalised outright or just ‘bailed out’—is a precondition for old-fashioned ‘Keynesian’ stimulus to work.

There are two aspects of the wreckage from the current crisis that have not attracted sufficient attention so far. One is the wreck of what was, until 2007, the widely accepted central-banking doctrine. The other is the damage to the macroeconomic theory that underpinned that doctrine.

The real interest rate. In the old monetarism of Milton Friedman, the real interest rate was determined by real factors and could not be manipulated by the Central Bank. Any attempt to do so would quickly destabilise the price level in Wicksellian fashion. This property was carried over into rational expectations monetarism and then into real business cycle theory and Dynamic Stochastic General Equilibrium (DSGE) theory in general. The Federal Reserve System under Greenspan put this proposition to the test in the years following the dotcom crash, pursuing an extreme low interest policy. The result was more Keynesian than Monetarist and, as noted, more Austrian than Keynesian: virtually no CPI inflation, but drastic asset price inflation and very serious deterioration of credit standards [11].

For many years the main alternative to Real Business Cycle Theory was a somewhat loose cluster of models given the label of New Keynesian theory. New Keynesians differed from New Classical economists in the extent to which they emphasised inflexibilities of prices or other contract terms as sources of short-term adjustment problems in the economy. Lately the two traditions have tended to converge [20]. The New Keynesians have come to adhere to the DSGE modelling technology whereas the New Classics are incorporating various ‘imperfections’ of markets to gain verisimilitude for their models. This convergence has been labelled the ‘New Neoclassical Synthesis’.

The Old Neoclassical Synthesis, which reduced Keynesian theory to a general equilibrium model with ‘rigid’ wages, was an intellectual fraud the widespread acceptance of which inhibited research on systemic instabilities for decades. Insofar as the New Synthesis represents a return to this way of thinking about macro problems it risks the same verdict. The obvious objection to this line of theorising is that the major problems that have had to be confronted in the last 20 years or so have originated in the financial markets—and prices in those markets are anything but ‘inflexible’. But there is also a general theoretical problem that has been festering for decades with very little in the way of attempts to tackle it. Economists talk freely about ‘inflexible’ or ‘rigid’ prices all the time, despite the fact that we do not have a shred of theory that could provide criteria for judging whether a particular price is more or less flexible than appropriate to the proper functioning of the larger system. More than 70 years ago, Keynes already knew that a high degree of downward price flexibility in a recession could entirely wreck the financial system and make the situation infinitely worse. But the point of his argument has never come fully to inform the way economists think about price inflexibilities.

So, there are three things we should learn from Keynes. The first was to take our social responsibilities seriously and focus on the macro problems of our own day. Today's problem is the ongoing credit crisis and its gradually unfolding consequences. The second was to try to understand what can be done about it. The standard Keynesian policies are not the answer. Neither is the central banking doctrine that has dominated in recent years. The third was to ask whether events proved that existing theory needed to be revised. On that issue, it was concluded



that dynamic stochastic general equilibrium theory as an intellectually enterprise has been bankrupted by the crisis. However, like a zombie bank too-big-to-fail it will no doubt be with us for many years. This conclusion does not mean that we should revert to the old Keynesian theory that preceded it (or adopt the New Keynesian theory that has tried to compete with it). What we need to learn from Keynes, instead, are these three lessons about how to view our responsibilities and how to approach our subject.

Intellectual humility was not a character trait that his contemporaries noted in John Maynard Keynes. He did not suffer fools gladly and did not suffer many economists all that willingly either (perhaps the distinction sometimes escaped him). But he was wise enough to recognise that the complex system of a modern economy is 'a delicate machine, the workings of which we do not understand' and that 'blundering' in the control of it can bring misery to millions and endanger the social order. The economist of today has the tools to slap together a model to 'explain' any and all phenomena that come to mind. The flood of models is rising higher and higher, spouting from an ever increasing number of journal outlets. In the midst of all this evidence of highly trained cleverness, it is difficult to retain the realisation that we are confronting a complex system 'the working of which we do not understand'. Humility in the face of the reality we seek to explain is also a lesson to be learned from Keynes. That the economics profession might be humbled by recent events is a realisation devoutly to be wished.

Was it the Keynesian revival of 2008–2009? In the wake of the financial crisis of 2007–2010 the free market consensus began to attract negative comment even by mainstream opinion formers from the economic right.

In the United States and Britain. In March 2008, free-market guru Martin Wolf, chief economics commentator at the Financial Times, announced the death of the dream of global free-market capitalism. Shortly afterward economist Robert Shiller began advocating robust government intervention to tackle the financial crisis, citing Keynes [16]. Macroeconomist James K. Galbraith used the 25th Annual Milton Friedman Distinguished Lecture to launch a sweeping attack against the consensus for monetarist economics and argued that Keynesian economics were far more relevant for tackling the emerging crises [6]. The British Chancellor of the Exchequer referred to Keynes as he announced plans for substantial fiscal stimuli to head off the worst effects of recession, in accordance with Keynesian economic thought [17]. Similar policies have been announced in other European countries, by the U.S., and by China [15].

A renewed interest in Keynesian ideas was not limited to Western countries. In a speech delivered in March 2009 entitled Reform the International Monetary System, Zhou Xiaochuan, the governor of the People's Bank of China, revived Keynes's idea of a centrally managed global reserve currency. Dr Zhou argued that it was unfortunate that Keynes's Bancor proposal was not accepted at Bretton Woods in the 1940s. He argued that national currencies were unsuitable for use as global reserve currencies as a result of the Triffin dilemma - the difficulty faced by reserve currency issuers in trying to simultaneously achieve their domestic monetary policy goals and meet other countries' demand for reserve currency. Dr Zhou proposed a gradual move towards adopting IMF Special Drawing Rights (SDRs) as a centrally managed global reserve currency [1]. Dr Zhou's view was echoed in June 2009 by the IMF and in September was described by the Financial Times as the boldest statement of the year to come from China [5].

In an article looking back at 2009, economics professor Arvind Subramanian wrote in the Financial Times that economics had helped to redeem itself by providing advice for the policy responses that successfully prevented a global slide into depression, with the fiscal policy stimulus measures taking their "cue from Keynes" [2].

In 2009 there were several books published by economists advocating a further shift towards Keynesian thinking. The authors advocated further reform in academic economics, pol-

icy making and even the public's general ethics. Theoretical arguments regarding the relative merits of free market versus mixed economy policies do not always yield a clear conclusion.

On November 8, 2008, Paul Davidson and Henry C.K. Liu co-authored an open letter to world leaders attending the November 15 White House summit on financial markets and the world economy urging reconsideration of Keynes' analytical system that contributed to the golden age of the first quarter century after World War II. The letter, signed by many supporting economists, advocates a new international financial architecture based on an updated 21st century version of the Keynes Plan originally proposed at Bretton Woods in 1944. The letter ends by describing this new international financial architecture as aiming to create (1) a new global monetary regime that operates without currency hegemony, (2) global trade relationships that support rather than retard domestic development and (3) a global economic environment that promotes incentives for each nation to promote full employment and rising wages for its labor force [3].

With a few notable the Keynesian resurgence has been largely driven by policy makers rather than academic economists. Until very recently mainstream economists have not generally favoured robust counter-cyclical fiscal policies. While the school of thought known as New Keynesian economics has dominated the teaching of macroeconomics at universities, New Keynesians largely believed that monetary policy was enough to stabilize the economy, and largely rejected the case for interventionist fiscal policy which Keynes had advocated. Some economists (primarily post-Keynesians) have accused the New Keynesian system of being so integrated with pro-free market neo-classical influences that the label 'Keynesian' may be considered a misnomer.

Yet there has been a shift in thinking amongst many mainstream economists, paralleling the resurgence of Keynesianism among policy makers. The New York Times reported that in the 2008 annual meeting of the American Economic Association mainstream economists remained hostile or at least sceptical about the government's role in enhancing the market sector or mitigating recession with fiscal stimulus - but in the 2009 meeting virtually everyone voiced their support for such measures [12]. However a substantial shift in opinion is less obvious in the academic literature. Speaking in March 2009, Galbraith has stated that he has not detected any changes among academic economists, nor a re-examination of orthodox opinion in the journals [13].

The 2008 financial crisis has led some in the economic profession to pay greater attention to Keynes's original theories. In February 2009, Robert Shiller and George Akerlof argued in their book *Animal Spirits* that the current US stimulus package was too small, as it does not take into account loss of confidence or do enough to restore the availability of credit. In a September 2009 article for *The New York Times*, on the lessons economists should learn from the crisis, Paul Krugman urged economists to move away from neoclassical models and employ Keynesian analysis. "So here's what I think economists have to do. First, they have to face up to the inconvenient reality that financial markets fall far short of perfection, that they are subject to extraordinary delusions and the madness of crowds. Second, they have to admit ... that Keynesian economics remains the best framework we have for making sense of recessions and depressions. Third, they'll have to do their best to incorporate the realities of finance into macroeconomics" [14]:

One more work is necessary to be considered. *Keynes: The Return of the Master* is a 2009 book by economic historian Robert Skidelsky. The work discusses the economic theories and philosophy of John Maynard Keynes, and argues about their relevance to the world following the Financial crisis of 2007–2010 [18]. The author refers to Keynes's view that an over-reliance

on maths is a mistake, because mathematical models will always depend on the validity of their underlying assumptions. Skidelsky says that modern mainstream macroeconomics has become closely integrated with maths, at the expense of other disciplines such as political economy and history, and that this is partly why it became so unreliable at making accurate predictions or offering good advice. Various schools of thought within modern economics are briefly discussed, such as rational expectations, real business cycle theory and efficient market theory. Chapter 8 sums up Keynes's relevance to the current age as of 2009. The author suggests that Keynes would likely advise us to rethink macroeconomic policy, with a greater emphasis on balanced growth and with a somewhat large role for government in ensuring there is a smooth flow of investment to help protect the economy from unpredictable shocks. Macroeconomics should be reformed so that it again recognises the role of uncertainty and so it draws on other areas of knowledge such as history and International political economy, with a less central role for maths. The global savings glut needs to be addressed. Ethics should once again have a role in guiding capitalism, as should Keynes's vision of harmony, where differences are cherished rather than pressured to conform, as can be the case with current concepts of "social cohesion" and "consensus".

Thanks to the Great Recession, we're no longer talking about "rational expectations" or the "efficient markets hypothesis." Instead, it's all about stimulus packages, federal spending and G-20 summits. In other words, it's all about Keynes [4].

Thus, are we moving back to the Keynesian economic approach with all these bailouts around the world, or should we define a new paradigm for economics after the world financial crisis has demonstrated the limits of the free market with its invisible hand?

The failure of economists, businesses and politics to predict and manage the recent catastrophic crash of the world's financial system has triggered a re-evaluation of the whole basis of current economic theories.

Since the end of the 20th century, economics has been dominated by the classical paradigm based on notions of rational consumers making rational choices in a simple supply/demand world of finite resources, with prices constrained by decreasing returns; all driving the economy to an optimal equilibrium point.

So far, this classical economic approach, initially conceived by Adam Smith, has been working well. Indeed, in normal circumstances people are generally rational. The market automatically allocates resources and controls excesses in an optimum way with minimum oversight or outside regulation required. Under this model, the economy has been working as an equilibrium system; a system that moves from one equilibrium point to another, driven by shocks from external disruptions – technological, political, cultural etc- but always coming to rest in a natural equilibrium state.

But in extreme or complex circumstances, people and the system tend to behave/react differently including consumers, banks, financial institutions, stock market traders and governments. And perhaps the most critically flawed assumption of this classical model has been that economic agents are generally rational. Whereas, we observed recently insolvent households taking mortgages that they could not afford, banks lending to insolvent households without conditions etc. leading us to the subprime crisis ...we know the result.

From this flawed assumption, the following question is raised: is it the theory that should be questioned or is it one of its hypotheses (namely the rationality)? Some would argue that questioning the hypothesis is questioning the theory. Anyway...

To tackle this current crisis, some voices have been suggesting more regulations as this would frame the rationality of economic agents and force them to behave in a more sensible

way; some others have been calling for more government intervention in order to set rules and monitor the whole system (with a big bailout here and there when necessary).

And would this mean going back to the Keynesian approach of economics?

Indeed, according to Keynes, excesses or deficiencies in aggregate demand are the rule and not the exception. Therefore, for Keynes, government intervention is needed to eliminate recessionary and inflationary gaps: *laissez faire*, *laissez passer* policies should be replaced with an active interventionist policy by the central government. Keynesians believe that monetary and especially fiscal policies are required; otherwise disasters like the Great Depression that followed the First World War or the crisis that we are facing now would certainly reoccur.

Was Keynes right? Or is Keynes right?

Not so sure. If the Keynesian prescription for active government involvement in the economy was warranted after the World War I, in the past few decades, government intervention has become less desirable...and some argue, less necessary. Indeed, since the World War II, we have experienced six decades of growing competition. The once oligopolistic market structures in autos, telecommunications, services, etc. have become very competitive, and government policies increasingly have impact across borders. Furthermore, nowadays, banks, financial institutions, manufacturers, energy suppliers are increasingly internationally managed; following Keynesian policies with their fundamentally collectivist, centralized approach would just lead to more trouble. For instance, if a multinational that has networks over the world is centrally managed in the way Keynes suggests, the collapse of one element of the network in one country would easily make the whole system topple like dominoes around the world as we have just experienced.

In short, if the Keynesian approach was likely to work after the First World War, the crash that we are facing now is far more serious than the Great Depression of 1929 as it can not be contained within borders or so easily solved by mass bailout, mass lending or big government investments/ job creation programs.

The need of an evolutionary or new economic model...

Instead of going back to the Lord Keynes School of thought, maybe we should rather think of a new model that would fit with the globalisation of markets, and that would -to some extent- set some global regulations to frame agent behaviours around the world, but ultimately leave the market free.

This new paradigm should be based on the principle that economies, markets, regulations, globalisation, as well as the internet (a new and very important component), consumers, enterprises and the brain all form complex adaptive systems in which agents dynamically and rationally interact, process information and adapt their behaviour to a constantly changing environment- but always reach a final equilibrium.

In this new model, and unlike the strict distinction between the too much and the too little government approach, the market should rather be a combination of an “invisible hand” and necessary regulatory elements (government that would not impede competition and risk) with the mindset that the market is henceforth a small village that needs to adapt to the constantly changing global environment.

To conclude this paper, it is strongly believed that free market still has a future, and markets are still perfectly self-regulating systems. They are only becoming enormously complex adaptive networks – too complex and interdependent for economists and governments to control or even understand.

The conclusions seem to be optimistic and even radical: we are all to become Keynesians now. However, as Keynes himself agrees, in the long run, the market forces will drive the econ-



omy into equilibrium, if the government takes appropriate actions to correct the short run fluctuations through appropriate macropolicies. Price still provides the best signal in resources allocation if greed and speculation are minimized and adequate levels of regulatory measures are instituted.

Capitalism has survived numerous booms and busts since 1690s, and 122 recessions in 21 advanced countries since 1960 alone. With economic policies based on Keynesian principles of demand management, capitalism will survive many more business cycles to come.

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Ivanov R. \*

## CONSUMER MOODS AS MAIN FACTOR AFFECTING DEVELOPMENT OF UKRAINIAN AUTOMOTIVE MARKET IN 2009-2010

**Resume** *The relevance of the material stated in article, is caused by the situation in the Ukrainian automotive market in 2009, when its decrease stated 77%. Usage of new methods for analysis and forecast of car sales development will provide fundamental realizing of main factors affecting it, and enables understanding of problem in certain companies planning and also governmental regulatory policy in this sphere. Modern methods of forecasting, described in the article, define directions for strategic planning in automotive companies.*

**Keywords:** automotive market, consumer moods, econometric forecasting.

**Аннотация** *Актуальность материала, изложенного в статье, обусловлена ситуацией, которая сложилась в автомобильном рынке Украины в 2009 году, когда его падение составляло 77%. Применения новых методов анализа и прогнозирования развития продаж авто в Украине обеспечит фундаментальное видение основных факторов, которые влияют на него, и позволит более глубоко понять проблему планирования деятельности отдельных предприятий, а также политику государственного регулирования этой сферы. Современные методы прогнозирования, рассмотренные в статье, определяют направления стратегического планирования для предприятий автомобильной сферы.*

**Ключевые слова:** автомобильный рынок, потребительские настроения, эконометрическое прогнозирование.

**Анотація** *Актуальність матеріалу, викладеного у статті, обумовлена ситуацією, що склалася в автомобільному ринку України у 2009 році, коли його падіння становило 77%. Застосування нових методів аналізу та прогнозування розвитку продажів авто в Україні забезпечить фундаментальне бачення основних факторів, що впливають на нього, і дозволить більш глибоко зрозуміти проблему планування діяльності окремих підприємств, а також політику державного регулювання цієї сфери. Новітні методи прогнозування, розглянуті у статті, визначають напрями стратегічного планування для підприємств автомобільної сфери.*

**Ключові слова:** автомобільний ринок, споживчі настрої, економічне прогнозування.

**Relevance of the problem.** Forecast of dependence between income and consumption is made for the period of economic stability. Under unstable and uncertain conditions forecast er-

\* Master student of the Department International economics of Kyiv National Taras Shevchenko University

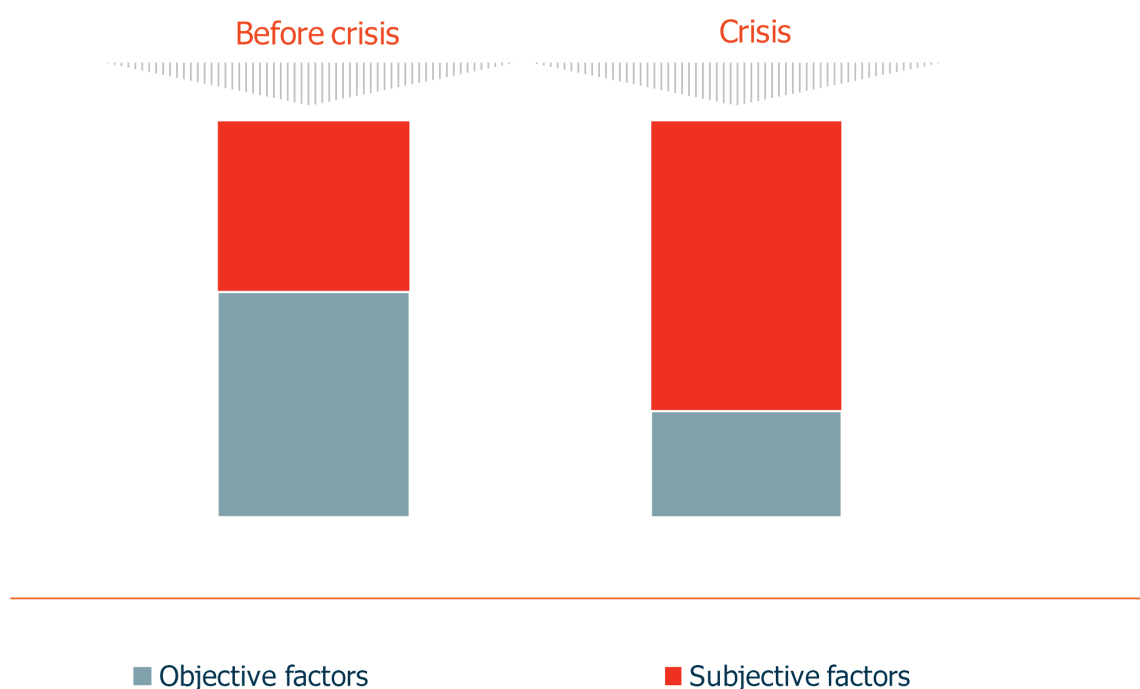


rors increase, because the objective factors change as well as reaction on them. Simultaneously, when consumers do not have experience of adaptation to current situation, their actions become promiscuous and chaotic, which increases importance of subjective factors (consumer moods and expectations). This means that consumer makes his/her choice according to his/her own evaluation and expectations for the future.

**Main aim of the article.** The author has created a model to forecast the development of Ukrainian car market considering objective and subjective factors. This model showed that the change of objective indicators in the beginning of 2009 defined only 30% in the fall of car market, while another 40% were caused by subjective factors.

Usually, the majority of car market representatives analyzes tendencies and builds forecasts about sales of new cars based on objective indicators. One of the most important indicators in Ukraine is availability of credits. However, even during the times of largest credit expansion, the share of car bought on credit equaled 40% (according to Autoconsulting). The other 60% of cars were bought by Ukrainians with their own money.

As the analyses shows, subjective feelings of people have huge importance, especially during the uncertain period (figure 1). First of all, these are consumer moods, which show subjective evaluation of current situation and expectation for the future.



**Figure 1.** Relative influence rate of factors on new car sales.

Source: calculations by author.

For illustration of consumer moods importance increase, let's examine two opposite periods of Ukrainian car market development:

- The period of intensive growth: 2007 – first half of 2008;
- The crisis, sharp decrease in sales of new cars: beginning of 2009.

**In 2007, car market grew due to car crediting and optimism of Ukrainian consumers**

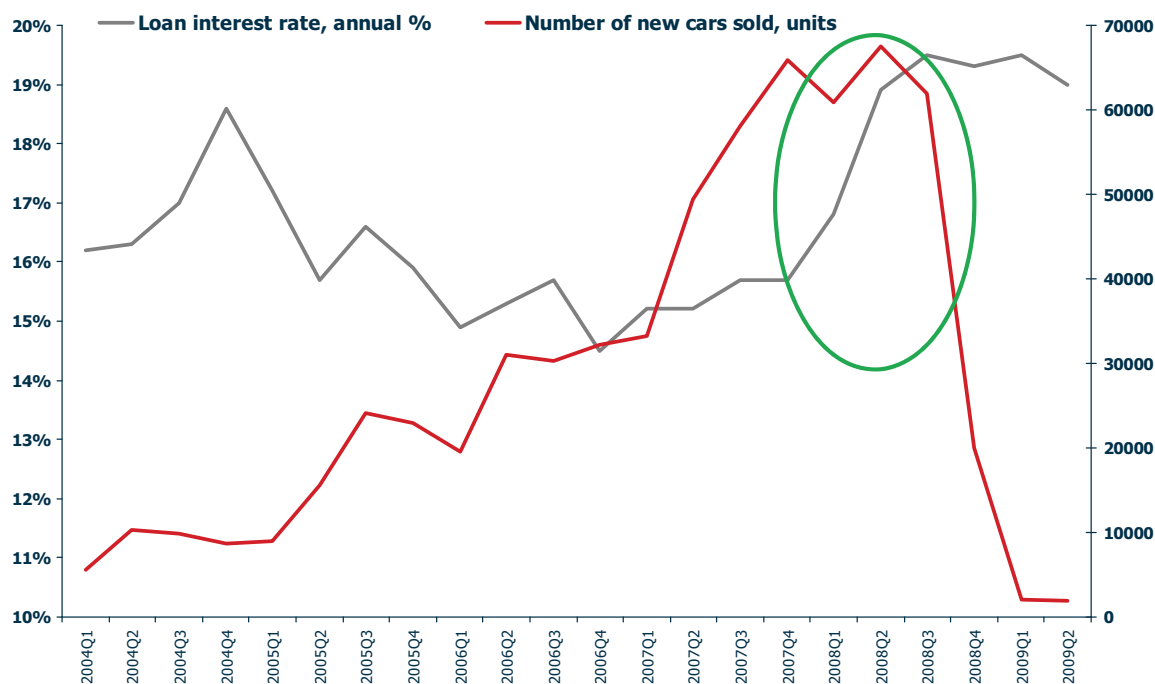
Intensive development of Ukrainian car market during 2007 and beginning of 2008 are explained, to large extent, by incomes of people and availability of car crediting. The incomes of Ukrainian were permanently growing, and the share of cars bought in credit reached its peak, 43%.

On the other hand, as our calculations show, the other important factor was that general subjective expectations of Ukrainians were optimistic. During this period, Ukrainian consumers optimistically evaluated their own well-being and economic situation in the country. This was exactly one of the reasons, which facilitated willingness to take the credits.

### Consumer moods restrain development of car market in 2009

In the first quarter of 2009 occurred a 70% fall of new cars sales in comparison with the first quarter of 2008. In addition, the share of credits taken for cars decreased from 40% in the first quarter of 2008 (61 000 cars) to 5% in the first quarter of 2009 (2 500 cars). It's worth mentioning, that among those 40% of people, who took a credit for a car in 2008, were people who could afford to buy a car by their own money. Consequently, significant decrease in crediting could explain the fall of car market only by 58 500 cars, which is 38%.

Usually, growth of credit rate is followed by stiffening of credit taking. In Ukraine, the rate begin increasing significantly in the second quarter of 2008 – from 15,5% to almost 20% (figure 2), so, the condition of taking the credit became harder. Nevertheless, the sales of new cars remained stable.



**Figure 2.** Conditions of car crediting and sales of new cars

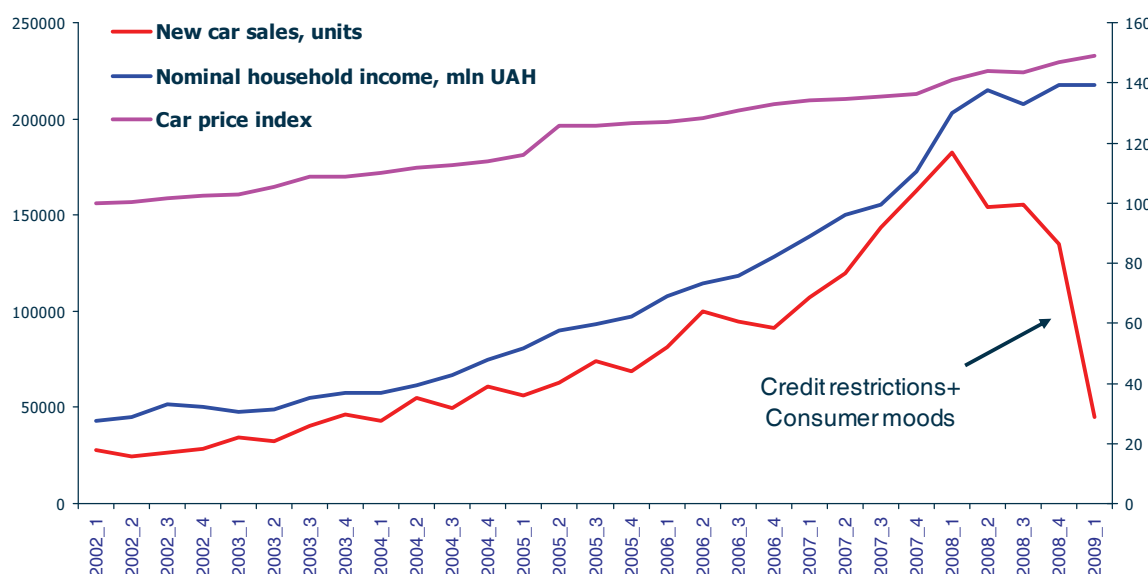
Source: sales of credited cars – Autoconsulting, credit rates – National Bank

So, this is one more effect that builds consumer moods. The people were optimistic and were continuing taking credits for buying cars even under stiffening conditions. Only in the fourth quarter of 2008, when the consumer moods reached the lowest margin on global level, the sizes of credited cars failed almost to zero. At the same time, credit rate remained the same as in the second quarter of 2008. But almost full stop in car crediting occurred only in the first quarter of 2009.

The other objective factor – income of Ukrainians – increased nominally in the first quarter of 2009 in comparison with the first quarter of 2008 by 4,8% (according to National Statistics Committee) (figure 3).

Significant influence had devaluation of hryvnya, however, in the beginning of 2009 the majority of market players didn't raise the prices; conversely, there was huge discount for previous years' cars, which in big amount were waiting in stores of car dealers. This is also shown by car

price index, which is calculated by National Statistics Committee. In the first quarter of 2009, it increased only by 24% in comparison with the first quarter of 2008 (figure 3).

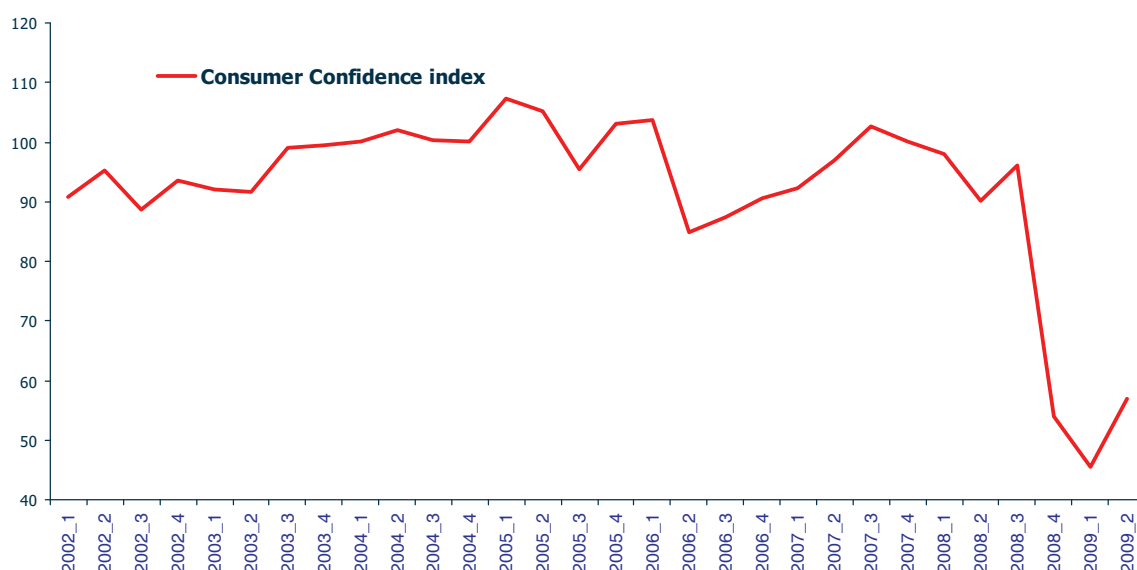


**Figure 3.** Connection of market dynamics with “objective” indicators

Sources: sales of new cars – Autoconsulting, nominal household’s income, car price index – State Statistics Committee

Consequently, the question is if objective factors, which are credits and devaluation of hryvnya, were the only ones which caused the fall of Ukrainian market.

For Ukrainian consumer a car is a “strategic purchase,” which needs significant financial investments for buying itself, as well as covering of service maintenance, fuel, and insurance costs. That is the reason why people, especially during the crisis, are driven by their subjective expectations.



**Figure 4.** Consumer Confidence index

Source: ICPS

In the beginning of 2009, consumer moods and the evaluation of the future economic situation in the country reaches the lowest level during the last 10 years (figure 4). Despite lots of

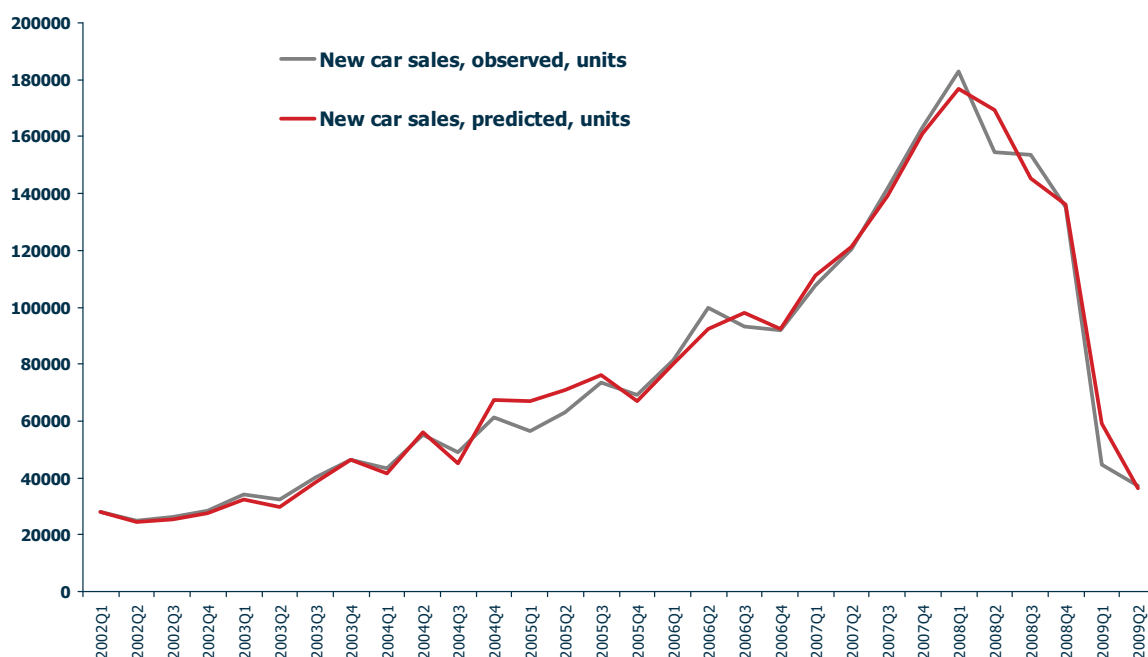
advantageous offers from car dealers, people don't hurry to buy cars. We consider that Ukrainians are restrained by subjective evaluation, uncertainty about their future ability to repay, and unfavorable situation in the country.

In June-July of 2009, car dealers started offering credit programs to people. However, it doesn't cause significant raise of sales. 16% of growth in July comparing to June is rather explained by the season changes. The proof for that could also be the 77% fall of new cars' sales in July 2009 comparing to July 2008.

Consequently, we can conclude that negative expectations of Ukrainian consumers restrain them not only from buying a car for their own money, but also from taking the credits, as long as they aren't sure in their ability to pay this credit off.

To prove our hypothesis about importance of consumer moods for car market, we analyzed connection between main objective (incomes, availability of credits, car prices, dollar rate, etc.) and subjective factors (consumer moods) in sales of new cars. For example, modeling a situation where consumer moods in the first quarter of 2009 remain the same as in the third quarter of 2008. Taking into consideration objective factors, the sales should reach approximately 100 000 of new cars. This could cause 30% fall. From our point of view, the other 40% were resulted by consumer moods.

As our research has shown, only consideration of both objective and subjective factors could most accurately explain consumer behavior (figure 5).



**Figure 5.** Real and modeled data on new car sales.

Source: real data on sales – Autoconsulting, calculations are made by the author.

The model showed as a result new car sales at the level of 171 000 units in 2009, the real result was 169500 units. This consequents an error of 3%, that it an extremely nice result and proves almost perfect quality of the model. The result of sales for 2010 is about 150 000 units.

Understanding the Ukrainian automotive market will be stagnating further, we got to the conclusion that sales might reach the level of 2008 only in 2014. Having analyzed the situation through segments we can say which ones will be the most prosperous and perspective. Actually they are more mass segments B, C, D, Compact SUV, Middle SUV (which have become

very popular recently). We can conclude which automotive companies will be more interested in Ukrainian market and how should they plan their activity throughout the nearest 5 years. Among such companies are:

- Nissan Motor
- Renault
- Toyota Motor
- Honda Motor
- Mitsubishi
- Fiat
- General Motors
- Ford
- Volkswagen
- Suzuki.

All these companies are actually importing cars to Ukraine, so the sales are object to import and excise taxes. In our opinion 10% import tax existing at the moment should be reduced to at least 5%. That enables a little recovery of sales, and due to economy of scale Ukrainian budget income will get more money. Also understanding very sensitive price elasticity on cars of mass segment, we can propose increasing excise tax and other payments only for expensive cars costing more than 50 000 USD. This segment of cars is less sensitive for price and its growth will not affect sales significantly. Consequently Ukrainian government will get additional income.

As a conclusion to all research conducted, we can draw out the following points:

- 1) forecast of dependence between income and consumption is made for the period of economic stability;
- 2) only consideration of both objective and subjective factors could most accurately explain dynamics of automotive market development;
- 3) credit restrictions are very significant for Ukrainian consumer, though they are not the initial ones;
- 4) during 2010 automotive market in Ukraine will continue to stagnate, it might reach the level of 2008 only in 2014;
- 5) mass segment car producers have higher potential for development in Ukraine during nearest 5 years;
- 6) Decrease of import and excise taxes for medium segment cars and increase for premium segment (price more than 50 000 USD) will lead to additional income for Ukrainian budget.

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*Skripka O.\**

## INTERNATIONAL MONETARY FUND AS THE FOUNDATION OF A NEW GLOBAL INSTITUTION: PERSPECTIVES AND CHALLENGES

**Resume** *The perspective of International Monetary Fund's reform is considered in the article. The main purpose of the article is to analyze the problems of today's global financial co-operation between developed and emerging countries and how it is being regulated by the IMF and other world financial organizations. The relevance of the material stated in the article, is caused by global financial instability and by processes caused by it. Since it is still a challenge for the world economy, the concerned information is of a great importance and can provide practical outputs in the area of international economic relations.*

**Keywords:** IMF, G20, reform, emerging economies, quota

**Аннотация** *Перспективы Международного Валютного Фонда рассмотрены в статье. Главной целью является анализ проблем финансового взаимодействия между развитыми и развивающимися странами, а также, как эти процессы регулируются МВФ и другими мировыми финансовыми организациями. Актуальность материала, рассмотренного в статье, вызвана мировой финансовой нестабильностью и процессами, которые она вызывает. Рассмотренная информация имеет большую важность и может быть использована для практических рекомендаций в международных экономических отношениях.*

**Ключевые слова:** МВФ, G20, реформа, развивающиеся экономики, квота

**Анотація** *Перспективи Міжнародного Валютного Фонду розглянуті в статті. Головною метою статті є аналіз проблем фінансової взаємодії між розвинутими країнами та країнами, що розвиваються, на сьогоднішній день, а також, як ці процеси регулюються МВФ та іншими світовими фінансовими організаціями. Актуальність матеріалу, розглянутого в статті, визвано світовою фінансовою нестабільністю та процесами, що вона викликає. Розглянута інформація має велику важливість та може бути використана для практичних рекомендацій в міжнародних економічних відносинах.*

**Ключові слова:** МВФ, G20, реформа, економіки, що розвиваються, квота

Global challenges that affected world economy during the severe financial crisis, forced countries to revise the international financial architecture and it is vital to reform global organizations such as International Monetary Fund, World Bank, or to create a new one that will be in charge of global financial system. These are the chief tasks of the research.

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\* Master student of the Department of World Economy and International Economic Relations of Odessa National Mechnikov University



Since the conference's objective is to report on perspectives of setting up a new global financial institution of G-20, this article correlates greatly with the task given.

The official information of IMF and related books were used in this article. What's more, the possibility of the most important reforms has been analysed in this work.

In the wake of crisis, politicians around the world are looking for tools to fix the international financial architecture: how to strengthen economic cooperation and how to effectively regulate financial structures. There are many players involved in this effort: international financial organizations, national governments and groups of countries, such as G-20 and the European Union.

The ineffective management should have been improved by a list of reforms. The IMF Executive Board sanctioned a first reform to the representation of four fast-growing under-represented countries such as China, South Korea, Mexico and Turkey in 2006. The purpose of the exercise is to ensure that both middle and low income countries are better represented on the Board, in the hope that developing countries will not choose to walk away from the Fund.

But this reform suffered significant resistance from subset of middle income countries in Asia, the Middle East and Latin America opposed the 'two-stage' reform process, and European Union members are still vehemently opposed to any change of the quota formula, which benefits the representation of small, open European economies [1].

Developing countries seeking to gain from the reforms three distinct advantages: first, the fact that the IMF's Article of Agreement stipulates that a country's representation cannot be reduced without their explicit consent gives every country an effective veto over the reform process. It implies that developing countries will not be able to lose representation without having the option to veto the deal.

Second, the impetus for this reform is developing countries own economic success - their pre-crisis economic growth and stability has made IMF relatively less important, and therefore the reform process is motivated by willingness to keep them as Fund's active participants.

The third advantage is that, rather unusually in the field of global governance reform, the United States is in favour of reform. The US is the IMF's most important shareholder and the only state with individual veto power over all reforms to the Fund, and its support for a substantial reform process could have moderated the anti-reform position of some countries, and in particular the EU members. This support is hardly can be named altruistic - the US stands to lose nothing from a new quota formula more weighted towards GDP.

Some countries are over-weighted with the current formula (e.g. Belgium, Spain), while some developing countries are under-weighted (e.g. Brazil, Turkey, Saudi Arabia).

The urgency of reforms in post-crisis time is great and developed countries are slightly more willing to revise the current governance of the IMF [2].

It is reckoned the region interested in the IMF's reform the most is the Asia in general and China particularly. There is general agreement that the IMF is the body best placed to help the growing number of debt-ridden emerging economies hit by the global recession; that if it is to offer this help, it will need more money; and that China, with its huge reserves, is best placed to provide those extra funds. But China is unwilling to finance an organisation over which it has little or no influence, while the EU and the US appear unwilling to cede control. Negotiations are already heated and protracted: China is driving a hard bargain, demanding immediate quota reform, IMF bond issuances to give it an alternative to US treasuries, and a reserve currency, managed by the IMF, to replace the dollar.

The US and Europe agree that the IMF needs to be bigger. It has about \$250 billion; Japan and the EU have recently agreed to lend \$100 billion each, but this will almost certainly not be

enough. The Institute of International Finance has shown credit flows to emerging economies have fallen from \$929 billion in 2007 to \$165 billion this year, driving businesses under, and wiping out government finances as tax revenues fall. \$500 billion won't fill the gap, if the crisis drags on into 2011. Simon Johnson, former IMF chief economist, thinks it could need \$1 trillion or even more to bail out emerging economies as the global recession takes its course. A recent IMF paper, 'Global prospects and policies', is pessimistic about developing country prospects. It will take a long time to restart international finance: the outflows of capital in the Latin American and East Asian financial crises of the 1980s and 1990s amounted to 5 per cent of GDP and capital inflows took years to reach pre-crash levels. While Asian and to a lesser extent Latin American governments responded to these crises by building up foreign exchange reserves, many eastern European countries have large current account deficits and high levels of external debt, both of which make fleeing capital much harder for governments to replace. The IMF is already bailing out Romania, Hungary, Latvia, Ukraine, Belarus and Iceland, and many other European countries are on the brink. The G20 must act swiftly if disaster is to be averted.

At present, the developed world is stalling for time. The US and Europe have agreed to bring forward a review of IMF voting weights to 2011, but the last one, after two years of negotiations, only managed to raise China's quota to 3.6 per cent – slightly larger than Italy's. The old G7 economies are also disbursing the new Japanese and European cash through the 'New Arrangements to Borrow', which circumvent the main IMF voting system. This means China won't have demanded rights. BRIC countries – China, India, Brazil and Russia – are drawing a red line under this issue: they are demanding governance reform now. And China is staking out a position at the edge of what is possible, to try to manoeuvre the US and EU towards the deal it wants. In exchange for giving more money to the IMF, it demands an end to the US veto. It suggests that the IMF should create a new reserve currency to replace the dollar, and issue bonds, which China would be happy to buy. Perhaps the most surprising development in China's position is its apparent conversion to the benefits of international multilateralism. Zhou Xiaochuan, president of the People's Bank of China, proposed in his recent speech that the IMF might become the trusted custodian of national reserves [3].

In 2009, exports of emerging Asia to countries outside the Asian region still amounted to almost 25 percent of regional GDP compared with less than 15 percent for the EU-15 and about 5 percent for NAFTA. As of September 2009, the Asian region held about \$3.75 trillion in international reserves, 60 percent of the global total, and almost \$2 trillion in sovereign wealth funds, 40 percent of the world total. For individual countries, those reserves and other financial assets may be invested within the region, but the region as a whole is in current account surplus of more than 5 percent of GDP. This means that on balance the region's excess of saving over investment must be invested outside the region.

It follows that the Asian region has an overriding self interest in the continued economic prosperity and financial stability of the entire world and, therefore, in strengthening the principal institution of global governance that is dedicated to sustaining and maintaining that prosperity and stability - the IMF.

Today, the Fund is under stress, threatening its capacity to play its assigned role. It faces an existential crisis, an identity crisis, a sharply reduced demand for its lending, and a lack of consensus about what its role in the global economic and financial system should be. The Fund's past and present contributions are badly misunderstood in the United States as well as here in Asia. Over the past 60-plus years, the Fund has evolved constructively to deal with problems that, in effect, have been assigned to the IMF because it was there. I would submit that this approach is more efficient than creating an additional institution and bureaucracy every time a so-called "new problem" arises either globally or regionally.

Despite becoming the repository of worthy new initiatives, today the Fund's major problem is that it has been phenomenally successful in discharging its fundamental mission. However, the Fund has not continued to evolve with the global economy and financial system over the past decade. Many other countries with growing stakes in the continued successful globalization of the world economy have turned their backs on the Fund.

Consequently, the achievements in the IMF reform process, which has been underway for about three years, have been limited. One significant, but partial and minor, milestone was passed in September 2006 with agreement on a first stage of adjustments in IMF quotas. If the emerging countries are disappointed, the damage to the Fund and the international economic and financial system will be lasting. It is difficult to exaggerate the collateral negative effects on the Asian economies that are highly dependent on the prosperity of the world economy.

The IMF faces twin crises of relevance and legitimacy. What needs to be done? The relevance agenda should include four elements: enhancing the IMF's role in surveillance, modernizing its lending facilities, leaving broad issues of economic development to other better-qualified institutions, and revamping the IMF's financial and business model. The legitimacy agenda should encompass five elements: management selection, internal governance, external accountability, realignment of representation on the executive board (what I call chairs), and redistribution of voting power within the Fund, so-called shares [6].

The IMF is not the only institution that can help diagnose and deal with these problems, but at a minimum there are lessons to be learned; they will be lessons for countries and financial institutions around the world, and the IMF is the unique global institution positioned to assist in this educational process. It is inevitable that there will be consequent, adverse external financial repercussions for some countries and the Fund will be back in the lending business on some scale.

IMF lending itself is also a public good. Its purpose is to mitigate the costs of crises and policy mistakes for the residents of the particular member country that is borrowing and for other members who would receive the adverse spillover effects if that particular member country had to adjust without the availability of external financial assistance. More than half the IMF's 185 members do not have meaningful access to international capital markets. For about half of the remaining countries, access is intermittent, in particular for countercyclical borrowing. Although healthy on balance, the increased scope and scale of private financial markets means that the potential adverse economic and financial effects of inherently volatile private capital flows have increased not declined.

The Fund is widely perceived to lack the kind of legitimacy that is necessary if it is to carry out its mission. This perception may not be well grounded - and it is probably exaggerated - but it is widespread and persistent. Something has to be done about that perception if the IMF is to overcome its existential crisis.

The issues with respect to the IMF's internal governance are more complicated. The Fund is an international organization, its members are countries. Its structure was established more than 60 years ago with only modest modifications in the meantime despite a quadrupling of its membership and a wholesale transformation of best practices in public sector governance. The respective roles and responsibilities of the IMF governors, the International Monetary and Financial Committee (IMFC), the management, and staff are ambiguous. Consequently, responsibilities are blurred. Radical change in this area is not a realistic possibility. However, constructive evolution is necessary. One can hope that the forthcoming IEO report on IMF Corporate Governance will contribute to this process. The activities of the executive directors should be more focused, and management and staff should be given more responsibility along with an

increase in their accountability [4]. External accountability is a crucial complement to the IMF's internal governance. Transparency is a key tool of accountability. Although the transparency of the Fund has increased substantially over the past decade, it is far from ideal. Furthermore - representation on the executive board - there are two issues. Is the board too large to be effective? It may well be, but its size cannot be reduced without dramatic changes in representation, where at least half the seats are occupied by representatives from the 27 traditional advanced countries, not counting Russia, and at least 7 seats are occupied by representatives from members of the European Union. Everyone knows what needs to be done to break this logjam: dramatic consolidation of European representation. The Europeans as a group have taken this issue off the table. Although the topic has been raised from time to time by officials from individual European and from other industrial countries including my own, my impression is that no pressure in this area has been exerted by the Asian countries. There are two tests for success on the issue of shares: First, will the new quota formula points toward a substantial redistribution of voting power away from the traditional industrial, or "advanced," countries as a group? Second, once adopted, will the formula be used transparently to implement a significant, immediate realignment of voting power away from those countries on the order of 10 percentage points including, but not highly dependent, on a permanent boost in basic votes? Every member of the Fund should receive some increase in its quota at this time [5].

Although it is true that the Fund's liquidity is at an all-time high, that should not be the only consideration. It is unfair and would be a mistake to limit the amounts that countries inevitably will borrow from the Fund over the next five years to the size of their quotas that were set a decade ago. Thus, it is unfortunate that the executive board has recommended to the IMF's board of governors that the Thirteenth General Quota Review be concluded without taking any action on the overall size of quotas. This action can be overturned as part of an agreement on the overall issue of quotas, but it sends all the wrong signals. The forces favoring the status quo are winning. If they do win, their victory will result in a progressively declining role for the Fund. It is in developing country's interests constructively to confront those forces and to turn them back. Once substantially diminished, it will be very difficult to restore the Fund to the role it should play in promoting economic growth and maintaining financial stability for the world as a whole. And in the view of the above developing, under-weight countries are pleased with another sort of rebalancing: that of global institutions to better reflect today's economic realities. From now on, the G20 will replace the narrower, Western-dominated G8 as the primary global economic talking-shop, giving the likes of China, India and Brazil a permanent seat at the table. In return, it is hoped that they will be more flexible in other areas, such as climate change and trade. The governance structure of the rejuvenated IMF will also change, with under-represented, mostly developing countries getting at least 5% more of the voting rights by 2011. Taken together, the Fund's overhaul and the G20's expanded powers mark an important shift in international macroeconomic policy. The other big institutional change is the ascension of the Financial Stability Board (FSB), a club of central bankers and financial regulators, which has also been broadened to include the big developing countries. From now on it will take a lead role in coordinating and monitoring tougher financial regulations and serve (along with the IMF) as an early-warning system for emerging risks. The FSB could turn into the "fourth pillar" of the modern global economy, along with the IMF, the World Bank and the World Trade Organisation. The FSB will also help to ensure that the rules governing big banks are commensurate with the cost of their failure. The main tool for this will be higher capital requirements. All agree that banks need more capital and that a greater share of it should be pure equity, the strongest buffer against loss. The G20 communiqué also supported forcing banks to hold especially high levels



in good times so they are better prepared to ride out the bad. Strengthened positions of developing countries are also supported by better economical results comparing to European countries. Big populous countries - China, India, Indonesia - did not tip into recession; they merely suffered slower growth. Brazil and the Asian tigers saw output fall but bounced back. Even before the crisis, according to the World Bank, nearly three-fifths of the growth in global GDP came from China and India alone. In 2010 pretty much all the growth in the world economy will come from outside the rich world. This has made reform of the international financial institutions, which already looked out of sync with reality before the crisis, even more urgent. The Fund's government admits the IMF needs to regain trust of its poorer members, so that they rely on the fund's resources, rather than their own reserves, to insure against crisis. Gaining this trust will require reforms to the fund's "quotas" to give emerging economies more voting power. One round of changes has already been agreed, though not yet implemented. The G20 countries have asked the IMF to complete its next set of quota reviews by January 2011. But to satisfy developing countries, rich ones would have to give up more power than they may be prepared to. To sum up the IMF's future depends on its flexibility and implementation of vital reforms. If it did not accept the changes then the setting up of a new global financial institute would be possible, with the dominating role of BRIC and other developing countries. Nevertheless until 2012 the International Monetary Fund will remain the number one global financial institute.

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*Kisterskaya I. \**

## FRANCHISING AS A MODE OF UKRAINIAN ENTERPRISES' WORK UNDER CONDITIONS OF CRISIS

**Resume** *The relevance of the material stated in article, is caused by influence of crisis on business activity of Ukraine. Objective of this research is to consider franchising as a way of the small and average enterprises effective functioning in Ukraine under conditions of world financial crisis. In the article there is presented the essence of franchising and advantages and disadvantages of this form of business development for both sides of the agreement. The development of franchising is investigated in the world and in Ukraine in 2008-2009. Forecast of the franchising development in 2010 is represented.*

**Keywords:** franchising, franchiser, enterprise, world financial crisis, franchise.

**Аннотация** *Актуальность материала, изложенного в статье, обусловлена влиянием кризиса на предпринимательство Украины. Цель данного исследования – рассмотреть франчайзинг как способ эффективного функционирования малых и средних предприятий в Украине в условиях мирового финансового кризиса. В статье рассматривается сущность франчайзинга, преимущества и недостатки этой форму развития бизнеса для обеих сторон франчайзингового соглашения. Исследуется развитие франчайзинга в 2008-2009 гг. в мире и в Украине. Представляется прогноз развития франчайзинга в 2010 году.*

**Ключевые слова:** франчайзинг, франчайзер, предприятие, мировой финансовый кризис, франшиза.

Nowadays franchising has become one of the most important and vital topics for discussion by professional community. World financial crisis has appeared fatal not only for a small business, but also for the companies – leaders of the market in the sector. Franchising allows large firms to master new market segments and to expand territory of economic activities without attraction of additional capital investments by granting to separate entrepreneurs the right to use an exclusive rights complex of intellectual activity results, goods, works and services that appertain to legal owner. Franchising relations also give considerable advantages for the development of small and average business. Franchisee uses technologies of the legal owner that has stable business reputation with a great demand on production. Franchising also helps to get the advantages in competitive struggle for resources and preferences of consumers.

Validation of considerable economic potential of franchising relations for participants of enterprise activity, in particular, and national economy developments, as a whole, is the wide franchising circulation in foreign countries. "Either franchising, or bankruptcy" is a saying of economists in America. A chance to survive for a firm without franchising reaches only 20 %.

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\* candidate for a Master's degree with a specialization in «International Economy», 5th course, economic faculty, Taurida National V. I. Vernadsky University, Simferopol, Ukraine



And it is in the steady market of the West. Today, for example, in the USA the annual volume of retails in franchising sphere reaches more than 40 % of the total amount of sales. It is estimated by the American experts in more than 1 billion of US dollars. Franchising assumes creation of a wide network of the homogeneous enterprises that have the same trade mark. Also entrepreneurs keep up identical conditions, style, methods and forms of goods sales or rendering of services. Standard requirements are the most important for quality of the goods (services) and the single prices established and regulated centrally.

The main franchising advantage is minimization of investments and risks at start of a new business. Chances for success are essentially higher, than those of independent entrepreneurs. Franchisee has an opportunity to use all the advantages of the strong settled brand, common standards of work and servicing, favorable commercial terms, essential marketing support and many other things.

Popularity of franchising consists in effectiveness and high stability of new enterprises. According to "Mr. Doors Home Inc", only 23 % of private enterprises survive after five-year activity in the USA market. Only 18 % of them still exist after 10 years, while only 8 enterprises out of 100 break up in five years, and 10 out of 100 break up in 10 years among those working on franchising system.

Companies with famous brands from the USA, Canada, France, Germany, Japan, Great Britain, and Australia spread their businesses owing to the franchising system. Each eight minutes one franchisee appears in the world because the effectiveness in such companies is twice higher than in ordinary enterprises. Great Britain statistical data testifies that each invested pound of sterling brings six pounds of profit in eight years (whereas the usual enterprise brings only three). German franchising association forecasts stable yearly 10-15 % increase of franchisee objects during the first ten years of the current century. The fact that during the last five years only 8 % of enterprises turned out to be insolvent confirms the economic viability of the franchising system.

One of the main reasons for franchising fast spread and success is the combination of profound knowledge, rich experience and strong financial position of the franchisor — a business organizer, and the franchisee - an energetic businessman, whose enterprise functions as a part of one complex, united by the franchisor.

So a content of franchising is as follows. A franchise is the agreement or license between two legally independent parties which gives a person or group of people (franchisee) the right to market a product or service using the trademark or trade name of another business (franchisor); the franchisee the right to market a product or service using the operating methods of the franchisor; the franchisee the obligation to pay the franchisor fees for these rights; the franchisor the obligation to provide rights and support to franchisees. Franchising is a faster, cheaper form of expansion than adding company-owned stores, because it costs the parent company much less when new stores are owned and operated by a third party. On the flip side, potential for revenue growth is more limited because the parent company will only earn a percentage of the earnings from each new store. 70 different industries use the franchising business model, and according to the International Franchising Association the sector earns more than \$1.5 trillion in revenues each year [1].

Product distribution franchises simply sell the franchisor's products and are supplier-dealer relationships. In product distribution franchising, the franchisor licenses its trademark and logo to the franchisees but typically does not provide them with an entire system for running their business. The industries where you most often find this type of franchising are soft drink distributors, automobile dealers and gas stations. Some familiar product distribution franchises in-

clude Pepsi, Exxon, Ford Motor Company. Although product distribution franchising represents the largest percentage of total retail sales, most franchises available today are business format opportunities. Business format franchises, on the other hand, not only use a franchisor's product, service and trade-mark, but also the complete method to conduct the business itself, such as the marketing plan and operations manuals. Business format franchises are the most common type of franchise.

There are two groups involved in a franchise, the franchisor (the person or company leasing the rights to the business name and system) and the franchisee (the person who purchases it). The right to the franchise is sold by the franchisor to the franchisee for an initial sum of money, often called the up-front entry fee, or franchise fee. This money will be paid once the contract has been signed. The contract (franchise agreement) details the responsibilities of both the franchisor and the franchisee, and is usually for a specific length of time (typically several years). Once the contract expires, it must be renewed. State laws often have an impact on the options for this renewal [2].

This initial franchise fee doesn't include anything except the rights to use the name and system, and sometimes training, procedures, manuals, and other assistance like site selection. It doesn't include any of the necessary inventory, fixtures, furniture or real estate.

In addition to the franchise fee, the franchisee must pay the franchisor royalty fees, or other on-going payments. These payments are usually taken as a percentage of sales, but can also be set up as a fixed amount or on a sliding scale. The terms of these fees will be spelled out in the franchise agreement. These payments are for the on-going services and support that the franchisor provides. Franchisors may also sell supplies directly to their franchisees.

Advertising funds are also paid periodically. These funds are usually put into a general account and used for national and regional promotion for the entire chain.

Franchisee makes the initial installment for the receipt of a licence to use a trademark in the amount of 5-10% of the total cost of creating a single outlet, a periodic fee (usually a percentage of gross income), part of the advertising costs, etc.

According to International Franchising Association, the initial installments for the majority of franchisees are in the range of \$ 20-28 thousand. Periodic fees vary on the average within 3-6% of volume of sales. The average volume of investment needed to create a single outlet, including the cost of real estate is about \$ 320 thousand, but in some cases can exceed \$ 1 million [1].

The franchiser provides personnel development, support in management, an advertising policy and the provision of operational services on demand.

It should be noted that cost of the entrance to the franchise business vary considerably by industry. When it comes to cleaning, filling cartridges and other "non-intelligent" services, the entrance fee is only \$ 5-10 thousand, but the restaurant business amount to \$ 200 thousand. The more popular brand than more possibility of the franchise and above the cost of initial investment, the higher the entry barriers.

USA Today reported that the 10 most popular franchising opportunities are in these industries: fast food, retail, service, automotive, restaurants, maintenance, building and construction, retail—food, business services, lodging.

In addition to franchising, there are two other popular methods by which businesses expand their market and distribution channels: distributorships and licensing.

In a distributorship, the distributor usually has a contractual relationship with the supplier; buys from the supplier in bulk and sells in smaller quantities; is familiar with local markets and customers; may do business with many companies, more than just the supplier/producer; may not receive contractual support and training from the supplier/producer like a franchisee. Some

distribution arrangements are similar to franchises, and vice versa. A franchisee with a great deal of leeway in how to run the business may look like an independent distributor. A distributor may be subject to many controls by the supplier/producer and begin to resemble a franchise.

Some popular distributorships include: Amway, Color Me Beautiful Cosmetics, Mountain Life Spring Water, Knorr Soup Vendor, Campbell's Soup Vending Machines.

Licensing, on the other hand, allows a licensee to pay for the rights to use a particular trademark. Unlike franchises, in which the franchisor exerts significant control over the franchisee's operations, licensors are mainly interested in collecting royalties and supervising the use of the license rather than influencing the operations of the business. Some popular licensors include: Netscape Communications, Apple Computer, Canon Inc., Woolmark, Compaq Computer.

The many advantages and disadvantages of owning a franchise should be carefully evaluated before deciding to purchase one.

Advantages from the Franchisor's point of view:

1. Financial: Franchising creates another source of income for the franchisor, through payment of franchise fees, royalty & levies in addition to the possibility of sourcing private label products to franchisees. This capital injection provides an improved cash flow, a higher return on investment and higher profits. Other financial benefits that the franchisor enjoys are reduced operating, distribution and advertising costs. Of course that also means more allocated funds for research and development. Additionally, there will always be economies of scale with regard to purchasing power.

2. Operational: The franchisor can have a smaller central organization when compared to developing and owning locations themselves. Franchising also means uniformity of procedures, which reflects on consistency, enhanced productivity levels and better quality. Effective quality control is another advantage of the franchise system. The franchisee is usually self motivated since he has invested much time and money in the business, which means working hard to bring in better organizational and monetary results. This also reflects on more satisfied customers and improved sales effectiveness.

3. Strategic: To the franchisor, franchising means the spreading of risks by multiplying the number of locations through other people's investment. That means faster network expansion and a better opportunity to focus on changing market needs, which in its turn means reduced effect from competitors.

4. Administrative: With a smaller central organization, the business maintains a more cost effective labour force, reduction of key staff turnover and more effective recruitment.

Advantages from a Franchisee's point of view:

1. Avoiding the unnecessary trial and error period in starting and operating a new business.
2. Lower financial risk, compared to other ventures, because investment costs are lower and profit margins are higher.

3. Business Format Franchising complete packages ensure a ready to go "turn-key" franchised unit.

4. Managing a small business whilst depending on the power of the franchisor company which has a bigger organization.

5. The franchisee has an opportunity to run a proven business concept with a successful operational track record.

6. The opportunity to learn the latest developments and changes in the local and global market from the franchisor and focus entirely on developing the sales revenues.

7. The benefit of operating under a recognized trade name/trademark, which can have better marketing results.

8. The franchisee has access to accumulated business experience and technical know-how in managing the business.

9. A unified store design which leverages the business reputation in marketing the concept.

Disadvantages from a Franchisor's point of view:

1. Considerable capital allocation is required to build the franchise infrastructure and pilot operation. At the beginning of the franchise program, the franchisor is required to have the appropriate resources to recruit, train, and support franchisees.

2. At the beginning of the franchise program there is a broader risk that the trade name can be spoiled by misfits until such time the franchisor is capable of selecting the right candidate for the business.

3. There is a risk that franchisees exercise undue pressure over the franchisor in order to implement new policies and procedures.

4. The franchisor has to disclose confidential information to franchisees and this may constitute a risk to the business.

Disadvantages from a Franchisee's point of view:

1. The requirement to pay the franchise fees and royalty to the franchisor, which in some cases can be exaggerated.

2. The transfer of all goodwill built in the local market to the franchisor upon expiration or termination of the franchise contract.

3. The necessity of abiding by the franchisor's operating systems, standards, policies and procedures.

4. Reduced corporate profit margin due to payment of royalties and levies.

For the majority of people, franchising has proven to be the most practicable way to become a business owner. Overall, it offers the lowest risks and the highest level of support. Because a franchisor doesn't succeed until the franchisees do, you'll find a team of dedicated professionals willing and able to help you every step of the way, from site selection to employee hiring to grand opening. They will keep in touch with you from the very beginning to years down the road and have Web sites, toll-free numbers, and an enthusiastic staff to make sure all your questions are answered quickly and completely.

Small and middle business provides 40-70 % of GNP in European countries with highly-developed market economy. The fact that franchising combines advantages of small and middle business adds to its popularity. For most people who are considering business ownership, franchising will provide the least risky means to obtain the financial and lifestyle goals you desire with the best chance of success.

**Table 1 Business Ownership Comparison**

	<b>Franchise</b>	<b>Business Opportunity</b>	<b>Your Own Business</b>
Potential Risk Factor	Lower	Moderate	Higher
Cost	Moderate to high	Usually moderate	Whatever you want to spend
Training	Yes	Possibly	None
Proven operating system	Yes	Yes	No
Ongoing support	Yes	No	No
Royalty payments	Yes	No	No
Up-front fee	Yes	Yes	No
Brand-name recognition	Yes	Maybe	No
National marketing fund	Yes	No	No
Marketing help	Yes	Maybe	No
Group buying power	Yes	Maybe	No

Every year Franchise Direct (a member of the IFA) makes a list “The top 100 global franchises” [3]. This study ranks the top 100 global franchise companies from the many thousands of franchises around the world. The ranking is based on objective and measurable criteria including system size based on numbers of units, sales revenue for the system, stability and growth of the system, number of years in operation and market expansion. The ranking is also based on the implementation of best practice in the areas of franchisee support and training, environmental policy and social responsibility.

The franchising industry is an important contributor to the economy of the United States in terms of output and employment. The direct economic contribution of franchised businesses is \$835 billion or around 4 percent of the U.S. private sector economy while over 9.5 million people are employed by franchises. It is also expected for the year 2010 that the franchise sector will produce more than 2 trillion dollars in the U.S. The role of franchising in distributing products to customers worldwide has grown considerably over the past 50 years. The regions most often targeted by US franchises were the Middle East, Western Europe, Central and South America and Eastern Europe.

While franchising is associated with the United States the franchise business model has been adopted globally and there are now major non-US based franchise companies in operation. Nearly 15% of the Franchise Direct Top 100 Global Franchises is comprised of non-US based franchise systems. The ranking includes for example, NaturHouse the Spanish health and nutrition franchise, the Kumon children’s educational franchise which originates in Japan, Cartridge World, the Australian printer cartridge refilling franchise, and Expense Reduction Analysts the UK originated consulting franchise.

In the beginning of the year 2010 Top 10 Global Franchises looked so:

**Table 2** Top 10 Global Franchises

Rank	Name of Franchise	Business Description	Country of Origin	Started as a Franchise Business	Countries	Total Units	International Units
1	McDonalds	QSR	US	1955	117	32,158	13,58
2	Subway	QSR	US	1974	91	32,501	9,432
3	KFC	QSR	US	1952	109	22,2	15
4	Burger King	QSR	US	1954	73	11,5	4
5	7-Eleven	Convenience store	US	1964	15	29,3	22,33
6	InterContinental Hotels	Hotel	UK	1956	100	4,4	1,074
7	Pizza Hut	QSR	US	1959	91	13,1	4,221
8	Snap-on Tools	Home Improvement Store	US	2001	150	3,4	300
9	Taco Bell	QSR	US	1964	100	5,845	245
10	Ramada Worldwide	Hotel	US	1989	47	910	359

Source: 2010 Franchise Business Economic Outlook, prepared by PriceWaterHouseCoopers for the IFA.

The Quick Service Restaurant (QSR) industry dominates the Franchise Direct Top 100 Global Franchises. But industry trends look so:



**Table 3** Market Share Distribution by Industry

Franchise Industry	% Market Share	Establishments	% Change over Prior Year
Automotive	4.25%	38,34	1.8%
Commercial and Residential Services	6.33%	57,007	0.3%
Quick Service Restaurants	21.4%	192,827	3.1%
Table/Full Service Restaurants	5.4%	48,609	2.1%
Retail Food	7.85%	70,722	2.4%
Lodging	3.53%	31,827	-0.8%
Real Estate	4.62%	41,63	3.0%
Retail Products and Services	9.8%	88,312	2.3%
Business Services	25.71%	231,151	1.7%
Personal Services	11.11%	100,151	1.8%
Total	100%	901,093	2.0%

Source: 2010 Franchise Business Economic Outlook, prepared by PriceWaterHouseCoopers for the IFA.

Service sector brands focused on everyday needs are one place to start. These include such basics as hair cutting salons, and home maintenance and repair (painting, plumbing, electrical, lawn care, flooring, and handyman services). Automotive service and repair, from oil changes and tune-ups to body work and rim rentals, also tend to stay steady in tough times.

Business services will always be in demand. Franchises offering tax preparation, accounting, computers, legal, and equipment leasing, for example, are evergreens. Some of these services might even be in greater demand as cash-strapped small businesses lay people off and outsource more of their business functions.

As consumers spend less on luxuries and look to save on necessities, dollar stores and used or recycled clothing stores have become more attractive. Rental concepts also are an option for cash-strapped consumers no longer able to purchase expensive items such as high-definition televisions, computers, large appliances, and furniture.

Personal services have remained strong so far, and look to continue. These include child care and supplemental education (art, math, gyms); senior and elder care (home healthcare, nursing, assisted living placement, and legal services); as well as fitness centers for adults (whether a traditional health club or the growing number of concepts providing one-on-one personal trainers).

Reductions in disposable income have been a boon for lower-priced food concepts. Fast-food brands across the nation are offering a growing number of products for less than a dollar. They're also touting value in terms of "bite per buck," adding new menu options, and going the extra mile with customer service. Healthier foods are coming on strong, from probiotic, low-calorie frozen yogurts to trans fat-free fries.

The top global franchises share a number of characteristics which have contributed to their success. These include the following:

1. Strong and internationally recognized brands. The world's leading franchises boast brands that are recognized around the globe and consumers easily associate the brand name and logo with their products and services. For example, with 32,000 units in over 60% of the world's countries, McDonald's Golden Arches and its mascot Ronald McDonald have gained universal recognition. Likewise, with 15,000 units, KFC's Colonel Sander's Mascot is recognized around the world. The 7-Eleven trademarks or International Hotel Group's Holiday Inn and Crowne Plaza also have strong brand recognition.

Brand building within a franchise is assisted by advertising fees which each franchise is obliged to pay the franchisor. These fees provide a constantly growing advertisement fund from

which the franchisor can establish global advertising campaigns. Effective brand management helps the top franchise operations maintain the integrity and consistency of their brands. Wherever the franchise is located worldwide the same quality of product and service is delivered and the same message is communicated.

2. Well defined business model. “In 2010 Franchising will be the most successful way of market expansion.”(J. Naisbitt)

The business model of the Top 100 Franchise companies is well defined and easy to replicate. There is a focus on reliable systems covering every aspect of the operation of the franchise. The business model also has a distinct competitive advantage as it combines strong branding, quality training and entrepreneurial freedom. For example Subway, which is recognized brand around the world, believes strongly in empowering their franchisees. Two slots are kept open on each store's menu board for individual franchisee creations. The simplicity of the Subway business model also means that unlike many of their competitors their restaurant sites are adaptable to any location. There are now over 6,000 Subway restaurants located in non traditional settings i.e. inside Wal-Mart stores, convenience stores, supermarkets, hospitals, schools, military bases and recreational facilities. This strategy has also contributed significantly to the rapid growth of the Subway franchise system.

3. Comprehensive training and ongoing support. The leading franchise companies recognize the importance of intensive training, follow up support and continuous learning. Strong technical and business training ensures customers receive excellent service and quality of products. It also ensures the success of each franchise unit. McDonald's realized from the beginning that the secret to success lies in quality management and competent employees and this can only be achieved through an exceptional training program.

4. Adaptability and Innovation. The most successful franchises are innovative and adaptable to a changing marketplace. The leading quick service restaurant chains for example, constantly offer new choices including healthier options, new toppings, new breads, fillings etc. In 2003, Pizza Hut introduced WingStreet Restaurants due to the rising popularity of chicken wings. Five years later they introduced restaurant quality pastas as people became more health conscious. Also, many of Subway's non-traditional restaurants serve a comprehensive, low-fat breakfast program.

Expansion into international markets can be successful if the target market is researched and a plausible strategy is implemented. A franchise needs to be able to adapt and change to the cultural differences in a new market and to be aware of current trends. For example, in Saudi Arabia, no pork products are served as it is prohibited by Islamic law. All meat sold is halal so McDonalds serves the McArabia which contains no pork products. In Indiana, there are strict religious laws about food preparation. McDonalds have implemented a system where meat and vegetarian meals are prepared in separate areas of the restaurant and chefs preparing vegetarian dishes wear distinctive green aprons to adhere to the local laws. While within Europe, strict EU food regulations made it difficult and expensive for US companies from the food industry to successfully enter the market.

We can also see how the franchise industry can adapt to new trends by introducing new concepts and new ideas for businesses. For example, in response to the ageing of the population there are more franchises set up that provide in-home non-medical companionship and domestic care services for the elderly. Two of these companies have made it into the Top 100 Global Franchises; Home Instead at no. 72 and Homewatch International at position 61.

Nowadays the world is undergoing an unprecedented economic crisis for this generation. Like all businesses, franchisors are watching events unfold, with a feeling that there is little they can do to turn the tide.

Franchisors who have previously been through tough economic times know that the franchising industry has proven itself to be surprisingly counter-cyclical, as more and more laid off employees look to the acquisition of franchises as their next career move. Some are disillusioned with the relative risk of being an employee, while others have a severance package that they end up using to buy a franchise. As many of these people have never owned their own businesses, they are interested in being in business for themselves, but not by themselves, which is what the franchise business opportunity model is meant to offer.

Franchisors pressured by slower unit growth are increasingly looking for innovative ways to help franchise candidates sign on to open new units. Some of these include: reduced franchise fees; lower royalty payments in the startup years; financing assistance; special programs or time-limited offers; help with build-out.

Many economists think that franchising is a better solution to help the country get out of the global crisis quicker than the rest. Franchising, as a business model, fits the qualifications of the affected workers noting that in these times of downsizing and layoffs, many people with management experience are looking for new careers. These displaced workers are the perfect candidates for franchisees that can make a franchise grow. Using the time, resources and network of the franchisee, the franchisor can expand his business. The franchisee, in turn, is given a livelihood.

Franchising is the better business model because it does not require someone to be an entrepreneur in the first place. Being a franchisee is not strictly being an entrepreneur. It is more of being a manager, which is what he was before getting retrenched.

Despite the limited support from government and the financing sectors like banks, franchising has already helped create thousands of businesses and millions of jobs. Capital investments in small businesses create jobs; small businesses have created 60 to 80 percent of new jobs annually over the last decade. Meaningful economic recovery and meaningful job creation will start with small business lending. In fact, the study determined that for every \$1 million in new small business lending, the franchise business sector would create 34 jobs and generate \$3.6 million in economic output.

If we analyze statistics of franchising in the world in 2009, we get the total number of franchise brands. But this data becomes interesting when compared to the following regions/countries of the world (you can see it in the table 4):

**Table 4**

USA+Canada	3000 + 1200
Brazil	1379
Mexico	820
PR China	2600
Japan	1246
Australia	1000
Egypt	340
South Africa	530

After several years of growth in the number of units, jobs and economic output, the franchising industry saw declines in 2009. The specific forecast for that year was: 10,000 franchise units gone; 207,000 jobs lost; \$4.2 billion in the value of goods and services vanishing.

Between 2005 and 2007, the industry found steady growth in all aspects of business, reaching in 2007 some 847,000 franchise units, providing more than 9.8 million jobs and generating \$816 billion in economic output. Growth slowed in 2008 and in 2009 the number of units, jobs

and output all how it was expected to fall, according to the economic outlook report, the first time the IFA has issued such a report.

Some sectors of the franchising industry are getting hit harder than others. Large job declines are predicted in automotive, retail food and retail products and services. Collapsing sales are ripping franchises in the lodging (a 3.2% sales decline), business services (a 2.8% sales decline) and real estate (a 2.1% sales decline) sectors most. Declines in unit growth were widespread across eight different sectors in the study, from business services (2.5% decline) to commercial and residential services (3.5% decline). The only positive notes: quick-service restaurants and table/full-service restaurants were expanded, though not as robustly as before; and sales, too, but that's mainly because of menu price inflation.

But in spite of dark forecast according to a report of the IFA Educational Foundation, franchise businesses reduced employment by 4.1 percent in 2009, resulting in a loss of 409,000 jobs as declining consumer spending caused owners to reduce costs. The number of franchise establishments in 2009 was estimated to have stayed relatively flat, declining 0.1 percent. Output of franchise businesses was estimated to decline by 0.7 percent in 2009, for a loss of \$5.7 billion.

In spite of these losses, franchise business leaders took the necessary steps to keep businesses open and prepare for the economic recovery expected to begin in 2010. The 2009 clearly demonstrated the importance of strong communications and relationships between franchisors and franchisees.

The economic outlook for franchising in 2010 shows some improvement. PwC forecasts that the number of business-format franchise establishments will increase in 2010 by 2.0 percent, from 883,292 to 901,093 — a net gain of nearly 18,000 establishments. After losing over 400,000 jobs in 2009, jobs in franchise businesses are expected to grow 0.4 percent, for a gain of 36,000 jobs. Overall economic output (the gross value of goods and services produced by franchise businesses) is forecast to increase 2.8 percent to \$868.3 billion — an increase of \$23.6 billion — in 2010.

And franchise business leaders are more optimistic about 2010 as well. In a survey conducted by IFA among franchise business leaders, more than half (51.3 percent) of survey respondents say that the economy will be better in 2010, compared to only one-quarter (24.6 percent) of respondents in the November 2008 survey. While more than 78 percent of those surveyed expect moderate to significant increases in franchise units, this is a drop from nearly 86 percent of those surveyed a year earlier.

The survey shows that the issues of greatest concern, both now and in the year ahead, are financing and access to capital. Nearly half of the survey respondents (49.2 percent) ranked “financing and access to capital” as their greatest concern, followed by nearly one-quarter of survey respondents (23.8 percent) who ranked “franchise sales/development” as their greatest concern.

The data show that these concerns are real. FranDATA is predicting a \$3.4 billion lending shortfall in 2010. Banks are expected to lend \$6.7 billion to franchises in 2010, compared to the \$10.1 billion that is needed to meet 100 percent of demand. The shortfall can be attributed to banks' conservative approach to a weak economic outlook and uncertainty in the commercial real estate market. At 100 percent lending, franchise business could create or maintain 305,000 jobs and \$32 billion of annual economic output in 2010.

Also franchising will be the best tool for the development of the small business in Ukraine. For Ukraine, where small and middle business is only in the process of its development, introduction of this type of business is becoming a relevant positive impulse for the economy growth. The franchising development in Ukraine contributes to solving the following problems:

- stimulation of appearance of new competing goods with well-known trademarks, widely advertised in the country and abroad, that will contribute to the expansion of new goods sale markets;
- enlargement of financial and material investments into franchising business on the part of franchisors - residents and non-residents, and also on the part of Ukrainian and Western banks under the guarantee of a franchisor;
- essential enlargement of work places on the labour market;
- further economy development of Ukraine due to the income increase into the country budget.

Franchise agreements in Ukraine are signed from the middle of 90th, however today in the Ukrainian legislation there is not a term "franchising". In jurisprudence there is a term "commercial concession" and legislation is used on the basis of it [4]. However it doesn't hamper the development of franchising and businessmen find the way out from such situation.

Inasmuch as under the franchise agreement the objects of intellectual property rights are granted, the franchise relations shall be regulated not only by the provisions of the Civil Code and the Commercial Code directly governing the franchise agreements, but also by special legislation, namely the laws of Ukraine "On protection of rights to trademarks for goods and services", "On protection of rights to inventions and utility models", "On protection of rights to industrial designs", "On copyright and associated rights".

Ukrainian economists regard the franchising agreement (agreement of commercial concession) to be the most perspective and effective method of business transaction in comparison with all other types of contractual relations, which are based on transmission of exclusive rights on the objects of intellectual property.

Different sources name a number of four hundred franchisers in Ukraine. But for all that, the actually situation is about two hundred of them develop active and constantly. Other are the Russian companies, which want to get into Ukrainian market or Ukrainian companies, which once has opened one or two franchise units.

Part of conceptions is adopted from abroad, especially in the field of trade and services. Greater part from foreign conceptions is Russian. Another are from Poland (Atlantic, Cropp Town, Reporter, RuckZuck), Germany (Liqui Moly), USA (International Kids Club, FasTracKids, Crestcom, Sport Life), Italy (Canti Cucine, Colours&Beauty), France (Frederic Moreno, Catimini, Carling), Great Britain (ChipsAway, Hostel) and others. Majority of them – about 60% – opens an own representative office. So, for example, a company Delta Sport develops such known worldwide brands in Ukraine, as Nike and Mexx; MTR-group is engaged in distribution of Broadway, Motor Jeans, Tom Tailor, KENVELO. Other give a preference to collaboration with one partner which gets a right to development of territory of whole country – Helen Doron Early English, FasTracKids and so on.

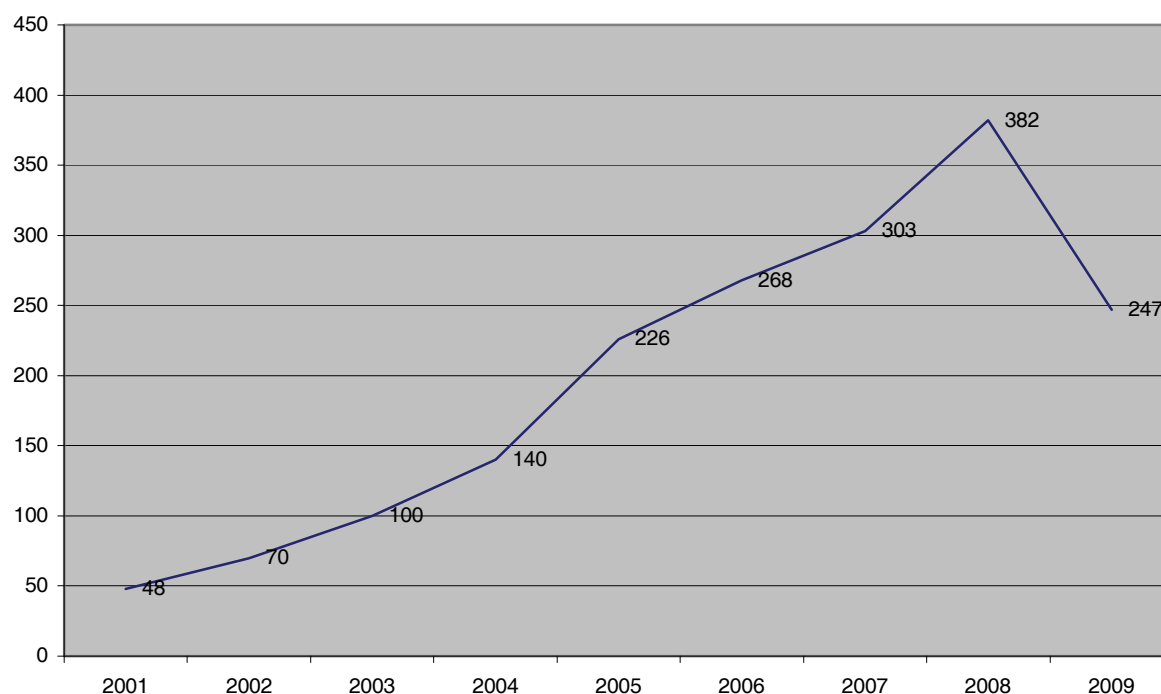
Every day franchises at the Ukrainian market become more various, new industries and technologies appear. A price range also enlarges: franchisee can choose from cheap franchises of domestic services or rental and expensive franchises of fashionable restaurants and production.

Most Ukrainian franchise systems are concentrated in the capital and only small percent of franchises are by birth from large regional centers. In addition, most of franchise units are situated in the biggest Ukrainian cities - such as Kharkov, Dnepropetrovsk, Donetsk, Odessa and Lviv. But many towns are not yet acquainted with franchising. There is a tendency of glutting the cities and companies redirect in openings of franchise units also in smaller towns.

In terms of the number of Ukrainian companies have claimed positive trend (pic. 1), but given that a number of companies that have suspended their development of franchising, the



key changes have occurred. Really working and most of the essence of franchising - approximately 30 companies. The main reason - a lack of margin development branch network and a network of franchising and its fundamental differences.



**Pic.1** Growth of franchisers' quantity in Ukraine by year

According to the data of Association of Franchising in 2008, number of franchisers increase from 301 to 380 (+26%), growth rate of business made 10 % for the year and numbers of outlets in franchising increase to 33,6 thousand (+85%).

In the first quarter of 2009, some franchisors halted its development program. This primarily affected the companies, where the concept of the business were not good, not worked out the strategy and the process of finding franchisees, as well as promoting their own franchises.

The drop in earnings in the middle and premium segment catering at 30-40%%. The fall in the networks of supermarkets is about 50%, which led many networks to the bankruptcy and the sale of its assets. In the field of construction and building materials - by 60-80%%.

Type of franchising, where the companies used its best efforts so far have remained unchanged, namely: production; trade; service; franchising of business format. Such a conversion, corporate and sub-franchising yet remained unheeded by the Ukrainian franchisors.

Industries are beginning to expand the use of franchising. Thus, if in 2008 they were 12-15 (trade, restaurants, beverages, vending, services), then in 2009 expanded to 20 because there were suggestions of Ukrainian companies in the hotel sector, health and children, design and architecture, distribution, tourism, personnel agencies.

Franchisee (investors) have also increased their activity. For example, if the Triarh Ltd in 2008 received 523 request for the purchase of any franchises, in the first quarter of 2009, already 456 requests, that almost four times higher than the previous year.

Legislative base of franchising in 2008 not been changed by the state, but the ship is beginning to understand the practice of the difference between a contract of «commercial concession» and the «License agreement». This makes Franchisors to draw attention to their contractual basis, and appeal to the experts for the preparation of contracts, as well as the methodology of our work in difficult conditions, lack of registration data contracts.

Attempts to group companies (Triarh, Vasil Kisil & Partners and others) lobby registration commercial concession contracts has been inconclusive. A positive trend is that the round tables and meetings with government officials have the opportunity to bring awareness of the importance of the concept of «franchise» for the Ukrainian economy and enterprise development in the Ukraine.

Many leading world brands have set up offices in the territory of Ukraine to monitor the protection of intellectual property. Personnel for franchising remain the key. If the word «franchise» is not a cause of bewilderment and questions, the essence and standards of franchising are still inaccessible to the majority of managers of companies that declared themselves to the Franchisor.

A crisis amended plans of development of the most franchise systems, majority of franchisees are operating in regions, where now there is rather difficult economic situation. However much, the periodic openings of other franchisors refute stability of this tendency. The most popular franchises in Ukraine nowadays - are those, which need up to \$10.000-15.000, such as: street-food, vending, tourist business and so on.

So after studying of franchising companies' activity in Ukraine it is possible to draw a conclusion that on the one hand 2009 has appeared heavy enough for the development, but on the other hand it has become a kind of a check of concepts on toleration and profitability.

Top-10 of franchising leaders in Ukraine looks like that: «Coca Cola», «Pepsi», «Carlsberg», «InBev», «TNK-BP», «Lukoil», «Empik», "League Invest", «Delta Sports», and also one Ukrainian company-franchisor - «Fast Food System» (FFS). The turnover of leaders is about \$ 850 million per 2009 year. Number of staff who works with franchisor and franchisees - over 200 thousand [5].

In 2009 the total goods turnover has made approximately \$2 billion (4 % of the total goods turnover of the country) in the franchising enterprises working under the license. For example, "TNK-BP" has sold 13 licenses (in 2008 – 17), "Fast Food Systems" has sold 19 licenses (in 2008 – 18) in 2009. So crisis actually has not weakened this segment. Such tendency is observed also in neighbouring Russia and Poland. Crisis was negatively reflected only in two kinds of franchises there: the real estate and "license" luxury in 2009. But inexpensive franchises in a sphere of food, education, trade and services for business have been developing contrary to economic problems.

Franchises in vending (sales of the goods and services through automatic machines) had the greatest demand in Ukraine in 2009. In Association of franchising in Ukraine it was counted that, in this direction, owners of licenses opened 1144 freight outlets, whereas they had not existed in 2008. This year a lot of new franchisors have appeared which have started to develop the networks actively. These are the concepts which do not require big investments (Scorini Caffè Punto, Delice, Enjoy, Kukuruznik, etc.). Also some known big companies declared about their development according to franchising (Insite, Sport Life). Some companies which have started to work in the market in 2008 (The Orange Elephant, Corn House, the Express Manicure, etc.) actively develop their networks. There are also such companies which have closed the franchising projects this year (Ephoto, Linline, Dorozhnaya Karta). The street-food's branch developed very actively in 2009. Franchising networks of the companies which work in this sphere, unite at the moment freight outlets which already number in the hundreds (Fornetti - 600, Chudopech - almost 200, Rumjanochka - is more 100). For trade sphere 2009 has appeared heavy enough: many goods developed networks of foreign brands therefore the dollar rate fluctuation affected their development considerably enough in Ukraine. Therefore it is possible to tell that there was no super considerable quantity of openings in trade sphere in 2009. Some companies

ended up with a brake even point, some opened little franchising shops and some franchisers expanded a network only by opening their own shops. As a whole the companies searched for possibilities of certain concessions for franchisee attraction, they developed anti-recessionary formats and selected assortment. The situation is ambiguous in branch of services for the population. As well as everywhere, concepts with a small amount of investments received the greatest support. For example, a tourist branch was developed very actively, while the expansion of beauty salons and fitness clubs networks was minimal [6].

Franchising is possible to consider as a perspective direction of commercial activity in Ukraine and it is necessary to expect the increase of a number of franchisers and, especially, franchisees. The main reasons of the franchising market growth in Ukraine in 2010 and next years: 1) growth of unemployment of the population (growth of the population interest in its own business creation with application of franchising); 2) economy transition into a recession stage (franchising covers all spheres of economy, some of them will be profitable even under conditions of crisis); 3) a collapse of the share market; 4) a lack of business financing sources (in a case with franchising an entrepreneur diversifies risks and creates steady profitability); 5) loss in value of real estate and rent (the business basis under franchising conditions creates benefits connected with lower initial capital investments) [5].

The Ukrainian market offers many opportunities for international franchising. However, as an entrepreneurial activity, franchising encounters the same general barriers, as the establishments of small and medium businesses do. These include the whole complex of taxes, high credit rates, crisis of nonpayment, unstable legislation, and very strict control under the subjects of entrepreneur activity by the state. The investment climate remains the major obstacle for franchises in Ukraine.

In order to accelerate the franchising development on the Ukrainian market, regard such steps

should be made:

1) to ratify a law "About franchising", where the rights of franchisor and franchisee would be protected;

2) to enhance activities of consulting and business centers for business plan preparation, management advice;

3) to develop banking crediting and leasing system for franchisee under the guarantee of franchisor (a franchisor could also give a credit to a franchisee on favorable terms);

4) to pay more attention in the institutions, universities, colleges at franchising technology and to investigate franchising experience on real life cases.

Franchising under conditions of crisis will be developing. However, medium-sized franchisers that work without strict system with franchisees can have a number of problems which in the worst variant will be the cause of some companies' liquidation. In the period of economic crisis it is better to trust large franchising networks which take care of their partners.

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Kozlovskii K.\*

## BASIC PRINCIPLES OF RUNNING AN AIRCRAFT CONSTRUCTION ENTERPRISE AT CRISIS.

*The article covers basic management principles of running the air construction enterprise as well as main stages of adopting and successful implementing strategic decisions.*

**Key words:** crisis, strategy, decision-making.

*У статті на прикладі підприємств авіабудівної галузі розглядаються основні принципи управління організацією, а також основні етапи прийняття і ефективною реалізації управлінських рішень.*

*В статье на примере предприятий авиастроительной отрасли рассматриваются основные принципы управления организацией, а также основные этапы принятия и реализации управленческих решений.*

**Problem placement:** The development of market relations in Ukraine stipulated a profound transformation as well as reorganization of management structure, generation and implementation of strategic decisions at state-owned enterprises, including aircraft construction industry. The intricacy of structure, large scales combined with lack of uniformity of state property, ambiguous results of its recent management show the dare necessity of profound improvements in aircraft construction enterprises management that is determined as one of the key issues stipulated by the state policy principles in the sphere of effectiveness and competitiveness recovery of the national aircraft construction enterprises.

**Research done:** The major research in the sphere of strategic decision-making as well as generation of company's strategy at crisis is done by the following analysts: M.Porter, S.Miller, D.Miller, D.Hickson, V.Kitushin, F.Byk. Nevertheless domestic scholars don't learn the specifics of decision making while running a state controlled aircraft construction enterprise at crisis. Nor such research is done for strategy-making, as well as potential ways of competitiveness recovery in terms of enterprises of this kind.

**Objectives:** to make an outlook of major principles of running an aircraft construction enterprise at crisis combined with basic steps of market strategy development and key stages of decision making.

Global economic recession, has put a number of principal issues before humanity including the prospects of international economy development, with the emphasis on its operations and mechanisms to promote the interests of the country.

It is worth mentioning that the current downturn has exposed considerable errors in the mechanism of wealth distribution within the global economy. They indicate that the development of the current system has achieved its top level, that demands its major modernization, especially its basic components.

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\* Postgraduate student of the Department of World Economy and International Economic Relations of the Institute of International Relations of Kyiv National Taras Shevchenko University



Theoretically, this is still an obvious problem of the contemporary model. On the other hand, a number of anti-crisis steps taken in Western countries were not approved by analysts. Such situation within time period can cause a repeat of the crisis of the world economy.

Considering the abovementioned, the global downturn has been the accelerator for many global processes.

There is a clear trend of transformation of the countries' participation model in challenging key global issues and creating appropriate mechanisms.

«G-20» can be considered as one of the key solutions. The major economies, urging the crisis, due to the the global society has seized that the most daunting economic problems are insignificant without the impact of major developing countries.

Initially, it was planned to hold an extraordinary meeting of the G-8. However, the plans had to be abandoned because the interests of such countries as China, Brazil, India, South Korea, as well as a large number of developing countries were not taken into account. Within such approach, it is absolutely impossible to create a powerful base for instant response to complex economic problems, including the crisis. After much debate, it was decided to convene a forum in the format of "G-20." The original idea of creating a "G-20" was an intent to promote the cooperation between different countries through the development of common solutions on the level of finance ministers and central bank heads. Moreover, such forum unites 19 countries, including representatives of the European Union and many developing countries, thus covering 90% of world GDP and two-thirds of the world.

Consequences of the crisis were so immense that an emergency mode was selected to convene meeting. At the same time there was another group of issues combining the organization, structure and concept of the new association. First, is to create the balance within the system of global economic regulation and to identify its main objectives and goals. It was noted that the managing of the consequences of the crisis should be one of the main but not the sole purpose of "G-20". The other group of issues included the place of the new association within the system of international organizations and institutions, as well as finding ways to a swift transition to the new format, taking into account social, environmental and economic factors. Only after the resolution of these problems has been found it is possible to consider a new organization as a new center of the development of international economic and political decisions. Certainly, the positive side of creating such an association is the increased role of developing countries in decision-making concerning the key issues of global economy.

The crisis has reemphasized the urgent need for control over the economy by the governments in many countries. First of all, this is true for the U.S., Western countries as well as a number of post-Soviet countries. By increasing public spending to support the private sector, these governments had to assume the functions of stabilizing the economy. Thus, some basic postulates of the free market theory were challenged, that was dictated by the processes occurring in the global economic space of the last ten years.

Governments adopted a package of measures, including increasing the budget deficit and the growth of external and internal debt.

Governments have gone to such drastic measures to stabilize the banking sector, as well as stimulate the private sector, which has led to increased consumption. So, for example in China, subsidies have reached \$ 600 billion and were directed to support the infrastructure and social services.

Experts believe that to combat the effects of the crisis more than \$ 5 trillion were allocated globally. Thereupon the budget deficit increased substantially. Thus, 2009 state budget deficit reached an incredible figure of \$ 1.4 trillion only in the U.S.A. In October 2009, Moody's issued a statement on the revision of the rating concerning its lowering from the AAA, in case the gov-

ernment fails to reduce the rate to an acceptable level. In the EU countries the public debt rose to 100% of total GDP, whereas it did not exceed 70% before the crisis. Budget deficit of the G-20 countries has increased from 2 to 10% of GDP.

We should add that the problems of national debt and budget deficits have become of first priority in many countries. The fall of the economy in Dubai and Greece, draws attention to the danger of the uncontrolled increase of budget deficit once again. Growth of public debt is no longer an issue of several countries, and threatens global economic prosperity. Japan's public debt reached a record high of 200% of GDP, which is unacceptable for the leading economies. A similar situation exists in the UK and the USA. The global economic crisis has led to the growth of the aggregate debt of "G-20" from 80% to 120% of GDP. In its turn, this means an end to a further borrowing as an anti-crisis measure.

In the medium term the world economy faces the serious problem of liquidity and a sharp tightening of credit conditions, as the government significantly reduced the number of grants and allocations, which led to the minimization of the state role in supporting the economy. Consequently, the decline in liquidity will lead to a drop in investment activity that is displayed on slowing economic growth, particularly in developing countries.

Another important factor affecting the recovery of pre-crisis level of economic growth is the level of consumption. In many leading countries, particularly the U.S., levels of consumer debt increased drastically. This is followed by the fact that most businesses have suffered tangible losses due to the recession, reduced the overall level of savings and welfare.

In the capital market investment funds operating in the interests of households are regarded as the major investors. But as their economic situation had felt a strong blow, the level of transactions with the funds fell significantly, while the funds, in turn reduce their activities. What is causing non-renewable damage to the economy.

The global economic downturn has disproved some the major economic views, both theoretically and practically. It showed that some of the key components of this model have become exhausted and require a major revision and changes that allow the resumption of economic growth. It should be noted that it is necessary to consolidate efforts to combat the effects of the crisis, as it is likely to strike again. The fact that, despite the massive injections of funds into the economy, the crisis was only temporarily neutralized, and indices of growth are unstable, only confirms this hypothesis. Also, the anti-crisis measures taken by governments, not always forge positive results, and as a result, the current situation has only worsened. Under such circumstances, it is extremely important that developing countries take part in the process of solution making and development of crisis management measures. Through active participation in discussing and finding suitable and effective crisis management measures, developing countries can facilitate in fighting the crisis consequences, thereby greatly enhancing their role in the international space.

For state-owned enterprises, crisis management is urgent, it is no longer limited to dealing with emergencies, and pay attention to the deep-level mining enterprise management reasons for becoming an integral part of business management. Management is not a point but a line of movement and they are interrelated. Crisis management the same way, it is the process of eliminating business risk factors of a series of activities, including three stages, namely, crisis prevention, crisis and defuse the crisis concluded.

1. Crisis Prevention. Focus on crisis management is crisis prevention, not crisis. Superior risk management not only able to prevent potential crisis situation, take active measures to pre-control, but also to prepare for possible crises, drawn up plans to ease crisis response.

Crisis prevention measures are mainly the following:

(1) Foster a strong sense of crisis. The concept of crisis management is contingency planning. Bad situation in the business, people easy to see that existence of the business crisis, but when the sun at high noon in the enterprise, be prepared is not an easy task, but the crisis will often come in to waste their time. Therefore, enterprises should first establish a kind of crisis management "crisis" concept, creating a "crisis" atmosphere, so that business and all employees to face the fierce market competition, crisis-ridden sense of understanding of business there is risk, product risk. Ideas to motivate employees to use the crisis sense of crisis and fighting spirit, keep fighting, keep the reform and innovation, and constant pursuit of higher goals.

(2) Te introduction of crisis management framework. Managers shall try to establish the framework of crisis management, organizational structure, which is mainly composed of three parts, the first part of an information system, the second part of the decision-making system, the third part of the operation of the system. Information system is mainly responsible for external work, by the Department of information integration, information and advice to the Department of Foreign Exchange Management Department of the composition. Information Integration Foreign Ministry sent a scout to collect information on the information, and collate the information collected and assessment of identification; information on the Ministry of Foreign exchange to meet the public, the media, interest groups and people outside the crisis, advice of the Department of Management responsible for the crisis caused by the impact and crisis management and related public interest groups on the organization's views and recommendations for improvement, some important information in a timely manner to senior corporate reporting. crisis management decision-making system is composed of the commander, responsible for the overall work of the crisis, he must have sufficient authority to make decisions, usually by the chief crisis manager, as the company's business decision-making levels, managers may also be secondary or primary served, but this time must be granted by the senior decision-making authority of its larger. operation of the system by the departments to the Department of the Ministry and actual combat, of which department to contact the department responsible for liaison with internal departments affected by the crisis and affected the sector, it is normal business areas affected by the crisis areas with a link, while the actual Department is responsible for the strategic plan of the crisis management response translated into actual strategies and plans, and through the expertise to implement these plans. This crisis management frame structure, no matter what type of deal, size and nature of the crisis, have clearly limited the work of each department and goals. The communication within the organization and provision of information to external groups separately, reducing misunderstanding and confrontation, reduces the impact of corporate reputation.

(3) The establishment of crisis early warning system. Crisis early warning system is the use of certain scientific and technological methods and means of production and operation process variables were analyzed and the possible source of crisis in the police set the alarm indicators, alarm capture time, at any time on the enterprise monitoring operational states, on the harm their own survival and development issues in advance prediction and analysis, to meet the crisis prevention purpose. Crisis early warning system mainly include the following aspects: First, crisis monitoring. Refers to the various factors that may lead to crisis and crisis of representation through rigorous monitoring, to collect information on corporate crisis, to grasp the changes in corporate crisis first hand. Second, the crisis prediction and forecasting. Means the monitoring of the information for identification, classification and analysis. Crisis monitoring and forecasting are complementary, they are enterprises in pre-crisis and crisis control the foundation and basis for, the most important thing is to collect and collate information, select the appropriate method to judge, to win the time of crisis. Third, pre-crisis control. An enterprise should ad-

dress the factors that lead to the possibility of enterprise crisis, to crisis response measures and the development of various plans, to effectively prevent the occurrence of a crisis or a crisis as far as possible to reduce the losses to a minimum.

2. Crisis management crisis prevention can only minimize the number or extent of the value, but can not prevent all crises coming. Companies can staff the following aspects:

(1) The fastest start the crisis management plan, if the initial response delay, will result in the spread and expansion of the crisis.

(2) The public interest should be the first place. To achieve long-term interests of the company from crisis to crisis, should pay more attention to resolve the interests of consumers and not just short-term business interests, take concrete action to show the sincerity of the company to resolve the crisis, as far as possible affected by the crisis of the public to make up loss, this will help safeguard the company's image.

(3) Open and efficient information distribution channels. Sincerity is the best strategy for companies in crisis. Enterprises should master the initiative of media coverage, by holding a news conference, using the Internet, telephone, fax the form to the public the specific circumstances of this crisis, the company's present and future responses to such content, information to be specific, accurate: always ready to accept the media and the public's access to low profile, full of compassion and affinity in expressing regret that position.

(4) Select the appropriate crisis management strategies, such as crisis stop strategy, risk isolation strategy, risk exclusion strategy, crisis strategy used. separate strategy, crises often have knock-on effect, a kind of crisis often lead to another crisis, this enterprise in times of crisis, the crisis should be managed to minimize the negative impact of isolation in the context of avoiding bring disaster other non-related production operations.

Suspension of strategy is the development trend according to the crisis, the initiative to bear the losses caused by the crisis, such as stop sale, recovery of product, closing the factories, department.

Elimination strategy. Requires enterprises to established crisis management measures, the crisis quickly and effectively eliminate the negative effects: positive material to good use, dilute the negative impact of the crisis, such as through the media to convey the concerns of the consequences of corporate crisis, measures taken, and ready to accept the media's access to and answer questions.

Utilization strategy. The strategy is to change "crisis" to "life" of an important part of the more in times of crisis, the more clear to a good business overall quality and overall strength. Long as honest, frank and responsible attitude, it may be a crisis into life. Handled properly, will receive a bad thing turned into a good result.

(5) Full notary or authority of the role of institutions to resolve the crisis. Use of authority in the public mind a good image, crisis management, it is best to invite a notary public or the authorities supporting the investigation, in order to win public trust, which often deal with the crisis on the company can play a decisive role.

3. Summary. Crisis management summary is the last important part of its development of a new round of crisis prevention has important reference value, therefore, deal with the crisis management of serious and systematic summary.

(1) Survey. On the causes of the crisis, prevention and treatment measures for the implementation of systematic investigation and analysis of are regarded as key factors.

(2) Evaluation. On crisis management and to conduct a comprehensive evaluation, including on early warning systems and procedures of, a crisis management plan, crisis decision-making levels evaluation, to be an exhaustive list of risk management of existing problems.



(3) Correction. Crisis to various issues involved in classification, corrective measures were proposed to improve the business management of enterprises, and instructed relevant departments to be gradually implemented, improve risk management content, and to educate employees, warning peers.

(4) Forward. Crisis is not the same business failure, a crisis often breeds transfer. Enterprises should create heavy pressure on the crisis into a powerful force to drive continued to seek their technical, marketing, management and organizational system series innovation, and ultimately take-off and development of enterprises

The national economic system is integrated into the world economy closely enough to be involved in the global processes. The eroded macro-stability of international markets could not but impact internal developments in Ukraine. The world economic crisis has already caused a series of bankruptcies of the world's leading financial companies and financial crisis rollover to the real economy sector, drop in demand on global markets and, as a result, plummeting commodity prices and stagnation of leading economies.

Given the limited financial resources inside the country and shrinking access to foreign loans, enterprises face a difficult choice: either to suspend production and lose markets, maintaining high prices in expectation of better times, or to reduce prices trying to restore demand and keep consumers. The latter option is for those manufacturers who care about their future, expansion and economy of scale; the former is for profiteers who make large money quickly and drop the production. [1]

In such conditions the strategy planning and decision-making processes are becoming of utmost importance, especially for state-controlled export-oriented enterprises, taking into account the increasing role of export-oriented production in the country's economic growth. In early 2008, production growth in export-oriented sectors accelerated dramatically, and the financial resources of the national economy were re-distributed, in particular through the banking system, from other sectors into commodities and export-oriented ones. [2] Thus the issues of enhancement in aircraft construction management are determined to be the key issues stipulated by the state policy principles in the sphere of effectiveness and competitiveness recovery of the national aircraft construction enterprises. For these goals to be achieved, clear requirements combined with the branch management reforming criteria shall be developed. Moreover, in order to boost the effectiveness of resources use as well as property use, the issue of methodological support and regulations of the private and JSC property nationalization is to be settled by the government.

The intricacy of structure, large scales combined with lack of uniformity of state property, ambiguous results of its recent management show the necessity of profound improvements in aircraft construction enterprises management. The preserving of enterprise's ownership over the property that ensures its activity, forms an integral part of its infrastructure and is vital for achieving its strategic goals shall be regarded as the strategic goal.

The key directions for the reforming process shall be the following:

1. Development of the legal base in the sphere of ownership relations.
2. Development of the high-skilled management.
3. Increase in enterprises' capitalization.
4. Introduction of the cutting-edge corporate management models.
5. Establishment of the specialized branch groups and investment funds.
6. Enhancement of the scientific and expert background for strategic decision-making.



Generally, the concept of running a state owned aircraft construction enterprise as well as its strategy generating process and decision-making requires revision, especially at crisis. In order to boost the effectiveness of its activity that will allow the government to integrate the national aircraft construction industry into the global economy the following provisions shall be considered:

1. Global economic challenges require new management approaches and concepts.
2. The timing factor is of great importance. All decisions must be well-timed.
3. In the terms of global competition and economic crisis the enterprise shall be regarded not like a single unit, but like a pool of conflicting components. The cooperation as well as competition is possible within such pool.
4. Strategic planning requires not only hands-on experience but also analytical skills. Using such multiple methods as project management, strategic planning can be transformed into a dynamic process integrating the strategy and organization.
5. Methods and facilities that utilize brand new approaches play an important role in efficient strategy planning.
6. The process of strategy planning shall be given the effectiveness on the basis of leadership.
7. The strategy planning is only the means aimed at achieving the ultimate goal of competitive benefits.

The fact that company doesn't possess a clear strategy only shows that the company has no strategy at all, or at least is unable to bring it to life. Clarity in scope with simplicity reflects the consistence in employees' actions and improvement in enterprise's performance, especially at crisis.

The improvement of management at aircraft construction enterprises is determined as one of the key directions within the state policy of refining the effectiveness and competitiveness of the aircraft construction industry. In pursuance of the abovementioned goals the exact requirements and criteria of the whole branch reforming concept shall be worked out. Methodological provisions and regulations of the nationalization and allowance into the state possession of the property complexes of the private and joint stock companies are to be accepted at the state level in order to boost the effectiveness of the use of the property resources. The mechanisms of the state business activity, its relations with other owners shall be created. They will comprise: exactly determined rights, liabilities and the way of receiving its share by the state within the mutual investment agreements, payments within concession agreements, principles of profit allocation and utilization in the state-controlled enterprises.

With the objective of the theoretical and methodological backgrounds development of the transformation of management systems in state-controlled enterprises the following principles are to be taken into account:

1. efficacy - drawbacks shall be removed with confidence.
2. adequate complexity - complex processes require complex solutions.
3. diversity - diversity of forms shall correspond to diversity of situations.
4. adequate change - if the object changes, the means shall be changed too.
5. analogy - same objects require same reformation approaches.

In order to analyze the management system and implementation of the policy in the sphere of state-controlled aircraft construction enterprises managing an integrated approach is usually used. Within its frames the real policy comprises logically specified contracts gradually joining interests of the system parties.

In order to boost the effectiveness of the enterprise's activity the main priorities shall be given to strategy and organization. Most state-controlled aircraft construction enterprises con-

sider the strategy to be the principle factor over the organization. But in the light of the recent economic recess due to crisis such approach requires being modified. Many enterprises separate strategy-making from problem-solving with budgets being designed without taking into account the newly elaborated strategies, thus most decisions and innovations in this sphere influence strategy and determine its limitations. Here the regressive interrelations are observed.

Recent researches clearly show the drastic necessity of refusal from the intuitive approach and switching to coordinated decisions.

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Savitskii S.\*

## STRUCTURAL MARKET REFORMS - THE MAIN DIRECTIONS OF FORMATION THE UKRAINE'S ECONOMIC STRATEGY AND TACTICS

**Resume** *The relevance of the particular article is caused by problem of crisis resolving in Ukraine and other countries. Author argues measures for crisis' resolving as a part of economic strategy, which are based on structural transformations in domestic economy system, directed to deepening of market reforms. Suggested approach considers revision of the interactions between economic entities as the way of resolution important economic problems – budget deficit, shadow economy, forming financial sector. Article includes statistic data, which illustrates government role in the economy, as one of the most important elements of current economic structure of Ukraine.*

**Key words:** VAT rate, government regulation, household's savings, economic structure, public expenses.

The aim of transition period in Ukraine was to transform administrative command economic system into market system management. Steps and measures, that were taken on this way, had unsystematic and tactic character. They didn't take into account the important feature of contemporary interpretation and meaning of market economy system - social aspect. Areas of economic transformation, which caused the biggest problems, were: privatization, taxation system forming, and assignment the government's role that is not typical for market economy. Those factors and lack of deep structural reforms caused forming in Ukraine the model of economic development, which is efficient under those prerequisites: inflows of foreign capital (mainly with speculative motives), low level of energy and labor resources' prices, availability of credit resources and high prices' level on export products. This model generated relatively stable economic growth during 2000 – 2008, but approved its inefficiency and short-term character in current crisis [2, 88].

Inefficient and uncompetitive economic model, which was formed, involves necessity of deep structural reforms on the way to social oriented market economy system.

In Ukraine, crisis resolving problem lies within the discussion of future effective national economic model and is widely analyzed by professionals of different field of studies. It was study subject for a large number of researchers among which are next V. Heyets, S. Lyovochkin, V. Phedosov, A. Krysovaty, V. Oparin, A. Sokolovska, I. Lunina, M. Karlin, O. Paskhaver and others. Different of those analysts implied different meanings in this subject. But less attention was payed to the view of forming efficient economic system's structure, as one of the ways, which ceases progress of crisis in Ukraine. In this article I want to argue view at the economic crisis' solving problem, mainly as the problem of inefficient economic structure in Ukraine.

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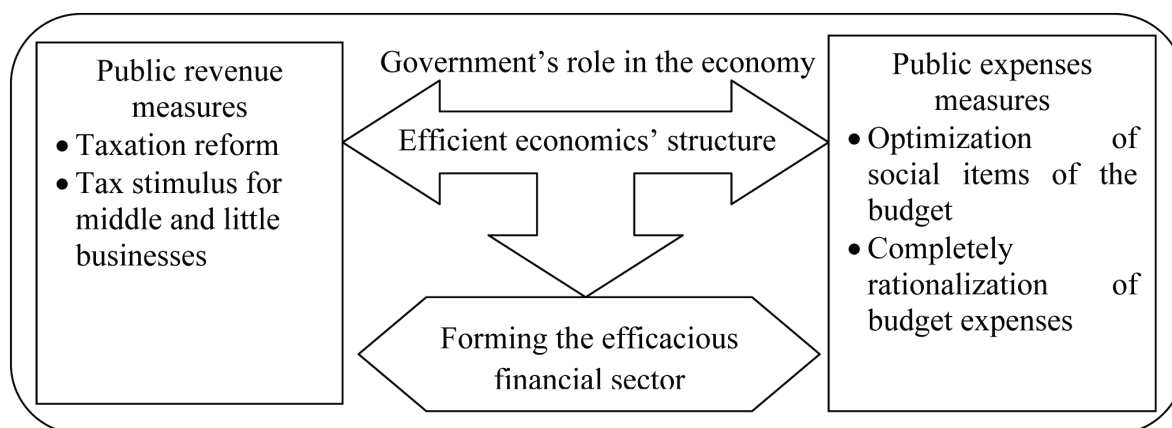
\* 4th year student of Economic faculty Volyn National Lesya Ukrainka University

The subject of the particular research is to recognize the lack of structural market reforms that caused the crisis in Ukraine and to suggest practicable ways of increasing economic system's structure efficiency taking into account recent changes in character of fiscal and monetary regulation methods that has appealed as a result of global crisis.

Analyzing economic system's structure we need to define such terms as economic system, economic system's structure and economics' structure efficiency. Tying all the theoretical background together, we can conclude following definitions. Economic system – a particular set of institutional arrangements and a coordinating mechanism designed to respond economizing problems and long-run economic efficiency. Economic system's structure is a current complex of connections and interactions between agents in economic system and the ways of their co-operation. Economics' structure efficiency means obtaining a particular output of product with the least input of scarce resources using the current system of institutional arrangements and formed economic mechanism.

The process of formation the Ukraine's economic strategy needs to consider range of factors and include measures in different branches of economic system. But, the main direction of the reforming should be referred to the government's role in the national economy. This factor consolidates main structural transformations that should be made.

Picture 1 illustrates that under the Ukraine's economic structure considerable would be to proceed economic reforms through the government's institutions. Otherwise (in case of relying on market mechanism), we can't ensure the result of those transformations. But, it also limits the implements that could be used because of necessity of realizing the model of social oriented market economy. It means government is designed to execute reforms that will form the efficient structure of the market economy system and simultaneously reduce the level of state's regulation in the middle- and long-run period [2].



**Picture 1.** The main factors of forming the Ukraine's reforms plan.

Those measures (picture 1) are designed to affect the economic system structure and increase the level of its performance and ability to respond external and internal impacts. I'll argue every item of denoted government steps below.

Describing the pattern of economic structure we need to consider following assertions: 1. Changes in the finance theoretical and practical background, caused by crisis processes; 2. Specialty of the government regulation in Ukraine (Table 1)

**Table 1** Assertions regarding the economic structure in Ukraine

Changes in the finance theoretical and practical background, caused by crisis processes	Specialty of the government regulation in Ukraine
Governments use fiscal stimulus as a main instrument against the crisis.	Majorly administrative methods were used to reduce the crisis influence. It indicates shortcomings of government regulation.
In some cases unsuccessfully realized fiscal measures undermines the medium-term sustainability of fiscal policy and puts pressure on the budget balance in the long-run.	High level of shadow economy, which is additional source for economic growth and at the same time effective and successfully tested way to avoid taxation.
The new area of government regulation has appealed managing of the given credit resources and satisfied government guaranties.	Mono-sectoral export structure that puts additional pressures on the foreign trade balance's deficit.
Necessity of finding new or improved methods of regulation in the financial sector.	High level of taxation pressure and default risk, which is caused by high budget deficit.

Source: [1; 2; 3], conclusions by the author.

Using the statements of government's regulation specialty, noted in Table 1 we can make the conclusion about the pattern of economic structure. It includes following components: state's corporations, firms and enterprises (excluding metal and chemical industry), enterprises of chemical and metal industry, consolidated budget, other centralized funds (including Pension fund), households (taxed activities), financial sector (as the instrument of capital's mobilization and allocation), shadow economy (non-taxed activities of all prior elements). At the same time we need to take into account fundamental changes in regulation to respond the crisis, which were concluded by other mature market counties (Table 1) [3]. Hence, we've got relatively new elements of economic structure: state's debt – issued guaranties and immediate debt, spoiled financial institutions (that increase systemic risks of financial system), nationalized banks (that transferred liquidity and capital risks to public balance sheets).

The level of overregulation in the economy is showed by the portion of consolidated budget and budget of Pension Fund to the GDP. Table 2 illustrates the general tax burden in Ukraine in 2002 – 2008. Researcher Chugunov I., has analyzed the impact of increase in tax burden to the decreasing of real GDP: one percent of increased tax burden causes maximum decreasing of real GDP after a year (0.885%), five (0.96%) and eight (0.847%) quarters [5]. Under this statement, in Ukraine's conditions, every government's measure that provides increasing of tax burden will put significant pressure on public balances in middle- and long-run. To assess the tax burden, we'll use the proportion of the amount of consolidated budget's revenues and Pension Fund's (PFU) own revenues to nominal GDP (table 2).

**Table 2** Portion of consolidated budget and Pension Fund's budget in GDP in 2002 – 2008 (in millions, current prices)

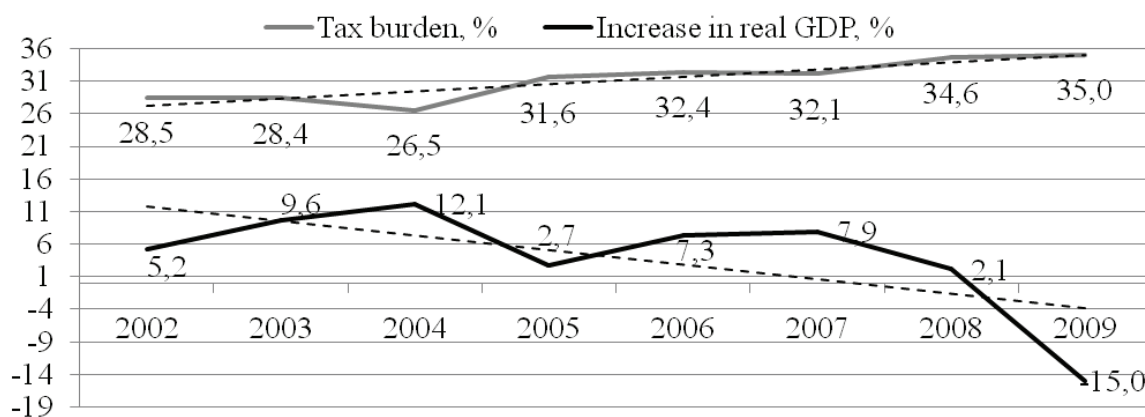
Year	GDP	Increase in GDP, %	Revenues of consolidated budget	Increase in consolidated budget's revenues, %	Portion of budget's revenues in GDP, %	Own revenues of PFU	Increase in PFU's revenues, %	Tax burden, %
2002	225810	10,6	61954	12,8	27,4	18908	-	35,8
2003	267344	18,4	75286	21,5	28,2	21532	13,9	36,2
2004	345113	29,1	91529	21,6	26,5	28182	30,9	34,7
2005	441452	27,9	134183	46,6	30,4	41591	47,6	39,8
2006	544153	23,3	171812	28	31,6	50561	21,6	40,9
2007	720731	32,5	219939	28	30,5	69961	38,4	40,2
2008	949864	31,2	297845	35,4	31,4	101836	45,6	42,1
2009	912563	-0,04	288580	0,03	31,6	111407	9,4	43,8

Source: formed on base of Ministry of Finance's and Treasury's data.



Analyzing the tax pressure on the economy using this method, we conclude that level of GDP, redistributed through state's centralized funds, tends to grow from 35,8 % in 2002 to 43,8 % in 2008 (table 2). It exposes the risks of public sheet's imbalances in the middle run and proves government's inability of solving crisis challenges through the mechanism of market regulation. Even during the years of stable growth (2002 - 2007) the level of tax burden was increasing, which is the evidence of strengthening current economic structure.

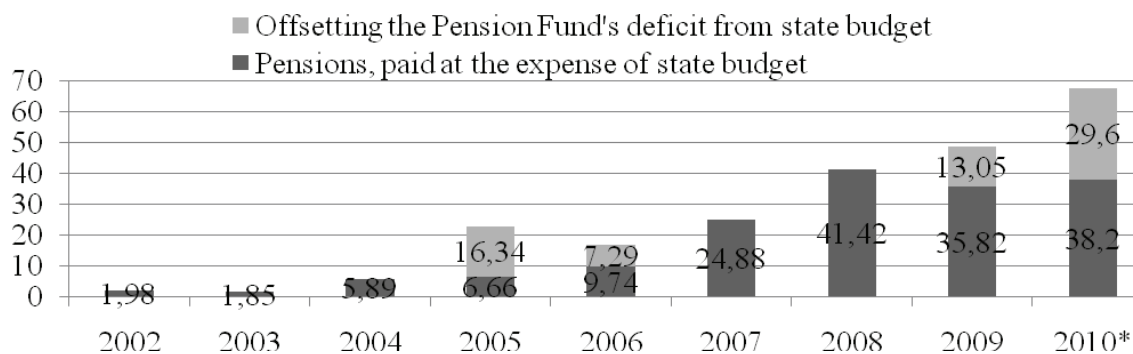
Another way of estimating the tax burden is to sum tax incomings of consolidated budget and own revenues of PFU. Comparing changes in the tax burden's level and increasing of real GDP we conclude that these indicators have opposite tendencies (picture 2).



**Picture 2.** The portion of tax burden in GDP and increase in real GDP during 2002 – 2009.

Source: formed on base of National Bank's and Statistics Committee's data.

Tying the statistic information together, we infer that government increased the tax pressure on the economy that results in reduced rates of real GDP growth (especially in 2004, 2005 and 2008 on picture 2) to provide fulfillment of its liabilities under existing economic structure. This process distorts the economic structure and undermines the system of public finance [8].



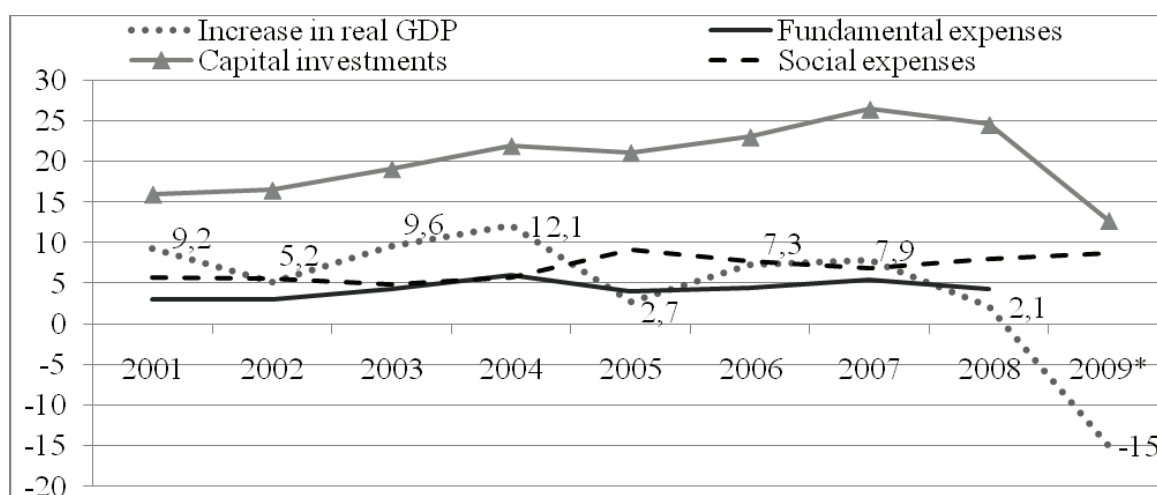
**Picture 3.** Budget expenses on the pension needs in 2002 – 2010.

\* - under the budget plan on 2010.

Source: formed on the base of Resolutions about Pension Fund's budget.

One of the most painful factors of magnifying government's expenditures and eventually level of tax burden is enlarged expenses of PFU (picture 3). Pace of state's revenues growth (including own revenues of PFU) is higher than it is for GDP. It determines the tendency of growing the state's role in the economy, which is the opposite process of forming effective market regulation under the transformed market economy system.

Although the portion of raised government expenses in the GDP, the structure of these expenses doesn't provide sufficient incentives of future economic growth and strengthening of small & medium size enterprises, which are the characteristics of structural transformations.



**Picture 4.** Real GDP growth, budget (consolidated) social, fundamental expenses and private capital investments in 2001-09. (As a percent of GDP)

\*- absence of fundamental expense's data.

Source: formed on base of Treasury's reports and NBU's bulletins.

The portion of fundamental expenses in consolidated budget is lower, than it should be, taking into account the level of government regulation in Ukraine's economic structure (picture 4). Increasing of real GDP is divided between social and capital expenses by proportion which benefits the first one. In case of crisis (2008 and 2009 at picture 4) under the existed economic structure government needed to provide sufficient funds for capital expenditures to offset the decrease in the level of private capital investments. But this step was not applied which is the evidence of inefficient regulation under the existed economic structure.

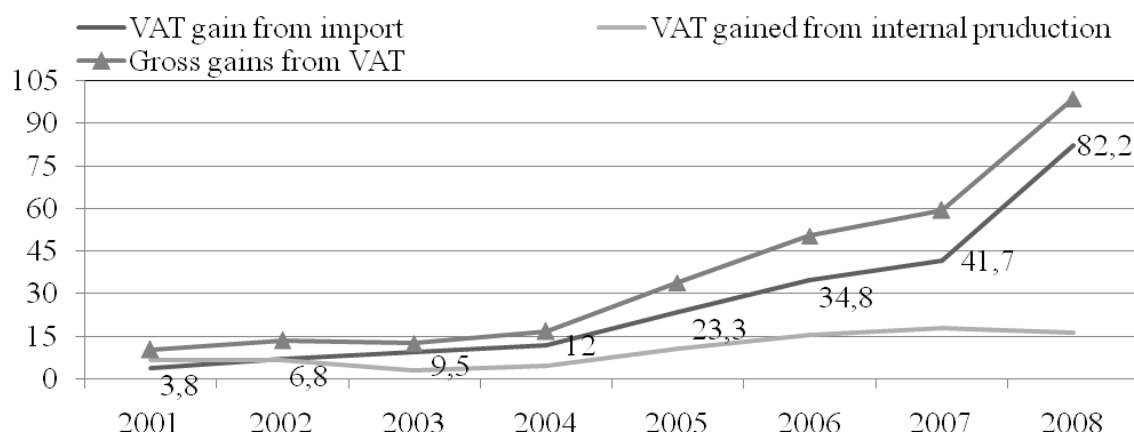
In response to crisis, especially lack of liquidity in financial sector, state has implemented steps to support banks and avoid default of Naftogas (table 3). Thus, the government's role in financial sector increased and made the economic structure more regulated. In any case, government management in real and financial sector is less efficient than private [2; 4]. Taking into account experience of other countries government defines increased amount of corporate equity in financial sector as a temporary measure that transmits risks to public sheets but doesn't eliminate it. IMF report notes that "the appropriate policy response to the crisis is not just "more" or "tougher" regulation but smarter requirements combined with better-funded supervisors, independent of industry and political pressures" [3, 42].

**Table 3** Increase in state's corporate equity at 01.09.2009 (in billions)

Economic entity	Before crisis	At 01.09.2009	Increase
<b>Banking sector</b>			
Savings Bank	1,12	13,89	12,77
Ukreximbank	2,06	10	7,94
Ukrigas Bank	0,7	31,7	31
Rodovid Bank	0,43	29,59	29,16
Bank "Kyiv"	0,22	3,56	3,34
Total	4,53	88,74	84,21
<b>Real sector</b>			
Naftogas	5,56	24,16	18,6

Source: [1, 128].

Another measure, which was used by NBU, was bank's refinancing. The amount of refinancing credits was growing rapidly from the beginning of the crisis in September 2008 and reached 229 billion as of September 2009 [1, 99]. Researchers argue that grew amount of refinancing establishes new areas to regulate in countries that use this measure: managing the given credits and control of their repayment; managing and selling of collaterals in case of banks' insolvency; managing and selling of banks' corporate equity, that were received to repay credits [1, 100]. Those arguments are also valid for Ukraine's government.



**Picture 5.** Gains from VAT in 2001 – 2008.

Source: formed on base of Ministry of Finance's data.

VAT has the highest portion in consolidated budget's revenues – 30,9% in 2008. At the same time this tax is the most criminalized (tax payers use different ways to evade this tax, repayment of tax credit has corruption features) among others. The major part of VAT earnings was gained from import products (picture 5). The one reason of this is magnified amount of import. On the other hand, conjuncture on the foreign markets allowed chemical and metal industry's enterprises to increase export and hence VAT credits' compensation.

Analyzing the compensations and gains from internal products' VAT reasonable will be to calculate its efficiency rate (table 4).

**Table 4** Efficiency of VAT earnings from products, produced inside the Ukraine (in millions)

Year	Gains from VAT	Compensation of VAT credit	Net gains from VAT	Efficiency of VAT (planned)	Portion of export in GDP, %
2000	8857	2387	6470	0,73	57,7
2001	10463	3879	6584	0,63	52,1
2002	12547	5864	6683	0,53	55,1
2003	13447	10321	3126	0,23	57,8
2004	16696	11968	4728	0,28	63,6
2005	23779	13305	10474	0,44 (0,49)	51,4
2006	30640	15042	15598	0,51 (0,51)	46,6
2007	36548	18869	17679	0,48 (0,47)	44,8
2008	48981	32593	16388	0,33 (0,46)	47,1

Source: formed under the Ministry of Finance's annual reports

As table 4 shows, even in periods where portion of export in GDP decreased the efficiency of VAT, gained from internal operations, also decreased. Ever-widening amount of VAT compensation causes problems in state's budget to repay it. It's the result of different tax evading plans used. At the same time, the major part of the export is the low processing products. It causes the exhaustion of Ukraine's recourses and losses from non-gained value added [2, 83].

**Table 5** Manufacturability export structure

Level of manufacturability	2001	2002	2003	2004	2005	2006
High level technology	4,5	4,5	6,3	6,2	3,8	4,6
Middle level technology (high level)	18,9	17,9	17,9	19,7	18,5	18,7
Middle level technology (low level)	54,5	54,5	54,6	55,4	57,3	55,9
Low level technology	20,1	21,9	20	17,6	19,7	19,7

Source: [6, 31].

Table 5 shows the technological pattern of export. This table proves the low-processing level of Ukraine's export and determines the absence of government's structural policy to improve it. Tying it all together, reasonable would be to repeal zero VAT rate on export products. This measure has sufficient theoretical foundation. In case of zero export rates, products, which were produced inside a country, are nonearning for the government: those products enrich external markets, because it wasn't taxed in the native territory. Obviously, ever-widening export gives higher employment and enhances monetary reserves. But on other hand (taking our export's structure into account), high portion of Ukrainian export are low processing level products, that indicates its feed stock character and inefficient use of earnings, gained by exporters. Instead of that we need to establish differentiated rate, which depends on a level of export product's processing: raw materials suggested to be taxed by 20% rate, middle-level processing products – 7-10%, and high level processing products will keep zero VAT tax rate. This measure will form state's structural policy in the technological area. It will also reduce the VAT credits' compensation and will help to struggle against evading of VAT. At the same time, policymakers can stimulate export trading using another instrument: differentiation of income tax rate, which will depend on amount of company's sales that had been sold abroad. Export sales proposed to be taxed at 18-20% income tax rate. This measure will keep the export raising incentive and stimulate higher level processing of export products.

Another direction of government's structural reforms needs to be a reducing of tax burden on the economy. This statement is closely concerned with two more categories – optimization of government expenses and problem of shadow economy (look at picture 1).

There are few important ways to reduce the tax burden and thus strengthen incentives of revealing earnings and paying taxes.

1. Decreasing the payroll due to Pension Fund. Existing rate causes concealment part of the salary in large amount of firms. Simultaneously, contribution to PFU is influential part of firm's general tax burden. Instead of that government need to perform Pension Reform, that makes three-level pension system. The second and third levels of it will provide resources for financial sector growth. Also the inherent part of pension reform is retirement's age rising – equal for men and woman. Government needs to combine different steps and possible measures in pension's reform process: establish maximum amount of government's pension per month; form-

ing the legislative background for private pension funds; taxing the pensions, which exceed fixed amount; deciding the most efficient organization form of Pension Fund. This reform needs to provide economic structure's changes that allow additional financial sector growth (by developing of second and third levels of pension system), reducing the scale of shadow economy (majorly by revealing the 'dark' salaries), reducing the Pension Fund's deficit and thus government contributions to it.

2. Differentiation of VAT rates. This suggestion includes decreasing of VAT rate for internal produced products to 17-18%. This measure also includes managing the VAT credits compensation from state's budget to make these compensations in time, according to the law. Decreased VAT rate will not decrease the price level but it will enhance the amount of firm's floating assets. Taking into account portion (and amount) of the internal VAT (look at picture 5) this step would not impact public sheets to the risk of high deficit.

3. Tax stimulus for SME. Single tax in Ukraine is widely used to stimulate business but the terms that regulate usage of it are obsolete and require revision. Portion of single tax in consolidated tax revenues of regional budgets decreased from 5,7% in 2004 to 3,0% in 2009. Reasonable would be to establish three different rates of this tax that depends on firm's period of life cycle. In first three years suggested rate of single tax will hold close to zero. Next two years it'll be half of complete rate. After five years from firm's establishment the current rate will reach complete rate of single tax. Also government needs to increase amounts of requirements held for taxing of single tax. The terms need to include mechanism that doesn't allow using splitting process to evade tax. This measure designed to develop SME segment of economic structure and thus enhance revenues of regional budgets.

There is significant difference between tax stimulus to respond the crisis in Ukraine and Europe countries. Hereby tax system in Ukraine, as an element of economic structure, which determines relations between state and economic units, is inefficient and needs deep transformations but not temporary measures like in Europe and some other countries (table 6). Table 6 illustrates that different countries use substantial fiscal measures to renew economic growth. IMF stuff concludes that "either government investment and/or targeted transfers ("Other" item at table 6 - Author) would have sizable multiplier effects on the economy... in an ideal scenario where is both global and supported by monetary accommodation, and where financial sectors that are under pressure are being supported by governments, every dollar spent on government investment can increase GDP by about \$3, while every dollar of targeted transfers can increase GDP by about \$1" [7, 16]. This conclusion refers to the changes in the character of countries' government regulation and its possible implication to the real and financial sector growth.

In case of Ukraine it's impossible to reach those results using such measures because of two factors (among others). 1. The existing social security system needs deep transformations because it doesn't provide efficiency of target transfers. Government needs to reform existing nonmonetary system of social preferences and form monetary system of public assistance that would allow pursuing policy of supporting hand-to-mouth households.

Under the existing economic structure government tries to provide targeted transfers policy through the pension system – this way distorts the pension system as it doesn't give support to all the needy, increases Pension Fund's deficit and is hard to abolish. 2. Ukraine's economic structure doesn't allow providing efficient monetary accommodation to fiscal stimulus and government support measures to financial sector have limited set of implements. As crisis showed, banks in Ukraine don't continue lending economy to supply filling the firm's operating assets and NBU can't break this tendency. Government measures to support financial sector have non-systematic character and in fact just transmits the default risk to public sheets' balances (see table 3).



**Table 6** Fiscal stimulus packages announced for 2009-10 as of January 17, 2009  
(As a percent of GDP in the region)

Item	2009	2010
<b>United States</b>	1,9	2,9
Tax cuts	0,9	1,2
Infrastructure	0,3	0,8
Other	0,6	1
<b>Euro area</b>	0,9	0,8
Tax cuts	0,3	0,3
Infrastructure	0,4	0
Other	0,2	0,4
<b>Asia excluding Japan</b>	1,5	1,3
Tax cuts	0,1	0,1
Infrastructure	1,1	0
Other	0,3	1,2
<b>Rest of G-20</b>	1,1	0,3
Tax cuts	0,5	0,1
Infrastructure	0,2	0,1
Other	0,4	0,1
<b>Total (PPP-weighted)</b>	1,4	1,3
Tax cuts	0,4	0,4
Infrastructure	0,5	0,3
Other	0,5	0,7

Source: [7, 14].

To ensure the long-run fiscal balance government bound to decrease public expenses consistently decreasing of tax burden. The main way to provide it is the process of optimization of the budget's expenses. It implies reducing government expenses by abolition inefficient expenses' items and general rationalization of budget expenses particularly of social expenses' items (see picture 4).

Reasonable would be to mark the following directions of public expenses' optimization.

1. Increasing of the gas price for enterprises and households. This measure is designed to balance the financial situation of Naftogas and break the practice of offsetting the price of gas from state budget.

2. Abolishing the system of government's preferences for coal mining industry – mines need to be sold (under the specified mechanism) or liquidated. This step is also one of the elements of strategic transformation plan of increasing technological level of Ukraine's industry (together with differentiated VAT rate).

3. Transformation the system of public assistance – monetization of the preferences and establishing the annual tax declaration for individuals compulsory.

4. Reducing the amount of public administration's expenses by decreasing the bureaucracy.

5. Keep the balance between increasing GDP and increasing wage in public sector – its important factor of budget's balance but hard to reach because of populist election pledges.

6. Transformation of public expenses' structure aimed to increase its fundamental part. Under the existing economic structure, where tax burden exceeds 40% of GDP, government

needs to provide higher level of fundamental expenses. Its raised amount will give reasonable impact to real sector growth, as this measure is used also in other countries (see table 6).

7. Government needs to work out the principles of government guaranties handling. Current facts prove that part of them are not reasonable and has implicit risks of public expenses' rising to repay them.

Transformation of the public expenses' structure designed to affect the economic structure and form additional incentives for economic growth – increasing the public expenses' portion in GDP at 1pct causes increasing of real GDP at 0,171% (one quarter lag), 0,123 (seven quarters lag) [5]. At the same time, government needs to keep budget deficit tight and debar government's debt rising in touch-and-go way.

Structural transformations, noted earlier are designed to provide incentives of shadow economy to reveal. Fiscal stimulus for SME, decreasing of tax burden, reforming the pension system and other noted measures will make economic structure, that lead to shadow operations be inefficient (which means the risk penalties of evading tax is higher than paying it). Regarding to solving the shadow economy problem government needs to provide accompanying legislative work, including abolishing the constraints of doing business. Revealing part of shadow economy operations will allow achieving important benefits: increasing of tax revenues, easing of economic regulation, increasing the amount of households' savings that are majorly result of 'shadow' activity, decreasing the scopes of corruption (shadow economy are major source of financial resources for venality).

Preceding factor of crisis resolution in developed countries should be response to crisis in financial sector [9, 4]. In Ukraine situation is quite different – inherent target of crisis resolution is resolving problem of real sector growth. At the same time it's hard to implement without renewing the lending process and improvement the system of monetary accommodation to fiscal actions.

Hence, we designated prerequisites of forming the financial sector as the element of economic structure and inherent condition of its high efficiency. Researchers note that current economic system is rather “symbiosis of the rudiments of administrative-command and market economy system” than full-fledged market economy system [4, 25]. And one of the reasons of such situation is incompletely formed financial sector. As financial sector we mean “financial corporations that are working on profit-and-loss basis and take part in social production and generate value added” [10, 64] (see picture 1).

Structural reforms in financial sector need to be ordered to: 1. Forming stock market that would allow unimpeded involvement of capital by enterprises. 2. Decreasing the level of economy's dollarization. 3. Measures to decrease rates at the market of capitals. Those steps are designed to implement the concept of capital mobility and ensure sufficient resources (including foreign sources) for real sector growth. NBU needs to marshal the refinancing process – in the first place credits are directed to systemic banks, small bank institutions that have liquidity problems need to merge with larger banks. Process of unlimited refinancing (without strict requires) is a risky and unjustified way of bank regulation.

Thus, structural market reforms are inherent part of Ukraine's economic strategy. They are designed to form the efficient economic structure that would allow renewing economic growth and continue the process of shaping the pattern of social oriented market economy. Transformations, mainly concerns the state's role in the economy through the budget's expenses, regulation of the financial sector, tax burden and character of regulation. Noted measures need to be realized, taking into account their interactions and current changes in theoretical and practical background of government's regulation of the economy.

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*Inanov A.,\* Taranenko V.\*\**

## THE PROCESS OF CAPITAL MARKET RESTRUCTURING AS A DOMESTIC POST-CRISIS UKRAINIAN ECONOMIC POLICY MAKING DETERMINANT

**Resume** *Stock market is the inalienable and important element of the financial system of market economy. Consequently, efficient and effective stock market development is the important stage of completion of domestic economy transformation. The process of the institutional development and acquisition of necessary high-quality market characteristics is far not completed yet. Research objectives are to analyze securities market and methods of improving efficiency of its performance in a post-crisis period.*

**Анотація** *Фондовий ринок є невід'ємним та важливим елементом фінансової системи ринкової економіки. Відтак, становлення ефективного та дієвого фондового ринку є важливим етапом завершення трансформації вітчизняної економіки. Процес інституційного становлення, набуття необхідних якісних параметрів ринку ще далеко не завершений. Метою дослідження є аналіз вітчизняного ринку цінних паперів та способів покращення ефективності його функціонування у посткризовий період.*

**Аннотация** *Фондовый рынок является неотъемлемым и важным элементом финансовой системы рыночной экономики. Следовательно, становление эффективного фондового рынка является важным этапом завершения трансформации отечественной экономики. Процесс институционального становления, приобретения необходимых качественных параметров рынка, еще далек от завершения. Целью исследования является анализ отечественного рынка ценных бумаг и способов улучшения эффективности его функционирования в посткризисный период.*

**Key words:** stock market, capitalization, shares, Internal Governmental Bonds (IGB), corporate bonds, FSTS (First Stock Trading System).

**Used techniques:** empirical methods, such as empirical treatment and empirical observation, also graphical and statistical methods.

Stock market is the inalienable and important element of the financial system of market economy. Consequently, efficient and effective stock market development is the important stage of completion of domestic economy transformation. Stock market in Ukraine exists already over 15 years, since the Act of Ukraine «About securities and exchange stock» was passed. But the

\* 4th year student, Department of World Economy and International Economic Relations of Odessa National Mechnikov University

\*\* 4th year student, Department of World Economy and International Economic Relations of Odessa National Mechnikov University

process of the institutional development and acquisition of necessary high-quality market characteristics is far not completed yet. Economists and politicians analyze the problems of domestic stock market development, find out barriers which hinder this development, search possibilities to reorientate the stock market to fulfill new tasks in the process of economic development, to design the measures of economic policy, that remove obstacles of forming of high-efficiency stock market.

On the modern stage of Ukrainian economy development it is necessary to set up new tasks for a stock market. These tasks are supposed to focus on the problem of providing economy with investment resources in a post - crisis period. Tremendous market development, beginning from 2005 year which ended up with an «overheat», and its passing towards crisis position in autumn of 2008 proved that reformation of regulation, infrastructure, introduction of innovative technologies are necessary.

Analyzing capitalization oscillation of Ukrainian equity market one can come to the conclusion, that imperfect legislation and infrastructure lead Ukrainian stock market to becoming the instrument of abnormal profit earning. Not simply profit but excess profit earning for foreign investors, especially international investment funds. At the same time it induced domestic companies to use different charts artificially to overvalue their performance results. In order to become more attractive for the foreign investor Ukrainian companies came up with such efforts, as an artificial overstating of trade volume, manipulation share quotations, etc. By the way, manipulation of share quotations was also used by asset management companies in order to get higher fees for the Co-investment institutes assets management, and also for the sake of amplification of the real cost of company which is for sale.



**Chart 1.** The dynamic of FSTS capitalization and trading structure

In other words the positive capitalization dynamics of domestic shares reflected economic reality very poorly, and euphoria of pre-crisis 2007 was just a “bubble, exaggerated by speculators”. Share prices on FSTS stock market were growing at incredible pace from the beginning of 2004. As the result at the beginning of 2008 for incomplete period of four years FSTS index has increased 1278 % (see chart 1). Although 2009 turned out to be one of the most severe years for the Ukrainian economy, share index of the Ukrainian stock market expanded at pace of 94 % by December, 21 and FSTS index - of 92 %. Significant price drop in January-February was replaced by active growth at the beginning of March. Market already grew approximately by 30-40 % in 2010. Furthermore on the basis of the results of activity it is now possible to state that shares of banks and electric power sector enterprises of the first and second FSTS listing levels remain considerably over-estimated (see chart 2).



	Financial sector	Power industry	Metal-lurgy	Car construction	Machine-building	Ore mining	Gas/Oil	Coal production	Chemical industry
P/E (Price-to-Earnings)	87.2082	Тра-98	Лип-30	12.1647	Грг-17	Кві-16	Чеп-70	6.1839	Лис-51
P/S (Price-to-Sales)	Бер-84	0.98	0.39	0.65	0.45	Січ-63	1-Лип	Січ-59	0.95

**Chart 2.** Average indexes P/E and P/S on 23.03.2010

As to Internal Governmental Bonds, they became the only source financing general government deficit in 2009. However, the situation on the market was illogical, when government bonds with the half-year term are accommodated with practically 30 per cent annual yield. That deprived banks with free funds any motivation for searching for alternative investment sources not only at the credit market but also in debt creation (extending credit). As a matter of fact, a few auctions on which national debt sold under unsustainable percents compelled to start speaking about possibility of government default. But even after active borrowings of 2009 the volume of national Ukrainian debt will not exceed 25 per cent of GDP that is far below the level in the developed countries. And it doesn't influence the indexes of those developed countries either. Thus, concerning the government bonds default, it is necessary to remember that the major part of these bonds belongs to NBU. Situation changed in March, 2010, when long-term Internal Governmental Bonds took place already under 16-17 per cent annual.

We hold the opinion that nowadays Ukrainian stock market does not fulfill its basic functions in relation to accumulation and redistribution of investment resources between different industries of economy and enterprises, formation of reasonable market value of enterprises, formation of informative indicators for investors, indication of the general condition of economy for all market participants, creation of the effective system of protection of investors rights and interests, assistance to the development of the system of the non-state pension fund and Co-investment institutes. But it also remains the effective speculating instrument to get profits.

The main task of stock market on the current stage of transformation of Ukrainian economy must be mobilization of temporally free resources of population and resident entities, secondary distribution of this money in those economy sectors, which require additional financing for further development. For the purpose of implementation of targets concerning attracting investments and providing with steady development growth it is necessary to remove number of obstacles which prevent further stock market development and high-quality implementation of all the functions laid on it:

1. Psychological non-acceptance and underestimation of stock market potential as an important element of the financial market economy system. A second-rate role is given to the stock market in comparison with the other sectors of financial system, in particular with banking sector and it is evidenced underestimation of stock market potential in reference to the possibility of investment resources of population and entities accumulation. The underestimation of fund market potential is observed both from the side of the government and from the side of entities and households.

2. Some details of stock market upon the whole, and special features of its structure in particular: substantial predominance of unorganized market over organized one, what negatively affects the transparency of market which deters foreign investors; presence of a few trade grounds where securities bidding takes place that complicates control over investment business and distribution of informative indicators in relation to the quantity and high-quality criteria of investment business; low level of stock market liquidity; lack of papers to trade on capital market, limited amount of market instruments; the participants of market manipulate the prices with the

view of overrating investment funds net assets; noncompletion of stock market institutional infrastructure and its bottom quality.

3. Low specification level of ownership rights which predetermines numerous corporate conflicts. Weak protection of shareholders rights, especially minority interests, low level of corporate management are nearly the biggest problems which slow down capital market development and restrain both internal and external investor. Among the most common violations of investors rights we mark: failure to adhere to the norms of the law, that estimates the order of share placing, violation of investors interests during issuing additional shares; delayed and incomplete release of information about issuers performance; discrimination of rights for investors during insolvency proceeding, bailouts, reorganization or liquidation businesses, which are the investment objects; nonobservance of general shareholders meetings schedule; acceptance of regulation norms that limit investors rights and interests; acceptance of regulation norms which limit rights and interests of investors; changing order and terms of dividend payments.

4. Weakness of internal institutional investors, presented by mutual funds, non-governmental pension funds and insurance companies, low activity of retail investor at equities market. The mutual funds market has appeared relatively recently – framework law that constitutes functions of mutual funds was adopted only in 2001, and the activity of non-governmental pension funds was established only at the end of 2003. The first asset management companies and investment funds obtained licenses at the end of 2003 – at the beginning of 2004, and non-governmental pension funds - only in 2005. There are seven different kinds of mutual funds functioning in Ukraine, some of which work with a population. There are three sorts of non-governmental pension funds and also asset management companies of different level in Ukraine. These institutes operating at mutual investment market allow satisfying the requirements of individuals and legal entities in mutual investing.

However, exceptionally formal and quantitative indexes are referred to above. Upon that the quality of mutual funds and non-governmental pension funds services, professional skills and population readiness are not taken into the account here. At this point nowadays the first thing to think about is the quality of asset management companies and non-governmental funds services, gaining experience, increasing professional management standards, and trust of potential investors, economy readiness, etc. It is not about quantitative growth of mutual funds and asset management companies any more. One of the most urgent tasks in relation to institutional investors development at Ukrainian market is diminishing of motivation for them participating in shadow schemes and prosecution of illegal transactions connected to money laundering.

Development of mutual funds and non-governmental pension funds must be a powerful impulse for capital market development activation and also for filling it with some internal investment resources. However growing personal income and free legal entities resources considerably stayed away from the mutual investment market. Since pension funds are main clients of investment funds, money, invested in non-governmental pension fund can be easily regenerated into investment expenditures with the help of capital market. Activation of private pension business is also possible due to individuals. However, at this point no special interest in non-governmental pension funds is being noticed. The reason for it is people being suspicious of long-term payments and also lack of knowledge about all the possibilities the system of the non-governmental pension provides. Only 0.28 per cent of Ukrainian population is attracted to the system of the non-governmental pension coverage. The possibility of use of the non-governmental pension system's potential for the purpose of investing depends on further development of the corporate non-governmental pension coverage and also on advertising and expository work among population and companies.

5. The weak personal interest of strategic foreign investors in Ukrainian stock market. The presence of strategic foreign investors at national stock market depends on such factors, as: macroeconomic and political stability; national legislation stability; precise rights support for shareholders, high level of corporate management; absence of barriers towards free capital movement (both to and from Ukraine), predictability of currency policy; transparency of both stock market and domestic companies disclosure. Majority of these factors are under satisfactory level which restrains international capital flows to the national stock market.

6. Not high rates of adjusting to a normative base which regulates financial relations to the requirements of international standards. The question is about implementation of international standards of information disclosure: International Accounting Standards of International Accounting Standards Committee (IASC) and international standards of information disclosure of International Organization of Securities Commissions (IOSCO). Harmonization of internal legislation allows to integrate the international stock market deeper and quicker and to promote the attractiveness of home capital market for strategic investors.

In the scope of investment potential increasing, along with the use of internal financial resources it is necessary to use possibility of participating in an international capital transfers. Procurement of foreign investments exactly through a stock market seems to be the most attractive form of international capital movement. It is caused by market providing mobility of capital movement and liquidity of holdings. Under such conditions of current Ukrainian economic performance a liquidity of assets is likely to be one of main factors that influence investment activity. Especially it concerns foreign investors who got used to economic and political stability, and as a result are very sensible to instability, that is usual for the countries with a transitional economy.

One of the powerful instruments of procurement of investments is procedure of initial public offering on international capital markets (IPO). This mechanism did not purchase the proper popularity among the most domestic companies, as it requires the high level of corporate management, transparency of company and accordance of its accounting to international standards. As an example for domestic companies can be Russia, where during 2006-2010 number of powerful companies hold an IPO enough successfully. Successful procedure of holding an IPO by leading domestic companies is going to increase the interest of external investors both to these particular companies and Ukrainian stock market in general.

Further stock market development depends on specific government actions concerning building-up the financial system. The effective restructuring of the financial system, further development of stock market, exceptionally on the basis of self-regulation is impossible. We hold the opinion that market relations at recently formed markets are not finally formed. Therefore the pace of stock market development, its high-quality aspects, and also opening of its investment potential, depend on specific actions of public policy and reformation of financial sector.

Thus, further stock market development is impossible without reformation of most market components and removal of obstacles which interferes this development. The role of stock market must be reconceived and substantially enhanced in investment resources procurement and in addressing these resources on renovation of industrial potential, creating conditions for establishing powerful institutional investors.

The successful stock market functioning requires existence of number of various institutes. In particular, presence of the following assumptions for market aims realization is necessary: freedom of capital movement; liquidity of securities, presence of the developed infrastructure of capital market, clear specification of ownership rights, information transparency of market; macroeconomic stability, high degree of confidence to the government, its institutes, and also be-

tween market participants, which makes nameless exchange possible. The presence of mentioned conditions in combination with an efficient capital market forms attractive and beneficial investment climate which provides additional financial resources flow to the economy.

For the purpose of high-quality restructuring of the Ukrainian capital market and its concentration on realization investment-innovative tasks the governmental policy in relation to it must be concentrated on the following: development of capital market and its infrastructure, in particular creation of effective depositary-clearing system which will assist development of trade at the organized market; concentration on securities trading on the organized market, introduction of international standards; adjustment of financial services market in accordance with world standards; consolidation of stock markets and other trade facilitators, improvement of property rights specification; popularization of trading among population; introduction of development strategy of new financial instruments.

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*Krupka M.\**

## INTERNATIONAL DEVELOPMENT STRATEGIES

The majority of international programmes on economic development known to be called the Decade of economic development, have been worked out since 1960 under the aegis of UNO for the decades to follow. The programmes of UNO (UNDP) development together with the programme of IMF and the World Bank stipulate the stepwise solution of acute social and economic problems of the developing countries and are directed to:

- the poverty decrease, demographic process optimization, the available power source application, the development of prospective ecological and economic programmes of the XXI century providing equal in rights partnership and international cooperation;
- the agricultural development in the under-developed countries;
- the activization of intellectual and creative abilities of the population and scientific and technological institution activity;
- the balanced tax policy implementation;
- the decrease of the general investment risks.

One of the latest programmes is the international development strategy adopted by GA UNO for the fourth decade (1991-2000) at the session of XLV (resolution №45/199) December 21, 1990. The previous three strategies were developed for the first (the 1960-s), the second (the 1970-s) and the third (the 1980-s) decade of the development.

The main aims of the strategy for the 1990-s were the enhancement of economic development in the developing countries and strengthening the international cooperation. The leading elements of the strategy are: improving living conditions of people in the developing countries, shortening the gap between rich and poor countries, banning the environmental degradation [1].

To achieve the main aims, the 1990-s strategy has stipulated:

- 1) to increase the economic development rate dramatically;
- 2) to ensure the development promoting the poverty level decrease, human resources use which is ecologically safe and stable;
- 3) to improve the international currency-and-finance and trade system;
- 4) to guarantee the firmness and stability of the world economy and the effective macro-economic regulation at the national and international levels;
- 5) to strengthen the international economic cooperation.

To increase the development rates, considerable financial inflow from the main sources of such resources income to the developing countries are needed. Such resources can be obtained through the official bilateral assistance channels, credits of commercial banks, direct private foreign investments and the assets of the international financial organizations.

In September, 2000 the world leaders, who gathered at the Millennium Summit formulated 8 aims which the world Commonwealth is to achieve before 2015. It is a large-scale programme directed at the poverty reduction. It includes: famine and poverty elimination; general primary education; male and female equality encouragement; child mortality reduction; maternity protection improvement; struggle with AIDS and other diseases; ecological stability provision; global partnership formation [1].

\* 4th year student, Department International Economic Relations of Kharkiv National V.N. Karazin University



The investigation results aimed at the achievement of the goals mentioned above have so far been uneven. It can be accounted for by a number of reasons. They are: the insufficient volume and inefficiency of the state expenditures and a large volume of the debts, the insufficient access of the exporters from the developing countries towards the market of the countries with the developed production as well as the decrease of the official assistance extension.

Uruguay Round of multilateral trade negotiations was held in December, 1993, 117 states participating in it. The main aims were the access expansion to world markets for all countries, the customs tariff decrease, non-tariff limit liquidation. Other problems of international economic relations, exchange of services, intellectual property protection, interstate coordination of trade and economic policy were also considered at the negotiations.

The international programme of the long-term economic development is based on certain conditions and standards (indicators). The complexity of the social and economic system has been predetermined by its polystructural structure, variety of the functions performed and diversification of economic and social processes. One cannot estimate the level of social and economic development system only by means of one or a few parameters. The following indicators may be used to characterize the stable development as a whole and each of its components (economic, social, ecological, natural resources):

**Table 1** The Main Indicators of the Stable Development

<b>Components of the stable development</b>	<b>Indicators</b>
Economic	GDP
	The production of the main kinds of goods per man
	The national economic branch structure
Social	The rate and quality of the population life
Ecological	Ecological indicators characterizing radioactive contamination, the level of the environmental pollution, the volume of capital investments directed at the ecological problem solution
	Indicators of anthropogenic stress on the territory
Natural	Indicators characterizing reproduction and rational use of natural resources
Stable development as a whole	Indicators of economic, social, ecological efficiency (labor productivity, capital intensity, GDP units, returns on assets, material capacity, etc.)
	Indicators of the internal balance of the system (absence of budget deficit, inflation, payment crises, domestic debt) and the external balance of the system (the state of the balance of payments, the current exchange stability and the volume of the state external debt)

The table was made by the author with a help of the materials [1, 2].

The world experience shows the absence of the unified approach when the national strategy of the stable development should be built. Each country determines independently the most effective ways of this approach taking into consideration political, historical and ecological circumstances.

To adopt the stable development strategy a number of mechanisms must be applied to the present conditions: information system with specified indicators, communication technologies,

international liabilities, accountability. The optimal correlation of indicators and standards must be provided by the corresponding legislation and market instruments. An authoritative governmental body should be in charge both of the procedures mentioned above and the work of the appropriate mechanisms. And this body must be given certain responsibilities.

The International UNO conference on the environment protection (Brazil, 1992) was devoted to the issues of stable development. Representatives of 180 countries supported the programme of actions for the 21-st century, which deals with the development of ecology, economy and social safety in close link.

Realization mechanisms of the stable development concept should be considered in detail. There are about 130 indicators which determine various sides and aspects of stable development.

Political and legal aspect contains the following elements:

- developed modern democracy;
- constitutional power;
- law-based state;
- civil society;
- the observance of rights and freedoms of a man;
- equal before the law, perfect legal system;
- branched system of institutions and codes of practice;

The Economic aspect stipulates:

- optimal combination of the state, efficient, private and municipal property;
- mixed economy functioning;
- presence of the joint markets (goods and services, capitals, capital issues, real estate, land, technology and labor force, currency values, etc);
- competitive environment and antimonopoly legislation;

The Ecological aspect covers:

- harmonic development of the economic, social, ecological processes aimed at the formation of noospheric structure and relations;
- theoretical study realization and the development of practical methods of the natural resource effective use;
- the development of low-waste and waste-free technologies;
- extensive implementation of bioengineering;
- stepwise transition from the energy resources to the alternative power engineering (sun, wind, water, biomass energy, underground warmth);
- legal, economic and administrative method improvement for the environment protection;
- ecological education of the population, etc.

The Social aspect stipulates the following problems:

- struggle with poverty;
- special attention to children and elderly people;
- creation of the national educational system for all categories of citizens;
- retraining and professional development of the personnel in the economic and ecological spheres.

The International aspect proclaims the principles of the international law in the sphere of the interstate relations, i.e.:

- fight for peace;
- new world war prevention and regional conflicts prevention;

- contradiction settlement with peaceful politic means;
- overall cooperation development between countries in various fields;
- provision of the international financial and another aid;
- facilitation of the peacemaking and nature conservation activities of the UNO by the states-members.

The Information aspect is aimed at:

- scientific achievement materialization;
- broad informatization of the society;
- mass application of the electronic communication means and the information exchange [2].

The basic set of the stable development indicators is divided into 3 main groups: social, economic and ecological. The EU statistics department also defines institutional indicators. 41 social indicators are united in 5 main groups:

- 1) struggle with poverty;
  - 2) demographics dynamics;
  - 3) education assistance;
  - 4) health care of the population;
  - 5) promotion of the stable settlement development;
- 23 economic indicators are united in 3 main groups:

1. economic development;
2. consumption character change;
3. financial resources and mechanisms;

The largest number of indicators is 55. They are concentrated in the ecological section which is divided into 5 subdivisions:

- 1) water resources;
- 2) land resources;
- 3) other natural resources;
- 4) atmosphere;
- 5) wastes [3].

**Table 2.** The Stable Development Indicators in the EU Countries

EU code	Statistic works of the governmental policy	Indicators of success evaluation
<i>Providing high and stable enough levels of economic growth and employment</i>		
H <sub>1</sub>	Economic growth intensification	GDP and GNP per man
H <sub>2</sub>	The increase of the investment of capital volume to the real economic sector, scientific researches and development new technologies	Gross and social investments, % GDP
H <sub>3</sub>	The support of a high and stable employment level	The correlation of the workers amount to the able-bodied population, %
<i>The achievement of social progress showing the demands of every citizen</i>		
H <sub>4</sub>	Overcoming poverty and social inequality	The amount of children in poor families, where adults have no qualification; unemployment
H <sub>5</sub>	The increase of human capital, improvement of professional abilities	The qualification of the population according to under age group
H <sub>6</sub>	The national health improvement	The expected duration of healthy men and women lifestyle
H <sub>7</sub>	The decrease of unsuitable accommodation	The unsuitable accommodation for residence, %
H <sub>8</sub>	The crime level decrease	The crime level, solved crime level%

EU code	Statistic works of the governmental policy	Indicators of success evaluation
<i>The efficiency of the environmental protection</i>		
H <sub>9</sub>	The decrease of greenhouse gases emission	Greenhouse gases emission
H <sub>10</sub>	The decrease of air pollution, long-term maintaining the quality of the air	The duration of the period of high and medium quality of the atmospheric air
H <sub>11</sub>	The transport system improvement	Road traffic
H <sub>12</sub>	The improvement of river quality	Rivers with high quality of water
H <sub>13</sub>	Overcoming long-term bird population tendency	The population of fowl birds
H <sub>14</sub>	The repeated use of land	New structures on the greenfield land
<i>The limit of using natural resources</i>		
H <sub>15</sub>	The transition from the waste allocation to their minimization	The accumulation of waste products and their control

The table was made by the author with a help of the materials [2, 4]

In total the indicators of the stable development give the integral idea of the quantitative characteristics of this concept and show the real state of things of its embodiment in certain states.

The model of stable development in the transformation processes of Ukraine should be taken into account. In 1997-1998 the first steps were made in Ukraine towards the gradual introduction of the stable development strategy at the international level. Verhovna Rada of Ukraine has developed and enacted about 250 national, international, field and regional programmes which are financed from the state budget. 137 of them are directly connected with processes of stable development, in particular towards “the Agenda for the XXI century”. The following issues can be specified among them:

- social and economic aspects – 55;
- preservation and rational use of resources – 47;
- enhancement of the role of the main population groups – 4;
- realization means – 31 [5].

87 programmes of the whole list of those promoting stable development have been completed. Economic and social strategy of the Ukrainian transition to stable development is specified by a number of official documents.

Strategic priorities of the country stable development:

I. The economic sphere has some strategic priorities of the country stable development:

- the adoption of the mechanisms to guarantee economic stability;
- implementing science and technology innovations and mastering an innovating way of development as the major factor of the stable economic development;
- realizing an active agrarian policy;
- strengthening economic prerequisites of the social sphere reconstruction.

II. The social sphere possesses the following strategic priorities of the country stable development:

- increasing intellectual national potential, comprehensive education development;
- reconstructing social sphere, lowering the unemployment level, reforming labor payment system, improving state social aid mechanism, introducing obligatory state social insurance;
- improving the state of children, youth, women and family;
- improving health care of the population, lowering mortality and lifetime raising.

III. The ecological sphere covers such priorities as:

- guaranteeing ecological safety of nuclear objects and radiation protection of the population and environment from the negative consequence influence of the accident at Chernobyl nuclear power plant;
- improving the ecological state of the Ukrainian rivers and the potable water quality;
- stabilizing and improving the ecological state in mountains and industrial centers of Donetsk and Transdnipier region;
- building new public water supplied and reconstructing the old ones;
- preventioning Black Sea and the Sea of Azov pollution and improving their ecological state;
- forming a balanced system of nature management;
- saving biological and landscape variety, developing nature and reserve issues [6].

An important achievement of the developed strategies is their correspondence to the stable development principles:

- 1) overcoming poverty and increasing the life level of the Ukrainian citizens;
- 2) providing constant resource protective economic growth;
- 3) improving the national economics structure on the basis of the innovative development model;
- 4) integration into the European structure and into the world economic system;
- 5) providing ecological balance, lowering the stress on the natural ecosystem;
- 6) preserving biological diversity;

According to the stable development concept we consider Ukraine to be able for the stable development ensured exceptionally by means of the effective use of all kinds of resources, restructuring industry, and creative potential of the nation for the development and prosperity of the state [6, 7].

The main stable development priorities of Ukraine as a democratic state are derived from the system of universal values and the necessity of the global noospheric civilization formation.

Taking into consideration the peculiarities of the transition period, the national goals of the Ukrainian stable development are:

- 1) the economic growth;
- 2) environmental protection;
- 3) social justice;
- 4) rational use of resources;
- 5) population stabilization;
- 6) education;
- 7) international cooperation.

The main goals of stable development may be implemented by means of the structural reconstruction of the economy, the change of the production model, creation of the social, economic and ecological safety factors, and the set up of strict standards of the natural potential use. Target parameters of stable development are defined by the achieved level of stable development, indicators of the life level, and the environmental condition.

The important components of stable development are financial, material and technical, intellectual, and normative legal provision. The realization of this concept should be based on the legislation, financial sources and the organizational mechanism. The financial provision of the transition to stable development has 3 main sources:

- 1) centralized assets from the state budget;
- 2) state enterprise assets and the assets of the private economic sector;



3) external sources: foreign credit lines, commercial credits and direct foreign investments [7].

The transition of Ukraine to stable development is carried out according to several stages:

The first stage (transitional) – 1996-2000:

- overcoming ecological and economic crisis;
- normative legal base development;
- balanced production and consumption;
- adaptation of Ukraine to the world ecological safety system.

The transitional stage of Ukraine to stable development stipulates overcoming the economic crisis: stabilization, revival, increase. The renewal of the state guidance of economic processes is of decisive importance at the stage of economics stabilization.

Technical re-equipment in the material production and in the nonmaterial sphere is the first priority at the stage of revival.

National economy reforms the increase of the production level on the basis of multipurpose resources according to the demands of the domestic and foreign markets and is essential at the growth stage.

The second stage – 2000-2010:

- stimulation and structural changes regulation;
- fuel and energy problem solution;
- provision of the high quality of the population life and equal in rights partnership of the country in the international economic cooperation;
- society democratization;
- creation of the noospheric development basis.

The third stage (the period of noospheric development):

- creation of the global system of environmental protection.

Basic indicators will be: quality of life, rates of social and economic development, providing the environment guidance according to the world standards, use of the newest energy sources, equality of rights and mutually beneficial international cooperation [2, 7].

Thus, the conclusion can be drawn that the stable development concept formulates theoretical methodological factors and determines the qualitative and the quantitative parameters and indicators of the balanced harmonic economic growth both in the national and in the world economy as a whole.

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*Hrytsko S.\**

## GLOBAL FINANCIAL CRISES IMPACT ON THE ACCESS OF TRANSITIONAL ECONOMIES TO INTERNATIONAL BOND MARKET

**Resume** *The relevance of the material stated in article, is caused by the necessity of understanding the difference in borrowing conditions during the course of and after the crises, and their impact on the access of borrowers from transitional economies to bond markets. In the article the role of debt financing in the economic growth is reviewed, current trends in the international economy are determined, the comparative analysis of borrowing conditions is conducted and the econometric analysis to determine factors that influenced the borrowers' behavior is made. The conducted research may be broadened by analyzing the changes in the access of Ukrainian companies to other sectors of financial market.*

**Key words:** global financial crises, Eurobond market, transitional economies.

**Анотація** *Актуальність обраної теми пов'язана із необхідністю визначення змін в умовах залучення боргових фінансових ресурсів у зв'язку із кризовими явищами у світовій економіці з метою оцінки їх впливу на доступність до боргового капіталу позичальників із транзитивних економік. В статті визначена роль боргового фінансування в економічному зростанні країн із транзитивною економікою, виділені сучасні тенденції розвитку світової економіки, проведений порівняльний аналіз умов залучення боргових фінансових ресурсів та економетричний аналіз факторів, що впливають на поведінку позичальників на ринку єврооблігацій. Проведений аналіз може бути розширений через розгляд впливу кризи на доступність позичальників до інших секторів фінансового ринку.*

**Ключові слова:** світова фінансова криза, ринок єврооблігацій, транзитивні економіки

**Аннотация** *Актуальность выбранной темы обусловлена необходимостью определения изменений в условиях привлечения долговых финансовых ресурсов во время мирового кризиса с целью оценки их влияния на доступ к долговому капиталу заемщиков из транзитивных экономик. В статье раскрыта роль долгового финансирования в экономическом росте стран с транзитивной экономикой, выделены современные тенденции развития мировой экономики, проведен сравнительный анализ условий привлечения долговых финансовых ресурсов и эконометрический анализ факторов, которые влияют на поведение заемщиков на рынке еврооблигаций. Проведенный анализ может быть расширен путем изучения влияния кризиса на доступ заемщиков к другим секторам финансового рынка.*

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\* Master student of the Department International economics of Kyiv National Taras Shevchenko University

**Ключевые слова:** мировой финансовый кризис, рынок еврооблигаций, транзитивные экономики

Growing interdependence between different countries and their markets allowed the US economy's liquidity problems to spread over the world, which finally resulted in the global financial crises in 2008. The liquidity problems felt by US banks and financial institution have overtaken the world debt market and greatly influenced the behavior of market participants and borrowing conditions. Such hazardous effects were most dangerous for transitional countries because their economic growth depended extensively on external finance and trends in commodities markets. The global downturn caused the fall of industrial production and export revenues, which led to budget deficit and an increase in the demand for external finance.

The fundamentals of bond issues and the basics of market functioning are presented in the works of well-known corporate finance scientists Ross A., Westerfield W., Mishkin F., Sharpe W., Brealey R. and Myers S. Among the national economists who pay attention to financial markets are Blank Y., Sutormina V., Vahnenko T. and others. Research concerning reasons and consequences of the global financial crisis are proposed by Sharov O., Burakovskyy I., Galchinskyy A., Geec V., Doroshenko I, but unfortunately their studies are mainly directed to the crisis impact on the whole economy of Ukraine or its domestic financial sector. Market analysis of debt conditions is also presented in research, published by the Bank for International Settlement, the European Central Bank, Deutsche bank, etc. Unfortunately, all these studies are devoted to the observation of global financial market changes and rarely concern Ukraine. So the crisis influence on the Ukrainian companies' access to the international bond markets hasn't been analyzed yet. Therefore the research aimed on understanding the financial crisis impact on the debt market conditions is essential.

The main goal of this research is to trace how conditions in the international debt market are changing throughout and after the current financial crises as well as determine main factors and outcomes of such changes.

In order to reach this goal, different research methods are used, such as comparative analysis to evaluate the changes in underwriting volumes, interest rates and institutional structure of debt issues. An econometric analysis has been applied to determine factors that influenced the borrowers' behavior, systemic methods - to define market conditions and borrowers' drivers. In order to conduct the comparative analysis data and statistics from ECB, IMF, BIS, Cbonds and Global Financial Data are applied.

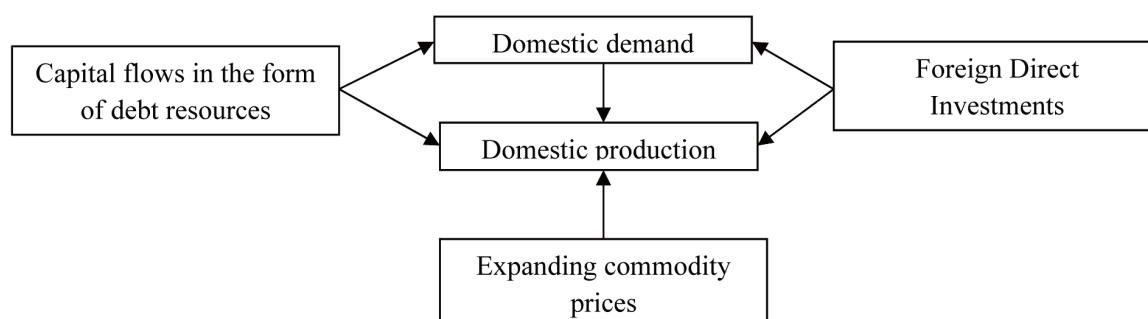
A global financial crisis has influenced the borrowing conditions for companies all over the world, but the deepest effect it has on borrowers from transitional economies. Such negative effect can be explained using several factors, peculiar to the transitional economies development.

A high growth rate of the Ukraine in pre-crisis period (about 8% in 2007) was mainly spurred by 3 main factors, which had an international source [10]. These are: vast amounts of credit resources obtained in the international financial markets, foreign direct investments, and positive dynamics in the commodity markets, which are the main sales outlet for Ukrainian industrial companies.

In 2007 the commodity prices reached their peak and further economic growth of those countries which production is oriented on international market. Among these countries is Ukraine, as Ukrainian export in 2007 equaled to more than 45% of GDP and the share of materials in export of Ukraine was 62.6% [9, 10].

Favorable conditions in the financial markets (moderate interest rates, high incentives of international investors in securities from the emerging economies) were used by the large domestic industrial corporations in order to expand their productive capacities and satisfy growing

demand, domestic and international. Financial institutions have used raised external finance primarily to provide consumer credits, which stimulated domestic consumer demand and therefore economic development. On the other hand, consumer demand was also spurred by the foreign direct investments flowing into the country.



**Figure 1.** External factors of GDP growth in Ukraine, 2007.

Hence, Ukrainian economic growth was mainly due to the flow of international capital resources. Consumption, financed by debt capital, greatly exceeded production capacities, and therefore the problems with debt repayments were inevitable. In the Ukraine these problems appear in 2008 both on the corporate and national level.

As we can see, debt financing was the main source of economic growth for emerging countries and simultaneously the main cause of fast financial crisis spread. But it is necessary to understand that fully-fledged economic recovery is impossible without revival of debt relations. The improvement of such relations should be performed in the following ways. First of all, Ukrainian companies have to establish an effective plan of repaying existing debt. Second, in the case of an inability to perform their liabilities companies have to make an agreement with investors about the restructuring conditions of debt. And finally, Ukrainian borrowers have to search new possibilities for raising money in order to foster country's recovery and consequently innovation-based development.

So a comparative analysis of conditions in the international debt market is important for future economic development.

Research of the debt market conditions for borrowers has to be started with a provision for some knowledge about current trends in the international economy, which give groundings for debt market conditions. Among such trends are: declining rates of economic development in most countries in 2008 – 2009; large-scale liquidity injections into the economy and stimulus plans launched by governments in order to stimulate economic growth; low interest rates set by regulators; a cautious attitude of investors to risky assets; the loss of confidence to credit rating agencies; reevaluation of most securities and a large scale writing-down of assets by financial institutions.

1) Declining rates of economic development in most countries in 2008 – 2009. According to IMF data, in 2009 most developed countries suffered from economic recession. The GDP decline in the USA equaled - 2.4%, in the Eurozone -4%, in Great Britain -5%. The economic decline was most intense in the first half of 2009. Moreover debt problems in certain countries in Euro area, such as Greece, Portugal and Spain, also threaten the stability of the Euro currency and the pace of economic recovery in Euro area [8].

2) Large-scale liquidity injections into the economy. In order to restore confidence in the financial system, in October 2008 the governments of the UK and the USA announced a Rescue plan for banks. The UK government has introduced a package of measures aimed at rescu-

ing the banking system that makes available 400 billion pounds (692 billion USD) of fresh money. The US government has implemented a 250 billion USD (143 billion pounds) plan to purchase stakes in a wide variety of banks, such as Citigroup, JP Morgan Chase, Goldman Sachs, Morgan Stanley, Bank of America, Merrill Lynch, State Street and Bank of New York Mellon, etc. Governments of Germany, France, Italy, Spain, Holland and Austria have also launched the bank bail-out plans, offering over 1.5 trillion euro in guarantees and fresh capital into the banking system [4].

**Table 1** Overview of the World Economic Development

	2008	2009
Advanced economies	0.5	-3.2
United States	0.4	-2.5
Euro area	0.6	-3.9
Japan	-1.2	-5.3
United Kingdom	0.5	-4.8

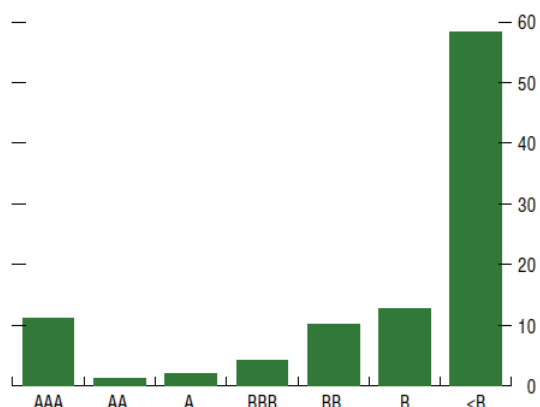
Source: IMF World Economic Outlook Update, January 2010, p.2

3) Low interest rates set by regulators. The interest rates in developed countries have been reduced to unprecedented values in order to stimulate credit activities. See table 2

**Table 2** Interest rates of the main market regulators.

	Current value	Change	Last date
FRS target rate, %	0.25	-0.75	12/16/08
FRS discount rate, %	0.75	0.25	2/18/10
ECB refinancing rate, %	1.00	-0.25	5/7/09
BoJ target rate, %	0.10	-0.2	12/19/08
BoJ discount rate, %	0.30	-0.2	12/19/08

Source: Cbonds



**Chart 1.** Change in ratings of AAA-bonds (in percent, as of June 30, 2009)

Source: IMF Global Financial Stability Report, October 2009, p. 93

4) A cautious attitude of investors to risky assets and the loss of confidence to credit rating agencies. Most of investors withdrew their capital from the emerging markets, while some financial institutions implemented limits for the amount of credit resources available for borrowers from certain countries.

5) Reevaluation of most securities and a large scale writing-down of assets by financial institutions. According to the Global Financial Stability Report, around 58% of all AAA-bonds in 2007-2009 were changed to a <B category. [7] See Chart1.

Such factors significantly influenced debt market conditions and therefore the access, which borrowers from transitional economies had to global financial markets.



For the analysis of borrowing conditions we have chosen the following indicators: Libor 12-month and Target Fed Funds Rate, as the primary benchmarks for the cost of money in the international financial markets; JPMorgan Emerging Markets Bond Index Global, which depicts sovereign and credit risk by tracking total returns for USD denominated debt instruments issued by emerging market sovereign and quasi-sovereign entities; the Fitch foreign-currency sovereign rating, measuring the country credit risk; and, finally, USD/hryvna exchange rate, reflecting efficiency of debt issuance in foreign currency and price for it in hryvnas. The results of conducted analysis are presented in the Table 3.

**Table 3** The comparative analysis of access conditions to Eurobond market by Ukrainian borrowers.

Conditions	Pre-crisis period (June 2007)	Crisis period (December 2008)	Post-crisis (December 2009)	Current data (March 2010)
LIBOR 12-month	5.4%	2.38%	0.99 %	0.87 %
Target Fed Funds Rate	5.25 %	1.00%	0.25%	0.25%
EMBI+Ukraine	122	2024	1005	468
The Fitch foreign-currency sovereign rating	BB-/Positive (25.10.2006- 14.05.2008)	BB-/Negative (25.09.2008)	B-/Negative (12.11.2009)	B-/Stable (17.03.2010)
Exchange rate	5-май	июл-56	июл-98	июл-92

Source: National bank of Ukraine, Fitch Ratings, IMF Data and Statistics, The Fed (U.S.) Prime Rate Website, Global Financial Data

In spite of lowering the main market benchmarks, such as LIBOR 12-month and Target Fed Funds Rate (from 5.4% and 5.25 % in June 2007 to 0.87% and 0.25% in March 2010 respectively), the cost for debt finance for the last two years has grown significantly for borrowers from transitional economies. This happened because of a liquidity squeeze in the market, high risks associated with transitional economies, and economic downturn, caused by the fall in commodity markets. Such cost increase can be depicted by the dynamics of the JPMorgan Emerging Markets Bond Index Global, which achieved its peak at the end of 2008, amounting 2024. But fortunately for borrowers, during 2009 the yield of government bonds from the emerging markets was declining, signaling the return of a demand for securities from emerging markets.

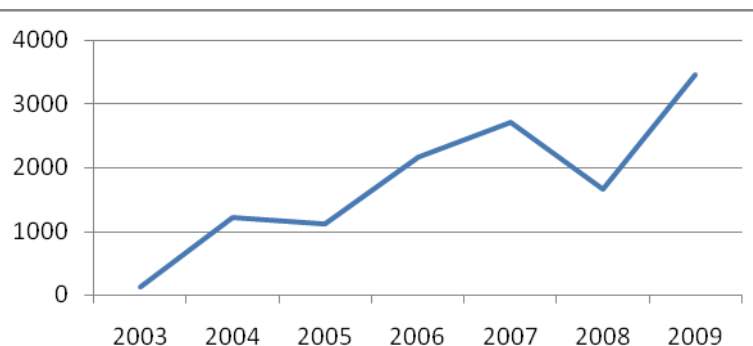
The increase in country risk for foreign investors can be traced by analyzing the Fitch foreign-currency sovereign rating. Due to deteriorating economic fundamentals and a rising risk of a currency crisis, in third quarter of 2008 Fitch Ratings Agency cut Ukraine's sovereign outlook to the lowest measure for the last 10 years – "BB-/Negative". However, at the end of 2009 - beginning of 2010, the improvement of borrowing conditions can be seen. This is confirmed by Fitch Ratings Agency, which revised Ukraine's sovereign rating outlook in March 2010 from negative to stable, expecting intensification of macroeconomic and financial stability after the presidential elections and a formation of a new government.

The sharp depreciation of Ukrainian national currency towards the US dollar caused an increase in coupon rates calculated in hryvnas. Such a rise in cost was most hazardous for companies and financial institutions, which obtain their profit in national currency. This situation caused an inability of some borrowers to serve their debt.

Worsening debt conditions for borrowers from transitional economies in 2008 lead to:

- a reduction of issues from the Ukraine in 2008 and a tendency of debt restructuring in 2009,

- a price increase of the debt capital (from 5 - 10 to 10-13%),
- changes in the sector structure of borrowers,
- a decrease in the average amount of a single issuance.



**Chart 2.** Volumes of the Eurobond underwritings by Ukrainian companies (in mln. USD).

Source: Author's calculations based on the basis of Cbonds data

The first pick of the Eurobond emissions was observed in 2007, and amounted to 2725 million USD or 14 issuances. [See Appendix A] The main issuers in 2007 were banks, which collected about 84% of the total sum. Among the companies from non-financial sector, that entered the Eurobond market in 2007, were Interpipe Ukraine, GNG (Galnaftogaz) Finance and XXI century. The 91% of all resources

were attracted in the form of LNP for a period of 3-7 years. The interest rates for those emissions varied from 5 to 10% in USD. At that time the price for bond issuances on the national market amounted to 12-16% in HRN. All emissions were in USD, and according to credit rating agencies, these emissions were speculative. The average amount of a single issuance was about 200 million USD. It should also be noted that almost all emissions in 2007 were carried in the first half of the year.

As a result of tight conditions, in 2008 Ukrainian companies were able to procure only four issuances of Eurobonds with a total raised capital of 1660 million USD, which is a 40% decrease compared to 2007. Only one real estate management company (XXI Century Investments) and three Ukrainian banks, which were owned by large industrial corporations (PrivatBank and AlfaBank) and international bank (Ukrsibbank), were able to enter the Eurobond market in 2008. Two emissions were carried in the form of LNP (by Ukrsibbank and AlfaBank), the two others - in the form of ABS (by PrivatBank). All issuers have fixed rates for their bonds emissions, except PrivatBank. The average interest rates were about 10-13% and average sum of single issuance – 184 million USD.

In 2009 the improving conditions in this market gave an opportunity to several banks and companies to restructure their debts. This caused an increase of underwriting volumes of 27% in comparison with 2007 and a 200% increase in comparison with 2008. The underwriting volumes in 2009 amounted to 3466 million USD. The vast amount of money was raised by only five issuers, of which 76% fall on two issuers: "Alfa-bank" and "Naftogaz of Ukraine". The large scale bond restructuring conducted by Alfa-bank exchanged 3 issuances, amounting to 1045 million USD with the maturity in 2009-2010 on 3 tranches with the maturity in 2012 and an increased interest rate from 9.75 to 13%. Moreover the largest Ukrainian public company, which controls whole cycle of oil and gas operations in the Ukraine (extraction, refining and sales) restructured its Eurobonds 2009 and other loans by issuing new securities with a maturity in 2014 amounting to 1595 million USD. The repayment of these new securities is guaranteed by the Ukrainian government at a value of 500 million USD. The interest rates rose from 8.125% to 9.5%. The other three restructurings were conducted by "First Ukrainian International Bank", "XXI Century Investments" and "Finance and Credit bank". In spite of Fitch Ratings enhancement and EMBI+Ukraine decrease, the price for Eurobond remained at the same level as in 2008. The average amount of single issuance rose significantly due to large scale restructuring and amounted to 578 million USD.

Hence, an increase in Eurobond emissions in the Ukraine was caused by an inability of companies and banks to pay their obligations. One half of attracted finance was raised with the help of the government. So positive figures of Eurobond net emissions doesn't mean return of investor's interest to Ukrainian securities, but just a result of the absence of other ways to pay for old liabilities.

The above analysis has shown that the volumes of Eurobond underwritings depend greatly on external conditions in financial environment. In order to assess such level of interdependence, an econometric model was constructed [See Appendix B]. The model describes the relations between the amount of raised capital by Ukrainian companies through Eurobonds, the lending rate proposed by Ukrainian banks (DLEND\_RATE), the 12-month Treasury constant maturity rate (DBOND\_YIELD), and the Emerging Markets Bond Index (DEMBI). The 1st or 2nd differences of all variables were used in order to make them[]-stationary. The model was constructed using the quarterly data for 5 years (from 2005 to 2009).

$$DDBOND = 410.00 * DLEND\_RATE - 1932.36 * DBOND\_YIELD - 2.02 * DEMBI + 131.49$$

The model was tested on stability by the Ramsey Reset Test, on the existence of heteroskedasticity by the White test, and autocorrelation by the Breusch-Godfrey serial correlation LM test. [See Appendix C]

The model illustrates that capital, raised by Ukrainian companies through Eurobonds, is inversely proportional to the 12-month Treasury rate and EMBI, and is directly proportional to the lending rate, proposed by Ukrainian banks.

From the conducted analysis it can be seen that a global financial crisis has a harmful effect on the access of transitional economies to the international bond market. In spite of actions taken by the governments of developed countries, aimed on lowering interest rates, the borrowing conditions for transitional economies have deteriorated. The price for financial resources have risen considerably and therefore influenced the volumes of borrowed funds, types of borrowers and aims of underwritings. According to the constructed model, it can be seen that capital raised by Ukrainian companies is strictly dependent on 12-month Treasury rate, EMBI and a lending rate proposed by Ukrainian banks.

The crisis impact on the access of transitional economies to different financial markets is a vast subject that may be broadened by researching the change in the access of Ukrainian companies to other sectors of financial market, such as syndicated loans and equity market. It also can be deepened by analyzing more factors and their consequences on the access to Eurobond resources.

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**Appendix A.** Volumes and quantity of Eurobond underwritings by Ukrainian companies in mln.USD, 2003-2009

	2003	2004	2005	2006	2007	2008	2009
Volumes	130	1223,92	1125	2170	2725	1660	3 466
Quantity of issues	2	5	8	10	14	4	5

Source: Author's calculations based on the basis of Cbonds data

**Appendix B** Econometric model. Estimation output.

Variable	Coefficient	Std. Error	t-Statistic	Prob.
DLEND_RATE	410.0004	100.7059	4.071264	0.0016
DBOND_YIELD	-1932.356	477.4619	-4.047142	0.0016
DEMBI	-2.015803	0.523970	-3.847176	0.0023
C	131.4874	144.0480	0.912803	0.3793
R-squared	0.630300	Mean dependent var		-23.43750
Adjusted R-squared	0.537874	S.D. dependent var		817.3977
S.E. of regression	555.6655	Akaike info criterion		15.69053
Sum squared resid	3705169.	Schwarz criterion		15.88368
Log likelihood	-121.5242	F-statistic		6.819572
Durbin-Watson stat	3.138111	Prob(F-statistic)		0.006185

**Appendix C.** Tests of a model for stability, absence of autocorrelation and heteroskedasticity

<b>Ramsey RESET Test:</b>			
F-statistic	0.080206	Probability	0.923514
Log likelihood ratio	0.254623	Probability	0.880459
<b>White Heteroskedasticity Test:</b>			
F-statistic	0.242499	Probability	0.950668
Obs*R-squared	2.226674	Probability	0.897716
<b>Breusch-Godfrey Serial Correlation LM Test:</b>			
F-statistic	2.683179	Probability	0.116720
Obs*R-squared	5.587644	Probability	0.061187

Sokirko A.,\* Ustyanov V.\*\*

## INFLUENCE OF FREE ECONOMIC ZONES AND TERRITORIES OF PRIORITY DEVELOPMENT ON MARKET TRANSFORMATIONS IN UKRAINE

*This paper investigates the role of free economic zones (SEZ) and territories of priority development (TPD) in a market transformation of economy of Ukraine, their impact on improving foreign economic relations of Ukraine, partly out of financial crisis and promoting economic growth.*

**Key words:** free economic zones, territories of priority development, the European Union, foreign trade activities of Ukraine.

After the collapse of the Soviet empire in the early 90-s began a new era known as the "transformation", which meant the system changes from socialism toward a market economy. Mixed initial conditions determined the different approaches of Central and Eastern Europe to reform.

Today there is a clear direction of the transformation process in most countries. 27 Central and Eastern Europe has received membership in the European Union, others try to reach a level sufficient for entry, others still make decisions about how to improve the economic system. Ukraine is in a 2nd category.

First, Ukraine was considered one of the strongest post-Soviet republics in 1992 but it rolled into the abyss of economic depression. On the other hand, if initially it was considered a potential center of ethnic conflict and political instability, they then turned Ukraine into a democratic, peaceful society that clearly was confirmed among the new European and world order.

Market transformation of regional socio-economic systems in a transitional period means acting growth opportunities of all actors of their interests, namely personal, group, ethnic, regional industry, government, etc. It is designed to provide institutional, organizational and legal and economic preconditions for rational use of available natural resources, industrial and geopolitical potential. Its core is a restructuring aimed at forming a competitive environment and market infrastructure, promote decentralization and internationalization of investment processes. A positive point to be considered in this component of the transformation policy shift from sectoral to functional principles, which at first are task specific problem identified as the most priority directions of social policy and economic development. Requirements of the population, on the one hand, and natural-resource and infrastructure capabilities in the region, on the other, are essential for the formation of goals and criteria for development of regional socio-economic systems. Of great importance in this process of free (special) economic zones (SEZ) and territories of priority development (TPD).

This question is very important for Ukraine, because creation FEZ and TPD will lead to improvement of foreign economic relations of Ukraine, a partial exit from financial crisis and promoting economic growth.

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\* Master Student of the Ukrainian Academy of Customs

\*\* Master Student of the Ukrainian Academy of Customs



Ukraine needs investment. The powers that be realize this, and they also know that potential investors need incentives and guarantees, otherwise they will place their money elsewhere. To encourage investment in the country, the government created special economic zones (SEZ) with preferential taxation in areas where the overall investment climate was otherwise unfavorable.

Improvement of the territorial structure of Ukraine to some extent concerned with the creation of free economic zones, inter-territorial production complexes and various multinational companies. It is need to use the features of the geopolitical position of Ukraine in general and its specific areas, particularly those that are advantageous economic and geographical position (transport units, regions, where the international ways, etc.). Thus we must work with national interests from a position of unity and independence of the Ukrainian state. The essential condition is that Ukraine, as a young nation, was stage centralization and consolidation of those parts of its territory that have developed because of their long stay within the same State. So without improving public administration and economic reforms can not strengthen the territorial unity of the state itself. This fully applies to the formation of free economic zones. Soon they must cover a small area. Free Zone, as territorial and border systems should be one of the specific ways of integrating Ukraine into the global economy.

Special Economic Zones (SEZs) have been established in 120 countries to promote business and increase foreign investment. Stimulated by more liberal economic policies in these zones, as compared to the host countries' typical economic laws, a variety of institutional consortia have invested in more than 3,000 SEZ implementations worldwide.

In most cases, an SEZ is structured as a combination of public-private partnerships in which the public sector provides incentives such as infrastructure, equity investments, soft loans, and bond issues that enable a private sector developer to obtain a reasonable rate of return on the project.

A Special Economic Zone (SEZ) is a geographical region that has economic laws that are more liberal than a country's typical economic laws. The category 'SEZ' covers a broad range of more specific zone types, including Free Trade Zones (FTZ), Export Processing Zones (EPZ), Free Zones (FZ), Industrial Estates (IE), Free Ports, Urban Enterprise Zones and others. Usually the goal of a structure is to increase foreign direct investment by foreign investors, typically an international business or a multinational corporation (MNC).

The first joint enterprise zones (BSI) in the world considered the territory of large sea ports, railway junctions, airports. They usually was out from customs regime on the territory of the principal and operating through duty-free goods. Preceded the formation of such zones offer a "free port", is areas where they could be stored duty-free goods that come to the area for later sale. The first news of "free ports" associated with the XVI-XVII centuries.

There are two main conceptual approaches to the creation of Free Economic Zones:

- territorial approach - ECO functions as a specifically designated area covered by the profile;
- custodial approach - introducing a special regime, which provides certain advantages certain companies located in any which areas of the country if they meet certain criteria.

So, according to a Law of Ukraine "On general principles for the creation and functioning of special (free) economic zones" special (free) economic zone is a part of Ukraine and on which a special legal regime of economic activity and order of application of the legislation of Ukraine. In the special (free) economic zones introduced preferential customs, finances, tax and other economic conditions of national and foreign legal and natural persons.

Ukraine currently has the chance to turn these zones into a powerful investment mechanism. The Economy Ministry prepared a draft law changing the regional development legisla-

tion, which it said would help overcome the negative consequences resulting from the 2005 cancellation of privileges. However, Kostyantyn Kuznetsov, economic expert with the Kyiv-based think tank Razumkov Center for Economic and Political Studies, strongly disagrees with their reasoning. "It's simply not true," he says. "On the contrary, the amount of direct foreign investment in late 2004 was USD 8.4 billion, and it had risen to USD 22.4 billion as of April 1, 2007, according to Ukraine's State Statistics Committee. This is an absolute growth in foreign investment. The cancellation of privileges in the economic zones did not scare investors away, but instead attracted USD 4.8 billion in investment in the steel giant Kryvorizhstal, which allowed Ukraine to fulfill its privatization plan for the very first time," he said.

The government has made moves to improve the situation by determining clear criteria for the operation of the zones, introducing incentives for investors, and establishing a system of state control over project realization.

According to the new draft law, territories must fulfill the following criteria in order to become a special economic zone: average monthly salaries should not have risen above 85% of the country average for three years; unemployment levels must have remained about 110% of the country average for three years and investment projects must create employment.

There is a great deal of capital available to come to Ukraine, but there are too few viable projects from the point of view of investors. Ukraine has the human capital, consumer markets, location, natural resources and infrastructure to grow rapidly for a sustained period. Yet the administrative business environment, security of property rights, minority shareholder rights and ability to enforce contracts are lacking to the degree that Ukraine continues to forgo the lion's share of its opportunities for sustainable growth. Given the apparent incapacity to improve the business climate throughout the country, and a desire to develop especially depressed regions, starting in 1999 the authorities turned to the creation of free enterprise zones, where basic ingredients needed by investors were to be secured within pre-defined territories, and where special privileges were awarded. Among the motivations for these zones, it was thought that they would help to attract technology and foreign investment to Ukraine.

Ukraine has a multitude of sector subsidies, free trade zones and priority development areas. The following industries are considered "priority" and have been receiving subsidies of different magnitude during the last five years: shipbuilding, coal mining, steel, motorcars, aircraft, space, chemicals, pharmaceutical, and construction.

Name	Location	Area	Established	Time limit*
NCEEZ Syvash	Autonomous Republic of Crimea		1996	5 years
Slavutych	Slavutych, Kiev Oblast	2,000 ha	30.06.1998	till 01.01.2020
Azov	Mariupol, Donetsk Oblast	315 ha	21.07.1998	60 years
Donetsk	Donetsk, Donetsk Oblast	466 ha	21.07.1998	60 years
Zakarpattia	Uzhhorodskiy Raion and Mukachivskiy Raion, Zakarpattia Oblast	737 ha	09.01.1999	30 years
Yavoriv	Yavorivskiy Raion, Lviv Oblast	116,000 ha	17.02.1999	till 01.01.2020
Interport Kovel	Kovel, Volyn Oblast	57 ha	01.01.2000	20 years
Kurortopolis Truskavets	Truskavets, Lviv Oblast	774 ha	01.01.2000	20 years
Mykolaiv	Mykolaiv, Mykolaiv Oblast, shipyard territory, and adjoining area	865 ha	01.01.2000	30 years
Port Krym	Kerch, Autonomous Republic of Crimea	27 ha	01.01.2000	30 years
Porto-Franco	Odessa, part of Odessa Trade Sea Port's territory	32 ha	01.01.2000	25 years
Reni	Reni, Odessa Oblast	94 ha	17.05.2000	30 years

\* Initially planned time of operation given. All zones were shut down on March 31, 2005.

In addition, special Economic Zones existed in Ukraine until March 31, 2005. The first created was the North-Crimean Experimental Economic Zone Syvash (since 1996). From 1998 to 2000 11 new zones were created: Azov, Donetsk, Zakarpattia, Interport Kovel, Kurortopolis Truskavets, Mikolaiiv, Porto Franco Odessa, Port Crimea, Reni, Slavutich, and Yavoriv. There are also nine special priority areas granting privileges comparable to those of free economic zones. For purposes of brevity moving forward, all types of Ukraine's free or special zones in Ukraine will be referred to, simply as "zones".

The privileges are granted not to all activities in the zones but only to a list of investment projects specified by government resolutions. In order to qualify, a project should meet the following criteria:

- the project belongs to the list of priority types of economic activity;
- minimal investment is in an amount from US\$0.2–3.0 million, depending on the type of the activity;
- the project is approved by the zone authorities; and
- there is a contract with relevant Central Government bodies.

The purpose of the special (free) economic zones are attracting foreign investment and supporting the promotion of joint activities with foreign investors to build business export goods and services, supplying the domestic market of high quality products and services, attract and implement new technologies and market methods of economic development market infrastructure, improve the use of natural and labor resources, accelerate socio-economic development of Ukraine.

PDA - the priority development territory - the territory where the prevailing adverse socio-economic and environmental conditions, poor condition of employment and which introduced a special regime of investment to create new jobs.

The purpose of the PDA is the formation of new and existing jobs resuscitation by attracting foreign and domestic investment under preferential customs, finances, tax and other conditions of economic activity.

Relevance of free economic zones in Ukraine has a system of factors that can be divided into the following groups: economic, ideological and administrative.

To economic factors include: the ineffectiveness of the existing method of economic management, the need for radical changes in economic policies, low productivity of state enterprises, a significant burden of budget deficits and debt, numerous investment programs funded by the budget.

To ideological factors include: changes in the key principles that underpin economic management, namely, the refusal of the state of uncharacteristic for her role of producer and supplier of products, as well as policies that inhibits individual freedom and promotes monopoly restricts the possible choice buyer.

It can not take into account the causes and groups associated with the need to change management style. High level of state ownership in the country generates bulky, inefficient bureaucratic structures that eventually transformed into "state within a state", working on their own wellbeing, strengthening their power.

Same these reasons territorial movements such as Economic Cooperation Organization (ECO), become important, fairly mobile element of market transformation. ECO target applications are creating new jobs, broadening the export base, improving the country's balance of payments, effective use of local resources, promote market reforms. International experience confirms that the use of ECO - an effective means to attract foreign investment into the country, creating favorable conditions for their operation.

It should be noted that Ukraine, occupying an advantageous geographical position in Europe, not the full use of cross-border cooperation to address their socio-economic problems. In particular, this applies to foreign economic relations. Border Development of regional cooperation as one of the specific ways of integrating with the common process at the macro level involves the division of power between the center and administrative areas, which makes it possible to react quickly to market demands, including the relevant cross-border merger.

National economy and regions by attracting foreign capital to receive the following benefits: more efficient use of local natural resources, introduction of new technologies, development of trade and export, production of goods for export; restructuring of national and regional economy, rising employment levels, job creation and reduce unemployment, increase welfare, domestic market saturation ECO high-quality goods, creating favorable conditions for international lending, obtaining new sources of funding opportunities for training and retraining of qualified personnel and the development of foreign economic relations, socio-economic rehabilitation of the region.

However, in the opinion of counsel for the organization of the UK ECO John Hansen, there are two dangers in creating SEZ: provided benefits not offset by work area or benefits not stimulate increased investment, and previous negative situation in the region continues to be stored. In the first case by reducing the tax burden the budget deficit even greater. The danger lies in the second variant of extremely high interest rates in Ukraine are very low ratio of bank assets and industrial countries (about 1:200). Therefore, success will occur only when ECO facilitate access to world capital markets. Yes, Leonid Minin believes that the establishment in Ukraine of special (free) economic zones has two advantages: it is the highest level in Europe transitivity, skilled and cheap labor. Budget losses of NO hardly be because the country's economic complex collapsed so that without radical reconstruction of any serious income to give it out just can not. With high levels of government criminalization of society is seriously concerned about a problem of intensive zones with special investment regime without the simultaneous creation of control mechanisms. Much less hassle cause classic zones with separate territory. It is a very serious question of the new zones in the financial plan.

As world experience shows, has formed a wide range of forms of free economic zones. Goals, trends and development strategies, approaches to the separation zone, have formulated a clear concept of the timing and appropriateness of the development of ECO. Common Criteria is also a reference to the territorial entities of different types of zone classification which takes into account:

- location areas according to geography position on border: internal (in-country) and external (right near the border);
- nature places zoning objects: local (point) based on small areas of individual enterprises, transport nodes, and complex - a significant development for the formation of territorial, administrative-territorial units that perform various functions;
- relationships with host country national economy: integration in mechanism of the principle of close cooperation with business entities beyond the development of horizontal linkages, and created primarily to increase the impact of freely convertible currency and localized in one small area with a small contact with the rest of the economy;
- functional orientation when zones are distinguished by the criterion of performing certain functions: foreign trade, commercial and industrial, technological, tourist, banking and insurance, information, etc.

Based on this classification, the objectives are often the foundation ECO:

- job creation and thus solving the problems of employment;
- expanding export base;

- countries improve the balance of payments from the proceeds in foreign currency, effective use of local resources;
- stimulating market transformation.

Investigation of effectiveness of ECO functioning directly concerned with identifying factors the effectiveness and achievements and failures due to operation of ECO in the process of their evolution.

Factors efficiency can be conventionally divided into positive, in those that promoted the effectiveness of ECO, and negative, that is, those that inhibit it. It is clear that the achievement of ECO is the result of positive factors (or the result of mitigating the negative factors), and the shortcomings and failures-negative zones.

Negative performance factors include:

- political instability in the country;
- instability and vagueness "in the legal regulation of economic activities;
- mechanical transfer its state experience of other countries;
- existence of too centralized management of the state;
- no state-level ECO constructive policies, including the sectoral and geographical priorities: lack of strategy and tactics development programs ECO (this applies to the creation of financial and credit structures, mechanism of guarantees for foreign investors, which hamper investment, is not conducive to their return);
- consumer market imbalance in the host country, the negative balance of payments, structural imbalances, lack of market mechanisms enshrined;
- multiplicity of purposes and ambiguities that can cause unreasonable distribution of benefits to almost all activities and operations in any area of subjects;
- area designers claim to receive benefits due to a depressed economy of the region that are not associated with a cost-based needs of local FEZ territory of favorable economic and geographical position and resource potential. In this case a SEZ without creating internal incentives to attract national or foreign investment in manufacturing, only artificially supports the mediation sector. Thus they are deprived of local budgets, a significant portion of tax funds;
- Lack of flexible and effective mechanism for estimating and resolving the problems encountered in the development zone. This means failure management area or the host government to adapt to changing environments, make the necessary adjustments to adapt the organizational structure of the zone to the new issues that arise during the evolution of the zone (reduced zone management adaptability):
- poor choice of location for the zone. For example, an underdeveloped region with poor roads and air transportation. Based on worldwide experience creating ECO can provide some important parameters of the location zone. Namely:
- remoteness from major world centers of high demand (which includes both geographical location and transportation, communications, general basic infrastructure that already existed in the region);
- availability of labor (both in qualitative and quantifiable);
- existence of other factors: scientific and technical personnel, raw materials, climate, environmental conditions, the amount of arable land, etc.;
- bridge market presence, which can sell their products. International experience shows that ECO should be set up on the main areas of commercial, industrial, data communications, taking into account regional cultural and historical traditions:
- size not optimum zone. Zone size is a critical performance factors. It is believed that in countries such as China, Malaysia, Mauritius, Singapore, Macau large areas has become a major factor in industrial development. But on the other hand, large areas require large investments too,



especially the organization of infrastructure that makes inefficient functioning of such zones. Especially when you consider that we should expect positive results in 5 (now already is 10) years from the time zone. ECO Really profitable in the world is no more than 50 (this fact shows that profitability can not act as a generalizing, a universal criterion of efficiency and ECO can play a role only local criteria)

The adverse effects of operation of ECO. ECO failures or shortcomings in the planning stage of its development and operation can be considered:

- reasonable costs involved in the organization area, with the volume of foreign investments (Liberia - Infrastructure organization \$ 15 million investment - \$ 600 thousand):

- attempt firms located in areas, the internal market as a field for the dumping of products that do not meet international standards, suitable for implementation on a more demanding foreign markets (China, Guangdong Province);

- weak inverse relations firms zones host country that leads to the inability to effectively implement the country's comparative advantages, particularly its natural resources, most areas NIK PSA (Exception: United Arab Emirates, Ghana, Trinidad and Tobago). Final causes of this phenomenon has not yet established, but several of them are: in many countries, foreign companies operating in the area had established lines of supply to another zone, so they do not need local suppliers;

- poor areas;

- a significant difference in perceived ideas feedback from management and potential investors;

- cultural upheavals of foreign investors free economic zones (according to Western experts, it will be a significant disadvantage in the new states in terms of international comparisons). Means of reducing shock:

- functioning special stores, access to foreign television and radio programs and even adoption of English or another foreign language as a lingua franca;

- ignored psychological barrier that occurs when the organization entering the host country on FEZ territory and unjustified attempt to address the political and national-cultural problems through the establishment of SEZ (at this point the authors project zones in Ukraine);

- high level of unpredictability accurate economic forecasts for the further operation of the zone (example - Mauritius);

- unreasonable distribution of benefits in almost all activities in the area and the operation of any of its subjects, resulting from a large plurality and ambiguity of objectives which it set for area designers and organizers (India, China)

The above achievements and shortcomings ECO can serve as useful lessons for the newly independent states which deem it necessary to use the ECO as a means for economic growth state, and instruments of world economic integration. Refer to have some useful lessons from the activities of ECO in the process of their evolution, at which point foreign experts:

- transformation of export-import processing zones and industrial zones (Manaus in Brazil, China, Mexico, Barbados);

- national organization enterprises in the SEZ (in some states, such as in India, it is required):

- ECO understanding how a large area, not as a small industrial enclave (China, Sri Lanka, Mauritius). World experience shows that the evolution of territorial zone approach usually applied in the initial stages zones transformed secured. This ensures a stimulating effect on the area of the economy of the host country;

- evolution zone-oriented production of goods for exports, targeted services (Thailand);

- a completely new, such that meets global standards, the administrative system within area (Malaysia, Sri Lanka):

- means that some countries were able to attract some areas of heavy industry sector, which are characteristic of zones.

The experience shows that usually directed investments in electronics, light industry (textiles and clothing), furniture and food industries, are those in the industry, whose products have high cost or are easily transported; specialization export industrial zone depends on the first investor. Each zone takes the main place in any one industry. Often, that industry, which represents the first foreign enterprise zones, gaining the greatest development. For example, if the first zone investors are electronic firms, then these investors are automatically inclined to this area. Moreover, if industry takes the leading position in one area of the country, then, practically, it dominates the whole country.

Studying of foreign experience shows that through the creation of free economic zones in many countries managed to stabilize the economic situation and bring them to the crisis. Being the prevalent economic free zones in industrialized countries of the Pacific region, including South Korea, Taiwan, Singapore, Hong Kong. Among developing countries, the largest distribution of free economic zones have acquired in Mexico, Trinidad, Sri Lanka, Ghana, United Arab Emirates.

This way world practice confirms the feasibility and necessity of establishment of SEZ like a most activity in Ukraine. However, considering the financial and economic aspects of the ECO and relevant experience gained in China, Korea, Ireland, Hungary, Yugoslavia, Poland and the U.S. should bear in mind that ECO is a very costly, because their organization is associated with much investment. Estimated amount of initial investment in the SEZ is 5000 dollars per job.

In considering the place and role of special economic zones in the economy of regions and countries should assume a priori that the economy of special economic zones and the relevant territory's economy largely interdependent. Practice shows that the higher efficiency observed is in countries which are characterized by dynamic development. This is South-East Asia, South America. But in these countries as a zone of the same class, but different in size and production volume indices are unequal. Higher efficiency in small marked area. It is connected with the mobility of such zones, the ability to more quickly adapt to conditions that frequently change management flexibility. That is, the effectiveness of the zones depends above all from the same factors, and production activities, located directly in the zones.

Clearly, the resident country on whose territory or create a special economic zone, expects some positive effects. They can be direct, like a profits or indirect, that occur in the acquisition of new technologies, training workers new professions, production and social infrastructure, reducing unemployment, increasing exports, import substitution etc. Of course, each resident of the creation on its territory of special economic zones primarily focused on attracting foreign investment, along with the capital to get advanced technology, innovative technology, intellectual potential, management experience. It is also allows the state to plan in the long term restructuring of the economy, increase the volume of production.

As experience shows, foreign investments are usually delivered to the countries where the political situation is stable, dynamic economy, create appropriate conditions for investment. The latter means that residents of countries in placing areas should bear the related costs. For example, China at an early stage of development zones (am 80-years) spent one dollar to attract around 7.5 Yuan. China covers the costs incurred rapid engagement zone and its effective functioning in the next. Important to use new technologies, advanced marketing principles and management. Products of new creation enterprises should ensure saturation of the domestic market and simultaneously establish the global market. Thus, as the practice more effective is the creation of zones of small-size objects associated with their greater mobility, more simple, reliable

device management. This is one reason that the objects of this class is placed in the zones and what they represent small and medium-size capital companies.

Often traced element of the national mentality. Foreign investors and entrepreneurs of foreign origin drawn to their historical homeland. These often have medium and small capital, celebrated national patriotism, easy to climb. That this can be explained by the fact that the biggest investors in special economic zones of China are Huatsyao, that is the Chinese who live outside Greater China - Hong Kong, Taiwan, in other states.

Experience of special economic zones showed that it due achieved a significant macroeconomic effect, which is comprehensive in nature. In terms of international economic relations, he is at the expense of economic growth factors such as integration into the world economy, comparative advantages from the point first of all, the global economy, introduction of free or preferential trade, and the inclusion in the reproductive process of foreign investment .

If you consider the effect of the activity of special economic zones from the perspective of the national economy, it is formed as a result of attracting investment and intensification of export-import links, rapid economic development of the region and the state as a whole, the formation range of innovations, and receives a demonstration effect. Capital investment in the involvement, increased export and import links provided within the provision of special economic zones of various incentives (tax, customs and other), creating a favorable climate for investment, especially foreign ones. This is an important factor of market reforms and national economic development, its integration into the world economy. Easing, in turn, activates Economic, including foreign trade, as a special economic zone and areas that are in its sphere of influence. In addition, simplified way of national companies to foreign markets formed some experience on it.

An economic benefit for development of the region shows that the development of areas of priority activities is a necessary starting impulse. Functioning of Special Economic Zone is one of the sources of income to replenish local budgets and state budget. This applies to direct taxes referred to the budget, but also increase the tax by the intensification of the mass circulation of goods and services, intensive financial activity, attracting private and other businesses to cooperate of Zoning structures, etc. In addition, the concentration of much of the taxes and other mandatory payments to the local budget provides an additional incentive for development.

Existence of special economic zone creates favorable conditions for social development of regions, as rising standard of living of the population, settled acute social issues, such as unemployment, expanding services to the public and others. Scales, which carries the idea of special economic zones as an instrument of regional policy can be used for purposeful development of Regions of correcting economic development, deprivation of negative trends.

Economic benefits for national development based on the fact that the establishment and functioning of special economic zone gives not only the economic effect for the region, but the macroeconomic effect for the state as a whole. Special economic zones should be regarded as a powerful instrument of state policy of economic restructuring, when these zones can be introduced at once in several regions. Since the formation of special economic zone integrating certain areas (regions) in the global economy, so created a kind of "Ostrivka" competitiveness in the economy, which is not yet ready for international competition.

The special economic zone may be used as a range of innovations, have a demonstration effect. Because of its relative isolation special economic zone acts as an active research facility for implementation and testing of new technology developments in a particular area. Obviously, the successful implementation of new developments will be the basis for the transfer experience to other regions, will have major practical implications in view of economic reform demonstration deployment.

It should be emphasized those economic benefits that are achieved with the creation of free economic zones. They can provide direct and indirect. Direct benefits are revenue administration area in national and hard currency payments, taxes and rent paid by companies operating in the area income workers, profits as a result of utilities (water and electricity, communications, sewerage) supply of raw materials, etc., profit from relationships with companies located outside and income through extensions turnover of goods and services. In the indirect benefits is revitalization of the region and expand economic cooperation with other regions and countries, improve local skills, achievements of the new technologies and best practices, increase the quality of goods and services acceleration restructuring processes in industry.

Effective functioning of SEZs is largely determined by events on creating a favorable investment climate in the SEZ. It is necessary to ensure long-term and controlled nature of economic policy, terms of liberalizing the movement of capital and goods, to ensure reliable guarantees for the protection of property rights, establish effective forms of interconnection of local authorities, local and regional governments and of economic development and management of BMS.

Principles of forming FEZ:

1. The flexibility and dynamism of the SEZ.
2. Speak of many approaches, shapes and patterns SEZ.
3. Perspective development.
4. Compliance with the priorities of the FEZ priority directions of development of regions and states.
5. Subject to the requirements of national security.

SEZ created as economic enclaves that are beyond the country's economy that takes. Practice establishment and operation of SEZs shows erroneous view that the impact zones on the national economy can only be positive and requires no special control measures. FEZ, speaking a form of international cooperation is the result of a compromise between the investor and the party takes. This situation highlights a certain internal contradictions inherent in SEZ, as part of international economic relations.

As with any complex formation, special economic zones may cause a negative impact on regional economic system. Components to this effect include unjustified economic regime disintegration of a certain region due to the allocation of special economic zone, the redistribution of resources for its development to the detriment of other regions. The formation of special economic zone may become a factor activation of unwanted economic activities cause like other regions, sometimes unfounded, have their own area with similar privileges. Everything must be taken into account in substantiating a zone to maximum limit potential defects.

Experience of special zones in developing countries, shows that side-founder sees benefit in them, however, should not exaggerate their significance.

Thus, SEZ is a tool of foreign economic relations and improving economic structure of certain regions. As the practice of creation and functioning of the IX, the main advantage of SEZ for countries in transition from administrative-command system to market. Faster more efficient and attract national economy to the use of scientific and technological, organizational, managerial, economic experience of leading countries, attracting foreign investment, creating jobs, solving problems related to the preparation of modern professional staff - all of which should materialize in concrete results - growth of export potential, the accumulation of international reserves, optimize economic structure. Therefore, the creation of SEZ should be concerned not only individual regions, but also healed state, leading to a weighted and balanced policy towards the center regions, which are committed to the creation of SEZs.



For coherent integration of the economy in the world economy ties are created free economic zone. They may be established on the initiative of local authorities. Proposals for the establishment of ECO are made to the Government of Ukraine by local authorities (districts) in areas which will be organized. The most promising areas for the establishment of such zones is Transcarpathian, Donetsk, Luhansk and Kharkiv regions and cities of Odessa, Mariupol, Sumy. Financing of the works on preparation of investment projects provided the initial creation of the SEZ.

Among the most important problems whose solution is possible by creating an area with favorable geographical location more favorable compared with other forms of foreign trade conditions, we should observe:

1. Ukraine's economy in attracting foreign capital, advanced technology and management experience;

2. Infrastructure for expansion of international economic relations (including monetary and credit, insurance, information, transport) that allows use ECO as a conduit between internal and external economies;

3. Development of export zones and increase foreign exchange receipts, including by processing raw materials coming into the world market in unprocessed form;

4. Efficiency introduction of domestic and foreign scientific and technical developments, followed by transfer of results to be used widely in the economy of the country and abroad;

5. Testing at the local level various ways of introducing new forms of management adapted to the conditions of the world market;

6. Practical training of our staff and methods of international business, followed by using skills obtained outside;

Based on a specific target and industry orientation of ECO can be divided in several types:

1. Integrated special economic zone of industrial origin (Kharkov, Donets Basin, Luhansk, etc.);

2. Foreign trade - free customs zones and ports of export production zone and transit zone (Odessa, Mariupol);

3. Or functional sector (technology parks, tourism, insurance, banking and other areas).

All types of free economic zones can perform national economic and foreign functions. Foreign trade zones are mainly intended for foreign exchange earnings due to a special warehouse, lease of premises for exhibitions, reloading and handling of transit cargo.

Technological Parks and techno polis can help speed up scientific and technological process based on activization of international cooperation in implementing the results of the national basic research to develop new high technologies, finished products and expand their exports. ECO complex character created for relatively restricted areas with their advantageous geographical position along the transport routes of international importance, where there are conditions for the involvement of foreign capital in order to create industrial infrastructure.

Financial and credit policy may become an effective regulation of the target orientation ECO.

For enterprises of Ukraine, joint ventures and foreign companies working in the SEZ can be provided such tax breaks:

- reduction (cancellation) of income tax (revenue) and its transfer abroad (foreign investors);
- increase in the release of taxes (for joint ventures and foreign enterprises);
- issuance of tax credits (temporary release from taxes with further payments);
- setting of deadlines for accelerated depreciation of production assets;

Enterprises, located in the SEZ could help attracting foreign investment, introduction of new technologies, activating domestic market, improving the investment climate in Ukraine.



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**Katakli S.\***

## **BASIC TENDENCIES OF DEVELOPMENT OF BANK BUSINESS IN UKRAINE IN POST-CRISIS SITUATION**

**Resume** *Relevance of research theme. The research objective consists in revealing of the basic weaknesses of bank sector of Ukraine, which steels advancing factors of financial crisis, the events, made direct impact on development of bank sector of Ukraine during the last few years, and also revealing of prospects of development of bank business in post-crisis conditions.*

*Methods of research. During theme studying the following methods have been applied: methods of the economic and economic-statistical analysis for an estimation of a current state bank activity of Ukraine, competitiveness of represented services and tendencies of their development; at definition of key problems of the market of banking services - methods of expert appraisals; by consideration of a current state and development trends of bank business - analysis and synthesis methods.*

**Keywords:** bank sector, credit activity, active operations of banks, a monetary policy, capitalization of banking system.

**Аннотация** *Мета дослідження полягає у виявленні основних слабких сторін банківського сектора України, які стали визначальними факторами фінансової кризи, подій, мали безпосередній вплив на розвиток банківського сектору України в даний період, А також виявлення перспектив розвитку банківського бізнесу в посткризових умовах. При дослідженні теми були використані методи економічного і економіко-статистичного аналізу для оцінки поточної діяльності державного банку України, Конкурентоспроможності послуг, що надаються і тенденцій їх розвитку; при визначенні ключових проблем на ринку банківських послуг - методи експертиз; при розгляді поточного стану та тенденції розвитку банківського бізнесу - методів аналізу і синтезу.*

**Ключеві слова:** банківський сектор, кредитна активність, активні операції банків, грошово-кредитна політика, капіталізації банківської системи.

Today all over the world is a significant transformation of the international activities of banks in the direction of the requirements of a globalizing world economy. This finds expression in a concentration of banking capital, including through utilization of the mergers and acquisitions, international expansion of banks' business, diversification of product range, including the expansion of non-bank banks offer products and services.

Last years were characterised by unprecedented development of bank sector of Ukraine: rapid growth of consumer crediting, inflow of direct foreign investments, the beginning of the period of consolidation of industry. During the period from 2004 to 2007, the volume of a portfolio of various credits has grown more than 10 times as much in absolute indicators, doubling

\* 5th year student of the Department International Economic Relations of Taurida National V.I. Vernadsky University

annually. Thus, rates of increase of credits exceeded indicators of deposits that had led to the increased risks of refinancing and liquidity, and to currency risk, as result of essential loans in the international markets of the capital.

At the same time, quality of incomes of Ukrainian banks remains in a very low level: in a retail segment it is 1.7 bank products per client of a bank, and in a corporate segment – basic products with low profit prevail, and, correspondingly, excessive dependence on risky percentage of interest incomes. Moreover, the inefficient infrastructure, processes, and technologies of banks give a large quantity of possibilities for reducing expenses and improvement of an indicator of costs-profits ratio of banks.

The Ukrainian banking sector is continuously growing foreign competition: every tenth bank has foreign members, including more than 18 banks are fully controlled by western parent companies. Today, banks with foreign participation have higher return on assets and capital and, accordingly, can offer substantially better terms of credit, both businesses and individuals.

Pursued in recent years the policy of financial security is largely aimed at consolidating the Ukrainian banking system through its enlargement. This policy is enforced, because to compete with such global giants as Citicorp, Credit Swiss Group, UBC Warburg, Lloyds, HSBC Holdings, Deutsche Bank Ukrainian banks are not yet able. In this regard, a need "to take measures to create a stable banking system that meets the interests of the real economy."

Different aspects of the formation of the theoretical foundations of research in international banking in Ukraine, as well as its development focus on the work of such economists as Bogdanov AA., Bogomolov, OT, SM Borisov, AS Bulatov, Vidyapin VI, Gracheva, MV, Gusakova NP, Ershov, MV, Zhuravleva GP, Kuznetsova IP, Lomakin, VK, Movsesian AG, Ognivtseva SB, Terekhov AA, Fanenko MP, Khalevinski ED, Handrueva AA, Scherbanovoy H. N. etc. Among the works of foreign authors, the problems affecting the international activities of banks, it should be noted works of N. Birdsall, D. Blackwell, J. Dyer, D. Kidwell, PA Cayley, A. Lajoux, G. Molla, M. Monti, R. Peterson, S. Reed, J. Cinca, A. Smith, J. Foster, B. Fulcheri, A. Hall, F. Evans, and others.

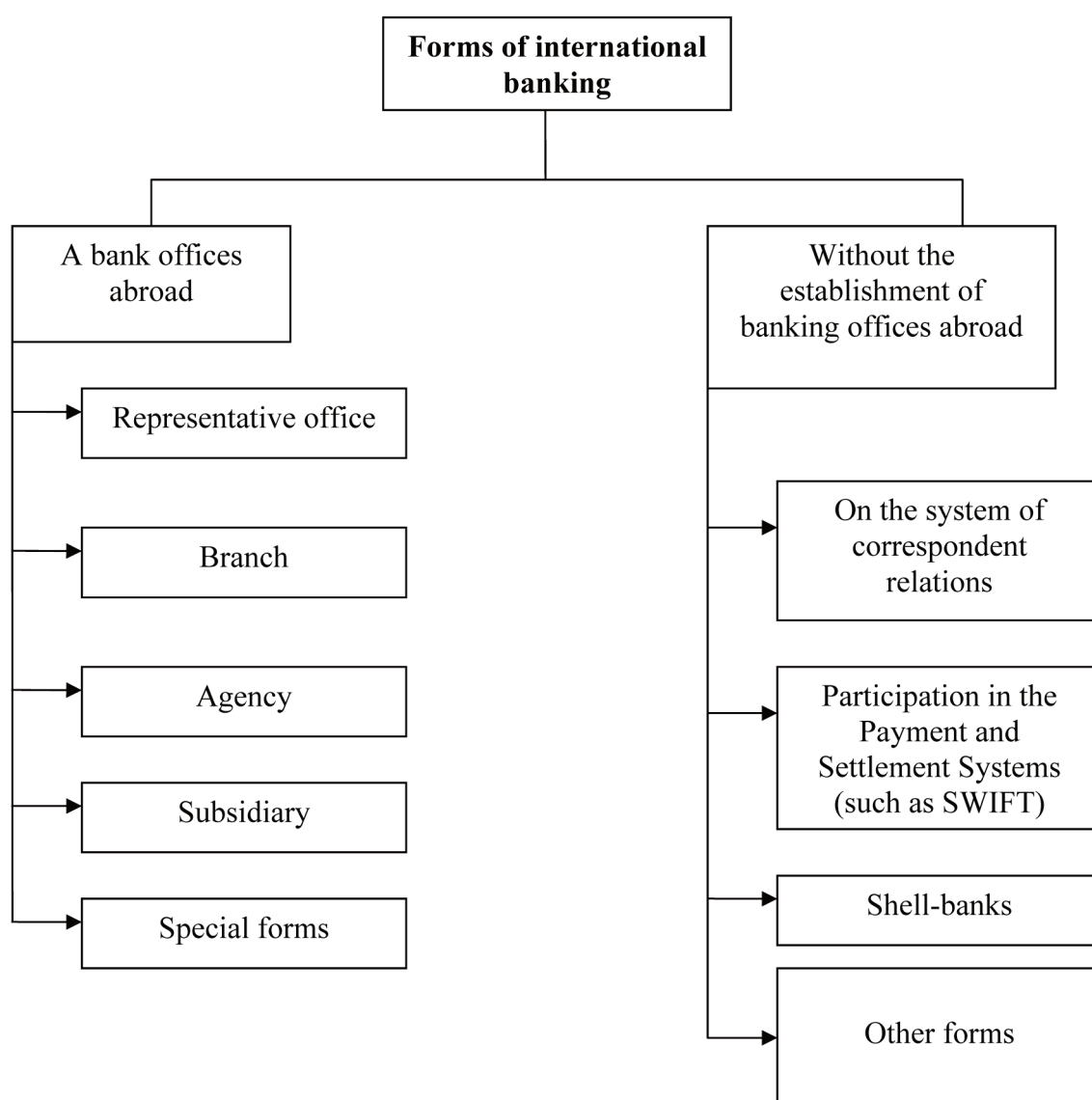
The main trend of the global economy this is the rapid development of global financial markets and the emergence of new financial instruments, which, in turn, affect the dynamic development of the banking. Banking is now a highly dynamic activity, which absorbs in itself all the latest technology of international financial transactions and is constantly in the center of media attention as a result of the functioning of foreign exchange, currency and stock markets. The main feature of the banking business is growing number of services that they provide international banks. Foreign trade company could not expand their activities without the timely flow of money and other resources offered by international banks. Banks not only ease traffic flows of existing corporate resources, and promotes credit financing for local and international markets.

International banking - the system of methods and approaches to the organization and management of banking operations, which are carried out in the international economic and legal environment. It is the management of international banking transactions. Banks that carry out international operations are its subjects.

International Banking unfolds in two main ways: through banking offices opened in foreign countries, and without the direct presence of the bank in a foreign country (Fig.1).

The objective basis of international banking is an international movement of capital, which plays an important role.

Banking activities are considered, especially as all kinds of activities which, in accordance with the mandatory requirements of direct legislation and regulations is possible only after the registration of a credit institution and obtaining a permit (license).



**Fig.1.** Organizational and legal form of international banking

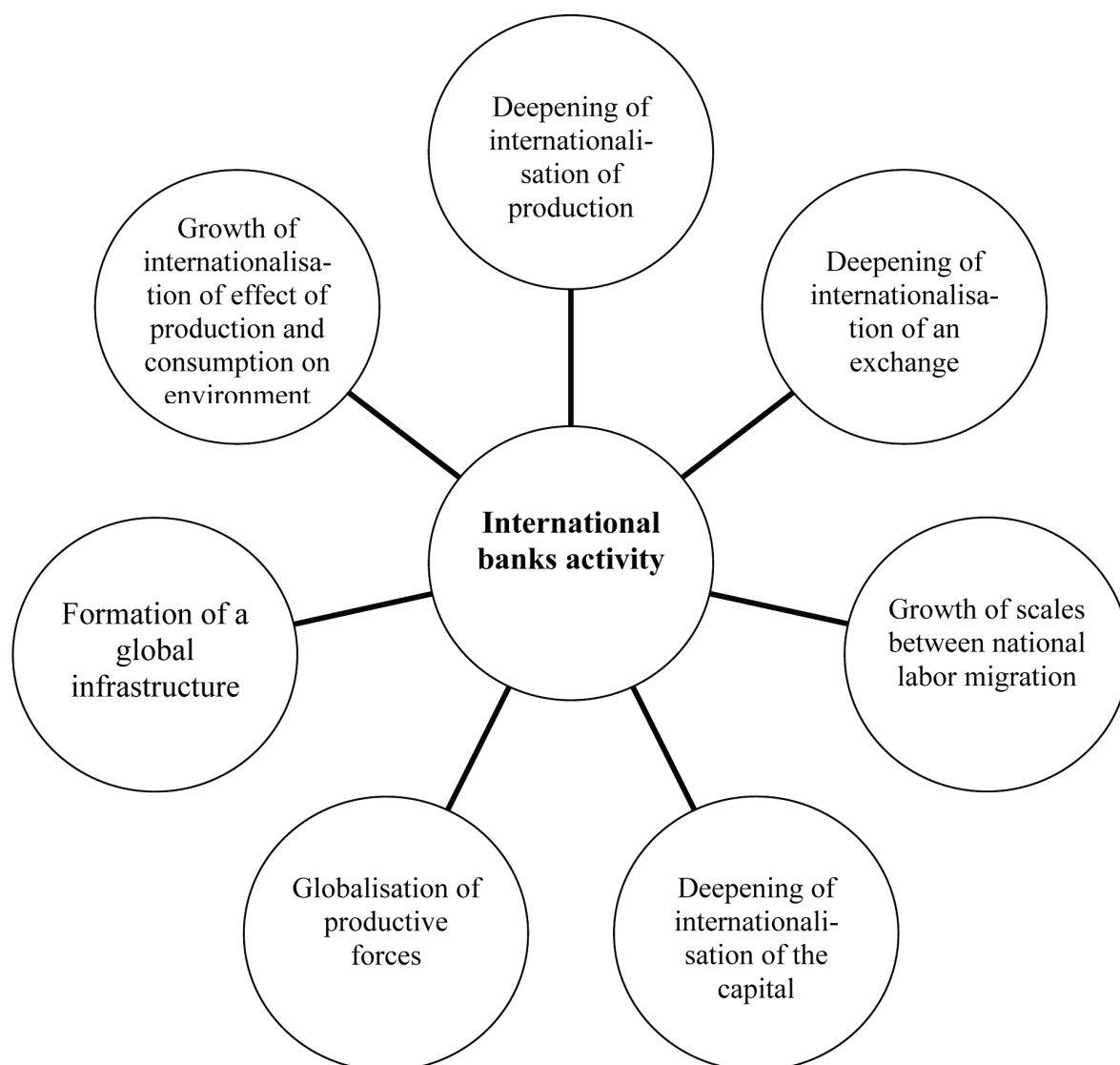
Systemic insights and international banking activities can be considered as development and concretization of dialectics in relation to the study of international economic problems, a necessary component, along with economic analysis, modern methodology of economic science. This methodological approach is applicable to the study of all international banking activity.

Modern globalization of the world economy is expressed in the following processes that affect the international activities of banks (Fig.2):

The deepening of the internationalization of capital is the growing international movement of capital between countries, primarily in the form of direct investment, internationalization of stock market.

At that time, both individually banking crisis has its own dynamics, we can always identify the main common elements of the crisis. Based on the most common reasons that banking crises can be classified into two categories: Micro (or "bad" banking business) and macroeconomic (or worsened ("bad") business environment).

Banking crises are often result from improper conduct banking business: Ill-conceived and reckless lending policies, excessive risk taking, poor organizational management, inadequate



**Fig.2.** Influence of conditions and factors of globalization of the world economy to international banking activities

internal controls, the emphasis on increasing market share of the organization, rather than on profitability as well as failures in monetary policy and the mismatch of requirements and obligations under the terms of banks themselves or by their borrowers. These factors are compounded if the bank's shareholders do not have something significant at stake in the banks - that is, without sufficient investment funds in banks and, if bank managers have little personal responsibility for the risks they take.

In some developing countries these conditions could be much worse if the power is concentrated in the bank in one hand, and when banks serve as personal "money boxes" or pyramid schemes and industrial groups, or clans. In these circumstances, lending "their" customers, transactions on the basis of insider information confidential and frank fraud may go unpunished. Similarly, state banks can be used as quasi-financial agencies, whose activities are based primarily on political criteria rather than on commercial principles that threaten their financial stability and definitely can affect the atmosphere in other banks with higher levels of management.

The "bad" banking can only receive additional incentives in the absence of reasonable legislative and control framework, as well as the appropriate market discipline.



Weak control over the activities of financial institutions may be expressed as follows: Politics concentrated lending, thoughtless drafting loan or investment portfolios, inadequate credit evaluation, which leads to an overestimation of the profits of the bank and its capital, mismanagement, etc.. Also, control of banking activities may face a lack of management, as well as lack of qualified personnel who may be insufficiently motivated (in material terms, inclusive).

Insufficient transparency and financial reporting, the low level of accounting and auditing means that the market - ie creditors of the bank - will not have sufficient information in order to establish discipline among the owners of the bank.

Market forces are facing problems associated with the imperfection of the basic principles of work with troubled banks. These include the weakness of the legislative, legal and institutional frameworks of interaction with banks and companies, which are on the verge of bankruptcy. The expectation that investors and lenders come to help, could reverse any reformist policies.

Crises can be caused by macroeconomic factors, which actually have nothing to do with the banking system. Even highly complex banking systems, which operate under strict and effective legislation could be affected by volatile macroeconomic conditions, or referring to ill-conceived economic policies of the state. Macro-economic difficulties may be associated with the following points: Credit boom, which to some extent caused by too large for the volume of investments or changes in tax legislation, the rapid development of a so-called. "Bubbles" in real estate and / or securities, which then cease to exist; economic slowdown and / or decrease in export or loss of export markets, excess capacity / profitability decline in the real economy, reducing the total investment, the growth of budget deficits and / or current-account deficit, reducing public debt servicing capacity, sharp changes in currency exchange rates and interest rates, etc.. Not all of these factors are controlled by governments, but national leaders must be willing to adopt macroeconomic policies that would take into account the weakness of the banking system of a particular state.

As long as banks remain liquid, the violation of the banking sector may continue for some time, until a number of triggers not make depositors and creditors completely disappointed in the banking system. This can be market-based, strategic and policy "shocks" that are "awakens" the signal to address the problems that have so far been ignored, leading to significant changes in expectations and management system banks.

The emergence of a situation of illiquidity in one bank may rapidly spread to other financial institutions as well as the unstable situation of the bank or payment system negatively affects the credibility of all banks, and leads to the fact that the lender or investor seeking to get their money back even though a stable position, for example, private banks. In this case, the "disease" has a local character, however, may also spread beyond the state, ie take the form of the problem of international concern. This can happen in the case where the emergence of a systemic crisis in the country occurred in the financial and trade channels.

Premature financial liberalization, together with inadequate training of bankers and regulatory authorities also led to the emergence of banking crises. Bankers may not have the necessary skills to manage price risk, and supervisors - the resources and rights to monitor the more complex new types of risk.

Loss of confidence in the government and its ability to conduct macroeconomic changes can cause a systemic crisis. This concern can violate the trust in the banking sector and the domestic currency.

However, the most important issue in the occurrence of banking crises is that knowledge of the specific reasons for their occurrence is not enough. The main thing - is the ability of authorities to jointly develop a strategy and then apply it.

Politicians must understand that there is a problem that requires quick and decisive action. Develop a political consensus is an important step. This process should be open and honest. The owners of banks and borrowers must be protected from authoritarian intervention by government authorities.

For the Ukrainian banks, the leading search tools and information necessary to improve reliability and efficiency of its international activities important to the development of these two types of global marketing, with all the attached standard set of banking services:

- manufacturing (industrial) marketing, involving the development of modern Ukrainian banks lending to industries and other industries. Among them are of particular importance: Project financing, leasing and factoring, bank involvement in the formation and activities of TNB and financial-industrial groups;

- international marketing, aimed at developing international nature of banking operations. This trend, primarily realized through powerful branch networks throughout the world and adopting new information technologies, which enables to perform operations on an international scale. We should also mention the role of international marketing in the development of foreign economic relations: TNB are not only creditors, foreign trade, but also direct them to the participants by introducing a mechanism of factoring, forfeiting, leasing, franchising and others;

The advantage of the marketing strategy of differentiation of banking services is that it gives the cross-border bank leverage pricing. Another strategy is the strategy of market segmentation in the implementation of which the market is divided into segments, and the bank should determine the most profitable of them. Both of these marketing strategies sufficiently profitable, effective, apparently, they must be applied in conjunction. In addition, the strategies it is important to determine the impact of new services on the risk for the banking activity in general.

Major trends in the development of the banking system of Ukraine for the last time period associated with efforts to maintain the liquidity of the banking system, minimizing the negative impact of financial crisis, the normalization of relations between banks and their customers, which have been substantially eroded due to financial problems of banks.

To implement these measures had been adopted several legislative acts, in particular:

- 1) Resolution of the Board of the National Bank of Ukraine "On additional measures concerning the activities of banks" № 319 of 11 October 2008 (repealed Dec. 4, 2008);

- 2) Law of Ukraine "On Priority Measures that prevent the negative impact of financial crisis and on Amending Certain Legislative Acts of Ukraine" № 639-VI on October 13, 2008;

- 3) The Cabinet of Ministers of Ukraine "On approval of the state's participation in the capitalization of banks" № 960 on November 4, 2008 (Order redrafted in accordance with the Resolution of Cabinet of Ministers № 148 of 18 February 2009);

- 4) Decision National Bank of Ukraine "On approval of the Special-order measures for the financial health of banks" № 405 of December 1, 2008;

- 5) Resolution of the National Bank of Ukraine "On Certain Issues of banks" № 413 of December 4, 2008;

- 6) Law of Ukraine "On Amendments to Some Legislatives acts of Ukraine concerning the prohibition on banks to change the terms of the contract of bank deposit and loan agreement unilaterally" № 661-VI on December 12, 2008.

- 7) Resolution of the National Bank of Ukraine "On Introduction of the National Bank of Ukraine currency auctions" № 469 of December 29, 2008;

- 8) The Joint Resolution of the Cabinet of Ministers of Ukraine and National Bank of Ukraine "On the order of the refinancing of banks during the financial crisis" № 44 dated January 29, 2009 (repealed Decree of CMU and NBU № 238 of March 11, 2009);

9) The Joint Resolution of the Cabinet of Ministers of Ukraine and National bank of Ukraine “On the maintenance of liquidity of banks” № 238 on March 11, 2009.

The above legislation was taken as the origin of specific problems in the banking sector due to financial crisis.

So, with the beginning of the financial crisis has considerably increased the outflow of money from banks in connection with the recovery of depositors their deposits. This was accompanied by the presence of the Civil Code of Ukraine norms, which gives the investor the right to demand return of the deposit before the expiry of the deposit.

To reduce the outflow of funds from banks using the NBU has already proven in 2004, way - adopted Resolution № 319, which allows the bank not to return deposits to investors before the end of the contract.

Since the restriction of the rights of depositors, enshrined in law, the NBU is illegal, December 4, the NBU adopted Resolution № 413, which changed its restriction on the recommendations of the banks to adopt measures to attract deposits. Banks began to offer investors more favorable conditions for short-term deposits at 1-3 month, raising interest rates, and after a while began reporting an increasing number of investors willing to sign short-term deposit contract.

Experiencing difficulties with the outflow of funds, on the one hand, and difficulties in attracting low-cost loans from foreign and international financial institutions - on the other hand, banks have been massively raise interest rates on loans already granted them, motivating this behavior of rising credit to themselves. These actions put the banks in the plight of borrowers who have no clear and unambiguous mechanism for the protection of their rights.

To remedy this situation, the Verkhovna Rada of Ukraine adopted the Law № 661-VI, which complemented the Civil Code of Ukraine regulations establishing that the rate of interest adopted by the loan agreement can not be increased by the bank to unilaterally. The law also introduced a rule on what the condition of a loan agreement on the right bank to change interest rate unilaterally void.

One of the most serious problems faced by borrowers of banks with loans in foreign currency, has been the rapid devaluation of the hryvnia. To address this Decree № 469 of the National Bank of 29 December 2008 were entered currency auctions to sell foreign currency to banks to meet the demand of individuals borrowing for foreign currency for the repayment.

For the purchase of foreign currency bank should establish the registry credit agreements. The registry includes information on loan agreements concluded before 15 October 2008. This information is entered into the registry in consultation with the client-borrower.

Bought this way the currency must be used within five days only to fulfill the obligations of borrowers under the loan agreements entered in the register.

Selling currency bought at auction should be the bank at a rate not in excess of the auction rate of 0,2% of the purchase.

In order to support the liquidity of the banking system and develop the order of state involvement in this process were adopted by the Law № 639-VI, Decree of the Cabinet of Ministers № 960 Resolution of NBU № 405.

Law № 639-VI envisaged the establishment of the Stabilization Fund due to exceptional income from the privatization of state property in 2008 and receipt of such funds in full in 2009, as well as through targeted placement of government securities.

Stabilization Fund should be used, inter alia, the provision of loans to repay, refinance loans received by Ukrainian banks by foreign creditors until September 15, 2008, to provide financial assistance to banks, as well as for other purposes.

To speed up the banks' capitalization Law № 639-VI have been simplified procedures and reduced time to take appropriate action.

Thus, the deadline for receipt of approval of the Antimonopoly Committee of Ukraine on the concentration in the banking sector was reduced to five working days. In the implementation of measures to improve the financial condition of the bank decide on changes in bank charter, changing the size of its share capital may be appealed to in court only for one month from the date of their adoption.

According to international experts, principal causes of vulnerability of the Ukrainian economy are the following:

1) Heavy deficit of account of current operations:

- In 2009 is expected to increase the current account deficit to \$ 24 billion, representing 10% of projected GDP. Such volumes will require external funding.
- About \$ 10 billion. of the current account deficit is likely due to increases in prices of imported gas

One of the most frequently used indicators of investors, credit default risk of bonds is the premium for credit default swaps (CDS). CDS - is a contract, such insurance, which provides for compensation of losses on bonds in case of default by the issuer of its obligations. The buyer pays the CDS insurance premiums in exchange for compensation of damages in case of default. CDS Market was established in 1994 and today it is estimated at \$ 45 trillion. Studies have shown that CDS premiums determine the risk of default before bond ratings and spreads: it is the best harbinger of defaults, and accordingly, the impending risk.

Award CDS on five-year bonds issued by governments of developing countries at the moment is in the range from 50 to 200 basis points per year.

- If the premium exceeds 500 basis points, this indicates that investors expect a default of such bonds. As a result of issuing new bonds difficult to sell or upgrade an existing debt.
- A few days before the collapse of banks Bear Stearns and Lehman Brothers CDS premiums they reached 740 and 724 basis points, respectively.

2) Burden of external debt (for last three years the total external debt has grown up to 45 % a year and has reached \$100 billion).

- The external debt of a private sector has grown up to \$85 billion of which \$29 billion makes a short-term debt (classified on initial term of repayment)

- Over the past two years, the total external debt grew by 45% annually and reached \$ 100 billion

- At present, the external debt of Ukraine exceeds the average for countries in a similar credit-rating category:

- at 60% of GDP, the ratio of external debt to GDP in Ukraine is above the average of 40% for countries with a similar rating.

- at 120% of revenues for the current account, the ratio of external debt to current account receipts in the Ukraine are also above the average of 84% for countries with similar ratings.

3) Weakness of bank sector as the defining factor implies: high rates of growth of crediting have led to a high level of problem assets; credit growth contributed to essential increase in monetary aggregate at the level of 44 % a year, and an external debt as well; necessity to discharge great short-term debt, high deficiency of the account of current operations, fast growth of consumer crediting and big commitments of banks in foreign currency.

A number of studies of emerging markets has shown that the high rate of credit growth led to high levels of problem assets. The rate of growth of bank lending in Ukraine have been high over the past 5 years: 60% per year. Vulnerability of Ukraine due to the necessity of repayment



of a large short-term debt, high current account deficits, Rapid growth of consumer lending and large banks' liabilities in foreign currency. These risks are reflected in higher premiums on CDS in Ukraine from 250 to 600 basis points since mid-2007 - more than in other countries. In addition, inflows of portfolio capital in Ukraine dropped from I\$ 3.3 billion. in the first half of 2007 to \$ 350 million in the corresponding period in 2008. Partly as a result of the PFTS index has dropped by 65% YTD (as at September 19, 2008), that is one of the strongest falls in world. These risks do not mean that the crisis is bound to happen, but merely indicative of its high probability.

The first quarter of 2009 became as a crucial period – the beginning of intensive recession after rapid growth. It was characterised by panic moods in the market after deterioration of solvency of banks, and also devaluation of national currency.

This period was characterized by intensive withdrawal of resources from bank system that led to substantial decrease in credit activity, mass refinancing of banking establishments of the NBU, a panic in the financial market bringing operative intervention of a regulator in the activities of banking establishments, toughening of the bank legislation by National bank of Ukraine to stabilize situation the financial market.

The bank system has experienced the scale crisis in corpora. Persistent negative tendencies and low business activity in economy led to further reduction of liquidity of bank system, losses of some banks due to formation of reserves to cover possible losses on active operations and strengthen intervention of a regulator into the activities of banks (including the activities, at global and operative level).

Later, the following tendencies of the development of bank sector of Ukraine and the changes connected with it were observed:

- 1) maintenance of rigid monetary (currency and monetary and credit) policy of the NBU;
- 2) accumulation of free liquidity that has led to essential depreciation of resources in the interbank market;
- 3) low credit activity of banks and scale re-structuring of already given out credits to the population and the enterprises;
- 4) considerable volume of assignments to reserves to cover possible losses on active operations of banks (despite liberalization of requirements according to solvency of borrowers for the purpose of formation of reserves) that caused unprofitable, loss-making activity of some banking establishments;
- 5) support of affiliated divisions in Ukraine by foreign bank groups at is minimum-necessary level and complete recapitalization of separate banks the state. The latter was a conditionally positive moment as had not helped to restore financial institutions to the full extent (especially after defaults of state Ukrgazbank and Rodovidbank under bonds);
- 6) increase in the number of cases of NBU operative intervention into the activity of banks and the beginning of liquidation of separate small banking establishments.

Only by the end of 2009 first signs of stabilization of bank system alongside with preservation of essential risks began to be observed. It is, first of all, connected with the fact that NBU and other state structures took a number of measures concerning the bank system to influence on stability of the financial market.

It is possible to allocate the following basic events which have made essential impact on a current condition and prospect of development of bank system of Ukraine:

First, a change of requirements to the structure and adequacy of regulatory capital that, in its turn, enables proprietors to hedge partially currency risks of investments and to support the interest of foreign banking capital in further development of affiliated divisions in Ukraine.



However there are also negative aspects of such actions: essential easing of requirements to capitalization of banks that can be negatively reflected in their solvency in future.

Second, change of the legislation for the purpose of protection of borrowers – physical Persons (coming into force since November of the law of Ukraine of 6/23/2009 № 1533-VI «On Modification of Some Laws of Ukraine Overcome Negative Consequences of Financial Crisis»). It can affect the quality of bank actives at the expense of increase in volume of non-payments under credits negatively.

Third, attempts of some domestic banks to restructure the obligation to external creditors; in case of successful re-structuring it can improve short-term liquidity of such banks.

Fourth, relative stabilization of resource base and maintenance of comprehensible level of the saved up liquidity that in turn can promote renewal of credit activity of bank system both in the country and behind its limits.

Hence, from all aforesaid, it is possible to draw to the conclusions that for last year the bank system passed some stages of development, and the general financial condition of banks has considerably worsened. Nevertheless, during this period banks and supervising bodies undertook a number of actions. The most important of them were: toughening credit policy, increase of reservation, changes in the bank legislation to reduce susceptibility of financial sector to currency and credit risks. At the same time, risks of a bank segment remain considerable, due to low level of trust to banking establishments, weak regulatory and an operational environment, and an unstable situation in the country as well.

Maintaining a stimulating monetary policy in the developed countries (the majority of the Central Banks have saved discount rates at former low level) and emergence of "crisis immunity" at international investors promotes returning of the capital to emerging markets, and can be positively reflected in trunk-call items of domestic banks with foreign creditors (including potential ones).

Probably, a large part of the banking businesses which are now in the course of re-structuring of the foreign debt will reach positive result or will settle up with creditors at the expense of refunding of external loans of NBU and/or the international financial organizations.

Preservation of uncertainty in the currency-course policy is an additional risk factor for the bank assets, an essential part of which is nominated in foreign currency, and can also be negatively reflected in solvency of separate financial centers.

In view of certain indulgences of capital requirements for banks, "Credit-Reitin" does not expect significant complete capitalization of banking system; therefore, adequacy of the capital of the majority of banks will be supported at minimum necessary level. At the same time, despite significant volume of the generated reserves, volume of writing off problem credits, it can essentially decrease the demand of banks for the capital to resume business activity in the credit and share markets.

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*Polyvana T.\**

## INTERNATIONAL AND DOMESTIC POLICY RESPONSES TO THE FINANCIAL CRISIS IN CENTRAL AND EASTERN EUROPE<sup>1</sup>: LESSONS FOR UKRAINE

**Abstract** *The paper studies main successes and failures in policy responses to the financial crisis in Central and Eastern Europe on the global, regional and domestic levels. It is argued in the paper that despite the failure to prevent the crisis at all levels, coordination of global actions on global and EU levels and high discipline of the CEE countries on domestic level helped them to go ahead in successful dealing with the crisis. The paper identifies key lessons for Ukraine, the main of which is that coherent and consistent economic reforms are the only key to success.*

**Key words:** financial crisis, Central and Eastern Europe, policy responses, crisis prevention and resolution

**Аннотация** *Рассмотрены основные меры по урегулированию финансового кризиса в странах Центральной и Восточной Европы на международном, европейском и национальном уровнях. Доказано, что несмотря на неспособность предотвратить кризис на всех уровнях, координация усилий на глобальном и европейском уровнях и внедрение всех необходимых мер странами ЦВЕ на национальном уровне помогли им относительно быстро преодолеть негативные последствия кризиса. Выделены главные уроки для Украины, основной из которых заключается в том, что ключ к успеху лежит только в проведении четких и последовательных экономических реформ.*

**Ключевые слова:** финансовый кризис, страны Центральной и Восточной Европы, меры по урегулированию кризиса, предотвращение кризиса

**Анотація** *Розглянуті основні заходи по врегулюванню фінансової кризи в країнах Центральної та Східної Європи на міжнародному, регіональному та національному рівнях. Доведено, що незважаючи на неспроможність попередити кризу на всіх рівнях, координація зусиль на глобальному та європейському рівнях та впровадження усіх необхідних заходів країнами ЦСЕ на національному рівні допомогли їм відносно швидко подолати негативні наслідки кризи. Визначено головні уроки для України, основний з яких полягає в тому, що ключ до успіху лежить лише у проведенні чітких та послідовних економічних реформ.*

**Ключові слова:** фінансова криза, країни Центральної та Східної Європи, заходи по врегулюванню кризи, попередження кризи

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<sup>1</sup> Central and Eastern Europe here includes Bulgaria, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Poland, Romania, Slovak Republic, and Slovenia.

\* Postgraduate student of the Department International Economy, Economic faculty Kyiv National Taras Shevchenko University

## **Introduction**

The ongoing financial and economic crisis raised a number of new questions and challenges to be addressed by academics and state officials both on the global and national levels. What are the primary causes of the crisis? What lessons should be learnt? How to adjust the global financial system and prevent such negative consequences in future? Those questions become a subject for political discussions at the highest levels, G20 Summits and World Economic Forums in Davos.

The global crisis has many specifics. One of them is unequal extent of the crisis impact across the regions. Central and Eastern Europe (CEE) is believed to be among the regions most harshly hit by the crisis. According to the IMF assessments the overall GDP decline in the region in 2009 was around 8,4%. At the same time the region is anticipated to recover quite soon. The IMF forecasts the region to have a positive output starting already in mid 2010 and reaching 4,0% GDP growth in 2012 [1].

Meanwhile, individual countries in the region were also unequally hit by the crisis. Estonia, Latvia, Lithuania were the most harshly damaged with GDP decline in 2009 reaching -14,0%, -18,0%, and -18,5% respectively. At the same time Czech Republic (-4,3%), Slovak Republic (-4,6%) and Slovenia(-4,7%) were hit the least and Polish economy had even grown by 0,97% in 2009 [1]. The reasons staying behind such differences in crisis impact across the countries vary. Diverse macroeconomic and financial vulnerabilities and policy responses to the crisis are among them.

The Central and Eastern European countries in times of the crisis became a subject of a number of academic and policy studies and debates. The key issues addressed are main causes of the crisis (Anders Aslund [2]), lessons to be learnt (Agnes Benassy-Quere, Benoit Coeure, Pierre Jacquet, Jean Pisani-Ferry [3]), the role of the EU in dealing with the crisis (Zsolt Darvas, Béla Galgóczi [4; 5]). Ukrainian authors are mostly focused on theoretical approaches to explain root causes of the crisis, its global imperatives and impact on the Ukrainian economy (Umantsiv Y., Shevchenko V, Shelud'ko N, Shklyar A. [6-8]).

At the same time this paper aims at identifying main successes and failures in policy responses to the crisis in Central and Eastern Europe on the global, regional and domestic levels and revealing relevant lessons for Ukraine.

Major tasks the paper seeks to achieve are: to study main policy responses to the crises in the CEE countries on global, EU and domestic levels; to define key obstacles for successful resolution of the crisis in Ukraine and to draw principal lessons for Ukraine.

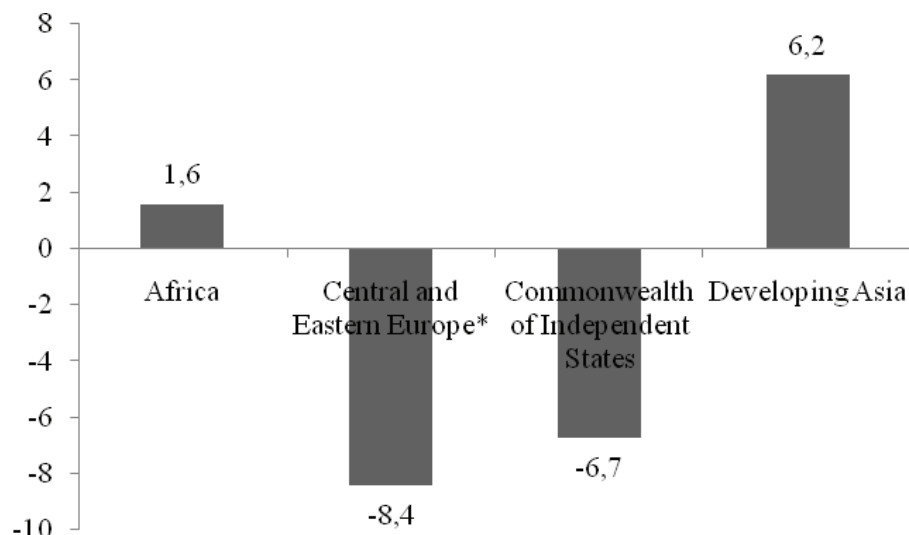
The paper argues that despite the failure to prevent the crisis at all levels, coordination of global actions on global and EU levels and high discipline of the CEE countries on domestic level helped them to go ahead in successful dealing with the crisis.

The paper is structured as follows. First of all, it presents key data on the extent to which the CEE countries had suffered in times of the crisis. Later on, it introduces main findings on successes and failures in policy responses to the financial crisis in CEE countries on global, EU and domestic levels. Finally, it reveals key obstacles to successful resolution of the crisis in Ukraine and draws main lessons and conclusions for Ukraine.

CEE countries in crisis: heavy damages but fast recovery

Central and Eastern Europe was among the regions that were the most harshly hit by the financial crisis. In 2009 the regional GDP decline was 8,4%, what was the lowest among other emerging and developing regions (Figure 1) [1]. This was to a large extent influenced by the growth in trade and financial links of the region with the rest of the world and especially with the EU after accession of the ten new member states in 2004 and two more in 2007. As the Di-

rector of the IMF's European Department Marek Belka said “because Europe is very open in terms of trade, and because its financial sector is so closely integrated with the rest of the world, the region cannot avoid being significantly impacted by the financial crisis” [9].



\* According to the IMF CEE region does not include Czech Republic, Slovak Republic and Slovenia, which are considered as an advanced economy and eurozone members respectively. However, for the purposes of the research GDP growth was recalculated by taking into account the data on these countries.

**Figure 1** GDP growth in emerging and developing regions in 2009, %

Indeed, market reforms in times of transition, liberalization of trade and financial markets and fast-growing economies of the region spurred international trade, attracted new investments and foreign capital. At the same time these growing links became also major channels of transmission of external shocks to the economies. Financial crisis originated in advanced economies spilled over to the emerging European countries including those from CEE. Liquidity markets were frozen. Short-term foreign debt capital was withdrawn. Global demand fell bringing to stagnation in commodity markets. Consequently, international trade volumes also declined. In the whole, all this had a very negative impact on the regional economic growth.

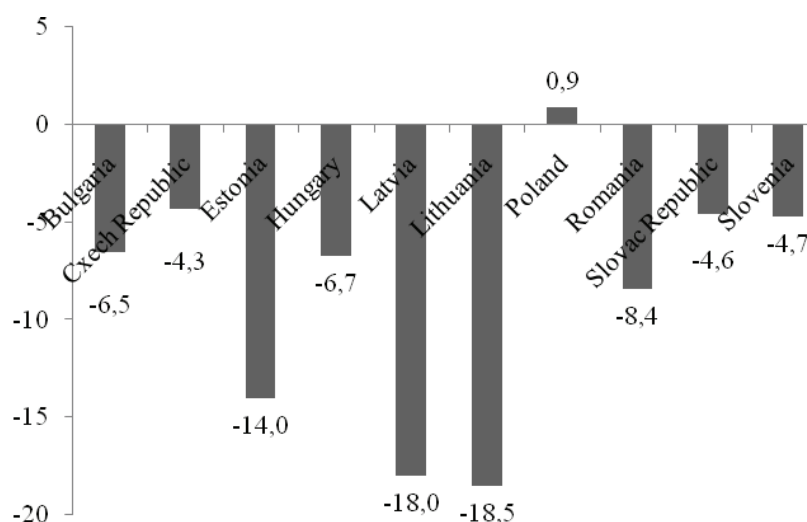
At the same time, the extent to which the countries had suffered was different. The most harshly hit were the Baltic states with 2009 GDP decline reaching 18,5% in Lithuania, 18,0% in Latvia, and 14,0% in Estonia. Hungary, Bulgaria and Romania also suffered significantly with fall of GDP by 6,7%, 6,5%, and 8,4% respectively. Meanwhile, Czech Republic, Slovak Republic and Slovenia had their GDP dropped by less than 5%, while Polish economy even grew by 0,9% in 2009 (Figure 2) [1].

Key explanations on that are in different macroeconomic and financial vulnerabilities in the economies. The countries that suffered the most had very weak macroeconomic fundamentals, such as excessive current account and budget deficits, fixed exchange rate regimes, and huge credit expansion before the crisis. In all the six countries with the largest GDP decline current account deficits throughout 2002-2007 were far larger than 5% (Hungary: -6,9%, Bulgaria: -11,1%, Romania: -8,3%, Estonia: -12,3%. Latvia: -14,4%, Lithuania: -8,6%) [2, p.11]. Estonia, Latvia, Lithuania and Bulgaria have also fixed exchange rates. As a result much of the current account deficit was supported by increasingly accumulated foreign debt that exceeded 100% of GDP in those states.

Hungary had also a very large budget deficit throughout 2005-2007 (5-10% of GDP) and thus had accumulated a large amount of public debt (more than 70% in 2008) [2]. Consequently,

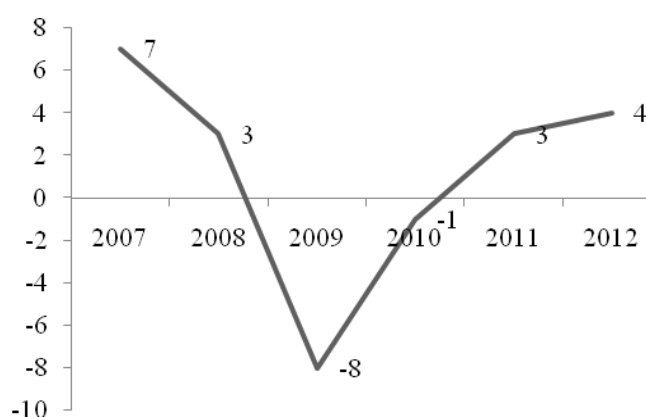


when the global liquidity and commodity markets froze and economic activity and export volumes fell, these countries had very few tools to support their economies and their creditworthiness was undermined. All this brought to a very sharp decline in output growth and challenged macroeconomic stability of the economies.



**Figure 2** GDP growth in CEE by countries in 2009, %

At the same time, the region is also expected to overcome the crisis successfully and relatively fast. The IMF forecasts the region to have a positive output starting already in mid 2010 and reaching 4% output growth in 2012 (Figure 3) [1].



**Figure 3** IMF forecast for GDP growth rate in CEE countries, %

The reasons for that are numerous. Among the mitigating factors at the region are foreign bank ownership in the CEE countries by West European member states, membership of some of them (Slovenia and Slovak Republic) in eurozone, and political and economic integration with the EU.

In this paper it is argued that successful international and domestic policy responses, supported by EU membership *inter alia*, had helped the CEE countries to deal with the crisis effectively and relatively fast.

### Policy responses to the crisis: successes and failures

#### *Global level*

One of the main failures of policy-makers at all levels is their inability to prevent the crisis. On the global level it is the IMF that is responsible for maintaining global financial system stability. Quite frequently it is argued that in the beginning of this century “the IMF was itself in a crisis, because it had almost no clients left for its emergency lending facilities after the crises of the 1990s” [10, p.32]. There were plenty of debates on whether it was the responsibility of the IMF for the crisis to become global or not. However, the role of the IMF is not indeed ade-

quate to the current developments in the global financial system. As a result the issues regarding reforming of the IMF and global financial architecture at large have been vividly discussed at the highest political levels, namely G20 Summits.

Nevertheless, crisis control and resolution policies were quite successful at the global level. Coordination of efforts of the most powerful economies can be assessed as strong enough. Starting from November 2008 a new global institution was created – G20 - with the purpose to increase the voice of the developing countries in resolution of global problems. So far three G20 Summits have been held: in Washington, London and Pittsburgh. The main outcomes of the Summits are presented in Table 1.

**Table 1** Main outcomes of the G20 Summits [11-13]

Summit	Date	Main outcomes
Washington	November 14-15, 2008	Reached a common understanding of the root causes of the global crisis. Reviewed actions countries have taken and will take to address the immediate crisis and strengthen growth. Agreed on common principles for reforming national financial markets: <i>strengthening transparency and accountability, enhancing sound regulation, promoting integrity in financial markets, reinforcing international cooperation and reforming international financial institutions</i> . Launched an action plan to implement those principles
London	April 2, 2009	Launched a Global plan for recovery and reform, where five main priorities were defined: restoring growth and jobs, strengthening financial supervision and regulation, strengthening global financial institutions, resisting protectionism and promoting global trade and investment, ensuring a fair and sustainable recovery for all. It was agreed to provide US\$1,1 trillion for recovery programmes.
Pittsburgh	September 24-25, 2009	Agreed to develop a framework for strong, sustainable and balanced growth, to strengthen the international financial regulation system, to modernize global institutions to reflect today's global economy.

One of the most effective outcomes of the Summits was the decision to provide US\$1,1 trillion for recovery programmes. Great deal of the money was used to provide financial support to the most suffered economies, including those from CEE, through international financial institutions, mainly the IMF. As a result, the IMF had allowed around US \$50 billion under standby arrangements (SBAs) to 14 countries in crisis [10, p.32]. Under the SBAs the country gets loans in exchange for reforms in monetary, financial and fiscal policies. Emerging European countries have obtained the largest part of the IMF loans.

In the CEE region main recipients of the IMF loans were Hungary, Latvia and Romania. Along with the IMF support those countries received financial resources from other international financial institutions: the World Bank, European Commission, European Investment Bank, European Bank for Reconstruction and Development. However, the share of the IMF financial support was the largest, while resources granted by other institutions, especially European ones, were limited (Table 2).

**Table 2** Financial support to the CEE countries during the crisis, US \$ billion

Country	Date	Overall sum	Allowed by the IMF	Allowed by the EU	IMF loan type
Hungary	October 2008	25,5	15,7	8,4	17- month SBA
Latvia	December 2008	17,75*	2,35	4,3	27- month SBA
Romania	May 2009	26,4	17,1	6,6	24- month SBA
Poland	May 2009		20,58	-	12- month FCL **

\* the lion's share of the funds were allowed by Scandinavian countries – Denmark, Estonia, Norway, Sweden.

\*\* flexible credit line

Consequently, coordination of international efforts on the global level to overcome crisis (in CEE countries *inter alia*) may be assessed as effective so far, even though a number of planned actions for global economy recovery are still to be done.

### *EU level*

Policy responses to the crisis in the CEE countries at the EU level gained different assessments by EU economic policy researchers and experts. Some argue “policy responses from Europe were neither timely nor adequate and the initiative was left to a large extent to the International Monetary Fund” [5, p.5], while others say both the IMF and EC showed an excellent ad hoc cooperation: “the IMF had the staff, rules, and procedures for handling a financial crisis, while the EC had neither, so it conceded and assisted instead” [14]. The crisis thus pointed on necessity to rethink EU level financial supervision and regulatory framework with aim to enhance ability to prevent and successfully deal with union-wide financial difficulties in future. So far the EU had made a number of steps aimed at developing efficient regulatory framework for economic recovery of the EU region (Box 1).

#### **Box 1** Main policy actions of the EU during the crisis [15]

- Refi (interest rate on main refinancing operation) was cut from more than 4% in September 2008 to 1% in May 2009;
- A European Economic Recovery Plan developed by the de Larosi re Group was adopted in November 2008. The plan was built on two key pillars: a major injection of purchasing power into the economy (to boost demand and stimulate confidence) and the need to direct short-term action to reinforce Europe's competitiveness in the long term (“smart investments”);
- Large public interventions in the banking sector were approved (around 44% of total EU budget);
- An increase from € 12 to € 50 billion of the lending ceiling was approved for the EU support facility for non-euro area Member States in financial difficulty.
- An ambitious reform on European supervision system was launched in parallel to what was agreed during the G20 Summits. According to this reform the EU member states financial stability will be secured based on two main principles: creation of a European System of Financial Supervision through establishment of the network of financial supervisor at the EU level and formation of a European Systemic Risk Council responsible for macro-prudential surveillance, mitigation of systemic risks and prevention of large-scaled financial crises.

Moreover, EU membership itself had a mitigation impact on financial stability in CEE countries. It helped making policy institutions stronger and more credible in the new member states and EU membership perspective at large was a strong motivation for them to provide institutional and market reforms, what enabled them to overcome the crisis quite efficiently.

Thus, despite the failure of the EU to provide sufficient financial support to the CEE countries in crisis it proved to be successful enough in learning financial crisis lessons. EU actions went in line with the agreements reached at the global level and were aimed at development of effective crisis prevention policies through establishment of supranational European financial supervision institutions.

### *Domestic level*

To study successes and failures in domestic policy responses four case studies will be examined: Hungary, Latvia, Romania and Poland. The first three are the cases of the most harshly hit economies in the CEE region and Poland is a successful case of the country that managed to overcome the crisis relatively easy.

#### *Hungary*

Despite the fact that Hungary was always among the most economically developed countries that joined the EU in 2004 it was one of the first countries that were the most harshly hit in the region in times of the crisis. The reasons for Hungary to become the region's weakest link include: risky financial solutions to improve the popular feel good by successive governments that accumulated excessive public debt, large amount of foreign exchange-based domestic lending and lack of effective cooperation among two main political parties [16]. As a result GDP fell in mid 2009 by 7,2%, manufacturing by 21,3%, unemployment rate was 10% [17, p.3].

Main policy measures in the country included a number of immediate and long-term measures [18]. Large foreign and domestic currency liquidity provisions were given, social transfers shortened and taxes increased. In November 2008 Hungary received US \$15,7 billion from the IMF under 17- month SBA. The IMF programme in the country was targeted at sustainable fiscal adjustment of 2,5% of GDP and bank capital enhancement through additional resources provided to finance a guarantee fund for interbank lending [19].

Implementation of the reforms proved to be successful so far even though the country has the next parliamentary elections scheduled for April 2010. According to the IMF executive board third review dated as of September 25, 2009, "macroeconomic and financial policies in Hungary are on track" [20]. Fiscal sustainability has been further strengthening through implementation of structural spending reforms. Financial stability is being maintained by providing institutional reforms, improving supervisory agency's independence, enhancing the central bank's authority in macro prudential supervision and monitoring of the banks that received the state's financial support.

#### *Latvia*

Latvia is the second CEE country that met with harsh economic challenges during the crisis. Major preconditions for that were large foreign capital inflows and pre-crisis credit boom, especially after its accession to the EU. Consequently, the country accumulated large external imbalances that were at the core of severe financial difficulties in times of the crisis. In December 2008 Latvia got large financial support from the IMF, EU, and Scandinavian countries. The Latvian case is special in that the country opted for not to let its currency float with aim to enter Eurozone as soon as possible. This had an impact on the reforms package approved for the country by the IMF.

Main objectives of the IMF 27- month SBA for Latvia were aimed at restoring confidence in the Latvian banking system, providing fiscal measures to limit budget deficit and prepare the country for fulfilling Maastricht criteria, and implementing structural reforms to rebuild competitiveness under fixed exchange rates [21]. The decision of the Latvian government to preserve fixed exchange rate was assessed as a policy failure by many researchers. Indeed, according to some estimations loss of output from peak to bottom of the crisis will be around 30% and "the depth of the recession and the difficulty of recovery are attributable in large part to the decision to maintain the country's overvalued fixed exchange rate" [22, p.3]. Nevertheless, the reasons staying behind this decision were quite clear: eurozone membership, small estimated affect on export growth and possible negative impact on the pegs of Estonia and Lithuania [9].

Overall, the IMF second review under SBA as of February 17, 2010, assessed the program implementation process as quite successful. Economic and GDP growth recovery is expected to take place in the end of 2010-beginning of 2011[23].

### **Romania**

Main problems the country encountered with during the crisis were external imbalances, credit expansion, and high budget deficit. However, the Romanian government had at once launched a comprehensive program to respond to the crisis challenges. The programme was twofold. It contained institutional component aimed at creation of ministerial working groups in charge of implementing the anti-crisis measures adopted by the government and strategic component focused on adoption of anti-crisis programme for which € 13 billion was allocated. The anti-crisis programme consisted of 23 policy measures in three categories: economic (stimulation of economic recovery and growth), financial (increase of liquidity) and social. The lion's share of the total budget was allocated for economic measures (81%) [24].

Along with these measures the IMF has approved US\$17,1 billion to Romania under 24-month SBA in May 2009. The IMF programme objectives required to reduce budget deficit to 3% of GDP by 2011, maintain adequate capitalization of bank and liquidity, target inflation and bring it within the range of the National Bank of Romania by end 2009, and secure adequate external financing [25].

The case of Romania reminds that of Ukraine. The country was also embarked in political infightings before Presidential elections scheduled for November 22, 2009. The IMF delayed its next tranche to Romania in November 2009 until the new government was formed [26]. Nevertheless, the latest reviews under SBA with Romania held in February 19, 2010, approved disbursement of the next tranche. Policy implementation process was assessed as strong “despite a difficult political and economic environment” [27].

### **Poland**

Poland can doubtlessly be called the most successful case. It is the strongest economy in the CEE region and the only European country that achieved a positive GDP growth in 2009.

Such success is explained by nothing else but timely and proper market reforms and efficient and well-thought macroeconomic policy. The statement of Mr. John Lipsky, First Deputy Managing Director and Acting Chair of the IMF, quoted in the IMF press-release on approving US\$20.58 billion to the country under flexible credit line arrangement, gives a comprehensive explanation for economic soundness of the Polish economy:

*“Poland’s economic growth has been very strong and well-balanced in recent years. Private consumption growth has been robust, the external position is sustainable, and the banking sector is well-capitalized. The avoidance of acute imbalances during the boom years reflects a very strong and timely policy implementation. A long-standing and effective inflation-targeting regime and a freely-floating exchange rate have helped build confidence in monetary institutions and anchor inflation expectations. The authorities’ EU commitments and their euro adoption target have provided a strong fiscal anchor. Banking supervision has been fully compliant with EU laws and directives. Its institutional framework has been buttressed by the unification of financial supervision and the creation of the Financial Stability Committee”* [28].

Moreover, a large domestic market, a diversified economic space, strong human capital, a number of economically significant regional clusters, and residual effects of Poland’s shock therapy program in 1990s are considered as mitigation factors that helped the country to manage economic downturn better than others in the region [29].



Thus, assessment of the four case studies had shown that all the three countries that suffered the most – Hungary, Latvia, and Romania- failed to eliminate major risk factors before the crisis, mostly large external imbalances. The Hungarian case has proved how dangerous may be excessive populism followed by accumulation of large public debt. Latvia proved that delay in letting the national currency to float may have very negative consequences. Political instability in Romania demonstrated how lack of internal cooperation may prolong the crisis in time. Finally, the Polish case proved that only coherent and consistent reforms bring to economic prosperity and stability in times of crisis.

### *Crisis in Ukraine: causes, consequences and responses*

Ukraine may doubtlessly be called the economy that suffered the most among emerging European countries in times of the crisis. Ukrainian economy has grown very fast since 2000 (more than 7% annually) but appeared to be greatly overheated by mid 2008: credit growth exceeded 70%, inflation increased to almost 30%, nominal wages accelerated by around 30-40%, consumption boom led to surge in imports at an annual rate of 50–60% increasing thus current account deficit to almost 7% of GDP, leaving the rigidly managed currency substantially overvalued [30, p3].

The Ukrainian economy was exposed to external shocks through two main channels of transmission:

- Trade links. Terms-of-trade for Ukraine, in which steel represents around 40% of exports and 15% of GDP and gas imports around 6% of GDP, deteriorated substantially with the fall in commodity prices due to sharp drop in global demand and raise of prices for gas imported from Russia from around \$180/tcm in 2008 to approximately \$330/tcm in 2009 [30, p.3].
- Financial links. Growing economy and opening of the financial sector led to significant increase in foreign capital inflows, especially external short-term debt, which was covered by international reserves only at 75% in September 2008 [30, p.3]. Large capital supply resulted in credit expansion especially in foreign currency due to overvalued domestic currency and low interest rates.

As a result, Ukrainian economy experienced significant losses in 2009: real GDP fell by 14%, inflation reached 16,3%, unemployment rate was almost 11%, and real monthly wages fell by 11% [31]. (Table 3)

As an immediate policy response to the crisis Ukraine had no choice but to request for the IMF financial support. In December 2008 the IMF approved US\$16.5 billion two-year stand-by-arrangement for Ukraine, which was 802 percent of Ukraine's quota and was granted under the Emergency Financing Mechanism [31].

The SBA programme for Ukraine has two key objectives: 1) "to restore financial and macro-economic stability and thereby facilitate better confidence"; 2) "to facilitate adjustment to potentially large external shocks and allow a gradual reduction of inflation" [30, p. 10]. To achieve those objectives the following measures were defined:

**Objective 1:** To restore financial and macroeconomic stability

Measures: a) appropriate liquidity support and expansion of deposit guarantees; b) a stronger bank resolution framework, including availability of public funds for recapitalization; c) a stronger framework for resolution of household and enterprise sector debts.

**Objective 2:** To facilitate adjustment to potentially large external shocks and allow a gradual reduction of inflation

Measures: a) a flexible exchange rate policy, supported by base money targets and an appropriate intervention strategy; b) transition to inflation targeting (as a new nominal anchor); c)

resetting incomes policy in line with targeted inflation, while protecting the most vulnerable; d) maintaining a prudent fiscal stance; and e) bringing energy sector prices more in line with costs.

**Table 3** Ukraine: Selected economic and social indicators, 2006-2010 [31]

	2006	2007	2008	2009	2010
<b>Real economy</b>					
Real GDP	7,3	7,9	2,1	-14	2,7
Unemployment rate	6,8	6,4	6,4	10,7	10
Consumer prices (period average)	9,1	12,8	25,2	16,3	10,3
Real monthly wages (average)	18,4	15	6,8	-11	-1,2
<b>Public finance</b>					
General government balance	-1,4	-2	-3,2	-6	-3
Public debt (end of period)	15,7	12,9	19,9	35,4	38,6
Of which: external debt (foreign currency denominated)	12,5	10,1	15	25	23,8
<b>Balance of payments (percent of GDP)</b>					
Current account balance	-1,5	-3,7	-7,2	0,6	0,1
Foreign direct investment (end of period, billions of U.S. dollars)	5,3	6,4	5,5	3,4	3,8
Share of metals in merchandise exports (percent)	42,2	41,7	40,8	35,3	34,5
Net imports of energy (billions of U.S. dollars)	8,1	11,5	16,7	11,5	16,1
Goods terms of trade (percent change)	-0,3	9	8	-13,6	-2,1
Goods and services terms of trade (percent change)	1,5	7,4	8,8	-9,1	2,2
<b>Exchange rate</b>					
Exchange rate regime	de facto peg		managed float		
Hryvnia per U.S. dollar, end of period	5,1	5,1	7,7	...	...

Along with the IMF SBA, the Cabinet of Ministers of Ukraine launched a domestic anti-crisis Action plan **“Overcoming the global financial and economic crisis impact and consistent development”** on December 25, 2008. The main objective of the Action plan was defined as “to lessen negative impact of the global financial crisis on the Ukrainian economy, contain further spread of the crisis, hindering of economic development, and worsening of the people’s quality of life, and overcome negative consequences of the crisis” [32, p.5]. Major priorities of the Programme include: 1) to achieve macroeconomic stability; 2) not to allow for worsening of the people’s quality of life; 3) to facilitate entrepreneurship development; 4) to promote investment activity; 5) to support real sector of the economy [32, p.5-7].

Despite a number of commitments Ukraine had taken, far from all of them were realized. The National Bank of Ukraine let hryvna to float in the end of 2008, what had a stabilizing effect on current account deficit but decreased real wages substantially (Table 3). A large bank stabilization programme was launched. Many banks were recapitalized (Rodovidbank, Ukgazbank, bank “Kyiv”, Prominvestbank,) and deposit insurance coverage was increased from UAH 50,000 to UAH 150,000, which had to cover 99% of individual accounts [31].

At the same time, many structural reforms Ukraine was supposed to do are still put on hold mostly because they are very unpopular among people. First of all, it is necessity to increase gas and heating tariffs for households, what is the priority measure for rebalancing NAK Naftogaz financial structure. The tariffs were supposed to be gradually increased and reach the level of gas import price by mid 2011. However, the National Electricity Regulatory Commission of Ukraine had so far increased the tariffs only by 35% in October 2008 [33]. Further gas price increases for households were cancelled [34] mostly due to upcoming Presidential elections in Ukraine scheduled for January-February 2010.

Additionally, commitments to provide tax and pension reforms with aim to cut budget deficit, were also not fulfilled. The Law on social standards signed by former President of Ukraine Victor Yushenko in October 2009 and intention to approve an expansionary budget were harshly criticized by the IMF. Consequently, in October 2009 the IMF delayed the next tranche to Ukraine. As IMF Mission Chief to Ukraine Ceyla Pazarbasioglu said at that time:

*“For any economic program to be successful, there must be a minimum level of consensus... When the economic program was designed a year ago, there was a broad consensus in Ukraine... but the pressure of events and political developments means that consensus is now much harder to achieve” [35].*

Now the new President and the new Government are showing their readiness and intention to resume cooperation with the IMF. This is quite understandable since without the IMF funds it will be very hard for the Ukrainian economy to recover soon. Negotiations are being held at the moment and the IMF seems to be inclined to provide the next tranche under condition of further reforms implementation. So, now everything depends on whether new Ukrainian officials stop continuing doing populist promises and improve their discipline in terms of commitments fulfillment or not. As there is no much choice the first option seems more feasible.

#### **Lessons for Ukraine: the only key to success is coherent and consistent reforms**

While the financial crisis is global in its nature and very few countries in the world managed to avoid dramatic economic losses, the range in severity of the crisis impact on national economies points out on the presence of much deeper economic problems in the economies that suffered the most. This is especially relevant for Ukraine, which economy has been staying virtually unreformed for more than a decade.

It is often said that crisis may be regarded as both a loss and an opportunity as it gives new impetus for rethinking of the current state of affairs and drawing lessons for the future.

The analysis of successes and failures in policy responses to the financial crisis in the CEE countries at global, EU and domestic levels allows drawing the following lessons for Ukraine:

#### **Lesson 1: Key causes of the crisis are deeply rooted in structurally unreformed Ukrainian economy and lack of timely and proper policy responses to major economic challenges.**

There have been a plenty of papers written on key priorities for reforming the Ukrainian economy. The most recent is the World Bank staff paper “Making Ukraine Stronger Post- Crisis” [36]. The policy paper summary identifies three main challenges that stand out as high priority for Ukraine:

- stabilization of public financing through fiscal reforms;
- stimulation of private investment by upgrading technologically, rebalancing the excessively commodity-driven sources for growth, and deregulating Ukraine’s economy and fostering competition;
- restructuring of the financial sector through reconsidering of the past legislation and strengthening regulation and transparency to regain trust.

The main problem here is whether the new Government will finally find the political will for those reforms or it will limit itself only to extinguishing the fire and solving the short-term problems.

#### **Lesson 2: EU membership proved to be both a good benchmark for successful reforms implementation and a source of an added value in terms of efforts coordination in times of the crisis.**

Economic and political integration with the EU is seen as one of the mitigating factors in the CEE region during the crisis. First of all, as the Polish case has shown, using EU practices and implementing EU standards on timely and proper manner can help avoiding significant

losses. Second, EU financial support, although not too large, still presents an additional source for fostering the post-crisis recovery. Therefore, it is crucially important for Ukraine to go on with its European course, use EU best practices to the maximum, implement EU standards and thus speed up its EU integration perspectives.

**Lesson 3: The IMF assistance is very important for fostering economic recovery in emerging countries during the crisis.**

All CEE countries, which suffered the most during the crisis, have requested the IMF support to deal with the crisis. The IMF's support is crucially important not only in terms of finances but also in getting assistance of its experienced staff and using its well-developed rules and procedures. The SBAs, which are being developed together with the national authorities and take into account national economic situation, enable to set a clear anti-crisis programme with identification of major priorities and policy actions. Therefore, it is vitally important for Ukraine to resume cooperation with the IMF, which will not only bring to the benefits outlined above but will also send a positive message to the international investors implying for restoration of political stability in the country and direct course on reforming process acceleration.

This list of course is not exhaustive, but all in all, there is one principle lesson to be learnt by Ukraine: **only coherent and consistent reforms lead to sustainable economic development and help to maintain macroeconomic and financial stability in the long-run**

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*Kuzmin P.\**

## GROWTH DEVELOPMENT OF UKRAINIAN ECONOMY AFTER CRISIS WITH THE HELP OF BSEC

**Annotation** *Actuality of this theme is predefined with possibility of finding of new direction of economic cooperation of Ukraine with the purpose to defeat crisis influences. Today Ukraine feels the second wave of crisis, what shows us falling of economy and GDP, grows of unemployment as a result. A situation is heavy, but not critical, and the new wave of foreign investments would be able to fix our economy and bring back to life economic relations in the middle of the state. Being an actual member of Black Sea Economic Cooperation, Ukraine, during activation of own role in this association, would get long-awaited investments, new markets of sale of its products and increase of transit potential. It would allow Ukraine to back on the level of the highly developed states very soon.*

**Keywords:** BSEC, cooperation, project, crisis, investment, potential, transit.

**Аннотация** *Актуальность темы обусловлена возможностью получения нового направления экономического сотрудничества Украины с целью преодоления влияния кризиса. Сегодня Украина переживает вторую волну кризиса, в результате чего падение экономики, ВВП продолжается, а безработица растет. Ситуация чрезвычайно сложная, но не критическая, поскольку новый поток иностранных инвестиций мог бы укрепить экономику и приободрить промышленные связи внутри страны. Являясь действующим членом Организации Черноморского Экономического Сотрудничества, Украина, при активизации собственной роли в союзе, могла бы получить ожидаемые инвестиции, новые рынки сбыта собственной продукции и увеличение транзитного потенциала. Это позволило бы Украине выйти на уровень высокоразвитых государств уже достаточно скоро.*

**Ключевые слова:** ОЧЭС, сотрудничество, проект, кризис, инвестиции, потенциал, транзит.

**Анотація** *Актуальність теми зумовлена можливістю виявлення нового напрямку економічного співробітництва України з метою подолання кризових впливів. Сьогодні Україна переживає другу хвилю кризи, в результаті чого падіння економіки, спад ВВП продовжується, а безробіття зростає. Ситуація надзвичайно важка, але не критична, оскільки новий притік іноземних інвестицій зміг би зміцнити економіку та поживавити господарські зв'язки в середині держави. Являючись дійсним членом Організації Чорноморського Економічного Співробітництва, Україна, при активізації власної ролі в об'єднанні, могла б отримати довгоочікувані інвестиції, нові ринки збуту*

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\* 5th year student of International Relations faculty Volyn National Lesya Ukrainka University

*нашої продукції та збільшення транзитного потенціалу. Це дозволило б Україні вийти на рівень високорозвинутих держав вже досить скоро.*

**Ключові слова:** ОЧЕС, співробітництво, проект, криза, інвестиції, потенціал, транзит.

Ukraine is an actual member of Black Sea Economic Cooperation, or BSEC, however the size of relations between the states-members of association is not so big, as we could want. So, during activation of role of our state in BSEC, we would get long-awaited investments, new markets of sale of our products and increase of Ukrainian transit. Therefore important is research of processes of cooperation of Ukraine with other participants of BSEC and their tendencies.

Primary purpose of this work - to identify possibility of Organization of Black Sea Economic Cooperation to play the role of basic support of the Ukrainian economy at the end of financial crisis.

A world financial crisis had a considerable influence on the economy of Ukraine: in a 2008 growth of the real Gross Domestic Product was 2,1%. Deeper falling did not take a place only due to the considerable harvest of grain-growing.

The quick collapse of GDP took place at the end of 2008. GDP is real in a fourth quarter 2008 went down in comparing to the analogical period in last year on 8%. There are not so many countries in world, which have such deep falling after a crisis [1].

Negative balance of foreign trade made 419,7 million dollars. It is only official information, however in practice it is possible to say, that this numbers could be much higher. For today it is possible to fix Ukrainian economy in a few ways: to stimulate more close cooperation with EU, with Russian Federation, or to take new credits from IMF. Majority forgets, however, that Ukraine is an actual member of the Black Sea Economic Cooperation, and fully can use this institution for own interests [2].

initiative of the creation of Organization of black sea economic cooperation (BSEC) was founded 17 years ago. It was based on an idea, that the increase of economic cooperation among the countries of the Black sea will be an instrument of growth economic development and strength of stability in region. Since that time BSEC developed into mature regional organization with wide institutional basis. From 1999 it was transformed in regional organization.

Усього	38591,6	100,0
Кіпр	8201,7	21,3
Німеччина	6580,8	17,1
Нідерланди	3814,2	9,9
Австрія	2564,8	6,6
Сполучене Королівство	2348,5	6,1
Російська Федерація	2061,5	5,3
Франція	1589,6	4,1
Сполучені Штати Америки	1381,5	3,6
Віргінські Острови, Британські	1340,5	3,5
Швеція	1256,4	3,3
Італія	921,0	2,4
Польща	862,5	2,2
Швейцарія	825,8	2,1

**Picture 1.** Biggest investors to the Ukrainian economy

With the size of 20 millions km<sup>2</sup> and a population of 330 million person, BSEC has enormous economic potential. For today three members of EU and four members of NATO at the same time are the members of BSEC. Also seven countries of EU and also seven countries of NATO have status of observer in this organization. Thus, unavoidable this organization will remain an important actor at the process of subsequent integration of the black Sea region in more wide Euro Atlantic region [10].

Today there are 12 countries-members of BSEC: Azerbaijan, Alba-

nia, Bulgaria, Armenia, Greece, Georgia, Moldova, Russia, Romania, Serbia, Turkey and Ukraine [7], and 13 observers: Austria, Belarus, Germany, Egypt, Israel, Italy, Poland, Slovakia, USA, Tunis, France, Croatia and Czech Republic [9].

A region could be characterized for Ukraine, as untapped potential. Level of cooperation with members, such, as Greece, Turkey, Azerbaijan is considerably below, than would be in a prospect.

Investments could be a basic of side of cooperation between Ukraine and countries of BSEC. Looking through of all members of BSEC we could see such countries as Russian Federation, Turkey, which has a lot of backlogs for investing. Also such countries as Germany, USA et. has status of observers, accordingly, they have opportunity inlay facilities to Ukraine.

At the same time, investment from countries of region is not so big, as could be through potential, what could we see from this column, which demonstrate us 10 biggest investors to the Ukrainian economy .

Looking through 10 biggest investors to Ukraine, we could see, that none of the states of BSEC is present there. Actually there is only one stable partner with a tendency to growth of collaboration for us – Russian Federation. At the same time the size of the Russian investments to Ukraine has only 5 % from all investments, what is understated because of big role of Russia in the balance of Ukrainian foreign trade – 25%. Through the analysis of other members of BSEC, a situation seems very bad.

Direct investments from Greece to Ukraine make only 0,7% from the general volume of investing to the Ukrainian economy by the countries of EU. At the beginning of 2008 they made 151,2 million dol. (0,5% from the general volume of direct foreign investments into the national economy) [4]. Of course Greece today couldn't be a perspective investor in our economy, with their "beforedefault" situation, however much information of 2008 showed absence of any work in the case of improve of relations and bringing of investments from fully happy country in that time. An alike situation is with investments from Azerbaijan, Romania, Bulgaria, and other members of BSEC. It is possible to consider the cooperation of Ukraine and Turkey as the unique exception. For today the Turkish investments in Ukraine attained almost 1 milliard dollars [3].

At the base of this information it is possible to do the row of conclusions:

1) Ukraine absolutely don't use investment potential of region and ignores possible dividends from a cooperation.

2) Our state have the hidden backlogs for an exit from a crisis, which, with the correct policy of demonstrations of own advantages can transform the crisis Ukrainian economy in prosperous already now.

Speaking about the economic relations of Ukraine with the states of region, for today their size also is not important in the general structure of balance of foreign trade. Actually, dominant country in the relations of Ukraine and BSEC presently is Russian Federation. At the second picture we could see geographical structure of foreign trade of Ukraine with the countries of BSEC at the year of 2008. The biggest size of export were carried out to Russian Federation — 23,4% (with an increase to the previous year in 24,2%) from the general volume of export, Turkey — 6,9%, with an increase to the previous year in 27 % (it is expected from data of official statistic of Ukraine; see picture 2). In trading of goods with Turkey Ukraine traditionally continues to have most positive balance among all foreign trade partners, which in 2008 makes 2 milliards and 683 million dollars. Also we could watch that the value of export to Bulgaria (on 99,6%), Greece ( on 53,4%), Azerbaijan (on 44,3%) was substantially increased.

Quick devaluation of the Ukrainian hryvnya resulted in the yet greater rates of growth of value of import. In particular a supply was increased from Georgia (on 91,3%), almost twice -

from Turkey, very little more than in 2,4 time, from Azerbaijan, and at 2,9 time - from Albania [8].

At the same time, as we could see from the table of trade at the region, the rates of growth are much higher than average, accordingly, it is possible to draw a conclusion, that limits of co-operation are not less than, with the countries of EU. With the governmental support of relations the situation of more than 500% increase of foreign trade balance of Ukraine and BSEC after few years could be real. And the sale of own products will mean the stable receipt of facilities into our budget.

**Table 1.** Geographical structure of foreign trade of Ukraine with the countries of BSEC, 2008

	Export		Import		Balance
	Thousand dollars	in % to 2007	Thousand dollars	in % to 2007	
All	67002502,8	135,9	85534445,7 -	141,1	-18531942,9
Countries of the CIS	23819222,7	128	33569461,8	131,3	-9750239,1
Azerbaijan	910572,5	144,3	75694,2	243,4	834878,3
Armenia	263681,5	122,6	25456,2	71,1	238225,3
Georgia	655988,4	124,3	191582,6	191,3	464405,8
Moldova	1178142	129,3	169569,7	100,8	1008572,3
Russia	15739123,5	124,2	19414249,7	115,3	-3675126,2
Albania	80405,6	77,3	407	291,4	79998,6
Bulgaria	1105978,1	199,6	239398,5	141,2	866579,6
Greece	339036,6	153,4	171837,2	146,5	167199,4
Romania	670502,7	106,7	1171079,9	150,4	-500277,2
Serbia	560455,6	—	87942,4	—	472513,2
Montenegro	2703,5	—	997	—	1706,5
Turkey	4633417,2	127,1	1950342,8	200,6	2683074,4

Another aspect of cooperation of Ukraine and BSEC is project activity. The attracted in the various projects of organization at the period after crisis would play a determining role in dynamic growth of domestic economy. Actually, today this sphere also can be described, as untapped potential. But the better expression in this case could be lost potential. Today Ukraine little carries on project activity of BSEC.

First of all it is important to mark the black “Sea synergy” which was founded by European Union for more close connections with a black sea region.

BSEC is a useful platform for a dialog and collaboration in all of region. Now, European Commission has a position of monitoring of economic processes in BSEC, using observing status [6]. Black sea Synergy included for itself the plural of measures on the most priority from the point of EU spheres of cooperation: democracy is in a region, control after the custom moving, observance of safety and decision of the “frozen” conflicts, transport, energy et [10]. For today Ukraine actually is not involved to the Black “Sea synergy”, first of all through the declared financial insolvency of our country to take part in the different spheres of project. A Black “sea synergy” is planned so that financing is carried out not only from EU but also from participant on parity principles, which did not find support from the Ukrainian side. The primary task of new government is forming of necessary documents for European Commission in relation to



bringing of facilities for educational, transport, scientific, technical, and, first of all, energetic projects. It is necessary also to build relations in the case of development of shelf of Black Sea for the purpose of a presence there considerable beds of oil and gas within the framework of the this program.

BSEC has considerable transit potential, which is shown from great interest from the side of EU in the questions of transit of gas and oil from the countries of the Persian bay, Azerbaijan (member), Russian Federation. That happens because of Ukraine, which is proved for european partners not from the best side and did not show necessary stability for a subsequent cooperation in the sphere of transit of oil and gas. Transit was the most geoeconomic advantage of our state before most countries of Europe, including BSEC. Using of this advantage would be the catalyst of future growth of the Ukrainian economy after crisis.

Early in 2005 the first project of the transit system of gas and oil was formed to EU by BSEC and was called Nabukko. In 2008 from the side of Ukraine was thrown out suggestions to creation of gas pipeline the White stream. Such pipelines as Blue stream-2, Caspian, accumulator of which was Russian Federation were also designed. Today the White stream is defective through absence of any the prospect, and in all other pipelines the role of Ukraine is or minimized, or absents, that can show a most catastrophe for a domestic economy.

At the same time, at the beginning of planning of Nabukko Ukraine was among the states which would be attracted in a gas pipeline. Building of 300-kilometre gas pipeline (by power after finish building in 2020 with 31 milliard m<sup>3</sup>) was begin in 2009. Azerbaijan (14 milliards m<sup>3</sup>), Iran (20 milliards m<sup>3</sup>), Egypt (14 milliards m<sup>3</sup>) and Iraq were examined as potential suppliers of gas.

Experts were usedr two basic possible scenarios of Ukrainian role in this project:

1. Complete integration of Nabucco into the gas-transport system (GTS) of Ukraine;
2. Building of bridge between Nabucco and Ukrainian GTS (it is possible also to use gas pipelines which today transport gas in direction of Turkey and Balkan countries in the case of taking out from Nabucco to Ukraine [6]. But modern realities are such, that Nabukko walks around Ukraine in behalf of Romania and Bulgaria.

On January, 28, 2008 in Brussels on meeting of committee on questions of foreign affairs of European Parliament was told a suggestion of prime Minister of Ukraine Timoshenko about new gas pipeline. She called to make more deep relations between Ukraine and EU because of building of gas pipeline the "White stream" (GUEU-White stream) from Turkmenistan through Azerbaijan, Georgia and Ukraine to Europe. At that time this project of gas pipeline the «White stream» had two variants – Ukrainian and Romanian. Also this gas pipeline played a considerable role exactly in development of shelf of the Black sea which would give, as the result, export of Ukrainian gas to the EU[6].

In 2008 this initiative had great support in Brussels, however now, when there was nothing done at last 2 years from Ukrainian side in this direction and basic future pipelines – Nabukko, North Stream and Caspian are in the different degree of completeness, situation with White Stream is catastrophic. However, each of them is in the stage of building. And gas, which was going to be used through the White stream already well moved to Nabukko. However today it is only beginning of building of Nabukko, so there is possibility to plug Ukraine in the list of transit countries of project. Actually, in the case of exception of our state from all of these gas pipeline projects, Ukraine will loose the high advantage before all of members of BSEC and the countries of Europe: transit.

Ourdays we have a union of international transport transportations inside of BSEC. Here Albania, Armenia, Georgia, Moldova, Romania, Serbia and Turkey take part[5]. In this groupment

Ukraine also has no role, as a potential participant through the poorly developed transport net. Speaking to prospects we could say, that after heavy winter, when all of roads in Europe are in the identically terrible state our state would interfere in this segment of cooperation of BSEC using Euro-2012.

BSEC is a serious capital base. High investment potential and considerable gold-value backlogs which have countries and observers of association would bring our aftercrisis economy of Ukraine on a new level. Using their investment, by the grant of tax deductions, within the framework cooperation or possible creation of Free Trading Zone would be an optimum decision to defeat the crisis phenomena for our state.

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Mokiy A., \* Fleychuk M. \*\*

**REGIONAL COOPERATION OF UKRAINE AND POLAND  
IN THE CONTEXT OF ECONOMIC SECURITY INCREASING  
AS THE CRISIS CONSEQUENCES COUNTERACTION**

**Annotation** *In the article we consider possibility of regional economic security level increasing in the process of Ukraine and Poland co-operation as crisis consequences counteraction. Also we analysed theoretical basis of regional economic security phenomenon.*

**Keywords:** economic security, Ukraine and Poland regional co-operation, structural deformations.

Problems, related to the comparative estimation of economic security strengthening is actual on all levels of managements, specially within crisis period: started from enterprise development (estimation of separate industries and spheres) to state policy forming and realization (estimation of regions, trans-regions, national and international economic relations on the whole). The primary purpose of complex region comparative estimation is determination of decision possibility of socio-economic tasks development on the basis of drawing on internal reserves and sources of the economy growth. Speaking about necessity of transboulder relations between Ukraine and Poland intensification we have to consider comparative estimation of Ukrainian and Polish border regions competitiveness level. In particular, in the field of monitoring and management of various factors production; socio-economic development; fiscal and monetary policy; enterprises; ownership and land-tenure; foreign economic activity; human potential and economic security development.

On the whole, beneficial economic activity providing belongs to major national priorities of every country, as it is a condition of society and region development stability and efficiency, in particular. Thus, it necessary to mark that at macroeconomic level theoretical bases of comparative description and monitoring of countries economic security, developed at too high scientific level, and for analysis at regional level a similar tools are characterized insufficient theoretical and empiric substantiation. Thus, expedient is to outline approaches to the region economic security estimation, and among the basic tasks is measured – the main threats to economic security in a regional context structuring.

For effective state policy in relation to reduction of differences in regions socio-economic development and development of the unique standards of reforms efficiency determination on regional level forming, and also for separate areas economic security monitoring is necessary to develop the tools that allow to estimate both potential and competitiveness of region and efficiency of this potential using. In addition, the presence of the unique indexes will allow to create a favourable climate for enterprise development, investment climate improvement and more balanced state policy realization.

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\* Doctor of Economics, professor of the International economic relations department, Lvov Academy of Commerce

\*\* PhD, associated professor of the International economic relations department, Lvov Academy of Commerce

In the process of region potential comparative estimation the followings basic principles have be considered: complexity of estimation, that allows to take into account all major indexes; system of estimation which allow to consider the basic indexes and descriptions of regional development intercommunications; accordance of the system of indicators to the tasks of annual analysis and regions economic and social development prognostication; maximal informing of the proper institutions about the results of regions development level estimation, which gives possibility to the state authorities of optimum decisions at national and regional levels making.

The structure of the offered analysis of model complex of socio- region economic development include two directions – an analysis and forecast of region resource potential, and also the analysis of the potential using efficiency. General conceptual approaches provide the following: methodological instruments of estimation and analysis using of both: macro and micro levels (for example of separate enterprise); possibility of tools using for the estimation of different regions clusters (transboulder including); availability and unambiguity of primary indexes and aggregated groups; possibility of the permanent monitoring of situation; variability of the methods depending on research aims, that have achieved by the proper weighing coefficients calculation.

On the whole, the review of existent methodological approaches enable to offer the method of region economic security calculation, using the territory socio-economic development indexes is the following:

$$K_u = \frac{\sum_{i=1}^n K_i \cdot (P_i - N_{pi})}{\sum_{i=1}^n K_i}, \quad (1.18)$$

where:  $i$  – weighted indicator index;  $n$  – total quantity of weighted indicator;  $K_i$  – concernment coefficient of  $i$  – indicators;  $P_i$  – actual value of  $i$  – indicators;  $N_{pi}$  – value of  $i$  – indicators in the basic period.

Instead of expert estimation of index after the level of meaningfulness it is possible to use correlation of actual and threshold value which allow to estimate the level of region socio-economic development on the basis of economic security. On the whole, at the analysis of region economic security it is necessary to take into account the row of complex indexes (figure 1), in particular: external political; food and power, economic (in particular, threats of investments and threats in the real sector), ecological and social threats. In a social sphere to the state „high level of danger” for progressive development of personality, society and state belong on the whole: a loss of capacity for the recreation of high-quality and rational quantitative level of population as a result of the critical falling of life quality; worsening of physical, psychological and genetic health of population; moral, cultural and professional degradation; personality protected level decreasing; intensive destabilization of society and loss of social prospects for its considerable part; growth of social conflicts and insufficient efficiency of state authorities.

In this context we would like to strike your attention to the set of destructive consequences that are caused by not taking into account the main principles of region security following. First of all it caused ineffective structure of GDP.

In particular, it touches the high share of consumption in the structure of GDP which is not instrumental in the economy growing in a strategic prospect (table 1).

Table 1. Structure of Ukraine's GDP, %. [1]

Indicators /years	1995	2001	2002	2003	2004	2005	2006	2007	1-3 Q 2008
Private consumption	55,13	68,56	68,02	67,6	64,24	69,49	70,88	70,7	72,34
Budget expenses	21,27	8,01	7,41	7,82	6,91	7,05	7,21	6,81	6,47
Fixed capital gross accumulation	23,4	19,73	19,21	20,64	22,59	22	24,64	27,56	25,88
Circulating capital reserve rate	3,28	2,07	0,98	1,37	-1,41	0,62	0,12	0,65	3,11
Export	47,07	55,46	55,09	57,75	63,63	51,48	46,62	44,84	48,51
Import	50,16	53,83	50,71	55,18	55,96	50,64	49,47	50,56	55,42

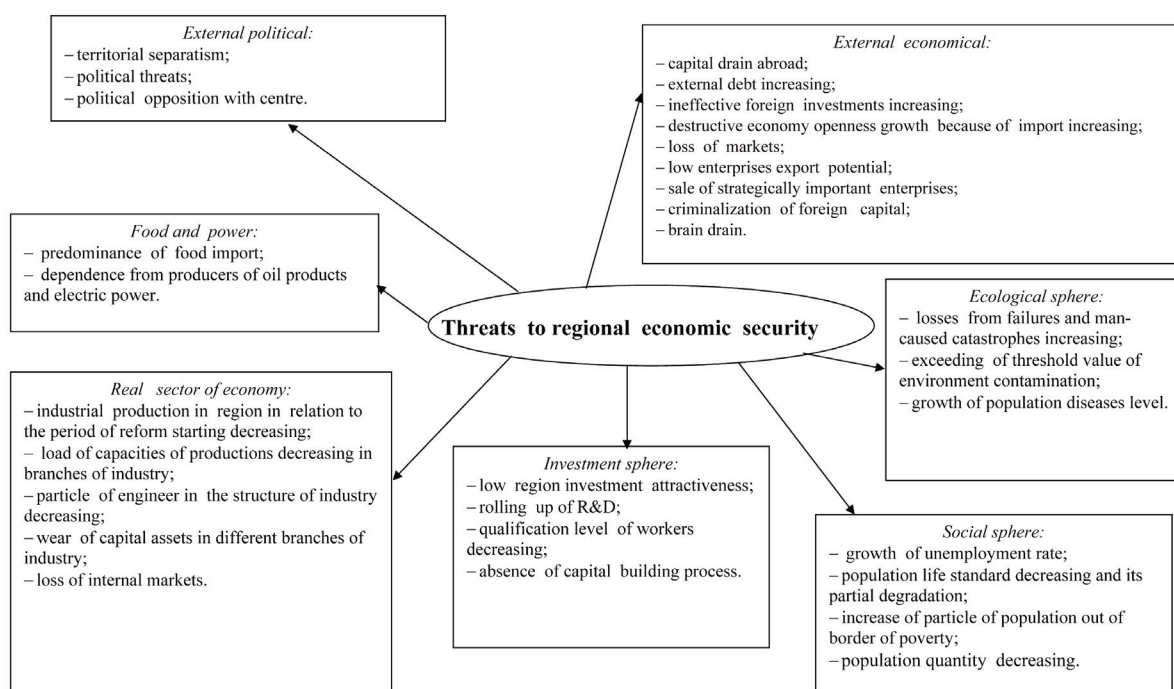


Fig 1. Classification of the main treats to regional economic security

For example – during 2001-2008 the level of private consumption in Poland (besides, this country is not the most developed among the CEEC countries, however, it has to be the nearest to Ukraine after start positions and mentally-cultural characteristics, that is why it was selected by us for comparison) fluctuated from 60,92% to 66,95% in attitude toward GDP (table 2), at the same time respective indicators in Ukraine made (64,24% and 72,34%). In addition, there is a high level of import share (in Ukraine in 2008 this indicator make 55,42%, and in Poland 44,49%), that, taking into account ineffective structure of external trade of our country worsens current account balance, decreases the volume of savings, volume of currency reserves and does the negative influences on the national income on the whole.

Among the countries of Central and Eastern Europe, which recently joined EU, in Czech Republic and Slovakia the level of consumption in this period made 47,03- 52,66% and 54,34-



61,23% accordingly (fig. 2), the level of investments fluctuated – in Czech Republic – 23,13-29,23% and in Slovakia – 20,63-30,90%, and governmental expenses – 18,85-26,22% and 16,20-20,61%.

**Table 2.** Structure of Poland's GDP, % [1]

Indicators /years	1995	2001	2002	2003	2004	2005	2006	2007	1-3 Q 2008
<b>Private consumption</b>	60,44	65	66,95	65,82	64,69	63,39	62,48	60,92	64,1
<b>Budget expenses</b>	18,69	17,89	17,89	18,13	17,59	18,08	18,27	17,99	17,59
<b>Fixed capital gross accumulation</b>	17,71	20,69	18,73	18,24	18,08	18,22	19,65	21,73	18,73
<b>Circulating capital reserve rate</b>	1	0,08	-0,11	0,51	1,99	1,04	1,4	2,07	2,89
<b>Export</b>	23,2	27,06	28,63	33,31	37,49	37,09	40,36	40,87	41,19
<b>Import</b>	21,05	30,72	32,1	36	39,84	37,83	42,16	43,58	44,49

It, with the certain warning, can testify to orientation of economic policy on investment growth and, at the same time, social orientation that can explains and relative political stability in these states. Instead, in Hungary and Romania the level of consumption during 2001-2008 fluctuated from 62,6-75,25% and 60,43-79,73%, investments – 14,34-31,86% and 15,43-42,26%, and governmental expenses only 9,58-10,54% and 14,76-19,19%. Taking into account known corruptions scandals<sup>1</sup> and in relation to the high level of shadow economy it can be considered as pre-condition of political and economic instability in the indicated countries.

Thus we would like to mention that it is very important to speak about mutual strategy of economic security on the regional level. In this context, as it is stated above, co-operation with Poland in this sphere is one the best direction to strength the degree of the economic security of our two countries. First of all because our mutual past, great possibility in economic and political sphere and in addition it is very mutually acceptable to compete together on the strong European countries market on one hand and to increase the level of energetic security on other hand.

On the whole, summarised the results of analysis of approaches to research of economic security evolution within various component we can do the set of fundamental conclusions:

- because of the fact that to every economic system inherent certain level of vagueness, the problem of safety takes universal character;

- economic security is one of the most important system characteristic, the loss of which can results in the threat of integrity and self-adapting of the economic system loss, up to its destruction;

- risks, threats, conflicts, are the forms of display of the unique process of economic security level decreasing;

- necessity in safety – it is one of the fundamental necessities of subject existence on all levels of manage– individual, family, enterprise, region, state, world economy (dissatisfaction of this necessity destroys the subject of manage outside the effective and stable participating in social-economic life);

- system character of economic security, necessity to provide dynamic balance between the forms of its destruction and instruments of its providing, and also fundamental character of necessity for any subject of manage stipulates application of international approach in research of this phenomenon.

<sup>1</sup> In particular, in 2006 they offered 600 thousands of euro for audio record of premiere minister F.Durchan on which he confessed about the untruthfulness of information which was given in his electioneering: „... I told electors in the morning, in the day and in the evening, hiding from them the real economic situation in a country and plan of reforms for an exit from a crisis, with the purpose of victory in April elections”.

Thus, at the strategic planning of regional development and decision of tasks in relation to competitiveness level increasing it is necessary to take into account and take proper measures as to neutralization of the set of threats economic security, which were considered above. In regional meaning this process has to be managed by countries-strategic partners. From our point of view Poland is one of the most acceptable international economic and political partners in short-time meaning in the process of Ukraine Eurointegration.

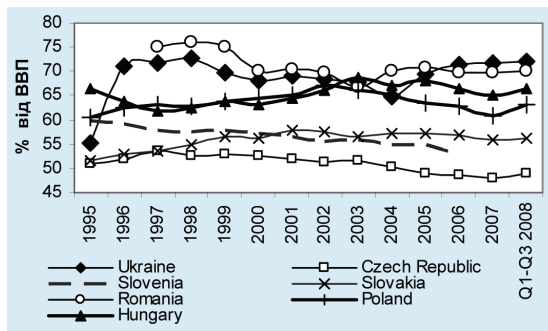


Fig. 2 a. Consumer level in the structure of GDP, %

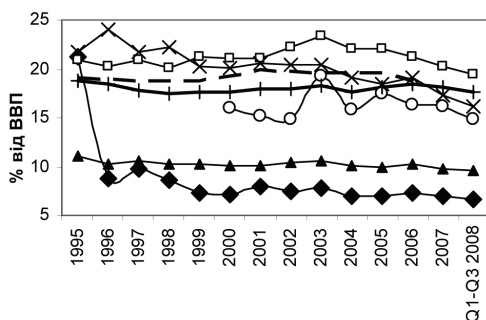


Fig. 2 c. Degree of government expenses in the structure of GDP, %

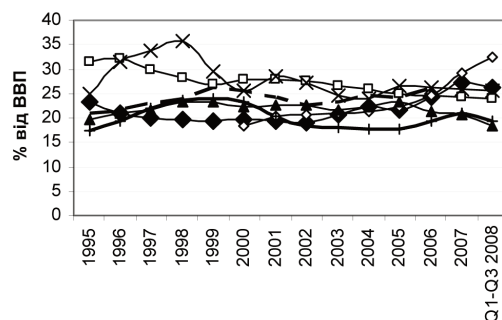


Fig. 2 b. Investment level in the structure of GDP, %

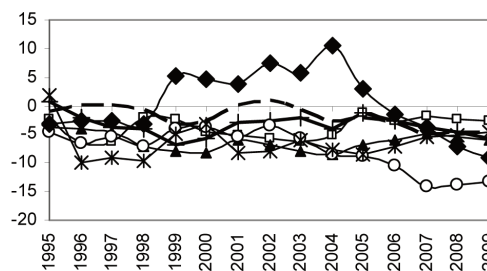


Fig. 2 d. Current account degree, in % to GDP

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*Borysenko O.\**

## CONTEMPORARY TENDENCIES TOWARDS REALIZATION UKRAINIAN FOREIGN ECONOMIC POLICY: CUSTOMS ASPECT

**Resume.** *The implementation of external operations without state participation is not possible because self-regulation of this part of the market can not only harm the economy of Ukraine, but also threaten the health and even life of the population. Today measures focus on improving the implementation mechanism of the fiscal dimension of the Customs and implementation of effective measures to promote foreign economic activities not relieve acute problems existing in foreign trade operations. Considering the relevance and importance of improving the forms of state control in foreign economic activity should transfer control to the information and analytical research and to support further development of such forms of customs control as customs audit.*

**Key Words:** foreign economic policy, international trade, customs control

**Анотація** Здійснення зовнішньоекономічних операцій без участі держави не можливе, оскільки саморегуляція цієї частини ринку може не тільки завдати шкоди економіці України, а й загрожувати здоров'ю та навіть життю населення країни. Заходи, що сьогодні направлені на вдосконалення механізму реалізації фіскальної складової діяльності Держмитслужби та запровадження дієвих заходів щодо сприяння зовнішньоекономічній діяльності, не знімають гостроти існуючих проблем у сфері зовнішньоекономічних операцій. Враховуючи актуальність та важливість удосконалення форм державного контролю у зовнішньоекономічній діяльності необхідно контроль переводити у площину інформаційно-аналітичних досліджень та митного аудиту.

**Ключові слова:** зовнішньоекономічна політика, міжнародна торгівля, митний контроль

**Аннотация** Осуществление внешнеэкономических операций без участия государства не возможно, поскольку саморегуляция этой части рынка может не только принести вред экономике Украины, но и угрожать здоровью и даже жизни населения страны. Мероприятия, которые сегодня направлены на усовершенствование механизмов реализации фискальной составляющей деятельности Государственной таможенной службы и внедрение действенных механизмов содействия внешнеэкономической деятельности, не снимают остроты существующих проблем в сфере внешнеэкономических операций. Учитывая актуальность и важность совершенствования форм государственного контроля во внешнеэкономической деятельности

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\* PhD., National Academy of Public Administration under the President of Ukraine

*необходимо контроль переводить в плоскость информационно-аналитических исследований и таможенного аудита.*

**Ключевые слова:** внешнеэкономическая политики, международная торговля, таможенный контроль

**Introduction.** Foreign trade is vitally important for the development of any economy. History knows no examples of economic prosperity of the country, which would be in economic isolation from the outside world. Integration into the world economic relations, which are formed and implemented as market-based, objectively creates the conditions for optimal resource allocation, increase the efficiency of national production, the solution of socio-economic problems. But at the same time it conduces to the increase in violations of customs regulations and amounts of movement of the goods by an illicit way.

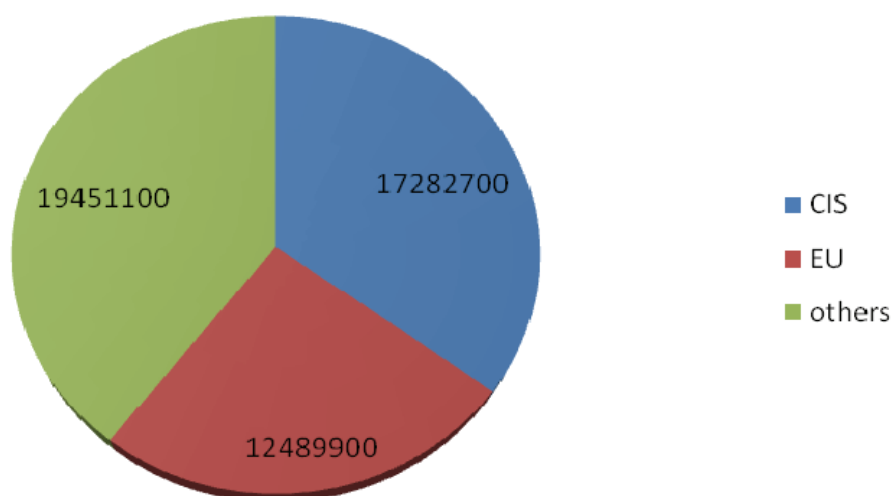
Contemporary stage in Ukraine is characterized by permanent increasing and widening scales of international trade, complication and reinforcing of dynamism of trade processes, reinforcing of demands of international organizations as to guaranteeing of free access of foreign goods to internal markets and lowering of national trade barriers. Deepening of integration of international demands into national practice of customs policy takes place.

Realization of these demands is associated with some potential threats to guaranteeing national Ukrainian interests. "An opening" of national boundaries for international trade can result in the state's economic losses such as budget deficit as a consequence of customs value deviation, harm to consumers' health and safety. It also can cause growth of smuggling etc. Under such conditions it's necessary for national customs policy that shall guarantee urgent reacting to external threats, efficient counteraction to possible negative effect of such threats.

According to State Statistics Committee of Ukraine exports of goods and services in Ukraine in 2009 amounted 49223.7 million USD, what was relative to 2008 62.5%, imports - 50604.4 million or 55% according to 2008. Negative foreign trade balance amounted to 1380.7 million USD. Coverage of import by export in 2009 amounted to 0.97 (in 2008. - 0.86) [4].

Ukraine has foreign trade with partners from 213 countries.

CIS countries exported 33.9% of all goods and to the EU countries – 23.9%. From CIS countries imported 43.3% of all goods and from EU countries – 33.9% (Fig.1).

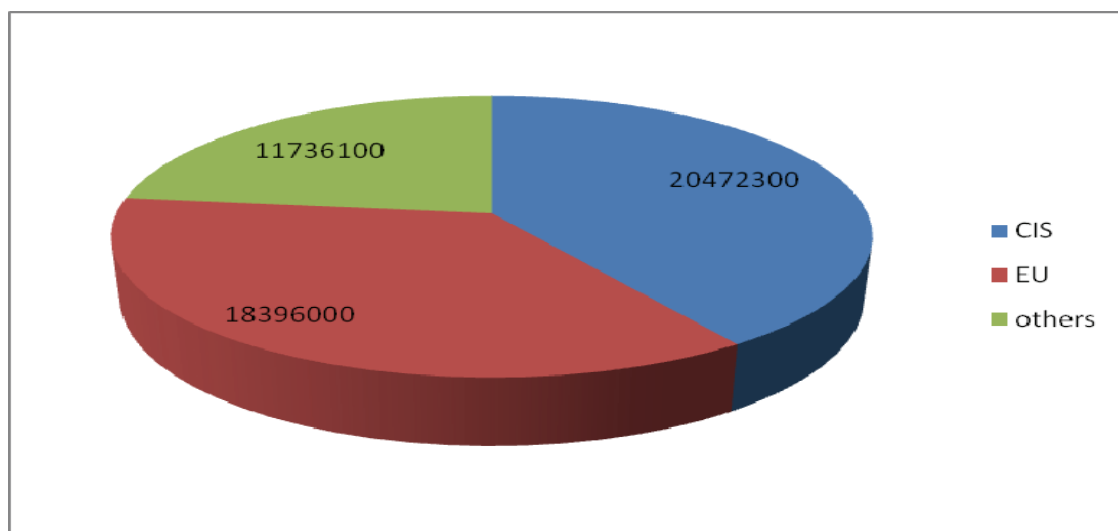


**Fig.1.** Exports of goods and services in Ukraine in 2009, thousands USD



Top export deliveries were carried out with Russian Federation – 21.4%, Turkey - 5.4%, China and Kazakhstan - by 3.6%, Belarus - 3.2%, Germany and Italy - to 3.1% .

The largest import incoming payment were from the Russian Federation – 29.1%, Germany - 8.5%, China - 6%, Poland - 4,8%, Kazakhstan - 4.5%, Belarus - 3.7% and Uzbekistan - 3, 6% (Fig.2) [4].



**Fig.2.** Import of goods and services in Ukraine in 2009, thousands USD

The intensification of foreign economic activity requires the improvement of existing forms of state control, the development of alternative forms and methods of state regulation of foreign trade operations.

Dynamic increase in the number of imported goods into Ukraine indicates that questions concerning development of effectiveness of customs control are really urgent. Increase in amounts of imported goods into Ukraine in 2009 has greatly revealed problems connected with lack of technological and physical capacity of national customs service for effective enforcement of suitable customs procedures.

Dynamic increase in the number of imported goods into Ukraine indicates that questions concerning development of effectiveness of customs control are really urgent. Increase in amounts of imported goods into Ukraine in 2009 has greatly revealed problems connected with lack of technological and physical capacity of national customs service for effective enforcement of suitable customs procedures.

Development of mechanism for implementing fiscal component in the foreign economic activity is possible only with the full realization of the functions of state control of foreign trade operations. In order to combat negative phenomena in this area, a number of the state program documents such as the State Program Against Smuggling, "Smuggling – Stop", Program to Combat Smuggling and Customs Violations in 2008 - 2009, approved by Presidential Decree of 04.03.08 number, 195 Program of the Cabinet of Ministers of Ukraine "Ukrainian breakthrough: for the people, not politicians," approved by the Cabinet of Ministers of Ukraine dated 16.01.08 № 14, main priorities and objectives of the State Customs Service of Ukraine in 2009, and others has been developed.

Scholars and practitioners in the field of economic, legal, organizational and technological aspects of focusing on issues of state control. Specific issues relating to the perspective of this study are reflected in the works of variety of researchers, as I. Berezhnyuk, A. Voytseschuk, O. Grebelnik, W. Draganov, A. Egorov, Y. Demin, N. Kalenskii, S. Koliada, V. Naumenko, P. Pashko, L. Pismachenko, A. Polonsky, S. Tereshchenko, I. Tonev, T. Totska, etc.

The problems of state regulation of foreign trade activities and methods of exercising state supervision and control of its effectiveness are widely considered in the works of domestic and foreign scientists widely considered. However, the mechanism of action of the combined effect of regulatory and supervisory activities of the State to control processes in foreign trade relations have not been investigated and requires further study.

**Formulation of the problem.** The purpose of this article is to disclose problematic issues in the implementation of foreign economic operations and the formation of alternative courses of implementing control mechanisms in the development of foreign economic activity. In order to achieve this goal it is necessary to solve the following problem: consider the basic parameters that characterize the foreign economic activity in Ukraine, to formulate the direction of improving controls in the sphere of foreign economic activity.

**The results of the study.** It is known that a characteristic feature of modern communication systems in the world economy is the growing interdependence of economies and the activation of their participation in the international division of labour.

Moreover, the hallmark of economic development has become an open market economic system, which provides the active interaction of various international economic interests.

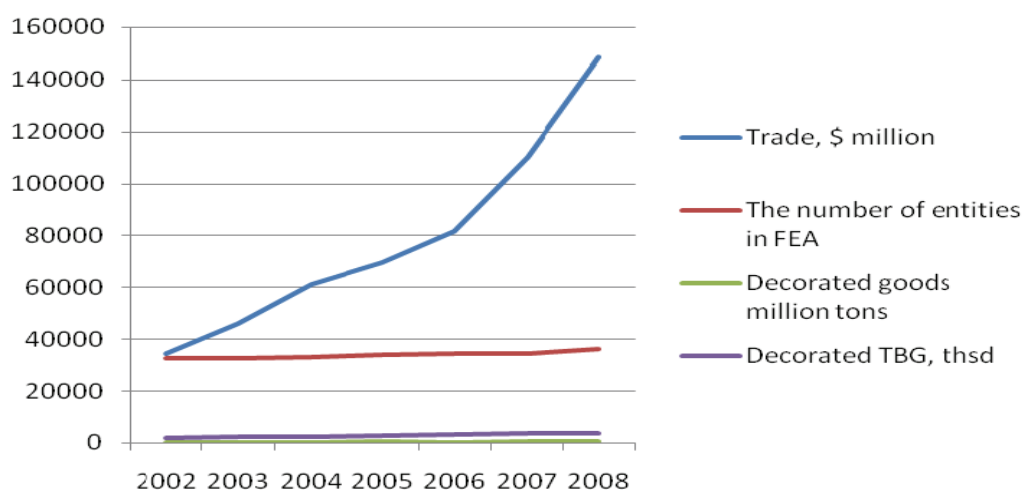
About the intensification of global integration, evidenced by the increase number and volume of foreign trade operations (Table 1). It should be noted, that Ukraine's foreign trade turnover in 2008 amounted to 148,668 billion dollars, which is 35% more than in 2007 (Fig. 3).

**Table 1** Dynamics of increase in the number and volume of foreign trade operations in Ukraine \*

Year	2002	2003	2004	2005	2006	2007	2008	2008
<b>Index</b>	<b>2002</b>							
<b>Trade, \$ million</b>	34300	45800	61113	69770	81682	110099	148668	4,3
<b>Including:</b>								
- Export	17900	23100	32455	34216	38419	49262	66967	3,7
- Imports	16400	22700	28658	35554	43264	60837	81701	5,0
The number of entities in FEA	32802	32566	32924	34048	34418	34320	36421	1,1
<b>Cleared goods, million tons</b>	365,2	419,3	421,7	428,9	423,9	484,3	427,6	1,2
<b>including:</b>								
- Export	110,9	118,3	127	126	128,3	145,5	149,8	1,4
- Imports	90,9	116,4	106,7	103,3	90,3	117,3	101,1	1,1
- Transit	163,4	184,6	188	199,6	205,3	221,4	176,7	1,1
<b>Cleared TBG, thsd</b>	1805,9	2080,4	2302,1	2620,8	2969,9	3301,6	3492,1	1,9
<b>including:</b>								
- Export	459,9	513,7	589,8	605,4	652	742	687,3	1,5
- Imports	583,5	684,1	698,6	869,1	1034,2	1135,9	1263,8	2,2

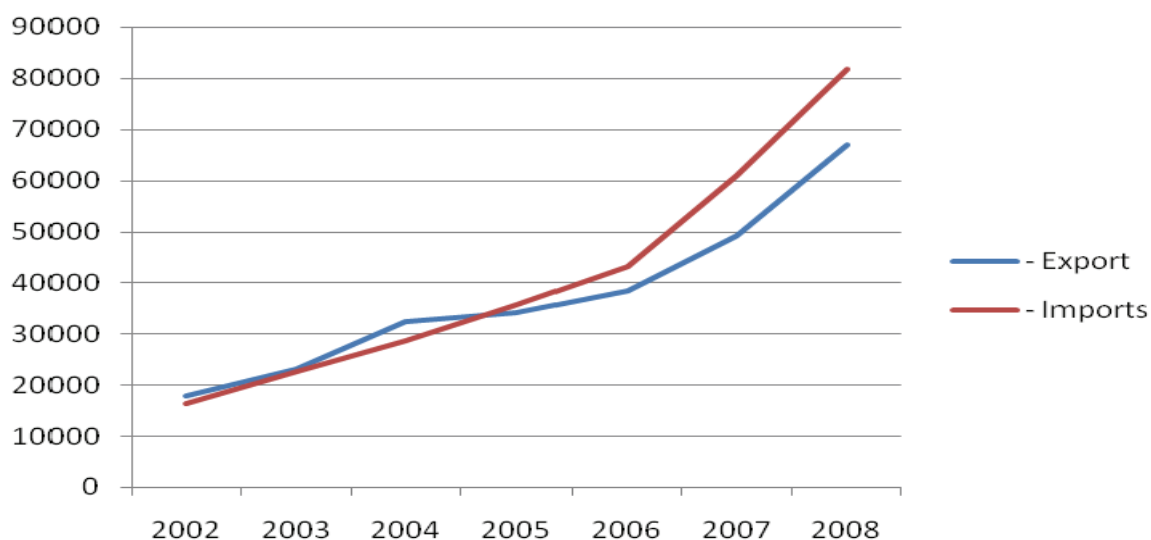
\* Data taken from the annual reports of "Highlights of the Customs Service"

The value of exported goods in comparison with 2007 increased by 17.7 billion or 35.9%, while imports - by 20.8 billion or 34.3% [2].



**Fig.3.** Index changes in the indices of quantity and volume of foreign trade operations (calculated in 2002)

We can trace in 2008, against growth of foreign trade turnover of 4.3 times and imports by 5 times compared with 2002, relatively steady trend of active subjects of economic activity and the volume of transported goods (Fig. 4).



**Fig.4.** Index changes export and import of products in Ukraine

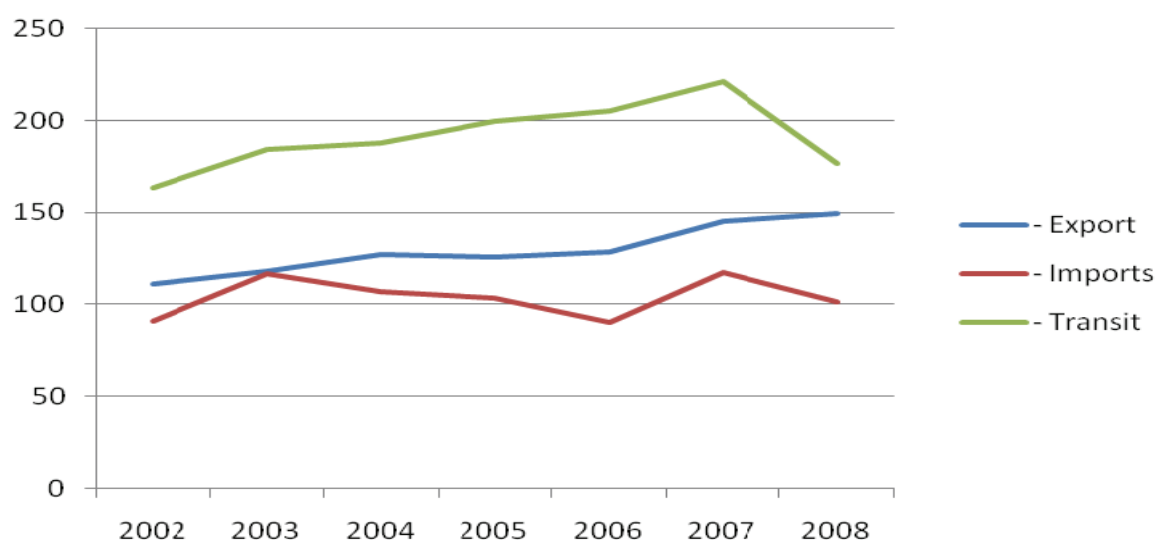
Along with the intensification of international integration the state regulatory agencies frequently fix the violations and abuses in the sphere of foreign economic activity. Every day more than a million tons of various cargoes move through customs border of Ukraine by rail, road, air and sea transport.

As the data of Customs Service of Ukraine indicate, in 2007 the average daily subject to customs clearance of almost 1.4 million tons of cargo, was passed about 240 thousand people and 67 thousand vehicles (Fig. 5). This trend continued in 2008: the average daily subject to customs clearance of 1.2 million tons of cargo, passed 240 thousand people and about 64 thousand vehicles [1, 2].

In accordance with the increase in freight traffic there is a need to improve the operational management of these flows and the application of a clear, developed and effective system of control. This will protect the economic interests of the state.

Not a secret that today the tools and technology of customs control behind the needs of bandwidth and global standards of control products. Every year the government allocates sub-

stantial funds for scientific and technological development of the State Customs Service of Ukraine and development of customs infrastructure, but these measures have not kept pace with growth in foreign economic activity and ingenuity of some economic agents to develop schemes and means to evade proper settlement with the state.



**Fig.5.** Index changes cleared goods, million tons

Significant growth of foreign trade requires a qualitatively new approach to the monitoring of international freight flows (Fig. 4).

The growth of commodity flows has shown the following issues of customs control, notably the substantial time required to carry out customs procedures, outdated technological goods passes, the impossibility of compliance with current legislation regarding the physical inspection of all goods that move across the border of Ukraine, etc.

In the total trade share of goods, moving in the illicit way, occupies a significant place. During 2008, were initiated 328 criminal cases on smuggling on the total amount of 5 billion 515.2 mln. Compared with the previous year, the number of criminal cases increased by 34, and the cost of items in cases of smuggling almost doubled (an additional 5 billion 94.2 million UAH.) [2].

The same trend towards an increase in violations of customs rules, resulting in the state loses substantial amounts of revenue to the state treasury. For violations of customs legislation in 2008 has been compiled 25,004 protocol of violation of customs regulations, total 6 billion 92,8 million UAH, which is more than 7 times higher than the level of last year (in 2007 passed 25 500 protocols total \$ 855.0 million UAH) [2].

There are great differences between the amounts of goods to be drawn on violation of customs regulations, and the goods on which a decision to withhold the revenue of the state. According to the facts of violations of customs laws in 2008 there has been delayed goods total \$ 6 billion 92.8 million UAH. Including the cost of actually seized goods is only 1 billion 46.5 million UAH or 17% [2]. The big problem is the commission of crimes related to intellectual property. The main objects of illegal movement across the customs border of Ukraine are the disks for laser reading systems and other audiovisual products. For example, in 2006 the customs authorities foiled attempts of illegal movement of 140 CDs in the amount of 229 thousand UAH, and in 2008 the customs authorities intercepted several attempts of illegal movement of the CD a total of 50.2 thousand, amounting to 620.8 thousand UAH. Moreover, the main foci of these

offenses are: the import of such goods to Ukraine - Russian-Ukrainian border area, in case of export from Ukraine – area of Polish-Ukrainian borders. [1, 2].

For Ukraine, as well as for other developing countries, an important problem is the presence of counterfeit goods (clothing, perfumes, alcoholic beverages), genetically modified organisms and products based on them, etc among the imported goods.

There is a practice of distorting the customs value of imported goods. Significant liberalization of import duty rates has not removed the problems common in Ukraine, the practice of manipulation of the customs value of goods. With the increasing intensity of import flows and the high workload of customs control agencies should expect an increase of abuse just in this area, where high physical workload of the relevant authorities does not allow to reveal mentioned violations.

Increasing the volume and growth rate calculations on export-import transactions through offshore zones provides a basis for allocating a separate stream of state control.

A growing share of export-import operations with the calculations through offshore zones creates opportunities for manipulation of the prices of contracts. These operations are aimed at the withdrawal of income abroad and tax evasion. This represents a significant threat to sustained economic growth and meets the national interests of the state.

An indicator of disadvantage is that the trend for a significant gap between the numbers registered in Ukraine and in fact active participants in foreign economic activities in the field of foreign trade. There is a necessity of thoroughly review the provisions for the likely abuse of the relevant area, as well as clarify the obstacles to the implementation of foreign economic activity in the formal legal framework.

However, there is no way to lower tax evasion subjects of foreign economic activity. Recently, the company who has a budget arrears due to the control activities carried out by customs authorities, are increasingly using the law granted them the right to appeal. The goal, which in this case is pursued by subjects, that prolong the process of appellate review of tax liabilities in order to minimize the amount of which shall be payable as a result of inflation or, to avoid all financial responsibility for the process of artificial bankruptcy. Another way of tax evasion is the use of some fictitious schemes of importation of goods that, in principle, are well known, but the law has not yet been resolved. For example, the import of cars as a representative of foreign investment, the existence and use of the scheme "cover" of imports of goods, by a declaration of their mode of processing on the customs territory of Ukraine, etc.

Also it is necessary to take into account the typical kinds of violations in foreign trade activities: False statements by the data in the shipping documents, filing false certificates of origin and others. Thus, the implementation of measures to strengthen control of the correctness of determining the customs value of goods allowed in 2007 to send to the state budget an additional 1 318,6 million UAH, that 157,6 million UAH more than in 2006. The economic impact, which made the adjustment of customs value for the year 2008, totalled 3 349,4 million UAH further directed the state budget funds, which is 2,5 times more than in the previous 2007 [1,2].

Additional revenue by increased monitoring of the adoption of classification decisions amounted to 108.0 mln. and 153.4 million UAH in 2007 and 2008 respectively. The state budget received additional 11.6 million UAH, and 42.7 million UAH in 2007 and 2008 respectively by checking the country of origin of goods [1, 2].

Analyzing the violations and abuses in the sphere of foreign economic activity, we concluded that, despite the considerable efforts of the State customs service to prevent the commission of customs offenses, as well as developing and improving tools and technologies of customs control, the amount on which offenses are carried out increase from year to year. How-



ever, it should be noted that the perpetrators - the subjects of foreign economic activity shifted from simple circuits and methods to more sophisticated, cost-calculated, using the entire arsenal of possibilities of imperfect existing legislation and bureaucratic features of the judicial system, the limited powers of customs authorities. Therefore, it is clear that this problem can't be solved only by increasing the number of employees or means of customs control. This extensive way of development, which solves some problems in arithmetic according to the cost invested in the technology development of physical control of goods. It's necessary to develop other more intensive forms of customs control.

In recent years considerable progressive movements to improve the national customs policy have been carried out. Positive achievements in execution of customs policy are considered to be:

1. Implementing interaction between customs bodies and subjects of foreign economic activity.
2. Making efforts to adjust Ukrainian legislation concerning protection of intellectual property to the level of the world standards
3. Searching for effective interaction with the customs services of contiguous states and countries that are trade partners.
4. Achieving certain progress in creation, implementation and development of electronic goods declaring system.
5. Taking measures to guarantee legal protection against importing goods of unsatisfactory quality into customs territory.

Moreover it is necessary to mention a range of problem factors of contemporary customs policy of Ukraine. They are:

1. Lag of customs control from contemporary needs in carrying capacity and world standards of goods control.
2. Widespread deviation of customs value of imported goods.
3. Growing of scopes and quantities of export-import operations through off shore zones.
4. Tendencies towards considerable gap between amounts of subjects of external economic activity registered in Ukraine and their factual participation in foreign trade. It is a necessity to study carefully this problem in the view of probable abuses in this sphere, and also to clear up obstacles to external economic activity in official legal field.

Considering marked tendencies and conditions of enforcing customs policy in Ukraine, the main priorities for increasing activity of the state policy in this sphere shall be:

✎ rise in defence level of national state interests by means of instruments of customs policy with simultaneous balanced implementation of international demands and standards;

✎ simplification of customs procedures for improved management system of risk assessment, that will allow to concentrate on identification and inspecting of loads of high risk;

✎ creation of the most favourable environment for participants of foreign economic activity aimed at more efficient execution of export-import operations;

✎ rise in effectiveness of efficient detection and counteraction to negative phenomena in the environment of external trade, which are potential threats to the state's safety and interests.

Implementing of these priorities will demand to take a range of measures in the nearest future, which will allow reinforcing a defence by level of national state interests, to create the favourable conditions for increasing of scopes of external trade, to influence positively on social and economic development of Ukraine.

Despite the problems, we suggest use of information and analytical methods in the field of unified information space of state control. Today State Customs Service of Ukraine working to-

wards the exchange of preliminary information about goods and vehicles that move across the customs border of Ukraine and other countries, the use of risk management, operational cooperation of customs authorities of neighbouring states at checkpoints at the border. The originality of our proposal is to obtain complete information on export-import operations in Ukraine and other states. The value of such complete information is as follows. Firstly, there is complete information on exports to Ukraine. The difference between exports and imports to Ukraine will provide information on the amount of economic smuggling indicating types of products, businesses exporters and importers, the timing of smuggling in control, etc. In addition, the fixation of such information in an electronic system would eliminate the negative influence of the subjective factor. Secondly, this information will be declared in the customs declaration confirming information. Thirdly, the cooperation of customs authorities on the basis of information processing and analysis will increase the speed and direction of activities. This will speed up the identification and receipt of "hidden" amounts to the State budget. And this in terms of inflation and budget deficit is important. Fourthly, the analysis of such information may be grounds for an in-depth monitoring of dubious enterprises of foreign economic activity.

One form of such in-depth control can be "custom control, which is carried out after clearance" or "customs audit". State Customs Service of Ukraine initiated work in this direction. Responsibility for organizing and carrying out documentary and desk audits of compliance with the participants of foreign economic activity requirements of the customs legislation of Ukraine by the Department of risk analysis and audit. In addition, the Department coordinates and oversees the work of customs bodies in this direction, supervises the elimination of violations, identified by such inspections, and provides the organizational and methodical maintenance inspections of foreign economic activity.

Reports Analysis State Customs Service of Ukraine shows that for the period from 01.07.05 till 19.06.06. Customs conducted 613 outreach documentary checks, and from 19.06.06 till 27.05.08 - 1291 check, that is an average of 634 checks per year [3]. The number of economic agents, for example in 2008, was 36421. Attention is drawn to the fact, that during 2008 328 criminal cases on smuggling was instituted, and for violations of customs legislation 25004 a protocol on violation of customs regulations were drafted. Some violations (the so-called "black" and "gray" contraband) can be detected only by an inventory or audit compliance with quality and quantity of goods (as range, article, class, etc.) which have been declared to customs authorities and registered the Customs, the quantity and quality of goods, which were reflected in the accounting records after such registration.

Furthermore, analysis of performance data of State Customs Service of Ukraine, significant differences between the computed amounts of customs offenses and the amounts recognized by the courts to redress in the state budget, significantly different. And it's not favour of the state. This suggests that the customs officials and officials of the judiciary use different, often mutually exclusive of the legal documents. Since, as shown by our study are listed in the state budget amounts exporters and are 13-15% of the additional amounts assessed on foreign trade operations, we can say the same about the effectiveness of existing legislation in this area. The economic effect of regulatory actions reduced from the fact that customs officers doing unproductive work, spending their time and expertise, public resources for actions that most likely on 85% will be appealed in court. Thus, the alignment of regulatory and legal support of foreign economic activity is a necessary condition for the existence of any kind of control in general and customs audit in particular. Since there are differences between assessed and listed the amounts that they can be considered a reserve or a missed opportunity to replenish the state budget by aligning the legislation in force.

Considering perspective of implementation in practice of the customs authorities of the customs areas of audit and ensure the effectiveness of this mechanism, it is necessary to hold a series of events: at the level of Ukrainian law Customs Service audit of the definition of its structure, tasks, powers, rights and responsibilities of officers and of officials, to make changes to legislation that would have made it impossible for evasion of the actual tax debt through the mechanism of groundless appeals, failure to provide for liquidation of the enterprise through the application of artificial bankruptcy procedures subject to the availability of such an enterprise budget debt, develop a methodical maintenance of customs control, which should be necessary for the two sides of Customs. These measures are aimed more at protecting the interests of the state, represented by the customs authorities.

**The findings of this study and perspectives for further research in this direction.** Everybody understands that the implementation of external operations without government intervention is impossible, because self-regulation of this part of the market can not only damage the economy of Ukraine, but also threaten the health and lives of the population. Measures that are directed on mechanism perfection for implementing fiscal component of the Customs Service and the introduction of effective measures to promote foreign trade, do not alleviate the existing problems in the field of foreign trade operations.

Considering the urgency and importance of improving the forms of state control of foreign economic activity must be translated into control information and analytical research and to support the establishment and further development of such forms of customs control as a customs audit.

Any delay in addressing these issues, even if the operation had already created dozens of structural units in the system of customs authorities, made it difficult to ensure full and qualitative performance indicators of government revenue, increase audit ability of international trade and does not contribute to the economic security of Ukraine.

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*Tsyganov S., \* Tsyganova N.\*\**

## CONSEQUENCES OF THE GLOBAL FINANCIAL AND ECONOMIC CRISIS FOR UKRAINE, ANTI-CRISIS MEASURES

*In the article the modern development of the developed countries' banking sectors is analyzed. Main banking crisis preconditions and consequences are examined. Key features of the banking crisis and anti-crisis measures are substantiated.*

**Keywords:** global financial and economic crisis, consequences of the global crisis and anti-crisis measures.

**Introduction.** The impact of the world financial crisis has demonstrated the inability of the banking system of Ukraine to counteract the crisis challenges, to adjust to changing market conditions and revealed the potential risk of the destabilization. In this sense, today the problem of defining the global financial crises' preconditions and consequences is extremely important for the banking system of Ukraine. The current situation in the banking industry requires the anti-crisis measures implementation at the macro and micro levels. In such conditions, the role of banking institutions as a part of the banking system is growing. Therefore, every bank in the country must have the stabilization program.

A crisis has a dual nature. It destroys and creates conditions for the further development at the same time. According to this theory, the integration of a country into the world financial and banking system means higher sensitivity of this country to external shocks. As a result the country implements more effective anti-crisis measures to minimize crisis effects and to create the basis for the sustainable development.

**Existing publications on the problem.** The problem of the financial instability is analyzed in the works of L. Abalkin, O. Baranovsky, I. Burakovsky, A. Galchinsky, V. Geets, A. Grytsenko, A. Greenspan, A. Griaznova, L. Drobozina, P. Krugman, V. Mazurenko, V. Mishchenko, J. Pahomov, G. Soros, J. Stiglitz, V. Fedosov, A. Filipenko, A. Chuhno etc. But at the same time there is a lack of complex researches on the preconditions, factors and the impact of the global crises on emerging markets.

**The main goal of the article** is to examine the nature, preconditions, key features of financial and economic crises and to analyze foreign experience of anti-crisis measures taking into consideration the Ukrainian realities.

**Main results.** Global financial crisis, started from the mortgage market crash at the end of 2006 in the USA, gradually covered all the countries in the world. According to the estimates, it became the largest crisis after the Great Depression of 1929 – 1933. The losses of the financial sector and a sharp decrease in trade volumes led to the GDP decline in developed countries (2-10%). The non-diversified economies have appeared to be the most vulnerable in the conditions of the global financial crisis due to their dependence on the foreign capital inflow and narrow specialization. In such countries one or two products accounts for 70 percent of total export, 50-70 percent of budget revenues. The crisis triggers drastic negative changes in the equity mar-

\* Dr. of Economics, Professor, Institute of International Relations of Kyiv National Taras Shevchenko University

\*\* PhD, associate professor, Kyiv National Economic Vadim Getman University

kets, capital outflow, payment problems and exchange rates' declines. The crisis appears to be deeper in developing countries than in developed economies it comes from. And in developing countries the economic recovery starts much later, in 12-15 month, following the recovery of developed economies [4, c. 22–25].

In the USA the peak of the financial crisis fell on September 2008, caused by the bankruptcy of the Lehman Brothers Holdings Inc., the \$50 bln acquisition of Merrill Lynch (in 2007 its market value accounted to \$100 bln) by Bank of America, Goldman Sachs and Morgan Stanley shares' price collapse (25% and 14% decline accordingly), the threat of AIG bankruptcy [7, c.20–29].

Financial and industrial sectors of the Ukrainian economy have also been affected by the global financial turmoil. It led to the output decline, the growing instability in the banking sector, the domestic currency devaluation, an increase in LIBOR, the gross debt growth, the sovereign rating deterioration.

At the beginning of the US mortgage crisis Ukrainian scientists argued about the crisis consequences for the financial system of Ukraine. Some economists declared that there was no threat for the Ukrainian financial system because of the absence of US mortgage bonds in the national commercial banks' portfolios due to low level of the equity market development in Ukraine. Other scientists considered that the foreign capital share in the banking system was sufficient to become a crisis conductor [5; 7; 10; 14].

According to the estimates of the International Monetary Fund, the former USSR countries experienced the deepest crisis consequences. Nevertheless, in 2010 the CIS economies are expected to grow by 2 percent. In the conditions of the global financial crisis these countries suffer from three large shocks: financial shock; developed countries' demand decline; decreasing commodity prices, energy resources prices. The IMF reports that Ukraine is one of the most crisis affected countries in the CIS region. In 2009 the GDP was expected to decline by 14 percent. In 2010 the GDP is projected to grow (+ 2.7 percent) with the inflation rate reaching 10.3 percent. The positive aspect of the forecast is that the current account surplus (0.4 percent of the GDP in 2009 and 0.2 percent of the GDP in 2010) is expected to change the current account deficit due to the import volume decline (but not the export growth) [20].

In the face of the uncertainties in the world economic development, it is difficult to determine the prospects for the national economy, deeply integrated into the world economic environment. At the moment the Ukrainian economy has several scenarios to develop. The global economic turmoil has not become the crisis of renewal for Ukraine. Conversely, it has deepened the contradictions of the national economic development. In fact, it means that the crisis hasn't performed its constructive function. This worsens the economic situation in Ukraine.

In Ukraine the financial crisis is mostly characterized by weakening of the main financial system structural elements' interrelations, chronic budget deficit, financial system imbalances, exchange rates' volatility and increased indebtedness, irrational budget expenses' structure and tax rates. At the moment, the national economy also suffers from the secondary consequences of the global financial crisis: increasing value of foreign financial resources, capital outflow, weakening consumer demand in the main export markets, unfavorable expectations of the economic entities due to global crisis demonstrative effect.

The financial turmoil also led to an increase in oil prices. In the second quarter of 2007 oil price was \$100 per barrel, but at the beginning of the world financial crisis in September 2007 the prices sharply went up. The economy of Ukraine extremely depends on oil and gas prices. The upsurge in oil prices led to the increase in prices of fuel and lubricant materials, resulted in transportation costs' and food prices' increase. The upsurge in oil prices caused the world infla-



tion rate growth, resulted in import price increase. Natural gas is another key energy source of Ukraine. The Russian Federation as a leading natural gas' exporter sets the gas price on the basis of oil prices.

Both developed and developing countries suffer from destructive impact of the financial and economic crisis. The urgent necessity of developing of effective anti-crisis regulative measures taking into account the national economic peculiarities determines the feasibility of studying of the global crisis consequences.

As the scale of the impact of the global financial crisis on economic growth has become evident, authorities around the world have taken unprecedented measures to fight against the crisis. However, the regulative interference of the authorities in the financial system cannot protect the world economy from the further system crisis escalation. The majority of regulative measures are intended to solve the crisis consequences while its reasons, destructive potential, duration are often ignored.

A term "crisis" means a crucial decision, a turning point, a sudden change, an emotionally stressful event, an urgent lack, an unstable position [3, p.328]. Modern scientists define "crisis" as an unstable economic situation, followed by the asset loss risk, the high level of uncertainty, especially one involving an impending abrupt or decisive change.

In particular, O. Baranovskiy defines "crisis" as a multi-aspects economic category, which economic essence has not been defined by the economists. O. Baranovskiy examines 10 types of crisis. They are monetary, debt, banking, credit, currency, financial, budget, payment, investment and inflation crises [1, p.112]. But we consider that all the mentioned types are the parts of the financial crisis.

The analysis of the scientific works shows that the most popular meaning of the term "financial crisis" is the disruption of the financial market equilibrium, following by the instability of financial institutions, a sharp GDP decline. We maintained that the main characteristics of the crisis are the macroeconomic equilibrium disruption, the unemployment rate growth, an increase of the uninvolved production capacity part; the real wages, corporate income and demand decline; a decrease in the retail and wholesale trade volumes; loan and currency market crash; payment defaults; the loan pressure, an upsurge in loan rates; lack of money supply, high inflation rate; a decrease in investment volumes, the capital depreciation; an upsurge in shares' prices, the panic at the stocks exchange; the mass corporate bankruptcy; growing social pressure [11, p.124].

A banking crisis as a part of a financial crisis is a feature of the market economy. In other words, a banking crisis is not an abnormal event; it is an ordinary feature of the dynamics of the economic systems. The experts of the International Monetary Fund identified 124 banking crises, taken place in 1970-2007. 24 of 124 banking crises were followed by the currency and debt turmoil and called "dual crisis"; 10 of 124 banking crises were defined as "triple banking crises" [10, p.20].

A banking crisis may start in the unfavorable economic conditions and also in a "healthy" economy. But unexpected banking crises don't happen often. There exist different definitions of the term "banking crisis" and its features in the works of scientists and leading international organizations' experts. For instance, International Monetary Fund experts L. Levin and F. Valencia examine this problem from the position of the financial institutions' and corporations' ability to meet contract commitments [20].

E.J. Fridley declares that the key feature of a banking crisis is a sharp depreciation of bank assets, a decrease in deposit volumes that demand the intervention of the government, the nationalization or forced mergers etc [13, p.75].

R. Duttagupta and P. Cashin, IMF analysts, examine a banking crisis from the operational point of view and declare the necessity of the implementation of the liquidity and profitability

standards in the banking sector. A.D. Kunt and E. Detriagache suggest identifying banking crisis through analyzing the return asset ratio (ROA), deposit base indicators, governmental resolutions on the implementation of urgent measures, bankruptcy of banks [20].

E. Detriagache, R. Rajan and J. Del Arrik, IMF experts, have proposed the indicators to determine the banking crisis beginning. They are a sharp decrease in deposit volumes, stabilization measures of the government; the value of anti-crisis measures exceeds of 2% of the GDP etc [20].

The Bank of International Settlements defines a banking crisis as a situation when at least one of the following conditions holds:

- large scale bank nationalization as a result of banking sector problems, frozen deposits;
- the value of anti-crisis measures in the banking system exceeds 2% of the GDP;
- there are bank runs or new important depositors' protection measures
- distressed assets exceed 2% of the GDP [21].

The above-mentioned features of the banking crisis have become the reality of the last years. According to the estimates of K. Rogof, the sufficient value of the anti-crisis package to rescue the world economy amounts to \$1-2 trln. US Treasury Secretary H. Paulson to support the US financial system presented a \$700 bln bailout plan to the US Congress. At the end of September 2008 the financial crisis reached the banking systems of the EU. As a result European countries announced the aid package to rescue the EU economy [2, p.8-19; 5].

There exist a lot of banking crisis characteristics, proposed by the scientists of Ukraine. O. Baranovskiy has generalized the term "banking crisis", defined by the different economists: "A banking crisis is a crisis in the banking sector, based on the domino effect, when the insolvency of several banks with distressed assets causes the panic, a sharp decrease in interbank loan volumes, the payment system and financial market crash" [1, p.419].

A banking crisis can be defined as a serious banking system malfunction related to the deposit base decline, an increase in "bad debt" volumes, urgent anti-crisis measures, a decrease in liquidity of banks, bankruptcy of banks. So in this sense, while determining the essence of banking crisis, it is necessary to take into account its institutional nature (system of social and economic relations), its organizational nature (the interaction of some economic organizations) and its management-related nature (efficiency-oriented and anti-crisis expenditures' minimization nature).

From our point of view, a banking crisis is a deep imbalance of the banking system, followed by the inability of economic agents to meet their obligations and fulfill their functions, the deterioration of the financial indicators. Although there are several sources of banking crises, the main source is a banking institution. In its turn, the banking lending is a main channel of a banking crisis, because the latter is followed by an upsurge in loan rates, loan and output volumes' decline and an increase in the unemployment rate.

Banking crises have some peculiarities. They are not cyclical. Defects in the commercial and central banks' management, governmental policy play a crucial role for banking crises. A banking crisis is a part of every economic system. Banking crises have similar mechanisms, preconditions, consequences and their own peculiarities.

A banking crisis often is a part of an economic crisis and as usual the former aggravates the latter. Banking crises lead to the economic situation deterioration, resulted in the decline of the real GDP, the consumption and the output; an increase in unemployment and loan rates, banking services' prices; the credit money deficit. In its turn, it worsens the conditions for the small and medium business development. At the same time, banking crises can be all-sufficient.

Banking crises can emerge at the micro, macro and international levels. We consider that banking crises at the micro and macro level have substantial differences. Today the process of

the banking system destabilization is taking place at all 3 levels. As a result of the financial integration development banking crises are likely to emerge oftener at the international level [18, p.129-135]. The anti-crisis measures for the micro, macro and international level should be developed taking into consideration this fact.

The most evident consequences of banking crises are bankruptcy of banks and the deposit outflow, resulted in the economic growth decline and a decrease in monetization indicators. According to the estimates of the International Monetary Fund, a country loses 10% of the GDP every year due to a banking crisis [20].

The recent banking crisis has revealed the banking system disproportions and defects of the banking regulation system. The economic globalization creates the illusion of the opportunity to solve the domestic economic problems at the expense of other countries. At the beginning of 2000, overheating of the US economy required the effective anti-crisis measures of the US Federal Reserve System. But instead of taking ordinary anti-cyclical measures, the Federal Reserve System decided to devalue the US dollar. At the end of 2008, Alan Greenspan recognized that mistake of the FRS strategy [20]. The excessive financial sector liquidity was directed to the speculative markets at that time. It caused the appearance of bubbles (in particular, at the mortgage market). In such conditions, the government should have taken ordinary preventive measures.

Main preconditions of the banking sector destabilization are macroeconomic indicators' deterioration, which negatively impact on the borrowers' activity; speculative markets' crash and payment defaults; depressed asset accumulation; lack of the liquidity in the banking institutions that led to the appearance of bank clients' crisis expectations; non-effective regulative measures.

The Japan banking crisis of the 90th gives the evidence that the crises can be caused by the depreciation of the banking assets or (and) an increase in distressed assets volumes. In Japan overheating of the economy and the stock market led to the corporate securities' depreciation (corporate securities compose an essential part of commercial banks in Japan). The considerable merger of the banking and industrial capital is a peculiarity of this country. The experts called that crisis "the soap bubble economy crash". The preconditions of the recent banking crisis in developed countries differ from the ones in Japan. The mortgage crisis transformed an essential part of loan portfolios into the distressed assets. For instance, in 2009 279 banks went bankrupt in the USA [22].

In emerging markets the banking crisis was also followed by the domestic currency devaluation, the drastic dollarization of domestic economies; a considerable increase in gross debt volumes and central bank reserves decline; an extreme increase in banking operations' volumes, the excessive politicization of the banking system (the Appointment of the Central Bank Head on the political basis); the essential dependence on the world financial market conjuncture (i.e. the impact of foreign capital on the domestic banking system).

The financial market globalization required the realization of the coordinated measures to overcome the crisis. In 2008 in developed countries central banks reduced refinance rates to stimulate the economy and to overcome the recession. The US Federal Reserve System, Bank of England, the European Central Bank, central banks of Canada, Switzerland and Sweden announced 0.5% cut in refinance rates. Bank of England cut the interest rates from 5% to 4.5%; the US Federal Reserve System cut the rate from 2 to 1.5%; the European Central Bank cut the rate from 4.25% to 3.75%. The People's Bank of China also cut the rate to 6.93%. In 2010 in the European Union the European Systemic Risk Board was established as a financial control body of the European Central Bank [23]. This measure was unprecedented.

The Basel Committee on banking supervision reconsidered the recommendations on capital adequacy and banking risks to reinforce the stability of banks. According to the Basel III the target is to achieve a 10.5% minimum total capital plus the capital conservation buffer. Central banks have already begun the implementation of new requirements. For example, in Switzerland the requirement for the 2 biggest banks (UBS and Credit Suisse) has been risen to 19% [2, 23].

The National Bank of Ukraine also rose this indicator to 120 bln hrn. But such a considerable rise will lead to an increase in the foreign capital inflow into the banking system of Ukraine (a rise from 120 to 500 bln hrn is being discussed now). In the short run it promotes the domestic banking system stabilization, but in the long run it will cause the additional risk of the banking system destabilization [24].

Barriers to prevent a banking crisis can be established at the micro, macro and international level. The effective banking management and the aid of the government play the crucial role for the maintenance of the banking sector stability. The banking crisis consequences depend on the anti-crisis management efficiency. In its turn, the opportunities of the anti-crisis management depend on the qualification of managers, the depth of a crisis, the market position of a bank, the economic situation and the impact of political and legal factors.

In the work of every system there are deviations caused by external and internal factors. The system is considered to be stable when it is able to remove deviations independently. Modern banking systems have not demonstrated the ability to remove deviations independently. The regulative impact of central banks was not effective enough so the governments had to implement the regulative measures [2, 19].

Developing the banking regulative measures the governments must consider main challenges of the modern world financial crisis. Regulative measures should not be limited to troubled banks' refinancing. The stable and sustainable economic growth can be the only reason to weaken the banking supervision requirements. In case of the dynamic growth of banking assets, the banking supervision requirements must become tougher.

The deposit insurance system should not be too liberal. In case of a bank bankruptcy depositors must lose some part of their deposits, so the depositors will carefully choose a banking institution to make a deposit. Such measures allow accumulating banking resources in the most reliable banks. The confidence in the banking system should have more fundamental basis than the deposit insurance system. The information openness of banks and banking systems is the key factor of depositors' confidence, which is the guarantee of success in the banking sector. It is necessary to reduce the corporate securities' share in the banks' investment portfolios. They are more risky and give the opportunity to hide some banking problems.

In the conditions of the financial market globalization the banking capital consolidation process will lead to the stability of the domestic banking system. But the governments should develop the foreign capital inflow control measures.

The world economy internationalization process cannot go through Ukraine, especially taking into account the openness of its domestic economy. Taking into consideration all the advantages and drawbacks, it is necessary to develop the effective strategy of the foreign banking capital allocation. On the one hand, the foreign investment inflow meets the needs of the domestic financial system development. It leads to the resource base extension, which is favorable for the social and economic development.

But at the same time there are serious financial and economic risks of a dynamic increase of the foreign capital share in the total banking capital. These risks are connected with the loss of the monetary sovereignty, the potential destabilization, fluctuations in bank liquidity, speculative changes in the money demand and supply, the possible financial resources' outflow. In this



sense, it is highly recommended taking into account foreign experience while developing the national strategy of the foreign capital allocation. The analysis of the banking integration experience of Western, Central and Eastern European countries gives the opportunity to substantiate the prospects of the integration of Ukraine into the world financial environment.

The analysis of the foreign banking capital impact on the host country shows its potential positive and negative aspects. The possible advantages of the foreign capital inflow are connected with the domestic financial sector development stage, its openness, the financial regulation system development level. The OECD countries' experience shows that foreign-owned banks intensify the competition at the domestic market (first of all, at the wholesale loan market). New financial instruments and banking products lead to the improvement of the market and existing services' efficiency. For instance, in the USA the competition of the foreign-owned banks caused a decrease in the interest margin, the appearance of new financial instruments (bank syndicated loans, fluctuating rate loans, forfeiting operations etc) [17, p.119].

This approach is extremely important because nowadays among three key goals of the monetary policy (efficiency, stability and depositors' interests' protection) the crucial role plays the maintenance of the high efficiency of the banking system on the basis of its modernization and the competition intensification. In such conditions the foreign capital allocation seems to be the essential elements of the state competitive policy.

In this light, it is important to improve the banking system efficiency, to intensify the banking lending and investment in the industrial and innovative sectors development. In its turn, these measures will allow to reinforce the position of Ukraine in the world economy internationalization process.

The global financial and economic crisis caused a sharp decrease in investment volumes, payment crisis, banking standards' violation in emerging markets. At the same time it revealed the drawbacks of the tax legislation, the payment system, the legislation instability. All these facts demonstrate the necessity of the banking system improvement. Recently some banks have not been able to independently fulfill their functions (lending, settlements, currency operations etc). In its turn, it impacts on the confidence in the banking system. One of the methods to restore the confidence is the capital adequacy that guarantees the safety of deposits.

Nowadays in emerging markets (in particular, in Ukraine) the banking system capitalization is an urgent measure. The banking regulation system improvement is a necessary measure to become an equal member of the European Community. But the regulation system improvement should be realized in accordance with the international standards, recently amended by the Basel Committee on banking supervision (Basel II). Moreover, to reinforce the depositors' confidence in the domestic banking system it is worth creating the conditions for the long-term investments. There are two methods to affect the domestic financial stability: the traditional bank lending channel and the direct banking capital channel.

Basel II gives the opportunity to improve the financial system stability in 6 directions: the risk management improvement, the prompt reaction to dynamic changes in the financial system, deepening of the international cooperation of the national banking supervision bodies, the financial stability test, the risk-oriented supervision and the transparency. In every country there was the independent system of the capital requirement regulation before the international standards were adopted by the Basel Committee on banking supervision. In some countries their own capital adequacy regulation system still dominates.

Merger or acquisition deal is the main mechanism of the capitalization abroad. This is an efficient method of the creation of the highly capitalized banking system in Ukraine. The total value of the M&A deals has reached \$4 trln. In Ukraine the value of the M&A deals accounted to more than \$5 bln (110 deals) [24].



In Ukraine the important conditions of the banking system capitalization are the economic environment improvement, the stability of money turnover, the consumer prices and money supply. To put into practice these priorities it is necessary to legalize shadow capital, to implement income tax benefits and long-term models of the annuity insurance, to improve the investment environment, to provide the conditions for the risk minimization and profit maximization in the banking system, to stimulate the long-term lending and to develop the insurance market.

The financial and economic crisis in Ukraine impacted on the monetary relations structure and led to the imbalance between the industrial and banking sectors. At the same time the prospects of the further economic development depend on the monetary and banking system balance, the financial market stability, the banking system ability to provide loan resources for the economy. The analysis of the aggregated impact of the monetary policy (conducted to provide the economic stability and positive structural changes) leads to the further structural balance deterioration. In fact, the main goal of the current financial stabilization policy is to reduce the inflation rate. But the term “financial stabilization” refers to more indicators and has more complicated structure. The key financial stabilization indicators are the inflation rate, the financial and banking system situation, the balanced budget, the domestic currency stability, the public debt level, money supply indicators, the payment system situation, the tax system efficiency etc. The inflation ratio decline, following the simultaneous deterioration of other stability indicators cannot be treated as the financial stability improvement.

In case of financial problems banking institutions take all the necessary measures of the financial stabilization. In such conditions banks have to restructure assets and liabilities to get rid of non-efficient operations, to limit non-operational expenditures to improve risk and liquidity management systems and to focus on the staff professional qualification. These measures are effective, but they cannot change negative trends, dominated in the banking system of Ukraine as a whole. Of late the trend of the banks’ financial situation deterioration has been appeared. This trend is connected with the payment crisis, changes in the monetary system and banks’ lending policy. According to the estimates of experts and the officials of the National Bank of Ukraine many banks are on the verge of bankruptcy in Ukraine.

In this light, the key problem is that it is necessary for the National Bank of Ukraine not only to permanently regulate the banking sector and to develop the program of the above-mentioned measures, but also to create the institutional provision (first of all, banking institutions). When the anti-inflation restrictive measures lead to the banking system stability deterioration, the National Bank of Ukraine should conduct the balanced monetary policy and take responsibility not only for the domestic currency revaluation, but also for the creation of the banking system stabilization conditions.

In this light, it’s worth mentioning that the financial crisis is the most favorable period to put into practice reforms as the economic entities realize the necessity of changes in the conditions of the turmoil. The crisis is not only the destruction. It contains the constructive potential, accelerates the economic development. Although, while treating the crisis as the positive phenomenon it is necessary to take into account the social aspect. The macroeconomic indicators increase due to shocks at the micro level, losses of some economic entities can’t be positive.

Majority of the scientists who stand on the favorable crisis impact on the national economic development, in general, ignore the fact that economic problems and difficulties firstly affect the most vulnerable low-income stratum of the society. The regulative anti-crisis measures are tighter regulation of the budget expenses and social project financing in particular, decrease budget deficit financing through borrowings, tax rates’ optimization, small business support, reinforcement of the economic entities’ legal responsibility for the tax legislation violation.

**Conclusions.** Nowadays the financial and banking system of Ukraine and the economic system as a whole, is in a crisis, resulted in the crucial budget deficit, an increase in the inflation rate, corporate payment defaults, a sharp domestic currency devaluation, the domestic and external debt. But the crisis has reincarnated market forces, meant to play a major role in the development of the financial and banking sector. The activity of market forces should be supplemented with new credible regulatory acts, and the financial liberalization policy followed by the effective monetary policy and the efficient management of systemic risks.

Today Ukraine requires the comprehensive program of the financial and banking system stabilization, closely connected with restructuring of the domestic economy and focused on the single nationwide market creation. To develop such a program it is necessary to coordinate the activity of the fiscal and budgetary and monetary institutions. However, to ensure the reality of funding, budgetary allocations should be indexed taking into account the inflation rate. The central budget, taking into consideration the crucial budget deficit, should finance the costs of national importance (social programs, state machine and military costs, public order etc.) and interregional programs.

These measures will be possible only if the general recovery of the banking and financial system are fulfilled, the real economy becomes the priority. But, unfortunately, there is a continuing capital outflow from the industrial sector and a decrease in investment volumes. This is reflected in the dynamics of real cash flows. Despite some formal re-monetization of the economy, the capital outflow from the industrial sector to the speculative market is going on.

The analysis shows that the situation in the financial and social sectors cannot be improved only by the budget limitations. To solve this problem it is necessary to allocate non-tax revenues, in particular through the domestic borrowing stimulation mechanism. One of the first priorities is the development of the domestic state securities' market. The tax reduction will boost incomes and savings of households and business entities that can be attracted to the budget through the financial market, and thus compensate the losses of tax revenue. The reduction and restructuring of budgetary expenditures are also highly recommended.

Thus, the financial stabilization and therefore the increase in the activity of the industrial sector largely depend on the degree of the banking system stability and require the development and the implementation of the complex program of the gradual stabilization of the monetary sector. In this sense, it is important to pay attention to the prevention of the bankruptcy of commercial banks through the reorganization and merger mechanisms. It is necessary to create a modern system of refinancing of commercial banks, the system of financial aid to the banks and restructuring of this sector. A special fund of the financial recovery of the banking institutions should be established at the expense of banks' reserve funds. It is also necessary to solve the problem of the optimal level of reserve requirements.

The priority of the economic strategy should be the elimination of discrepancies between trends in various areas of the monetary relations, and also disproportions between sectors of the Ukrainian economy. This is the contradiction between the needs of the industrial and financial sectors, the stability of the banking system and the conduction of the restrictive monetary policy.

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*Maksymova K.,\* Kayum J.\*\**

## THE GOVERNMENT INVESTMENT POLICY IN THE AGRICULTURAL SECTOR OF UKRAINE

**Resume** *In this article the main factors which influence the value of direct foreign investments and the role of the government in the field of the agrarian investments are investigated. In the result of our investigation we came to the conclusion that the government regulation of the agrarian investments in Ukraine should be based on the principles of active and passive regulation.*

**Keywords:** government investment policy, foreign direct investments (FDI), investment potential.

**Анотація** *В статті досліджені фактори, що впливають на обсяги прямих іноземних інвестицій, обґрунтована роль державної політики у сфері інвестування в аграрному секторі економіки. Зроблені висновки згідно яким в основу державного регулювання інвестиційної діяльності у сільському господарстві України мають бути покладені принципи активно-пасивного регулювання.*

**The relevance of research.** During 2008 and 2009 the tendencies of global economy development have changed. The world financial situation at that period was characterized by the deepening of the debt crisis.

The deficit of investment resources became one its consequences which tended the finding of the alternative ways of financing. Thus the further economic development of the country now requires the direct investments based on the investment potential.

**The recent developments.** The problems of the government regulation and pursuing the investment policy in the agrarian sector of Ukraine were discussed by many scientists and economists, such as Kirilenko I.G., Komarov V.A., Lanchenko E.O., Firsov E.A. and others.

**The subject of research.** Increasing the level of foreign direct investments is one of the ways of economic growth of agrarian enterprises. Nowadays there is a contradiction between the structural reconstruction of agrarian sector of economy with the help of investments and the low level of investments because of the high price for credit resources.

As a rule in the market economy the government plays a regulatory function. In realizing this function the investment policy formation should be among the major priorities of the government regulation in the world crisis context.

In the government investment research such methods as factor and investment analysis were used. The subject of studying is closely connected with the 'Mechanisms and instruments of Ukrainian internal and external economic policy regulation'.

**The aim of research.** The aim of the research is to prove that the agrarian enterprises need to be supported by the government and such support will increase the level of investments in the

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\* post-graduate finance and credit chair of SF "CATU" NUBNU

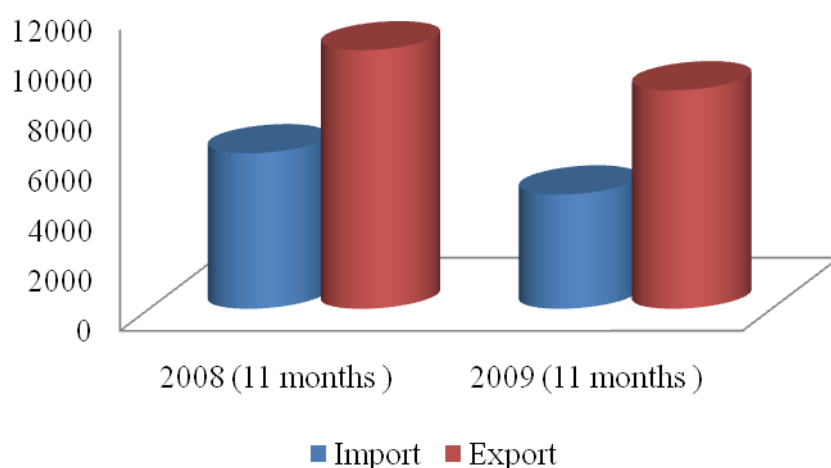
\*\* Phd. in economics, finance and credit chair of SF "CATU" NUBNU

agrarian sector. The aim of the research is reached with the help of solving its tasks. One of them is the analysis of economic situation in the agrarian sector of Ukraine. Another one is the analysis of the main external funds according to their resources.

At present the government of Ukraine has to consolidate its actions directed to the lessening of negative influence of the world financial crisis on the economy of the country particularly in the agrarian complex. The final aim of these actions is to maintain the living standards of population of the country.

Thanks to the policy pursued by the government the consequences of the financial crisis were minimized and the main macroeconomic indicators were positive. In 2009 export of agricultural products exceeded import (Diagram 1) in which meat and meat products prevailed. In the export of agricultural products wheat predominated.

As it is commonly known, the currency devaluation is one of the financial crisis consequences. Among the others export-oriented branches of the Ukrainian economy an agrarian sector benefits most of all from hryvnya devaluation. For example, the prices for wheat have been extremely high in the domestic market this year; on the contrary these prices have been decreased in the world market.



**Diagram 1** Foreign trade balance of agricultural products in 2008-2009 (mln. hrv.)

As a result incomes of many agrarian enterprises increased and the costs cut down. And the rise of their profits will stimulate the further growth of the agrarian industry. As the agrarian sector takes a small part in GDP (for about 7-8% in 2008-2009) and the harvest is not stable from year to year its development does not greatly affect the Ukrainian economy.

It is also necessary to point out that the agrarian complex plays the significant role in the economy of Ukraine, as it is well known that the agrarian sector is one of the leading branches in the economy of the state. The geographical position of Ukraine, its soil and climatic conditions, resources and historical background define the industrial and agrarian tendencies of its further economic development [3]. Analyzing the ways of external financing of Ukraine it is possible to distinguish the most popular of them: bank loans, government support and investments.

1. Since it is commonly known the bank loans are the easiest and the most frequently used way of getting the external funds in the countries with the highly developed system of financial intermediaries. Financial intermediaries play a key role in improving economic efficiency because they help financial markets channel funds from lender-savers to people with productive investment opportunities.



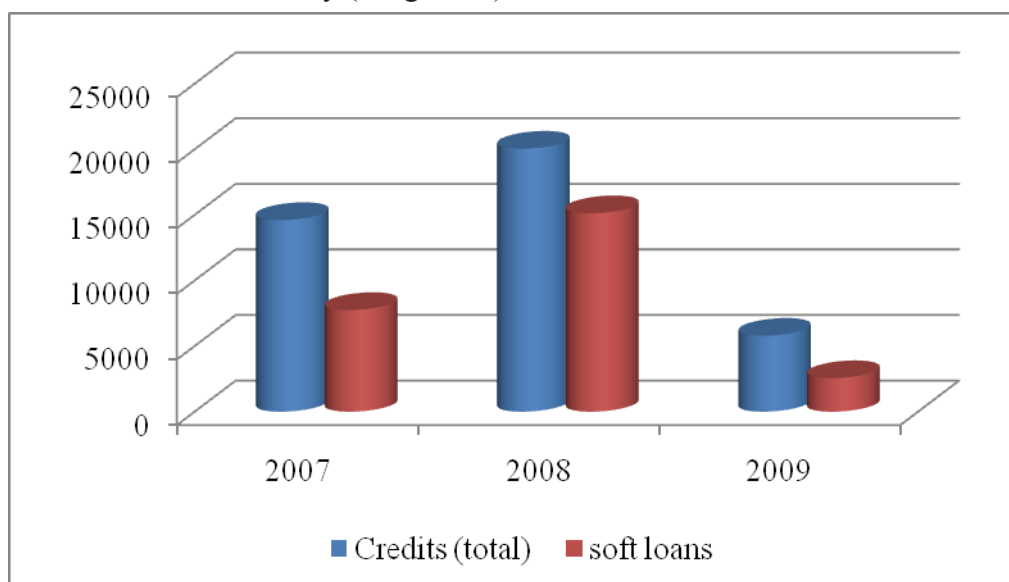
Without a well-functioning set of financial intermediaries it is very hard for an economy to reach its full potential. As to Ukraine this source of financing is too expensive because of the high level of inflation. The main reason of low economic effectiveness of this kind of financing is the high payment on the bank credits and the absence of reasonable guarantees.

**Table 1** Agricultural enterprises credits in 2008-2009

Indicators	2008		2009	
	mln. hrv.	%	mln. hrv.	%
Credits (total)	20053	100	5792	100
short-term credits	10300	51,4	4100	70,8
intermediate-term credits	6540	32,6	1150	19,9
long-term credits	3213	16	542	9,3

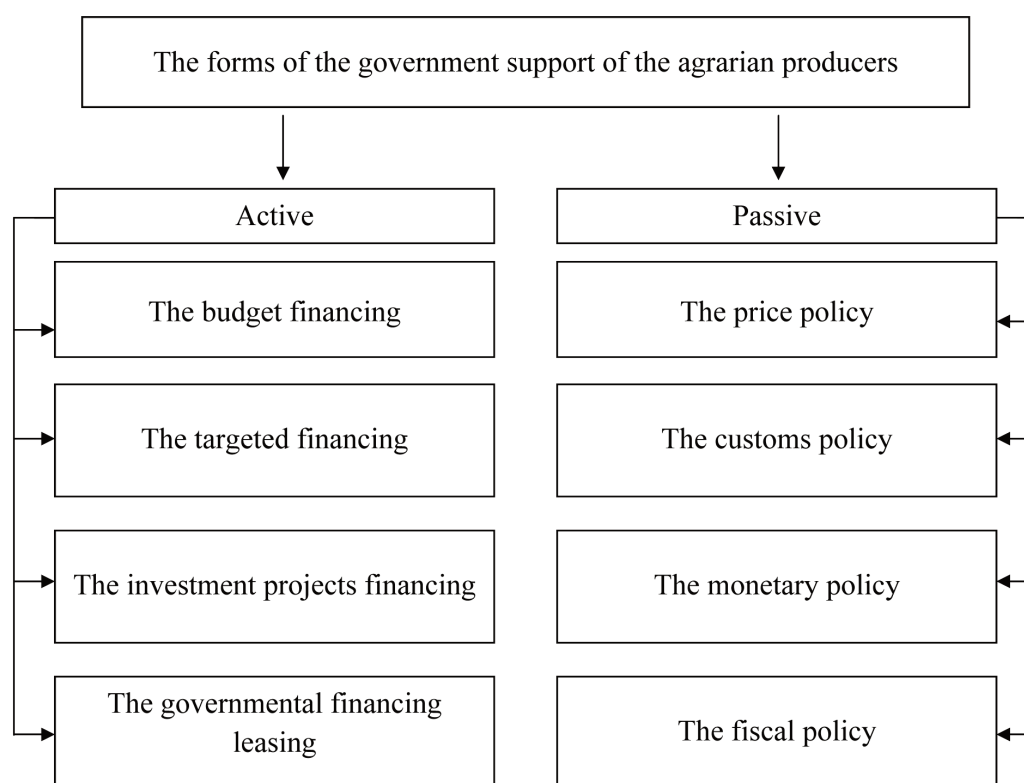
Loan funds are used by agricultural enterprises to cover outgoings and to purchase fixed agricultural assets including machinery for building and reconstruction of agricultural industrial facilities and acquirement of equipment for agricultural product processing. Agricultural enterprises obtained short-term loans - up to one year and intermediate-term loans - up to three years. In 2009 the credits given to the agricultural enterprises amounted to 5,8 bln. hrv., which made up 29 % compared to 2008: short-term credits – 4,1 bln. hrv., intermediate-term credits – 1, 15 bln. hrv., long-term credits – 55,7 mln. hrv. (Table 1)

Assistance in attracting of credit resources in agricultural sector plays an important role among the measures of state support. Nowadays soft loans account more than a half in total lending of this branch of economy (Diagram 2).



**Diagram 2** Agricultural enterprises credits in 2007-2009 (mln. hrv.)

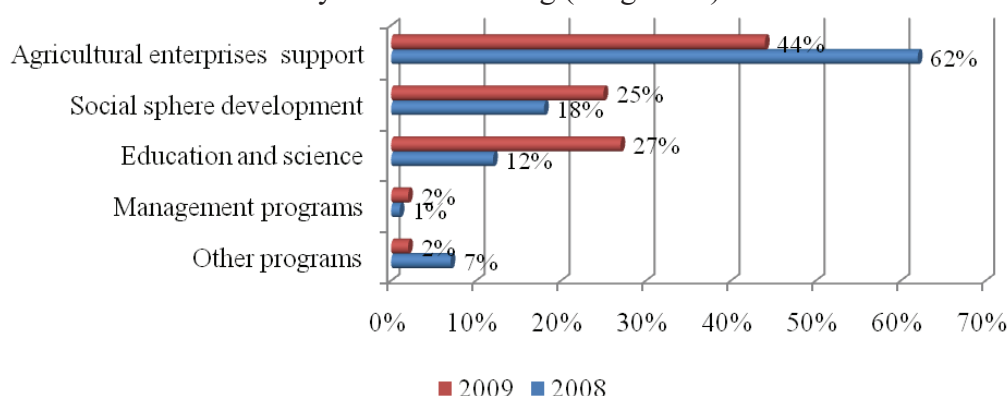
2. The government support is carried out with the help of investment policy which is considered as a complex of financial, legal and economic measures. The development or decline of the investment process is reached with the help of these measures. The forms of the government investment policy fall into two groups: active and passive regulation (Figure). The legal and economic measures belong to the passive investment policy when the government does not influence the investment process directly. The financial measures belong to the active investment policy when the government takes part in the investment process directly [4].



**Figure.** The forms of the government support of the agrarian producers

The important role in the organization of the investment process of the agrarian enterprises belongs to the state. The support of the government in the countries with market economy plays a regulatory function. The formation of the investment policy as a rule takes important place among the major priorities of the government regulation. With this in mind the government of Ukraine should intensify the investment support and regulation now in the terms of the world crisis.

Due to the government support to agrarian and industrial complex the total amount of state grants increased during 2006-2009 in Ukraine. In 2008 the volume of state grants exceeded 2 billion 921 mln. hrv., which is 500 mln. hrv. more compared to 2007 and 1 billion hrv. more compared to 2006. The volume of state grants accounted 441 mln. hrv. in 2009. For example, the European Union allocated for development of agriculture of France over 10 billion euro in 2008. Analyzing the structure of government budget costs in recent years it is possible to make a conclusion that the programs of financial support of stock-breeding and plant-growing predominated but there is a tendency of their reducing (Diagram 3).



**Diagram 3** Structure of budget costs of the Ministry of Agriculture of Ukraine in 2008-2009

Aimed at accelerated upgrading of machinery and tractor stock of agricultural commodity producers, the state finances the program to acquire the national agricultural machinery and equipment upon financial leasing terms and partially reimburses for the value of sophisticated agricultural machinery produced domestically. The national joint stock company "UKRA-GROLEASING" supplies the equipment/machinery on financial leasing terms and conditions.

Benefits of financial leasing include:

- 3,1% annual interest for the term of 3-7 years with 15% of the full value advance payment;
- annual interest rate is lower than on commercial credits;
- the pledge amount is considerably less compared to commercial banks;
- greater possibilities in using working capital;
- constant terms and conditions.

3. Investments including foreign investments are another way of getting the external funds. As a rule foreign investments are divided into two groups according to their forms: foreign direct investments and portfolio investing. As the financial market in Ukraine is not developed yet the foreign direct investments dominate in the structure of foreign investments.

According to foreign investors foreign investments are classified as:

- the governmental foreign investments;
- the investments of the international financial organizations;
- the private foreign investments.

The rise of the level of foreign direct investments is one of the traditional ways of economic growth of enterprises. It is important to notice that the private foreign investors in Ukraine are not active now, because of the low investment rating of the country. Thus the foreign direct investments are mainly provided by the international financial organizations, such as the European Bank of Reconstruction and Development and the Ukraine-Germany Fund.

The main investors of agrarian and industrial complex of Ukraine are: Cyprus (162,3 mln. dollars of the USA); Great Britain (74,2 mln. dollars of the USA); the USA (46,1 mln. dollars of the USA); Germany (34,6 mln. dollars of the USA); Denmark (32,6 mln. dollars of the USA); France (21,5 mln. dollars of the USA); the Russian Federation (20,5 mln. dollars of the USA).

The factors that influence the foreign direct investments are the following (Table 2):

**Table 2** Structure of factors that influence foreign investments

	<b>Internal factors</b>	<b>External factors</b>
<b>Inversely proportional quantities</b>	1. Expected level of inflation 2. The interest rate on commercial bank loans 3. The presence of large organizational formations	1. The volume of import 2. The LIBOR rate
<b>Directly proportional quantities</b>	1. The volumes of internal consumption 2. The level of inner investments 3. The labour productivity	1. The government support of foreign investments 2. The development of the agrarian market and the level of competition

1. Expected level of inflation. It is considered that inflation rate and the direct foreign investing are inversely proportional quantities, as the higher level of inflation, the greater degree of the future income will devalue. Therefore, the investors will have less stimuli to increase the volumes of their investments.

In August 2009 compared to July 2009 a consumer price index in Ukraine was 99,8%. In August 2009 compared to August 2008 consumer prices in Ukraine grew by 15,3%, as to the report of the State Statistics Committee. From the beginning of the year (August 2009 compared to December 2008) there was an increase in consumer prices in Ukraine by 8,2% . In January-August 2009 compared to January-August 2008 consumer prices in the country grew by 17,1% [8].

2. The interest rate on commercial bank loans. The wide range of interest rates in different countries is the reason of international flow of capitals, above all things in the form of portfolio investing. In 2009 annual interest rates in national currency diminished from 21,6% to 17,8% and in foreign currency it diminished from 12,6% to 10,1%. The credits given to the firms and companies grew by 3,9%, in 2009 as to the householders they reduced by 10,1% [5].

3. The presence of large organizational formations. For example, international investors support the creation of organizations in the form of the cooperatives in the countryside. The World Bank (WB) within the framework of the program on preparation of Poland to the entry to the EU halted financing of the projects related to the direct support of the separate agrarian firms. The WB gave the advantage of indirect support through the grants of investment credits for the development of agricultural regions as a whole and to introduction of the new technologies of production and realization of the programs of consolidation of the agrarian firms which were directed to the increase of the labour productivity.

4. The volumes of internal consumption. The majority of foreign investments are connected with industries which produce goods and services for an internal end consumption. The investors have to correct the volumes of investments taking into account the predictions of sale of goods which are planned to produce in Ukraine.

Thus, it is expedient to use the indexes of private consumption, because the foreign investors mainly orient to the industries which produce goods for private consumers (for example, food industry) [7]. Statistical data testify that the lowering of the level of private consumption in the second quarter of 2009 remained at the same level as in the first quarter of 2009, i.e. 11,6%.

5. The level of inner investments. It is considered that the volumes of the inner investing often serve for the foreign investors as an indicator of attractiveness of certain branches of economy and country as a whole. The increase of these investments testifies the growth of business activity and the willing of inner investors to expand the production. The main disadvantage of the investment climate for national investors is the low level of inner capital investments. It is generally known that the foreign investors will not inlay money in a country with such level of inner investing. In the second quarter of 2009 the decrease of investments in the fixed assets deepened by 57,8% [8].

In contrary the expulping of the foreign investments by inner investments is also possible as the participants of investment activity apply to the foreign investors because of the shortage of national savings. For example, as it was noted [2] bringing in and using foreign investments, including foreign direct investments are closely connected with the lack of financial resources.

6. The labour productivity. Even in the years of bloom of the collectivization of the agrarian sector of Ukraine, as a former republic of the Soviet Union, the labour productivity was seven times less than in agriculture of France, five times less than in Germany and ten times less than in Holland and the USA. Thus the contradiction between necessity of the investments for an update and retooling of material and technical base of production and investment opportunities is created. It is important to have the sufficient rate of return which is hardly to get because of the low efficiency of the use of available material and technical resources.

7. The volume of import. The export and investing are considered to be the alternative ways of cash flows abroad provided by the multinational companies. Therefore the volumes of foreign investments and import are defined as the inversely proportional quantities.

By the second quarter of 2009 the role of net export in the economy of the country became perfectly obvious. According to statistic data the adaptation of the current account transactions to the world prices has already taken place. For eight months of 2009 the current account deficit amounted 1,1 milliards of dollars, that is 7 milliards of dollars less than the sum of the current account in the same period of 2008 [8].

8. The LIBOR rate. It is well known that there is a reverse connection between the interest rate and the level of investments as an increase of interest rate reduces the rate of return of the investment project. Consequently, the LIBOR rate can be used as an indicator of the alternative cost for foreign investments. The LIBOR rate is closely connected with the deposit rate. The first one is possible to use for the correlation and regressive analysis.

9. The government support of foreign investments. The credit, price, fiscal, customs and insurance policies pursued by the government to stimulate the production of agrarian goods and the agrarian market development should be based on the new principles. To increase the investment rating of Ukraine and its investment potential two programs were worked out: "Programs of development of the investment activity for 2002-2010" and "The investment image of Ukraine".

10. The development of the agrarian market and the level of competition. According to statistic data the total volume of production of agricultural products in January-July 2009 compared to the same period of 2008 grew by 3,8%. In July 2009 compared to June the average prices for agricultural products decreased by 6%, the products of plant-growing dropped by 7%, the products of stock-breeding decreased by 3% [8].

Ukraine undertakes the measures to form agrarian market and develop its infrastructure. The infrastructure framework includes commodity exchanges, rural purchasing centers, urban wholesale and retail markets, cattle auctions, informational and marketing network, state monitoring system.

There are prior directions of investments in Ukraine supported by the government:

- Putting into operation of livestock buildings;
- Construction of storage facilities for fruits and vegetables;
- Construction of greenhouses for growing under cover;
- Construction of mixed feed, hay and silage structures;
- Land remediation.

Summarizing the main ideas mentioned above it is important to point out that the principles of active and passive government regulation are key elements of the government investment strategy in the agrarian sector of Ukraine. Therefore the government of Ukraine should support the development of the agrarian enterprises on this stage of economic growth.

The most of the Ukrainian scientists consider the formation of a favorable investment climate in Ukraine to be the main task of foreign direct investment strategy. According to the economists' point of view there are different ways of pursuing the investment policy. Among them are:

1. the financial governmental support of the agrarian and industry complex;
2. the price and monopoly state control;
3. the development of the agrarian market infrastructure;
4. the further development of the new forms of credit relationships, including forfaiting, factoring, discounting, and etc.



Conclusions. Finally it is possible to make a conclusion that the world economic crisis led to the negative tendencies in economy, especially in agriculture. As to the policymakers' opinion agriculture may become the leading branch of economy and stabilize the economic situation in the country in the context of the world economic crisis. There is no 'correct' strategy for economic development. Each country confronts a unique set of barriers and growth possibilities. The matter of great importance for Ukraine is to find its own way of economic development with the elements of both the market and former command economies taking into account the experience of the most competitive countries.

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*Radziievska S.\**

## WORLD FINANCIAL CRISIS AND COMPETITIVENESS OF UKRAINE

*The article focuses on the causes of spread of the world financial crisis on the economy of Ukraine, on the suggestions of overcoming it, as well as on enhancing competitiveness of the national economy in the context of the country's integration within the world economy.*

*Стаття посвящена виясненню причин розповсюдження мирового фінансового кризиса на економіку України и внесенню пропозицій, направлених на его преодоление, а также на повышение конкурентоспособности национальной экономики в контексте ее интеграции в мировое хозяйство.*

*Статтю присвячено виявленню причин розповсюдження світової фінансової кризи на економіку України та внесенню пропозицій, спрямованих на її подолання, а також на підвищення конкурентоспроможності національної економіки в контексті інтеграції України до світового господарства.*

**Key words:** foreign trade balance, world price, hryvnia exchange rate, competitiveness of the national economy, international economic integration, price competition.

The objective of the article is to analyze the causes of spread of the world financial crisis on the economy of Ukraine, to come up with suggestions of overcoming it, as well as to emphasize the importance of enhancing competitiveness of the national economy in the context of the country's integration within the world economic environment.

The current research is based on the method of experts' evaluation, systematic approach, and statistical analysis.

It is certainly true that the crisis has been the matter of research in the economic studies for many years. The scientists give qualitative and quantitative evaluation of possible direct and indirect causes of crises emergence in specific cases, show links between currency crises and other types of economic crises, study the effect of internal and external economic and political factors (O.Chugaev), reveal informative function of a crisis and its constructive role in the social processes innovation and intensification (A.Galchynsky).

Since the first world crisis of 1857 there have occurred about twenty world crises [16, p. 5]. Like previous ones, the current crisis follows the classical sequence of expansion, euphoria, financial distress and panic [25, p. III]. However, the recent world financial crisis is unprecedented in depth and breadth, with virtually no economy left unscathed.

Among the specific elements which have influenced the financial crisis scientists underlie first of all a global imbalance, in particular the fact that the global supply exceeds global demand [23, p. 6].

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\* Postgraduate student of the Department of World Economy and International Economic Relations of the National Transport University

The crisis started in the USA, and is still hitting world's major economies [6, p. 14], as well as the economy of our country. In the course of the crisis, even economies that were expected to grow, such as those of China and India, are still slowing down significantly compared to previous years.

Moreover, the crisis spread quickly, infecting the entire United States financial system, as well as the financial markets of other developed and emerging-market economies, including Ukraine, currency markets and primary commodity markets. Thus, it is considered by many prominent Ukrainian economists to be the worst and the most wide-spread one [1, p. 119].

Since Ukraine is integrated into the world economy, it could not avoid the impact of the crisis. There is even some logic behind the relation between the level of integration of the national economy into the world economy and the degree of exposure to the risks of being under the influence of the crisis. So, in the era of globalization the task for each nation is to enhance the country's competitiveness by choosing the right integration path and minimizing the impact of the world crises on the national economy. This crisis hit Ukraine hard and fast due to Ukraine's reliance on capital inflows, especially foreign direct investments and trade flows, in particular the export of steel and chemicals, as well as government debt, foreign assets in banking system.

Thus, the nature and the scope of this problem, having become especially popular lately, is of high importance.

Different kinds of financial shocks have had varying impacts on diverse economies. In the first quarter of 2009 gross fixed capital formation and manufacturing output in most of the world's major economies fell at double digit rates. Meanwhile, problems with solvency in the non-financial sector in many countries fed back into the financial system.

Most scientific research suggests that it affected strongly companies, incomes, and employment in the financial sector itself, as well as the construction, capital goods and durable consumer goods industries where demand depends largely on credit.

It seems logical to touch upon seven practical lessons for regulators mentioned in UN Trade and Development Report 2009, some of which could be relevant to the current research [25, p. 105-106]. Firstly, the financial efficiency should be defined as the sector's ability to stimulate long-term economic growth, while transaction costs, the number of available instruments, or the overall size of the financial system are relevant if they contribute to increasing social welfare. Secondly, regulatory arbitrage can only be avoided if regulators are able to cover the whole financial system and ensure that all financial transactions are overseen on the basis of the risks they produce. Thirdly, it is necessary to complement micro-prudential regulation with macro-prudential policies aimed at smoothing the leverage cycle which is explained by the fact that regulation is necessary because markets sometimes do not work. The forth lesson relates to the incentive structure within the financial industry. Compensation schemes within the financial industry promote excessive risk-taking and the incentives of credit rating agencies are misaligned and lead to rating inflation which can be attenuated by designing remuneration structures that do not focus on annual returns but on returns over a long term. The fifth lesson specifically relates to developing countries, which can increase their resilience to external shocks by maintaining a competitive exchange rate, limiting currency and maturity mismatches in both private and public balance sheets and having contingency plans to be implemented when all else fails. According to the sixth lesson, larger financial systems have a greater need for financial regulation. The seventh lesson relates to the need for international coordination. Regulators based in different countries should share information, aim at setting similar standards, and avoid a race to the bottom in financial regulation. However, it would be a mistake to impose a common regulatory standard. There is no single regulatory system that is right for all countries. Countries

with different levels of development, regulatory capacity and history need to adopt different regulatory approaches.

It is sufficient to state that competitive strength of the national economy experienced drastic challenges since Ukrainian goods and services failed to compete successfully in world markets. Indeed, competitiveness of the national economy is viewed as the ability of a nation's producers to compete successfully in world markets and with imports in their own domestic markets; competitive markets are the best way yet found for efficiently organizing the production and distribution of goods and services. The world financial crisis resulted in fewer opportunities for selling Ukrainian goods and services in world markets, in general fall in prices, and in overall drop of the country's well-being. Consequently, the current crisis has had a negative impact on the competitiveness of Ukraine.

For our purposes, let us mention that export value has been declining in Ukraine, the Russian Federation and Kazakhstan due to lower prices and, in general, also smaller volumes. As international investors and lenders turned away in the search for reduced risk exposure, capital outflows and currency depreciations revealed the vulnerability of the banking sector. Tightening credit and deteriorating employment conditions caused a fall in domestic investment and consumption just when foreign demand also receded. In the first few months of 2009, year-on-year industrial output dropped in the Russian Federation and Ukraine by about 20 and 30 per cent respectively. The Governments of the Russian Federation and Kazakhstan launched sizeable stimulus plans, using financial reserves accumulated from the high oil revenues of the past few years [25, p. 5].

The main channels through which the crisis influenced the national economy were foreign trade and financial outflows. Firstly, there occurred a sharp fall in private capital inflows. Secondly, FDI inflows declined which reflected a generally lower propensity to invest in real productive capacity, owing to shrinking final demand, tightening credit conditions and falling corporate profits.

However, before the crisis, Ukraine had seen enormous gross and net inflows of capital, largely attracted by interest rate differentials. Such inflows led to loss of international competitiveness of our domestic producers. This resulted in extreme financial fragility, with mounting domestic and external indebtedness, and currency mismatches between debt and income. When the external shock from the subprime crisis hit the global economy the flight from risk stopped short-term private capital inflows and forced currency devaluation with huge current-account deficits and debt commitments.

Concurrently with the reduction of foreign currency inflow (mostly in U.S.dollars since more than 70% of current accounts of the balance of payment in foreign currency are settled in USD) there occurred the outflow of the foreign capital [19, p. 59] which resulted into the sharp decline in the exchange rate of Ukraine's monetary unit and ultimately increased the price competitiveness of Ukrainian export.

In our view, among the crisis causes resulting in the profound effect on Ukraine's economy were the following.

Firstly, one of the main reasons of spread of the world financial crisis on the economy of Ukraine is a considerable negative foreign trade balance of goods and services. It has been negative since 2006 which is shown on table 1.

**Table 1.** Dynamics of foreign trade balance of Ukraine, in USD billions

Years	2001	2002	2003	2004	2005	2006	2007	2008	2009
Balance	2,88	3,84	2,84	6,92	1,29	-2,88	-7,26	-13,31	-1,38

Source: Зовнішня торгівля України товарами і послугами. Т.1: стат. зб. / Держкомстат України, 2009. – С. 17; Стан зовнішньоторговельного балансу України за 2009 рік. Експрес-випуск / Держкомстат України. 15.03.2010. № 521.

Secondly, a considerable gross external debt (as of October 1, 2009 it was equal to USD104,4 billion) [19, p. 79].

Thirdly, a high level of dollarization of the national economy.

Fourthly, the predominance of goods with insignificant amount of added value in export (mostly metallurgy products, demand for which decreased because of shrinkage in building, construction, engineering, and fall in the production of machinery in the developed countries).

As a result, the world prices for metallurgy products dropped. Thus, from June to December of 2008 the world price for carbon steel fell from USD1160 to USD 676 per ton, while on the EU market it was nearly 2 times down (from USD1344 to USD619), and in Asia – 1.5 times down (from USD913 to USD619) [6, p. 17, 32].

Consequently, Ukrainian metal products due to its high cost price failed to meet price competition and lost significant part of its foreign market.

Thus, out of the three strategies suggested by M.Porter in his classical Competitive Strategy: Techniques for Analysing Industries and Competitors, namely generic strategies of cost leadership, product differentiation, and focus or strategic scope, the price competition strategy (sometimes also called cost leadership strategy), which is the most widely used in Ukraine, seems to be the least effective one for improving the competitiveness of the national economy.

Cost leadership strategy, adopted by Ukraine, involves winning the market share by appealing to cost-conscious or price-sensitive customers which is achieved by having the lowest prices in the target market segment, or at least the lowest price to value ratio. However, this strategy doesn't stimulate entrepreneurial activity, scientific and technological innovation.

In other words, to succeed at offering the lowest price while still achieving profitability and return on investment, our economy operates taking advantage of cheap labor cost, paying low wages to high skilled employees, paying low price for raw materials, enjoying low quota of depreciation in production costs in comparison to those of the rivals. While maintaining this strategy, Ukraine is in constant search for cost reductions in all aspects of the business, which includes controlling production costs, increasing asset capacity utilization, as well as minimizing the other costs including distribution, research and development. Use of this strategy means that Ukraine will fall far behind its competitors in the long run since technological setup plays the key role in enhancing the competitiveness. Ukraine's economy should choose a differentiation strategy which is more likely to generate higher profits than is a low cost strategy because differentiation creates a better entry barrier. Differentiation primarily impacts performance through reducing directness of competition: As the product becomes more different, categorization becomes more difficult and hence draws fewer comparisons with its competition. A successful product differentiation strategy will move goods from competing based primarily on price to competing on non-price factors, such as product characteristics, distribution strategy, promotional variables.

Before turning to the central claims that will be made, it is necessary to add that the low level of technological processing, deficiency and/or inadequacy of modern technologies and relatively standard technological processes result in the final products being the same quality as those of the competitors. With these points in mind, it is necessary to mention that along the technological factors (designing, planning, advertising, production, selling, delivery, services, etc.) there are such significant factors as the world prices, tariff and nontariff instruments, the mechanism of the formation of the exchange rate, etc. that also contribute to shaping the final cost.

For Ukraine, metallurgy is the main export article. Unfortunately, metallurgy market development forecast is not very promising. It is important to note that the similar products of



competitors are considered to be of better quality, and are of higher competitiveness despite the price advantages of Ukrainian metal products [15, p. 30]. Meanwhile, the export of goods in 2009 is equal to 59,3% of 2008, and the import is 53,1% in comparison to the previous year [7]. The figures show the effect of the world financial crisis on the national economy.

At present, the global market for high technology goods is clearly dominated by developed countries, and Ukraine should account for an increasing share of this market by using possibilities to exploit natural comparative advantages and taking opportunities to build new dynamic comparative advantages. According to V. Novitsky, potential for expanding the volume and structural optimization of the mechanism of international economic activity could be better implemented at the technological, industrial, export policy, assuming full development of the sectors, whose level of development provides competitive advantages of Ukraine. These areas primarily are rocket-space industry, aircraft construction, shipbuilding, separate lines of machine building, production of energy equipment, nonferrous metallurgy, chemical industry, introduction of advanced biotechnology, new technologies in areas of electric, telecommunication, radio electronics, cryogenics, nuclear physics.

Furthermore, there is considerable scope for our country in the years and decades ahead to gain from the opportunities that will emerge from the structural change towards renewable sources of energy, climate-friendly technologies, low-carbon equipment and appliances and more sustainable modes of consumption.

The best and soonest way out of crisis for Ukraine is to improve quality competitive advantages, to increase the percentage of products with considerable amount of added value in its export, price, and demand for which have the tendency to grow. Fall in hryvnia exchange rate as the instrument for increasing the competitiveness of Ukrainian products worsens the terms of trade and affects national income [18, p. 63].

That is why the vector of integration of Ukraine should be directed towards the countries and regional blocks in cooperation with which our national economy could obtain new competitive advantages that would enable the country to meet technological requirements and to export advanced technology products.

Ukraine takes part in the development of regional integration processes with the countries of the European Union (EU), the Common Economic Space (CES), the Black Sea Economic Cooperation (BSEC) and the Organization for Democracy and Economic Development – GUAM (GUAM).

Let us analyze how Ukraine's external economic relations with the countries belonging to those international integration organizations influence the competitiveness of the national economy.

The EU countries are the consumers of a considerable part of Ukrainian export of goods, and their products constitute an essential part of Ukrainian import (tabl 2)

**Table 2.** Unit weight of export and import of goods of Ukraine to/from the EU countries of all its export and import of goods, %

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Export	33,9	35,5	37,7	33,7	29,9	31,5	28,2	27	23,9
Import	30,1	32,4	34,2	32,9	33,7	36	36,7	33,8	33,9

Source: calculations of the author are based on 1) Географічна структура експорту-імпорту товарів. Держкомстат України, 1998–2009. Дата останньої модифікації: 2/06/2009. [Електронний ресурс]. – Режим доступу [http://www.ukrstat.gov.ua/operativ/operativ2005/zd\\_rik/zd\\_u/gsp\\_u.html](http://www.ukrstat.gov.ua/operativ/operativ2005/zd_rik/zd_u/gsp_u.html); and 2) Стан зовнішньоторговельного балансу України за 2009 рік. Експрес-випуск / Держкомстат України. 15.03.2010. № 52.

As it is shown on the table, the unit weight of export of goods of Ukraine to the EU countries in all Ukrainian export had been increasing till 2004, while it fell in the year 2004, and in particular it dropped in 2005, and then in 2006 the unit weight of export of goods of Ukraine to the EU countries rose again, but not to the level of 2003, in 2007 and 2008 it fell again.

Unit weight of import of goods of Ukraine from the EU countries in all Ukrainian import actually had been increasing, except 2004, and only in 2008 it dropped.

Thus, external economic relations with the European Union are gradually improving due to import which plays the key role in stimulating the development of integration processes. At the same time this share in comparison with the overall import of Ukraine remains negligible: in 2005 it was equal to only 1,2% in all the EU import and 0,6% in all export [17]. So, it is evident that there is a necessity for working on this disbalance, for enhancing the competitiveness of Ukrainian goods and services on the EU market, for improving the structure of trade and for using the markets of new EU member-states in order to push Ukrainian products onto them.

Export of Ukraine to the EU countries consists mainly of ferrous metals, ore, energy materials, oil and oil refining products, scorias and ashes, textile goods, wood and wooden products, ferrous metals products – raw materials and capital-intensive products of heavy industry with insignificant part of added value. The prices for goods that dominate in the export structure of Ukraine to the EU countries can be characterized as unstable. While selling those goods, especially ferrous metals products and metal-working products, the level of competition has the tendency to increase due to the existence of EU firms on these markets which are becoming strong rivals to our enterprises.

The competition is going to be even tougher since the new countries where advanced technology manufactures, enterprises, firms produce the same goods are going to enter the market in the near future. Nowadays competitive advantages of Ukraine on those markets are provided by the low domestic prices for the factors of production – low level of wages, which contributes to the low level of price for iron ore, coal, electric power, considerably lower price for gas in comparison with the world price, not sufficient level of expenses for updating and modernization of capital assets, state subsidies. Increased The price for the gas imported from the Russian Federation has been raised after Ukraine's joining the WTO. Necessity for wage rise results in losing some of the competitive advantages. It is also important to note that one of the competitive advantages was the low exchange rate of the national currency, which was considered by many scientists to be understated [2, p. 201; 13, p. 81]. Exchange rate appreciation of the national currency could lead to the loss of this competitive advantage. Exchange rate depreciation resulting from the world financial crisis improved this competitive advantage, but its temporary character would hopefully mean the stabilization of the exchange rate and consequently strengthening of the national economy. It is easy to arrive at the conclusion that the commodity structure of Ukraine's export to the EU countries requires trenchant step in the direction of increasing the volume of products with a considerable amount of added value.

The EU enterprises can not be considered as active consumers of Ukrainian innovative products. Electrical machines and equipment may serve as an exception since the unit weight in all export to the EU is increasing lately. In 2009 the unit weight was 10,8% [20]. In 2007–2008 there occurred considerable growth in export of aeronautical or space apparatuses. It proves that there are positive changes in export of Ukraine to the EU countries which forms new competitive advantages.

In import of Ukraine to the EU countries ground transport vehicles, barrels, machinery and equipment, electrical machines, polymer materials and plastic dominate. In 2007–2008 there occurred a sharp increase in the import from the EU countries of aeronautical or space apparatuses. So, most products that are imported from those countries have considerable amount of

added value which contributes to the higher technological level of production in Ukraine and leads to obtaining new competitive advantages by the national economy.

Trade in services plays important role in modern development of the world market since in the developed economies unit weight of export and import of services in trade exceeds that of goods.

The significant part of services that Ukraine gives to the EU countries, constitute transportation services, which is explained by the movement of goods from the East to the West. It is important to keep those competitive advantages of Ukraine, as well as to provide the same services for goods transported from the West to the East and the South thus acquiring new competitive advantages. In order to increase the unit weight of financial, computer services and the other intellectual services in the export to the EU countries it is essential to form new competitive advantages by introducing modern information, communication, and financial technologies, as well as to provide the conditions for their active entry into the European technological, communication, and financial spaces.

The EU countries as of January 1, 2010 placed in Ukraine 31,4 billions USD in FDI, which is 78,3% of all FDI placed in the national economy [20]. This way the EU countries contribute to obtaining of new competitive advantages by Ukraine. At the same time it should be mentioned that the use of FDI requires improvement by investing more funds in machine-building, and in particular in innovation activity of Ukrainian enterprises.

Thus, the development of external economic relations between Ukraine and the EU countries is contributing to obtaining of new competitive advantages by our economy, but the realization of those advantages is taking place mostly not on the EU countries markets but on the markets of other countries, e.g. the CES countries.

The CES countries are the consumers of a considerable part of Ukrainian export of goods, and their products constitute an essential part of Ukrainian import (tabl 3).

**Table 3.** Unit weight of export and import of goods of Ukraine to/from the CES countries of all its export and import of goods, %

	2001	2002	2003	2004	2005	2006	2007	2008	2009
Export	24,8	20,3	21,5	21,6	26,4	27,9	31,8	26,6	28,1
Import	43,7	41	41,2	45,1	38,7	35,5	32,9	29,6	37,3

Source: calculations of the author are based on 1) Зовнішня торгівля України за 2001 рік, т. 1: стат. зб. / Держкомстат України. К., 2002. – 146 с.; 2) Зовнішня торгівля України за 2002–2007 роки: стат. зб. / Держкомстат України. – К., 2008. – 108 с.; 3) Зовнішня торгівля України товарами за 2009 рік. Експрес-випуск / Держкомстат України. 15.02.2010. – № 27.; 4) Зовнішня торгівля України товарами та послугами у 2008 році, т. 1: стат. зб. / Держкомстат України. – К., 2009. – 168 с.

The development of external relations with the CES countries, in particular with the Russian Federation, provides Ukraine with energy carriers. Russia buys the products of Ukraine's manufacturing industry, and what is the most important in view of transition of the national economy to the innovative model of development, the machine-building products. Ukraine's export to those three countries is formed by ferrous metals and products made from them. The strong and positive point is that there is a stable demand on the markets of those countries for the products of machine-building industry.

In general, the CES countries are the main consumers of Ukraine's machine-building industry. In 2008 the countries imported 67,7% of Ukraine's export of barrels, machines, apparatuses, and mechanical devices; 44,6 – electrical machines and equipment; 89,2 – railway or tram

locomotives, road equipment; 78,6 – ground transportation vehicles, except railway, 36,1% – aeronautical or space apparatuses.

Thus, in external relations between Ukraine and the CES countries the competitive advantages obtained during the previous years may be realized, due to similarity in production, technical, and technological bases, stability of the existing connections, as well as the opportunity of renewing the lost production and technical connections, nearly the same qualification and education level of the workforce, the low level of wages, the developed transport infrastructure. In export to the CES countries, Ukraine could also realize the competitive advantages which are provided by the import of modern technologies and equipment from the EU countries.

At the same time, it should be noted that there are opportunities for obtaining new competitive advantages in cooperation with the CES countries, first of all, with the Russian Federation, in high technology industries, e.g. aerospace industry. There exists a need to streamline the task of creating the true conditions for realization of macrotechnology "Ukraine – a high technological, aerospace state" before 2010-2015, which could be implemented in cooperation with the Russian Federation. In support of this statement let us analyze table 4.

**Table 4.** Export and import of aeronautical or space apparatuses of Ukraine to/from Russia, in USD millions

	2001	2002	2003	2004	2005	2006	2007	2008
Export	29,7	22,6	48	21	11,3	83,8	37,3	79,3
Import	26,9	13,5	10,6	22,5	9,4	22,6	12-июл	14,9

Source: calculations of the author are based on 1) Зовнішня торгівля України за 2002 рік, т. 2: стат. зб. / Держкомстат України. К., 2003 . – 270 с.; 2) Зовнішня торгівля України за 2003 рік, т. 2: стат. зб. / Держкомстат України. – К., 2004 . – 265 с.; 3) Зовнішня торгівля України товарами за 2004 рік, т. 2: стат. зб. / Держкомстат України. – К., 2005 . – 178 с.; 4) Зовнішня торгівля України товарами та послугами у 2005 році, т. 2: стат. зб. / Держкомстат України. – К., 2006. – 320 с.; 5) Зовнішня торгівля України товарами та послугами у 2006 році, т. 2: стат. зб. / Держкомстат України. – К., 2007. – 236 с.; 6) Зовнішня торгівля України товарами та послугами у 2007 році, т. 2: стат. зб. / Держкомстат України. – К., 2008. – 175 с.; 7) Зовнішня торгівля України товарами та послугами у 2008 році, т. 2: стат. зб. / Держкомстат України. – К., 2009. – 212с.

In order to take the existing competitive advantages of Ukraine in the CES counties special attention should be paid to the services, especially freight services since they are related to the implementation of the macrotechnology "Ukraine is a transit state". Geographical location of our country as the main factor providing the advantages in freight services is becoming of higher priority if Ukraine becomes one of the key economies with the same transportation services advantage belonging to the same integration block. Under these conditions the competitive advantages of these economies might result in monopoly in transportation services in a certain geopolitical vector which finally will bring a significant transportation rent. In other words, our country will gain if its cooperation with the CES countries is directed to providing the intensified integration processes between Western Europe, the Asian-Pacific Region and the South-East Asia.

In our opinion, in the light of this discussion the participation of Ukraine in the CES is advisable since the free trade zone within the CES, and free trade zone between Ukraine and the EU, as well as between Russia and the EU could result in the formation of geopolitical triangle Russia – the EU – Ukraine with the conditions of free trade zone. The intensification of FDI inflows will finally facilitate Ukraine's joining the EU. This idea is expressed by leading economists [14].

Evaluating positively the development of external relations between Ukraine and the CES countries from the point of view of enhancing the competitiveness of the national economy by



taking the competitive advantages created for decades years ago, it is important to take into account that the integration of Ukraine within the CES should be limited by the free trade zone since it would not contradict with the interests of the country and will contribute to achieving the strategic goal of Ukraine – eventual EU membership.

Clearly, main competitive advantages of Ukraine in BSEC and GUAM are formed on the markets of freight services in the geopolitical directions: 1) Western Europe – the Near and the Middle East, and 2) Western Europe – Caucasasia – the Central Asia.

Taking into account the above mentioned, let us arrive at the general conclusions about the impact of Ukraine's integration with the EU, CES, BSEC and GUAM on the competitiveness.

External economic relations with the EU contribute to raising the technological and technical levels of production, the factor conditions (the first determinant out of four main determinants of M.Porter's diamond which is used for determining the country's competitiveness). At the same time they facilitate the rise in demand in the domestic market (the second determinant of the country's competitiveness). Due to the financial services, as well as various business, professional and technical services (including legal, accounting, advertising services, studying of the market, public surveys, research and development services, services in architecture, engineering, services in the area of agriculture, mining operations, processing services) the management level is also improving (the third determinant of the national competitiveness).

These are just a few steps to take today to stabilize the economy.

The CES vector enables Ukraine to sell the goods with a considerable amount of added value, as well as to provide transportation services by delivering energy carriers to the EU countries. Some opportunities arise for the development of the high technology industries.

In general, it seems logical to form the strategy of Ukraine's integration into the above mentioned regional integration blocks. The EU countries is the source for obtaining new competitive advantages since they provide Ukraine with modern technical equipment and technology. In order to stimulate the import of modern technical equipment and technology it is advisable to reduce the VAT, and in some case to give it a zero rate. It is reasonable to conduct negotiations with the WTO representatives on obtaining the rights for using special protection and compensation measures in agriculture and food industries, as well as using the indicative prices in order to avoid economically ungrounded low prices for Ukrainian goods and services.

These moves could also improve foreign trade balance since Ukraine's technological level of production will improve due to its cooperation with the EU and the export of goods with insignificant amount of added value will diminish. Ukraine should ensure accelerated development of the industries of the 5th and 6th Techno-Economic Paradigms.

Those steps are necessary since Ukraine's total foreign debt (state and corporate) had reached 93.5% of the 912.563 billion hryvnia GDP in March 2010. On March 18, 2010 the National Bank of Ukraine stated the total external debt in Ukraine increased 2.3% to USD 103.973billion in 2009, and it considered a 4% GDP growth realistic for 2010 the same day.

With regard to the high level of dollarization, it is recommended to reconsider the dominance of the dollar as the main means of international payments for our country and to view the alternatives, one of which could be the Russian rouble since there is a much better chance of achieving a stable pattern of exchange rate in a multilaterally agreed framework for exchange-rate management which should be the basis for further policies and reforms aimed at stabilizing the financial system.

World losses brought by the financial crisis are 5 trillions of dollars. This is 160 budgets of Ukraine. Some economists consider the crisis to be connected to the dollar which became world reserve currency and did not manage with the new function. So, some authors believe that unsatisfactory functioning built on a dollar as a reserve currency of a world monetary-currency



mechanism, has a direct relation to the world crisis. Converting of currency of one country into international, gave the USA enormous benefits and advantages in the realization of a credit expansion, created significant possibilities for its businessmen. It is extremely essential to ensure that the process of making and cancelling credits has a commercial background.

While the deterioration of global economic prospects in 2008 caused a fall in commodity demand, the downturn in commodity prices was first triggered by a reorientation of speculative influences in these markets. Despite the downward correction in the second half of 2008, prices for all commodity groups, except oil, remained above their average of the past 10 years. A large number of commodity prices seemed to have bottomed out by December 2008, but at this point prices of most commodity groups had only retreated back to about the levels of 2007. Only oil and minerals and metals had fallen roughly to the levels of 2005. The prices of oil, minerals and metals, and agricultural raw materials were worse hit than others by the slowdown in demand resulting from the slump in industrial production in developed countries [25, p. 7]. The problem is that the crisis led to a loss of competitiveness of domestic producers in international markets. So, for Ukraine to come out of this crisis better than it came into it, there should occur re-orientation in the export articles from metallurgy as the main article of export gain to other key industries, such as food industry, engineering, agrarian sector, aerospace industry, nuclear power engineering, etc. since the progress in development of these sectors will determine the directions of intensification of Ukraine's integration into the world economy [25, p. 7].

The national economy felt the impact of the crisis through the general loss of confidence of the financial market in its ability to cope with their specific exposure to the crisis. Special attention should be paid to the problem of determination of the national currency exchange rate. In fall 2008 the National bank of Ukraine «allowed the national currency to float» introducing the new official exchange rate procedure resulting from interbank bidding.

The leading Ukrainian economists have already emphasized the necessity for strengthening the regulation mechanism of the National bank of Ukraine and for using a variety of tools to control the exchange rate not only by interventions. In the course of this crisis, financial distress spread directly across stock and bond markets and primary commodity market, and put pressure on the exchange rate.

Finally, the financial crisis contributes to renewed thinking about the need for regulation. Many scientists nowadays are on the side of those who warned of the dangers of excessive deregulation and actively called for more, rather than less regulation. During his research in the area of financial economics, Hans-Werner Sinn observed that, if people's ability to pay is limited and there is a lower bound to what people can be made to suffer if they fail to pay their debts, then people may have a natural preference to accept certain gambles on the presumption that, if the gamble succeeds, they win, and if the gamble fails, their creditors lose. This observation is fundamental to the modern theories of credit rationing and of banking regulation [24, p. 2].

One of the reasons of Ukraine's economy being easily hit by the crisis can be partly explained by the fact that the significant share of Ukrainian banking system belongs to foreign banks, and that corporations and private banks increase the import and the loans.

Summary. The research shows that in the era of globalization the necessity of establishing world regulatory agencies working together with the national governments and regional agencies to resist and to prevent the threats of crises becomes of high priority.

The analysis suggests that the following steps need to be taken:

- 1) to review the foreign trade policy – there should occur the transition from price competition to quality competition;
- 2) to strengthen the state control in monetary policy over currency exchange regulation and control over external debt including its part formed by corporate sector and private banks;

3) to intensify the coordination between interstate and world agencies aimed at regulation of global economic processes and facilitation of their effective functioning.

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*Hmara M.\**

## **DIRECTIONS FOR OPTIMIZATION INNOVATION AND TECHNOLOGY CLUSTER**

The formation of economic clusters is an important objective and the agreed process that contributes to the improvement of organizational and production structure of the economy and improve dynamics. This is a precondition of national competitive advantage through optimized use of the economic potential of society. Therefore, the definition of the efficiency of cluster systems is an important factor.

Research areas of optimization of technological innovation and clusters make the following conclusions. Firstly, the formation and development of cluster structures leads to the integral advantages, namely increasing the competitiveness of the economy, intensification of innovative processes and real mechanisms for reconciling the interests of government, business, science and education to the development strategy at both the cluster members and regional level and country.

Second, consistent steps towards maximizing these benefits is to build a network of business innovation structures at different levels: first level - a consulting and information centers (business) and technology transfer centers, or centers of technology transfer; other - business incubators that work with actually existing projects in stages of a pilot industrial designs, utility models and provide additional services to firms, third level - Technology Park, which provides conditions for research work with small and medium innovation and innovation-active businesses, provide services under the project out in the market environment. The fourth level - to build technological areas (edges), which creates an environment for the development of breakthrough technologies, information consulting, engineering activity, there is the university or holding a university where the research centers of large enterprises. This area will become the center for innovation development and capitalization of income.

Thirdly, in Ukraine the most promising from this perspective is the major industrial regions where the possible structural changes in the direction of the 5<sup>th</sup> and 6<sup>th</sup> class of technology. These regions by the criterion of total expenditure on areas of innovation include: the Donetsk region, Kyiv, Kharkiv, Dnepropetrovsk, Lugansk region.

Fourth, the effectiveness of the cluster shows that these associations influence not only on individual enterprises but also on the regional economy, as a whole. They form the basis for attracting foreign investment, small and medium businesses, training a wide range of businesses, increase flexibility and mobility of companies, a broad range of network structures. Clusters are simultaneously as a forum in which ongoing dialogue between business, government and academia on how to implement competitive advantages within the city, county, region, country and even at the supranational level.

Fifth, efficient development of high-tech clusters in Ukraine requires improving the institutional foundations of their creation and functioning. Under the existence of a contradiction between theory and practice of clustering market-developed countries and Ukrainian realities of

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\* Ph.D., Department of World Economy and International Economic Relations Institute of International Relations, Kyiv National Taras Shevchenko University

transformation of economy, development of effective national cluster systems requires adaptation of Western technology and scientific basis of domestic institutional mechanism to ensure the rational management support and motivational factors cluster interaction of business entities.

Radical changes in technology and technology, mobilization of technical, organizational, economic and social factors create preconditions for significant productivity improvements. Within the cluster there is a possibility of introducing modern techniques and technologies of broad use in the production of advanced forms of scientific organization of labor, increasing production culture, strengthening discipline and order, stability, labor groups, which directly affects the efficiency of human capital.



*Poluneev Y.\**

## COMPETITIVENESS OF A COUNTRY AS A SOCIO-ECONOMIC CATEGORY AND DEVELOPMENT STRATEGY

*The article aims at defining socio-economic categories such as 'competitiveness,' 'development strategy,' 'innovation' as well as factors and components, which have a direct and indirect impact on competitiveness of a country; at analyzing leading strategies to economic development from a historical retrospective. An integrated approach regarding prosperity and social welfare growth has been specified, based on a well known development strategy of a 'country competitiveness.'*

*Стаття присвячена розкриттю сутності таких соціально-економічних категорій, як «конкурентоспроможність», «стратегія розвитку», «інновація», визначенню чинників та компонентів, які прямо і опосередковано впливають на конкурентоспроможність країни, аналізу провідних стратегій економічного поступу в історичній ретроспективі. Виокремлено комплексний підхід підвищення суспільного процвітання та добробуту населення на основі апробованої стратегії розвитку «конкурентоспроможності країни».*

**Key words:** competitiveness of a country, subject of economic activity, international community, globalization, development strategy, innovations, economic breakthrough.

Modern tendencies of development of world economies, the main indicators of which happened to be mass globalization of financial markets and dissolution of borders between regional and state control of markets, help form new features and definitions of socio-economic phenomena and occurrences.

XXI century enabled us to take a new look at the role of human capital regarding the growth of economic competitiveness; at the role of education, science and knowledge factor in the development of innovation activities of enterprises, regions and countries; at the formation of the new imperative for the society in the light of ecological responsibility, etc.

All these factors make it crucial to define the notion of 'competitiveness,' including all the contents features that this notion has acquired over the last years within the bounds of contemporary economic science. Being employed in many countries as an ideological tool for political activity, the strategy of competitiveness of a country growth, or the strategy of advancing development, has become some cross state, highly-effective pragmatic way to unite the nations and raise societal welfare.

The purpose and objectives of this article lie in highlighting the main approaches of exploring of competitiveness of a country as a category of economic science, defining of the main factors and components that influence the formation of a highly-competitive state, specifying of the main definitions of 'development strategy', analyzing of international experience of competitiveness of a country strategy introduction in such countries as Japan, Ireland and Greece.

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\* PhD., of the Department of World Economy and International Economic Relations of the Institute of International Relations of Kyiv National Taras Shevchenko University

Speaking of the competitiveness of a country, on one hand, one should not narrow it down to the mere competitiveness of certain enterprises in the global markets. On the other – one should remember that business remains a key concept in this regard. Global challenges in the countries where the development of economy of knowledge is taking place, push for a new role of business – as an actor in the international markets under conditions of global competition, as well as a driving force for raising competitiveness of one's state, in general. Without business competitiveness, there can be no competitiveness of a country [8, p.5].

For defining the test subject – competitiveness of a country – it is important to give a precise definition of the notion of a 'category', which will enable us to better perceive how this term is going to be employed later on. According to contemporary philosophy, the category is defined as **'a universal form of thinking and consciousness that reflects general characteristics and relations of objective reality, general mechanisms of development...of occurrences'** [23; P.269]. Therefore, there arises a need for permanent perfection or development of new scientific categories, which are 'nodes' of the exclusive network of cognition ensuring adequacy of this test subject and method of testing network evolution.

Vital problems of economic cooperation and effective development of states in a global community are directly reflected in the decreasing level of influence of state economies, control over them exercised by the global community, enlargement of transnational corporations (TNC) etc. All these are a consequence, as well as a reason for establishment of new forms of counteraction between economic players; secondly, these are a source of contradictions and socio-political conflicts on the regional, state and global levels.

Among foreign scholars that have in-depth expertise in exploration of the theoretical principles of competitiveness, modern forms of competition, international competitive community, analysis of factors, advantages and disadvantages of ensuring of high competitiveness of certain countries [22] are worth being mentioned: G. Gruber, R. Kanter, P. Katzenstein, S. Linder, F. List, V. Marzinkewich, J. Mill, R. Nelson, M. Posner, D. Ricardo, J. Robinson, J. Saks, P. Samuelson, A. Smith, J. Shumpeter, F. Hayek, E. Heckscher, J. Hicks etc.

The most crucial results of exploration in this field have been made by the research centres of Europe and USA [22]. In particular, it is worth mentioning a research team headed by Michael Porter (USA), Professor of Business Administration at Harvard Business School, who contributed to analysis of competition in the global markets, competition between states and regions, as well as developed a theory of competitive advantages of states, believed to be a new paradigm in the economic subject; research school led by Professor of International Business Alan Rugman (Canada) focused on elaboration of management strategies for TNC competitiveness, trade and investment policy growth; research team headed by J. Danning (UK), Professor of Reddington university, working on analytical explanation of necessity of introduction of 'way of investment development of nations' etc.

Speaking of the research in this problematic conducted among Ukrainian scholars, first and foremost, it is worth pointing out the institutes uniting prominent economists of the country who present their concepts of Ukrainian competitiveness of a country growth. Among them:

- Institute of International relations of National Taras Shevchenko University of Kyiv and Institute of world economy and international relations – V. Andriychuk, V. Budkin, I. Burakovskiy, V. Vergun, M. Dudchenko, H. Klymko, Y. Matseiko, V. Novytskyi, Y. Pakhomov, O. Rohach, V. Rokoch, A. Rumiantsev, V. Sidenko, S. Sidenko, A. Filipenko, O. Shnypko, O. Shnyrkova etc. The main topics of exploration include models of transformation in the structure of the world economy and their globalization dimension; modern tendencies of internalization and international economic integration; elaboration of external economic strategic for Ukraine and its competitive advantages on the international arena etc.

- Institute for Economics and forecasting of NAS of Ukraine – V. Heiets, V. Aleksandrova, O. Balakirieva, O. Baranovskyi, V. Holovenko, A. Danylenko, I. Lunina, L. Moldavan, B. Overchenko, V. Tochylin, V. Yurchyshyn etc. – focusing on definition of theoretical and methodological principles of competition and competitiveness of a country in XX-XXI cc., elaboration of micro- and macro levels of state economy etc. A range of exploration of this institute was published in a system forming research regarding strategic and transformational development of Ukraine – ‘Economy of Ukraine: strategy and long-term development policy’, ‘Strategy of economic and social development of Ukraine (2004-2015). Through European integration’ (2004), ‘Strategy of innovative development of Ukraine for 2010-2020 under conditions of globalization challenges’ (2010) etc.

- Economic development research institute of Vadym Hetman National Economic University – D. Lukianenko, A. Poruchnyk, L. Antoniuk, A. Honcharuk, I. Kaleniuk, O. Mozhovyi, T. Obolenska, Y. Panchenko, P. Petrashko, L. Rudenko, N. Tatarenko, T. Tsyhankova, V. Chuzhykov etc. The main areas of research include international competitiveness of Ukraine, its cooperation with international structures (WTO, IMF, World Bank), development of financial and investment potential, human capital and its role in increasing competitiveness on the micro-, meso- and macro levels etc. Complex studies of this institute resulted in works, such as: ‘International competitiveness of states: theory and mechanisms of realization’ (2004), ‘Management of international competitiveness under conditions of globalization of economic development’ (2007) etc.

- Ministry of Economy of Ukraine Economic research institute – V. Besedin, S. Vashchaev, I. Yehorov, O. Yeliseienko, T. Kvasha, I. Mantsurov, O. Melnyk, I. Repin, N. Romanovska, A. Yatsenko etc. – working on mid- and long-term prognostication, state programs on economic and social development of Ukraine, substantiation of structure, investment, innovative and science exploration policies, research on economy branches, strategies of their development and competitiveness growth, exploration of socio-economic issues in the regions, their complex development, formation of free and special economic zones (clusters), cross-border cooperation issue studies.

It is also worth being mentioned that a systematic approach regarding economy and competitiveness of a country research can be traced in the works of the following Ukrainian scholars:

- Zhalilo Y. ‘Competitiveness of Ukrainian economy under conditions of globalization’ (2005) (Monography) in which the author clearly defines the factors of competition based on the innovative development model as well as issues practical recommendations as to introduction of necessary steps of economic policy of a state;

- Kvasiuka B. ‘Competitiveness of state economy’ (2005), which, for the first time, put forward calculation of priority products and services needed for ensuring sustainable trade balance of the state, taking into account the data of National accounts and inter-branch balance of Ukraine;

- Kriuchkova I. (edit.) ‘Competitiveness of Ukrainian economy: state and growth prospects’ (2007) (Monography), which, for the first time, provided a comparative analysis of the basic components of Ukraine’s competitiveness, including structural processes, labour market, entrepreneurship, tax system and state power efficiency. Also, the conceptual principles of Ukrainian economy competitiveness growth have been defined as a pragmatic way of introducing new reforms.

Certainly, it is rather difficult to embrace all works and scholarly publications whose test of subject was chosen to be state, region or enterprise competitiveness. However, in general, we can

argue that despite a big number of theoretical works, a few important issues still remain undefined. In particular, there is no common definition of ‘competitiveness’ as a socio-economic category – the variety of definitions arises from the criteria one author chose to follow; there is no common equally effective and leaving no alternative concept of advancing development, which would ensure fast-growing and qualitative economic breakthrough of one’s state or TNC – each economic player chooses its own development strategy based on the cultural, political and economic peculiarities of the environment; there is no integral, financially and socially valid approach to reforming Ukraine’s economy and competitiveness of a country strategy development ensuring combating of structural backwardness and liquidation of inefficient elements. For it is known that nowadays there are a few approaches regarding the country’s development: structural-innovative, investment, institutional strategic, internalization model etc.

Even though the notion of ‘competitiveness’ is widely used in the economic science and has become a popular category for use among politicians, there is no common definition of the term in the scholarly research.

The spectrum of definitions varies from exclusively technological characteristics arising from the narrow grounded definition of one’s company competitiveness (capacities for companies to design, manufacture and sell products, whose price and qualitative features are more attractive to customers than the products of their competitors, under current conditions [15, p. 406]) to the broad notion of competitiveness as a socio-economic stability of country’s system.

As a matter of fact, there can be traced the use of a narrow definition of the category, as well as its broad definition. At the same time, it should be taken into consideration that giving a ‘universal’ definition of the notion of ‘competitiveness’ can be seen as an attempt to somehow unite micro-, meso- and macro levels of the term’s use.

J. Saks persisted in the opinion that on a state level, the object of competitiveness should be conditions of social production and not a product itself, speaking of the company competitiveness. He saw competitiveness as a pre-condition and tool for sustainable economic development of a country. J. Saks took into consideration all possible ways of counteraction that have an impact on stabilization, predictability of economic development [24]. In general, he was right in his assertion, nevertheless, he did not consider important socio-political factors (culture, mentality, collective or individual consciousness, political regime, freedom of choice, civil society development etc), which do have an impact on competitiveness of one’s company, as well as region and state, as a whole.

In the research conducted by World Economic Forum (WEF), competitiveness of a country is defined from a perspective of mid-term (5 years) economic growth and is interpreted as **‘capacity to maintain stable real per capita growth rate measured by per capita growth domestic product rate according to permanent prices’** [13, p.29].

One more attempt to provide a ‘universal’ definition of competitiveness of a country was made by authors of Ukrainian Economic encyclopedia who defined the terms as **‘capacity of state economy of one country to compete with economies of other countries based on the level of effective use of national resources, growth of productivity of national economy that ensures high and steadily growing living standards of the population’** [4, p. 814]. In general, such an attempt may be partially successful, for not merely elements of sustainable economic development were taken into consideration, but also necessity to increase living standards of population based on this growth, which is directly dependent on state policy.

Yet, M. Porter was arguing that **‘the main goal of state is to provide its citizens with fairly high and growing living standards. State capacity to achieve this does not depend on the amorphous notion of ‘competitiveness’, but rather on how efficiently the national resources are being exploited, these being labor and capital’** [19, p.35].



This approach set forth by M. Porter substantiated in his famous work 'International competition' (1993) helps understand that by increasing labor productivity and capital movement any company or state has to overcome or consider a range of cultural (mental, traditional, psychological etc.), social (living standards, unemployment rate, number of retirees, etc.), political (political regime, political stability, presence of elite etc.) and technological (system of communications, innovative design, productivity etc.) obstacles in order to achieve the level of highly-effective TNC or the most affluent countries.

Bazyliuk Y. in his work '**Competitiveness of state economy: substance and provisions' (2002) emphasized that competitiveness as an economic category characterizes state of social relations in a country regarding provision of stable growth of effective national manufacture adapted to the fluctuations of the world state of affairs and domestic demand based on the exposure of national competitive advantages and achievement of better socio-economic parameters than of their competitors** [1, p. 6].

Therefore, it is important to draw the limits of understanding and peculiarities of competitiveness as a socio-economic category. Zhalilo Y. pointed out essential characteristics of this category as an economic one, as follows:

1. Competitiveness is **an attribute of every enterprise** based on the labor division and exchange of commodities that is a part of the world division of labor [7, p.13]. Thus, any TNC or state participates in a big number of international relations and strives to offer the most beneficial forms of cooperation between economic players to make a profit.

2. **Competitiveness has inner effluence** [7, p.14]. That is every globally competing country has, first, to conquer the domestic scene and gain a certain percentage of market through competition with other economic players. Thereafter, it can enter the international service scene.

3. **Competitiveness of state economy requires permanent expansion of sources** for self-sufficing development of economic players [7, p.14]. Fair competitive environment decreases profits of a taken economic player that are en masse a source of development. Therefore, their capacities should be enabled for growth in order to increase their own competitiveness and competitiveness of a state.

4. **Competitiveness** is defined by conditions of economic development of a state and **is dependent on the ability of the economic players to benefit under the conditions at its fullest** [7, p.14]. This characteristic proves the previous statement. However, it is important to underline that an ongoing development of mere economic players does not ensure socio-political and ecological development of a country, in general (what is a must). As a matter of fact, the state has to take care of that.

5. **Competitiveness of state economy arises from socio-economic optimality** achieved in society [5, p.105], which ensures that positive achievements from effective use of material, labor and organizational resources balance with the use of social and other budget programs [7, p.14].

6. **State bears responsibility over the state of competitiveness of national economy.** It is the state whose role is key in determining substance and tools of economic policy, fulfilling obligations regarding membership in world organizations and cooperation with other state partners, and also using oversight mechanisms capable of absorbing the negative factors of domestic and external origin and preventing from deteriorating of socio-economic parameters of state development [7, p.14-15].

Consequently, in a modern discourse of economic science, competitiveness of a country plays a role not just as an economic category, but also as a social one. More and more countries are starting to pay closer attention to human and social capital as a basis of effective development and productivity growth, speaking of both enterprises and states.



As a matter of fact, **competitiveness of national economy is a complex socio-economic category, dependent on various factors in which the key role is represented by business and labor environment; economic and technological infrastructure; education and professional skills; entrepreneurship and enterprise development and innovations. This category is a means of ensuring higher and more sustainable economic growth (through stimulus investments into new technologies and development of innovative business) and social welfare** [13, p.29].

Yet at the beginning of the last century German philosopher Max Weber in his work 'The protestant ethic and the spirit of capitalism' (1904) was exploring the counteraction of an irrational factor (culture, trust, social networks of cooperation) and economic development of states. He was confident that nations compete not only with their products and services, but also their systems of societal values (which can and should be straightforwardly influenced) and education.

In contemporary economics, an emphasis is put not only on the tangible products and services, but also (and to a bigger extent) on intellectual capacity. Ability of a nation to maintain up-to-date and effective educational system, increase intellectual capacity of labor force with the help of trainings is becoming crucial for competitiveness.

It is also worth mentioning that nowadays every highly-competing country with a steady growth rate develops and maintains, first and foremost, private entrepreneurship. In modern economic discourse, this has already been turned into an axiom.

The main task of a state in this lies in setting conditions and support for a favourable environment for the development of competitiveness of certain enterprises and the state itself.

A big importance in this also lies in the quality of execution. Majority of scholars believe that competitiveness requires qualitative execution of processes within the country, and to a lesser extent – state assists or even ideas. Japan, Singapore, Germany, Switzerland are examples of the countries that succeeded in the global economy due to the masterful transformation of ideas and technologies into concrete products and services. This proves importance of close counteraction between the innovative factor and social capital in a society.

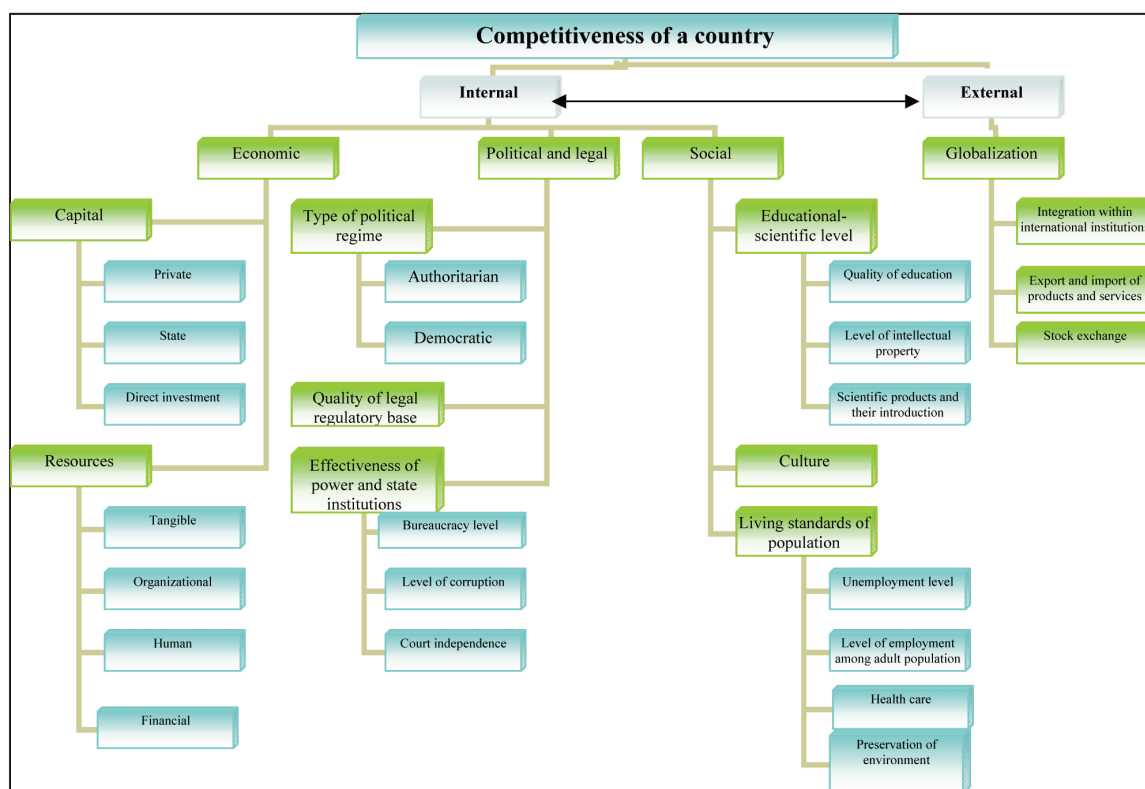
Finally, there should be political will and national consensus. The most difficult task for political establishment of any country that strives for high competitiveness lies not only in verbal ascertaining of the political will, but also in capacity to mobilize people and institutions for the sake of necessary transformations.

All this proves that competitiveness of a country is a socio-economic category of contemporary scholarly and common use, which has developed itself from an exclusive down-to-earth definition of a total sum of present capital and capacities to use resources (natural, labor); to understanding of it as a certain national ideology, a pragmatic way of development that is economically valid and socially accepted.

In the Figure 1, there are clearly defined factors and components of competitiveness of a country that have a direct and mediated impact on the state development, welfare growth, establishment of influence on the international arena etc. It is rather difficult to reflect a total sum of all elements, therefore their majority was divided into internal and external factors, the main components of the latter being socio-economic and political and legal elements.

Based on Figure 1, we can conclude that every country or economic player is under permanent pressure of globalization processes, which we define as external factors, and also a big variety of domestic factors – social, political and legal and economic – after embracing of which an enterprise or branch can break through the limits of internal competition.

However, it is necessary to clearly divide between competitiveness of a company, branch or state.



**Figure 1.** Factors and components of competitiveness of a country

One of the main criteria of competitiveness of a company (firm) lies a long-run perspective of growth of sales volumes, percentages of market and profits. Competitiveness of a branch is characterized by acquisition of a substantial and growing percentage of the world market by means of export of highly-qualitative products and services.

The concept of competitiveness of a country has its own specifics, since countries cannot disappear influenced by international competition the way uncompetitive companies do.

In a narrow meaning (valuable indicators of external economic activity), states do compete internationally. By this, indicators such as specific production costs in manufacturing industry, prices, real exchange rate - that is all that forms competitive positions of state branches in a global economy – are taken into account. In this sense, competitiveness of this or that country in a global context can be seen as a ‘sum’ of international competitiveness of national exporters.

In a broad sense, the main criterion for the category of ‘competitiveness of a country’ is those indicators that characterize stable improvement of living standards of population. Thus, competitiveness of a country (CC) lies in state capacity to create internal and external conditions enabling its companies to manufacture products and services, which meet the challenges of international markets, and enabling population to steadily increase their income and quality of living.

Increasing competitiveness of a country as a whole – either step-by-step or in an advancing mode (designed by the ruling elite as a ‘chase after game’; in Ukrainian case – as a ‘Ukrainian breakthrough’ advancing to the level of a competitive country) – should be seen, first of all, as a sort of investment project, i.e. a result, which is achieved by means of purposeful and consistent over the years (e.g. Finland needed some 20 years to realize its ‘breakthrough’, which resulted in the fact that nowadays this country is at the head of the competitiveness ratings), well-designed investments into the main factors of steady economic growth [18, p.30-31].

This results in dynamic growth of labor productivity (LP), innovativeness and eco-friendliness of industrial (business) processes, growing additional value in scientific and ‘knowledge-

cost' sectors of economy. That is the state economy is exploiting more and more effectively available (and to a growing extent – in short supply) manufacturing factors – natural and labor resources, capital and technologies for design of qualitative products and services. Steadily growing LP enables salaries and other types of population income to increase in a non-inflation way, which is a top goal of a project 'Competitive of a country' ensuring ongoing growth of population's real income and living standards.

Level of LP also determines an average level of investment income in a country. Since the average level is one of the fundamental factors having an impact on the rates of economic growth, the more competitive economy is likely to grow at a faster pace in a mid- and long-run perspective and be more attractive to direct foreign investments.

Investments within the limits of a 'national project' regarding increasing of competitiveness come from 2 main sources – state budget of a country and corporate sector profits. Public sector investments, as a rule, are made into such sectors as education, re-training of human resources, fundamental science and research and development, infrastructure. Private investments financed by means of enterprise incomes and household savings are directed into modernization of industrial assets, re-training of managers and personnel, research and development and innovative activity etc.

Therefore, world's most authoritative US school on competitiveness that actually equates state economic policy and competitiveness of a country growth policy, puts forth priorities of the latter in:

1. Establishment and maintenance of a stable macroeconomic environment in the long-run
2. Elimination of obstacles and simplification of regulatory-legal field for private entrepreneurship
3. Elimination of obstacles regarding freedom of international trade and capital movement
4. Setup of fiscal and economic stimuli regarding directing of private sector investments into main structural and infrastructural directions, which strengthen 'natural' competitive advantages of enterprises and branches of economy [18, p.30-31].

Importance of choosing a paradigm of competitiveness of a country for Ukraine as the main landmark of a long-term strategy is fully asserted by philosophy and direction of the Lisbon strategy of the EU, the future membership in which is nowadays almost an acknowledged priority.

In connection with this, we should clearly determine what competitiveness of a country is as a development strategy in order to define the most effective ways of its introduction for this or that economic player and a country, as a whole, taking into account globalization processes and cooperation within the boundaries of the international community.

Therefore, it looks appropriate to point out the main approaches to understanding of the notion of a 'development strategy', which is directly linked to the will to increase economic and social welfare of the society, state. The attitude of the Bulgarian scholar V. Manov looks quite productive, since he sees the strategy as a 'generator for development capacity' [12, p.297]. As the scholar argues, the key function of a strategy lies in setting conditions for meeting certain objectives. Thus, if the tactical objectives are formed on the basis of the tangible subject structure, who will achieve those, the strategy will have to embrace structural modification of the subject. As discussed above, 2 aspects are equally crucial while defining a strategy of any level: adequate goal setting and careful determination of organizational capacities [6, p.13].

Zhalilo Y. provides the definition of the economic strategy as an integral system of actions of a subject aimed at realization of a goal, objectives and priorities of its economic reproduction, taking into account a complex of effects of endogenous and exogenous factors, determined for

a long period of time [6; P.16]; whereas economic tactics is defined by the scholar as follows: as a form of realization of an economic strategy, a complex of adaptive means of effects exerted by the subject over concrete economic processes in order to give them features, determined by the objectives of the subject's economic strategy [6, p.16].

In our research, the development strategy encompasses somewhat broader understanding going beyond economic strategy, taking into consideration socio-economic substance of the main test subject of the analysis – competitiveness of a country.

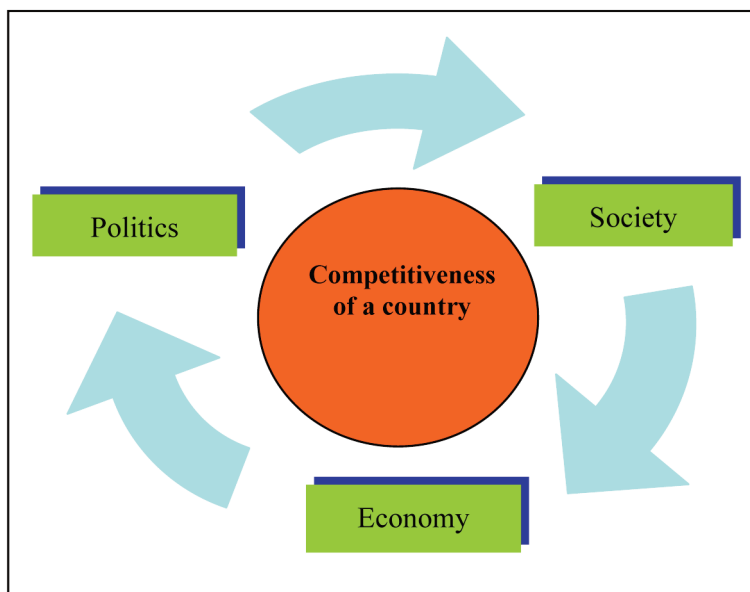
At the same time we cannot help but agree with the definition of a 'development strategy' of Honcharenko O. who defined it as an integral development which determines main priorities, objectives and directions of development taking into account basic parameters of external and internal environment and their possible alterations. In other words, formation and implementation of the national strategy, stimulation of political establishment to comprehend their role, state capacity and the role of the state in the regional and global geopolitical domain is a vital imperative, a determining factor in the historical and political future of the state [2, p.35].

Thus, competitiveness of a country as a socio-economic category within modern industrial relations under conditions of globalization is the least conflict-oriented, socially binding, pragmatically beneficial state development strategy, which effectively ensures steady welfare and prosperity growth of society.

While analyzing historical experience of employing various sorts of development strategies of the world's top countries – Japan, USA, Ireland, Sweden, South Korea, Singapore etc. – it is possible to claim that these countries' progress was ensured by clearly determined actions and tactical steps, independent of political and social changes.

Therefore, a strategy of competitiveness of a country is seen, in the first place, as an apolitical, all-social development program that easily binds competing political forces, solidifies societal groups of various interests and direction for the sake of national welfare and prosperity of the state.

In the Figure 2 there are 3 systems described – politics, economy, society – that form the unified domain of cooperation and influence competitiveness of a country. The competitiveness of a country itself is both a goal, i.e. a potential result of actions of this or that country (that strives to become a competitive player of international scene), and a foundation, platform (the-



**Figure 2.** Competitiveness of a country as a development strategy

oretical and methodological base, historical experience) for practical implementation of development strategy.

As an example, let us turn to the most successful projects illustrating competitiveness of a country as a development strategy from a historical retrospective. Majority of countries (examples) employed a scheme 'competitiveness=innovations', which facilitated a qualitative breakthrough in both economic and socio-political fields.

Novation (lat. Novation – change, renovation) is something new, not found before. According

to the civic law, novation means an agreement between the parties regarding replacement of the obligation concluded in the past. This results in novation [16, p.72].

Under innovation (engl. Innovation – novation, novelty) one means investment into novation.

The term ‘innovation’ as a new economic category was brought into scholarly use by Austrian scholar Joseph Shumpeter in early XX c. In his work ‘Theory of economic development’ (1911), J. Shumpeter, for the first time, discussed issues of new combinations of changes in development (i.e. innovation matters) and gave a full description of the innovation process [17, p.34].

According to J. Shumpeter, innovation is a main source of profits: ‘a profit, actually, is a result of performance of new combinations’, ‘there is no development without a profit, without profit there is no development’.

Innovation is a market realized result, obtained through investment of capital into a new product or operation (technology, process). Based on that it is possible to state that innovation performs 3 functions of renewal, investment, stimulation [11, p.85].

In order to prove that there is no alternative to competitiveness of a country as a development strategy, it is important to use all theoretical and empirically accessible material. Choice of 3 countries – Japan, Ireland and Greece – is based on the fact that the first one vividly demonstrates impact of social capital on to introduction of competitiveness of a country as a development strategy, the second and the third ones – represent bright examples of the economic breakthrough in Europe, which is important to note for Ukraine’s development.

**Japan as a centre of innovations in XX century.** The process Japan embarked on after World War II enabled this country to stand at the head of the list of world’s most competitive countries, which may be called the **innovative breakthrough of Japan**. It started around 1948, when the country was yet under military occupation. Until 1953, Japan achieved pre-war economic level of GDP. Since then, the country has preserved high rates of industry growth. During 1952-1963 GDP of this country almost tripled and was characterized with an annual increase of 9%; during the same period industrial output of goods increased by 5 times, whereas consumption doubled. From the start of the triumphant economic development and until 1970s Japan managed to firmly occupy its role of a top industrial country.

The main pre-conditions of Japanese ‘economic wonder’ were the following:

1) American occupation power conducted a range of important transformations that substantially fostered development of Japanese society and industry. The armed forces were dissolved, democratic freedoms were renewed, universal election law was enacted, the parliament and government was formed, the constitution was adopted. Occupation power conducted a series of economic reforms. Antimonopoly laws were enacted, according to which the biggest monopoly concerns were dissolved. US financial advisors conducted reforms of the tax system. Taxes on entrepreneurship were diminished. A firm exchange rate of yen was introduced.

2) In general, reforms revived and strengthened competition among enterprisers, fostered industrial growth. In 1946-1949 a land reform liquidating landlord landowning was implemented. State redeemed land from landowners and sold to peasants almost 80% of all agricultural lots. Competition among manufacturers was strengthened, which brought about labor productivity, crop capacity, expansion of domestic market of Japan, labor market was formed (a percentage of population involved in agriculture decreased from 48% to 8% in 2009).

3) Thus, big US investments as well as domestic capital accumulation helped fully renovate equipment, set up new enterprises. In March 1952 a law on fostering of rationalization of industry was enacted, according to which enterprises received state support, tax and other finan-



cial privileges as long as they modernized industrial production and renewed equipment. Majority of entrepreneurs followed this law, which enabled them to introduce new technologies, attract direct foreign investment aimed at modernization of manufacture. Japanese successfully implanted foreign achievements in the new branches of industry. Electronic metallurgy was being successfully developed, high-capacity automatized rolling mills as well as energy- and material cost-effective technologies were introduced.

As a matter of fact, at the end of 1970s, Japan turned into one of the most powerful world centres of metallurgy. Purchasing patents and licenses for scientific discoveries, pioneering technologies etc. and skillfully adjusting them to the country's conditions, Japanese made huge profits. A range of significant technological novelties were introduced and brought into mass production by Japanese firms, such as: nylon and transistor radio (second half of 1950s), audio stereo systems, video cameras and video tape recorders (1960-1970s), computerized robots, silicon crystal micro schemes (1980s), etc.

4) Japanese system of lifelong employment (wages are increased on an annual basis and are dependent on the person's age and experience) turned out to be very effective. Companies care about permanent increase of their employees' qualifications, their welfare and leisure. Changing of one's workplace is a rare occurrence and is condemned. Japanese employees work more intensively, enjoying lower wages and having a longer week day. This decreases cost of manufacture of goods, their price.

5) External economic ties, trade, in the first place, became extremely important for Japan. Import of raw material Japan has no resources in, generally comes from the developing countries that set out low prices. Cheap raw material fostered revival of Japanese economy. Japan exports its production to the developed countries – USA, Canada, Australia and European countries.

It is worth being emphasized that Japan did not lose its influence in the XXI c. The country continues to allocate significant funds to promote innovative attractiveness of its products and services, which is ensured on the state level by Law on scientific and technical development. Every 5 years government adopts 'Fundamental plan of science and technology development of Japan'. Its latest version will be updated in 2010 and is currently based on such standpoints: science and technology should be supported by community and be beneficial for society; focus on development of human resources and science competitiveness development regarding environment (decrease of birth rate and aging, security and counteraction towards global climate change etc.); development of research in 4 priority fields – bio sciences, informational and communication sciences, environmental studies, nanotechnologies and nature studies etc [21, p.503-509].

All facts mentioned above prove effectiveness of employing innovative development strategy in a process of increasing competitiveness of a country. As seen in the Japanese case, the state efficiently seized upon all opportunities and used own resources. Thanks to these and other factors, Japan reached new dimensions worldwide and turned into one of the world leaders.

The case of Ireland is absolutely different, a contemporary one. This country gained its independence in 1949. Irish wonder lay in the fact that this country had to reach its more affluent neighbors that were much more successful in terms of using their economic resources and advantages. A big success of Ireland that consisted of million euro 'donation' on behalf of the European Union aimed at structural transformation is seen as the main factor of renaissance of the 'Celtic Tiger' (as Irish call their countries) within the last 20 years.

Favourable economic and budget policy, reduction of taxes and cooperation of all branches of power had a big importance. Moreover, Ireland greatly succeeded in attracting professional foreign labor with the help of low tax rates. Since 1960s Irish investments into secondary and high education have paid off with own highly-qualified labor.

Over the last years Irish economy has been rapidly developing, in particular, its information technologies sector, which attracts attention from all over the world. 'Celtic Tiger' is perceived as a decent candidacy to hold European Silicon Valley.

In Ireland, there are European centers of practically all leading companies - Microsoft, Compaq, Intel, Dell, Panasonic, 3Com, Netscape, Novell, Corel, Symantec, Informix etc. that account for hundreds and thousands of employees. In addition to this, the government follows a saving policy allocating free funds to solve social issues. As a consequence, there is a significant decrease of the unemployment rate and decrease of a gender pay gap.

Today, in order to maintain competitiveness of a country and welfare growth, the government is following an innovative policy on the grounds of implementing the National development plan 2007-2013 and Strategy on the matters of science, technologies and innovations 2006-2013, the main objectives of which should meet:

1. Development of academic base and scientific programs, strengthening of scholar potential;
2. Establishment of a range of training centers for scholars, particularly, in the field of modern applied technologies;
3. Development of industry research on the basis of higher education institutions ensured by investments at a level of 2,5 billion until 2013;
4. Commercialization of functions of education institutions: economization of scientific activity, know hows, patents etc. for the sake of practical introduction [21, p.363-365] etc.

To conclude, while analyzing economic success of Ireland, we have found out that this country continues to follow the innovative development model. Aside from the aforementioned standpoints and the saving policy, the government continues to allocate significant funds to finance innovative activities, especially in the field of entrepreneurship and communication networks, attracting foreign investments and creating favourable business conditions for private and state companies. All this is directly reflected in the social development of state. Thus, Ireland is at the head of the rating - indexes of human potential development, living standards, political freedom. Ultimately, the chosen development strategy of competitiveness of a country proved its efficiency and competence, and was well supported by the population.

**Greek breakthrough** — this term is employed to define impressive pace of economic and social development of Greece starting from 1950s and until mid-1970s.

In the period between 1950 and 1973, tempos of economic growth in the country reached 7%. This indicator was second best in the world (Japan was the first one). Such development was ensured by industrial production that was growing at a 10% rate annually for a few years.

Also, fast revival of Greek economy after World War II was fostered by a range of measures, including (in addition to the Marshall stimulus plan affecting this and other European countries) the sharp devaluation of Greek drachma, attraction of foreign investment, significant development of chemical industry, development of tourism and services, in general, mass construction linked to big projects in infrastructure and renovation of Greek cities (brought about by dramatic urbanization, replacement of low-rise buildings with concrete multistoried buildings).

Actually, from 1950s (excluding downturn of 1980s, mainly connected with 'shadowing' of Greek economy) economy of Greece was characterized by positive growth indicators. Greece invariably prevailed over majority of European countries in section of annual GDP growth that amounted to 7-9% annually.

During global financial and economic crisis of 2007-2010 the country's economy was in certain recession due to significant foreign debt and inability to pay creditors off. Nonetheless, the

purpose of our research dictates understanding of development strategy to be key, and therefore it is crucial that years ago Greece managed to combat its domestic political contradictions and social conflicts through introduction of a pragmatic and more economically viable strategy of competitiveness of a country with the help of investment attraction, effective use of tangible resources. This enabled Greece to enjoy equal rights as an international actor.

As discussed above, the historical experience of a range of countries various development models – innovative, investment – proves necessity of realization of strategy forming development projects for every country.

Yet today, competitiveness has become a basic development strategy for countries, such as USA, Russian Federation, Germany etc.

Lack of a long-term strategy and stable economic policy is the main issue Ukraine is facing on its way to economic and socio-political growth. Most importantly, the strategy to be chosen for Ukraine should not contradict the projects already tested by international community and should consider domestic and geographic peculiarities of the country.

Based on this, competitiveness of a country is seen as a socio-economic category in a contemporary scholarly discourse, its introduction as a development strategy depends on a range of factors divided between internal and external. These components have to be taken into account while implementing action plans proposed by different governments through increase of competitiveness of a country under the limits of international community. The scope of tactically considered steps in the pursuit of one's goal and their effective introduction proves a non-alternative development strategy to be most beneficial – competitiveness of a country.

Further exploration in this field should be dedicated to substantiation of importance of social capital formation for the sake of competitiveness of a country, specification of peculiarities of influence exerted by political-cultural components on economic development of certain economic players and the state, as a whole. It is also important to analyze contemporary indexes and ratings of competitiveness of a country in order to detect the most critical positions Ukraine is currently lagging behind in, as well as advantages it can benefit from at the international arena under conditions of globalization.

A separate research dimension should encompass specification of theoretical and practical mechanisms that form a strategy of advancing development for Ukraine. We defined it as a **technology of economic breakthrough** [18] that has been partially substantiated by the author. This is a certain methodology defining those strategic development directions that will in the future help build consensus in the society. For it is for the concepts of a qualitative economic transformation (e.g. innovative development), its post-Soviet type, in particular, and introduction of the ideologically sound and socially binding course, which can be represented by competitiveness of a country, that will help form favorable conditions for the stable development of the country and steady welfare and living standards' growth of the population.

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Gabrylevych A. \*

## MONITORING OF ANTI-CRISIS ACTIVITIES OF COUNTRIES-MEMBERS OF THE EUROPEAN UNION: LESSONS FOR UKRAINE

*To analyse the priorities of anti-crisis policy of countries-members of the European union and mark out common and distinctive features with anti-crisis strategies of Ukrainian government. To analyse anti-crisis actions excepted by the government of Ukraine and to work out the main priorities of counteraction, directed on the stabilization and renovation of economy. The plan of long-term actions of fighting the world financial crisis in Ukraine was worked out.*

*Аналіз пріоритетів антикризової політики країн-членів Європейського Союзу та виділення спільних та відмінних рис з антикризовими стратегіями уряду України. Ґрунтовне дослідження прийнятих урядом антикризових дій та розробка основних пріоритетів протидії, направлених на стабілізацію та відновлення економіки. Розроблено план довгострокових заходів подолання світової фінансової кризи в Україні.*

**The key words:** anti-crisis actions, the European Union, reformation, stimulation, crediting, Ukraine.

On the European continent, the main structure, which promotes economic and social progress, mainly through a zone without internal borders, supports economic, political and social integrity, the foundation of economic and monetary union and introduction of the single currency is the European Union. The main foreign policy objective of the EU - to claim his identity in the international area, especially through the common foreign and security policy.

Through coordinated action, the Union could partly prevent the crisis on the European financial market, save millions of jobs. Member states are currently trying to implement the plan for economic recovery, which represents the most ambitious program to harmonize their economic policies. Rejecting the idea of protectionism, this plan aims at strengthening the single market, which is a catalyst for European growth.

With anti-crisis measures of the European Union, unable to find out that the financial crisis can fight and success. The European Union seeks to end free banking practices within their own borders. European example - is coordination at the international level.

No country can avoid such a destructive force - by joining efforts and resources, Europe can become stronger and better prepared to overcome the crisis calls.

Therefore the study of conceptual perspective Crisis measurements will enable objective analysis of the determinants of political strategies of the European Union in resolving crisis situations.

And as a conclusion, after reviewing the practice and results of anti-crisis actions in the European Union member states, we can respond to current issues: "What are the prospects of overcoming a particular course and the global economic and political crises?"

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\* Postgraduate student of the Institute of World Economy and International Relations

The aim is to review and analyze all megatrends world development and prospects for overcoming the global financial crisis. More on anti-crisis measures to stop the European Union.

**Objective:**

1. Single out the main areas of anti-crisis measures of the European Union.
2. Prioritize anti-crisis policy of small and big member states.
3. Based on thorough analysis to develop recommendations and a plan to overcome the global financial crisis in Ukraine.

Subject research fully meets the conference theme and makes a noticeable emphasis on institutional and evolutionary dimensions of the global financial crisis.

Methodological basis of research is to use an interdisciplinary approach as a method of analyzing complex economic and political processes. Studying the causes and stages of development of the global financial crisis took place through the involvement of general scientific knowledge and methods of Invent-analysis. According to the tasks at different stages of the items were used systemic, structural and functional methods of modelling and abstract "variation of scripts". Analysis of the institutional mechanisms of the EU anti-crisis strategies and their implementation in accordance with Ukraine was conducted by studying both basic and industry legislation.

The level of elaboration of the problem. The fundamental basis for understanding the theoretical aspects of selected topics were research issues affecting the global economic crisis, which can be divided into the following groups: fundamental work early twentieth century authors, translated into Ukrainian and Russian works of contemporary foreign scholars, practitioners and academics working in Russia and other CIS, domestic modern works of authors.

The first category includes work written by: F. Quesnay, Marx, M. Tugan-Baranovsky, M. Kondrat 'ev, E. Slutsky, B. Mitchell, J. Hicks, J. Kitchin, K. Dzhuhlar, D. Long, R. Frisch, J. Keynes. The works of these authors deals with the essence of crisis in the economy in general a fundamental sense. In many cases, their findings can be adapted to the realities of modern world system. At the same time, the important factor is that the nature of contemporary international economic relations has been transformed, and therefore the existing fundamental theories need further development. In recent decades, began to appear works are devoted to the study and analysis of management processes in the global economy. You can select these works of authors: P. Krugman, J. Corsetti, A. Sbratsia, D. Perikoli, D. Soros, M. Barkley, A. Bernak, P. Present, N. Rubin.

Unfortunately works of these authors are mostly devoted to the study of crises only in certain parts of international economic relations, such as: international trade, international monetary relations, international migration of labour and global geopolitical issues.

Analysis of modern global economic and geopolitical processes involved in a number of scientists in Russia and other CIS countries. These must include: V. Inozemtsev, M. Delyahin A. Nyekypelov and L. Kondrashov, I. Sheremet 'ev A. Lavut, W. Teperman and L. Novoselov, Borokh A. and P. Kuligina B. Heifetz. Works in most of its extent, considering the problem of global management processes through the prism of specific economic and geopolitical interests of Russia, defining its role in international economic and political system [7].

In recent years, appears several works of scholars that examine modern world system in terms of aspects such as: development of human civilization, global integration processes, the current trends of international monetary relations. You can select the work these artists: Yuri Pakhomov, A. Belarus, Mr Gubsky, L. Bakaeva, O. Plotnikova, S. Crimea, VA Novitsky, D. Lukyanenko, Y. Pavlenko.

2009 will go down in economic history as the year global economic crisis times of globalization. This crisis has become a challenge for all countries without exception. Therefore, the ob-

jective analysis of its causes, mechanisms and effects are extremely important both theoretically (sense reasons) and the purely practical (and minimize the negative effects of economic recovery) plan [4; 15].

### **Main anti-crisis measures of the European Union:**

1. Reformation of the financial system. Europe must have a shared financial market, the primary function - providing mortgages, pensions and loans. Activities promote decency, honesty, transparency and protection against system-wide threats and excessive risks. Provide a European structure of financial oversight of the work companies.

2. Support priority areas. Basically it is a joint effort to open markets to invest in long-term goals. The EU has earmarked about 400 billion €, 3,3% of their gross domestic product - more than two years to stimulate activity and support people.

3. Saving people in employment. Providing updated information on unemployment. Consultations with trade unions, business community on how to improve the situation. Key priorities - mobility (free to move around the EU member states), foreign investment, increase in middle-aged workers. Activities increase in consumer demand and encourage more investment in infrastructure - € 1.8 billion designated for the social fund and support staff.

4. Contribution to the reconstruction of the global economy. The need for public spending and stimulate the economy and calls for strengthening rules and tightening oversight of the financial industry. G 20 Congress, international financial institutions - monitoring the economic risks. € 400 billion allocated to support the economy in the EU Member States, targeted investments in clean technology to speed the transition to a low carbon economy. Increase assistance to developing countries and that most affected by global economic crisis - 800 bln. € [14].

The table 1 presents a monitoring anti-crisis policy priorities of member countries the European Union:

**Table 1** Priorities of anti-crisis policy of the European Union

Country-member of the European Union	Priorities of anti-crisis policy
Germany	Demand-side policy and investments primarily in education and infrastructure.
France	Support for priority sectors - automotive, construction, preservation of jobs.
Great Britain	Policies to stimulate consumption and economic growth.
Italy	Support for social services.
Spain	Attracting investment and support the building industry.
Sweden	Financial support from state financial institutions.
Finland	Promote consumption and reduce the tax burden.
Austria	State loans, direct financial injections into the real sector.
Czech Republic	Promote consumption and reduce the tax burden.

### **Ukraine -- Germany**

#### ***Common features:***

- Lending banks and other financial institutions;
- Repurchase shares of state financial institutions;
- Reform of accounting requirements;
- Transport infrastructure. Reconstruction of the highway, bridges, roads, ports, airports and railways;
- Agreements with major employers, employers of compensation, the introduction of partial unemployment benefits;
- Increased costs of training;

- Raid lending.

***Distinctive features:***

- Tax incentives to individual sectors. Ukraine has used only one type of tax benefits - reducing the tax burden on investment, while the overall tax burden remains high, despite the crisis;
- Government loans, direct financial injections into the real sector. The German government plans to allocate machine-building German companies 500 million euros. In Ukraine, planned to provide state loans MMC companies and chemical industries. In practice this measure has not been implemented due to lack of funds in the stabilization fund, which was identified as a source of funding of the event;
- Implementation of sectoral programs. The EU is buying products designed to remove excess goods from the market, organizations are producers, with 50% price paid by the state (and the cost of buying goods for further free distribution in schools is compensated by the EU at 100%). Industry programs as a tool of public policy need an overhaul [5];
- Promote consumption. In Germany, for stimulating consumer demand in the second package to stimulate demand provided for payment of a bonus of 2500 euros to purchase a new ecological car. In Ukraine, the tool has been formally applied in the construction industry, particularly through the declaration of redemption in the objects of unfinished construction companies to form the foundations of social service and housing, provision of preferential loans to individuals and legal entities for housing and state purchase risky mortgages. Anticipated spend about 3 billion game. Redemption of unfinished housing with a high degree of willingness (at least 70%) and buy up to 1 bln mortgage securities of mortgage institutions. The program is not actually implemented because of lack of funding. As of October 2009 purchase of real estate in the primary [1; 2].

**Ukraine - France**

***Common features:***

- Lending banks and other financial institutions;
- Expand support for housing programs (programs providing affordable housing);
- Guarantees on bank credits / reimbursements of interest on bank loans;
- Energy credits;
- Transport infrastructure. Reconstruction of the highway, bridges, roads, ports, airports and railways;
- Raid lending.

***Distinctive features:***

- To guarantee bank refinancing and debt for public funds. In Ukraine, this practice is not used;
- Redemption of "toxic" assets (buying assets in troubled banks lost access to credit funds). In Ukraine there is no appropriate practice, although the Law of Ukraine "On Amendments to Certain Legislative Acts of Ukraine regarding the features of the activities on the financial health of banks" provides sensational banks that serve as banks for toxic assets [8];
- Creating a financial institution regulation of financial markets. Ukraine does not have yet any coherent strategic vision at the state level reform regulation of financial markets, which would provide for a special institute regulation of financial markets in general;
- The requirement for banks to lend to businesses and households. French President insisted on creating the post of "credit ombudsman, which monitors banks using state aid transparency and compliance procedures for companies to access credit. In Ukraine, similar requirements to the banks are absent [3];

- Tax incentives to individual sectors. Ukraine has used only one type of tax benefits - reducing the tax burden on investment, while the overall tax burden remains high, despite the crisis;
- Government loans, direct financial injections into the real sector. Government supports for car industry (selection 5-6 billion euros). In Ukraine, planned to provide state loans MMC companies and chemical industries. In practice this measure has not been implemented due to lack of funds in the stabilization fund, which was identified as a source of funding of the event [6];
- Implementation of sectorized programs;
- Intensifying the introduction of digital technology. Governments allocate funds for technical equipment schools, universities, government agencies etc. Ukraine this event is not employed;
- Increased unemployment benefits and expanding coverage and terms of payment. Fiscal constraints did not allow Ukraine to go this way;
- Reduction of foreign labour quotas. Ukraine, the event is not used.

### **Ukraine – Great Britain**

#### ***Common features***

- Measures to provide liquidity in local currency;
- Expand support for housing programs (programs include affordable housing, expansion of loan guarantee programs);
- Repurchase shares of state financial institutions;
- Limited cash reward top management;
- Reform of accounting requirements;
- Energy credits;
- Project support public-private partnership;
- Increased costs of training;
- Consulting assistance;
- Raid loans;
- Forming of special fund for investment in small and medium enterprises.

#### ***Distinctive features:***

- Measures to increase liquidity in foreign currency. Ukrainian practice of interventions in the foreign exchange market bull less transparent. Limited opportunities of the Ukrainian economy and lack of proper incentives will not use currency swaps as a source of liquidity;
- To guarantee bank refinancing and debt for public funds. In Ukraine, this practice is not used;
- The requirement for banks to lend to businesses and households. To receive funding from the state banks should make the government so called loan agreement that provides certain amounts and types of compulsory credit consumers and businesses. In Ukraine, similar requirements to the banks are absent;
- Government loans, direct financial injections into the real sector. Government supports for car industry (the allocation of £ 2.3 billion), of ecological cars. In Ukraine, is planned to provide state loans MMC companies and chemical industries. In practice this measure has not been implemented due to lack of funds in the stabilization fund, which was identified as a source of funding of the event;
- Implementation of sectorized programs [1; 2];
- Intensifying the introduction of digital technology. Governments allocate funds for technical equipment schools, universities, government agencies etc. Ukraine this event is not employed;



- Reduction of foreign labour quotas. Ukraine, the event is not used [9];
- Development of trade finance. Government supports exporting firm through the Department for export credit guarantees. In Ukraine there are no programs to promote exports through the development of trade finance. However, in some government program documents provided by the state guarantee funds to attract businesses to fulfil export contracts [10].

Smaller EU countries expect to maintain their economies less money. Austria promotes tax reform to reduce the tax burden on citizens to three billion euros. Hungary, which suffered greatly from the crisis over 5 billion spent on support for small business. Sweden adopted its anti-crisis program volume in 2, 4 billion euros. Belgium plans to allocate to stimulate its economy 2 billion.

Most extensive program approved EU countries whose economies this year will be in a recession. Most complex, projected European Commission will be the situation in Latvia, where GDP is expected to fall by 3 per cent. For Slovakia, Romania and Poland predict apparent weakening economy, but not a recession. So in those countries such measures are not as relevant. Most countries, making its anti-crisis program, cover the budget deficit through government debt.

The reaction of public authorities in different countries on the global financial and economic crisis was, in fact, quite similar, although the magnitude of the reaction and differ. The first steps were aimed at addressing the most urgent current issues - short term bank liquidity problems and problems of housing and mortgage market, where the crisis and actually began. The next step was significantly scale that supports and stimulates the economy in general and / or specific sectors and institutional agents.

It should also be noted that evaluate the effectiveness of certain measures requires a separate study, because such estimates in the report are missing [12].

The global financial crisis has adversely affected the economy of Ukraine:

1. Following January 2009, falling GDP, relative to January 2008 was 20% and reduction of industrial production - 34,1%.
2. In January 2009, net capital outflows from the country amounted to - 2.3 billion dollars.
3. From October 2008 to February 2009 the country's banking system has lost 75 billion USD, deposits, or 25% of resources.
4. Bank loss reserves to support the hryvnia exchange rate for IV quarter of 2008 and January 2009 totalled 11 billion dollars [11].

Analyzing short and long anti-crisis measures can be identified against the main priorities:

First of all - the stabilization of the situation on financial markets. In this area we consider the experience of leading countries that have successfully restored stability of the banking system and credibility.

Ukraine activated mechanisms such as stabilization and most European countries: strengthening the state guarantees the return of deposits, the frequency of viewing the central bank discount rate, the introduction of universal moratorium on the early termination of term deposits, repurchase of securities that can threaten the stability of the banking system and limit speculative trading in stock market, the target involving loans of international financial institutions, assist banks threatened with bankruptcy.

It should be emphasized that the National Bank of Ukraine is an independent institution that measures taken and identifies actions to strengthen the banking sector. But the government will not stand aside. This is primarily manifested in adoption crisis bill, which, despite the political contest, took the Government of Ukraine. It contains the main directions of overcoming the consequences of global financial crisis.

According to this law, the Government took action to ensure state participation in the increase in authorized capital formation and stabilization fund. The important role played by decision of the International Monetary Fund loan to the National Bank of Ukraine to strengthen its foreign exchange reserves. Unfortunately, the Bank could not stabilize the exchange rate of national currency, which caused huge losses and population and entrepreneurs. Once again I emphasize that the government can not interfere in the activities of the NBU.

The second package of measures designed to overcome the general economic stagnation and decline of production in certain sectors, a sharp increase in unemployment. Government approved a series of decisions aimed at solving problems in the mining and metallurgical industry, construction, light industry and agriculture sector [13].

Thirdly, a number of measures designed to support exports.

Government by their actions and all links, including trade mission at the Embassy of Ukraine in other countries, strongly supports the strengthening of domestic producers as on traditional and new markets. It should be emphasized that all work carried out in accordance with WTO requirements.

In addition, to suspend the negative trends in bilateral trade has developed a series of measures to reduce the negative balance in foreign trade, which provides for: the introduction of more stringent control procedures for imports to prevent entry into the customs territory of Ukraine goods that do not meet the national veterinary, sanitary, environmental, pharmacological standards, government support the introduction of financial instruments of high-tech export, increased cooperation within the transport corridors through the integration of the transport system of Ukraine to the trans-European others.

Fourth, the reduction in the tax base should provide revenue to the state budget from other sources while reducing costs.

The Government completed a review draft and approved the State Budget for 2009 in accordance with the current situation and development agreements with the IMF. In addition, a series of decisions concerning a reduction in funding for the maintenance of the controls and concept approach to the reduction in 2009 administrative costs and other expenses not related to development and social standards.

Fifth, reducing their own sources of investment needed to increase investment in the economy, including through cooperation with international financial organizations.

One of the main sources of investment the Government is considering projects with the World Bank and European Investment Bank. Currently activated development projects on energy and transport systems, public utility facilities.

Government pays great attention to projects for Euro 2012. Agreement signed with the World Bank loan to attract the equivalent of 3 billion USD for 1930 under five percent per annum to cover the state budget deficit.

In general, measures to improve the stability of the financial system, maintain liquidity, restore confidence in the banking system will ensure the renewal of the mechanism of redistribution of temporary funds in the economy in favour of financing investment projects, projects for expansion and intensification of production and processes of legalization of the economy and financial stability.

Consequently, the expected gradual recovery credit as basic industries, including metallurgy, chemical industry and those sectors oriented to domestic market and is significantly dependent on the activity of credit - a food industry, trade, agriculture [3].

Obtaining additional working capital will allow domestic companies to alleviate the negative effects of global crisis, increase production efficiency and competitiveness of its products.

Along with prevention of loss of working capital of mining and smelting complex in falling demand for their products, stabilization of production will expand domestic consumption of steel products through its reduction and use of machine-building and construction industries. Thus, "run" several large projects such as building infrastructure or production facilities of railway rolling stock in the chain will increase domestic demand for engineering, metallurgical, extractive production, building services, wholesale trade and transport, financial services and many other activities under development and their production.

Incentive domestic production, when in fact frozen for a period of working capital business entities, facilitate reorientation of the state budget for implementation of priority projects that require the use of products and services is domestic producers.

All this is aimed on stabilizing and reducing the negative trade balance, facilitate the growing volume of import restriction and loading of domestic enterprises, guaranteed the financing orders and avoid mass unemployment [11].

In areas of good growth (lasting more than 1 year) phase include the following:

1. Improving the quality of governance by:

1.1. Involvement of the civil service trained and experienced professionals with their constant retraining.

1.2. Development of a clear model state with only the goals and values and on this basis, the creation and implementation of socio-economic development of Ukraine, based on science, technology and innovation development in the light of global challenges the world economy.

1.3. Of integrated and coordinated system of economic management of the country and its scientific-technical and socio-economic development.

2. Develop and implement national conservation programs and development of labour potential of the country, providing in it:

2.1. Reforming the health care industry;

2.2. Reorganization and updating of high quality, technical and higher education.

3. High-priority development sector and its transition to new technology by way of:

3.1. The introduction of targeted state policy to stimulate this process by:

3.1.1. Cancel inefficient tax benefits of innovation orientation and introduction of effective incentives to accelerate the creation of innovative products.

3.1.2. Improving special tax treatment technology parks.

3.2. Conservation and development of scientific and technological capabilities through:

3.2.1. Ensuring legislation provided funding level fundamental and applied research of not less than 1,7-2,0% of GDP.

3.2.2. Promotion expenses of business entities for research are made in-house and by attracting specialized scientific organizations and educational institutions through the use gross tax credit at a rate 50%.

3.2.3. Introduction of effective incentives investment projects and accelerates the innovation direction creating innovative products with innovative businesses and organizations [1].

Finally I want to say that it is important how we come out of the crisis, what lessons learned and how to begin to move on. The main result of the world overcome financial crisis in Ukraine has become a structural reform and incentives to increase the competitiveness of Ukrainian producers, in the future will gradually resume trend growth in Ukraine.

We developed a new variant of socio-economic development in 2010. Together with scientists from developed strategy for Ukraine in 2020, which is based on a clear understanding of global mega trends and place of Ukraine in the world economy, the need to overcome the critical backing of Ukraine from foreign countries. The document includes a program for improv-

ing the competitiveness of Ukraine for 2010-2012 years on the priority areas of Government economic policy and long-term strategy for the period from 2013 to 2020 years, based primarily on harmonic principles of sustainable development and integration [8].

Anti-crisis policy in Ukraine, as in other countries, defined as scale crisis and financial opportunities states. Analysis of the declared and implemented measures enables to formulate the following conclusions:

1. The government of Ukraine decisions and resorted to anti-crisis measures are generally consistent with the logic of action and crisis areas in other countries, although Ukrainian politics has its own specifics. In a country used tactics point response to the crisis, because Ukraine has no objective resources to fully offset the negative economic consequences of the crisis.

2. Realized measures in its totality to some extent helped to alleviate the crisis manifestations on individual sectors of the economy and population. In particular, this time as a whole could support the social sector despite the current problems. It was a social sphere is the most legally protected, but at the same time, remains the least reformed and the most expensive for the state budget. Given the weight of twisted protected items, reduction of budget expenditures, which resorted to individual countries, even in times of crisis in Ukraine is almost impossible to realize.

3. Economic consequences of the crisis and side effects of anti-crisis policy in Ukraine are largely repeating the situation in other countries. Thus, the overall post-crisis world phenomenon was the accumulation of public debt, which will require a responsible fiscal policy in the years to the crisis.

4. Economic policy in Ukraine in the medium term should be built taking into account the legacy of overcoming crisis, which over time will determine the country's economic dynamics. Lack of institutional and structural reform remains the biggest problem that hinders economic development in general and to prevent effective economic policy in particular. It is this factor poses objectively Government (executive power) to a choice between economic logic and political expediency.

5. Ukraine needs efficient and consolidated government that will implement economic reforms and ensure stable growth of prosperity [1].

### Literature

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Lytvyn A. \*

## IMPACT OF THE WORLD FINANCIAL CRISIS ON THE UKRAINIAN IT-MARKET

*The article examines the classification of IT market segments, investigates the development dynamics of the Ukrainian IT market, its structural changes caused by the world financial crisis, highlights the expansion prospects of the domestic market of information technologies.*

**Keywords:** information technologies, IT-market, world financial crisis

*У статті розглянуто класифікацію сегментів ринку інформаційних технологій, досліджено динаміку розвитку ІТ-ринку України, його структурні зміни внаслідок впливу світової фінансової кризи, проаналізовані перспективи розвитку вітчизняного ринку інформаційних технологій.*

**Ключові слова:** інформаційні технології, ІТ-ринок, світова фінансова криза

*В статье рассмотрена классификация сегментов рынка информационных технологий, исследована динамика развития ИТ-рынка Украины, его структурные изменения в результате влияния мирового финансового кризиса, проанализированы перспективы развития отечественного рынка информационных технологий.*

**Ключевые слова:** информационные технологии, ИТ-рынок, мировой финансовый кризис

### 1. Introduction

In the era of the global knowledge-based economy, informational technologies (IT) play a unique role in increasing competitiveness of economic sectors and the state as a whole. IT help to spur efficiency in the production process, they set business to the global level and make government more transparent. The success of IT industry should be a key determinant of Ukraine's potential to compete in the world economic system. There is an urgent need to resort to knowledge-intensive, value-added production in order to provide sustainable economic and social development.

This article is devoted to a contemporary problem of the IT market's transformation in Ukraine. The world financial crisis has posed brand new questions and choices for Ukrainian government and IT companies. It has caused the necessity to analyze the impact of economic crisis on the IT industry in Ukraine, to find accessible opportunities to withstand the crisis and to preserve the competitiveness of IT companies.

Impact of the financial crisis on the Ukrainian IT market makes a big interest for scholars and economists-practitioners. Berner C. and Starkell N. have explored the prospects of Ukrainian IT industry. Yaroshchuk M. has compared the drivers of IT industry in Ukraine, Bulgaria and

\* Postgraduate student of the Department of World Economy and International Economic Relations of the Institute of International Relations of Kyiv National Taras Shevchenko University

Romania. Pilipenko O. and Samokhina T. have taken the critical stand towards the characteristics of downturn in the domestic market of informational technologies. Despite the author investigates the development of the Ukrainian IT market and its structural changes caused by the world financial crisis. The aim of the research is to analyze the impact of the world financial crisis on the Ukrainian IT-market. Conclusions about the expansion prospects of the domestic IT market are also drawn.

Methods of the scientific research implied in the article are such as: complex and system, graphical and statistical analyses, comparison method. The empirical and methodological parts of the article are based on domestic and international scientific publications in this field, as well as on analytical and statistical data of international organizations and consulting companies.

## 2. IT market structure

The IT industry can be defined as companies' concentration on the development, production, distribution and sales of products and services in the field of information technologies. It indicates that IT industry covers a diversity of activities related to IT (ranging from hardware, software to IT services).

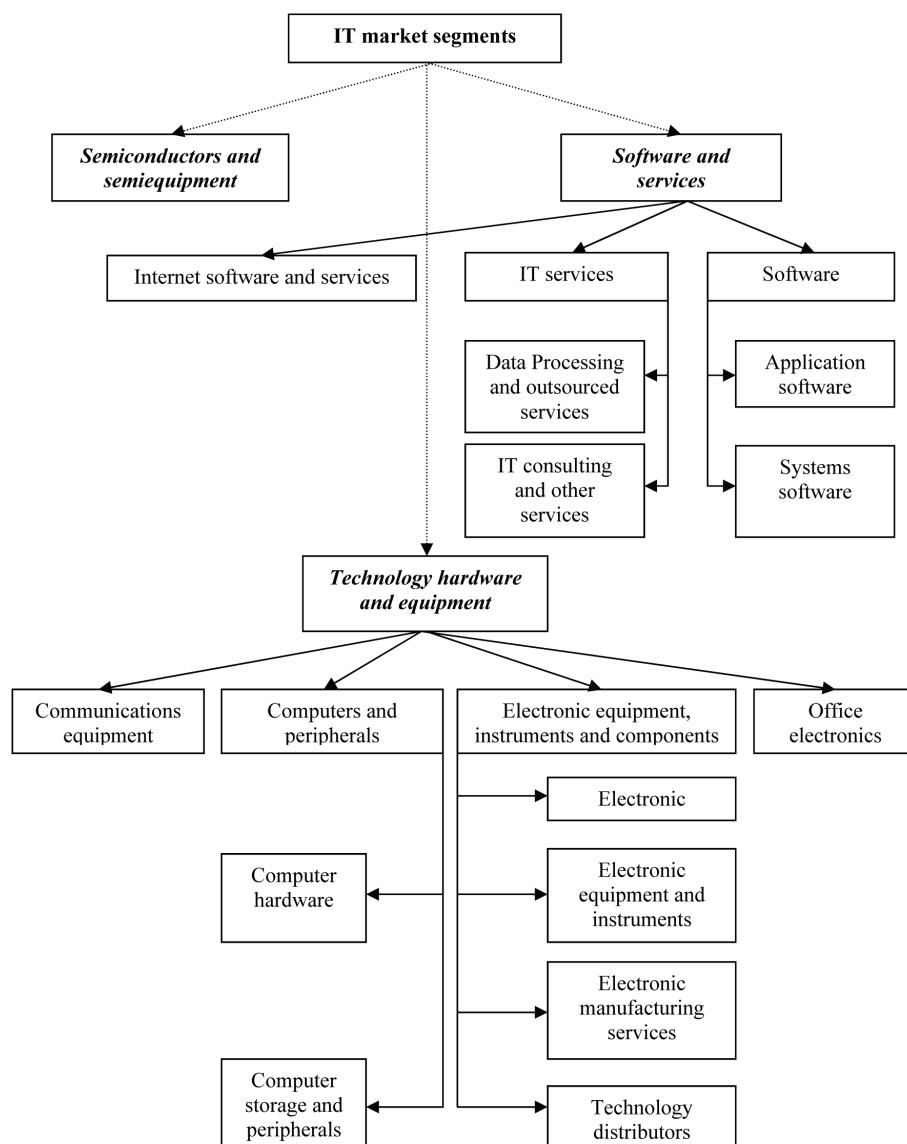


Fig. 1. IT market segments [12].

According to the international consultancy agency Bloomberg, the market of information technologies includes the following segments: semiconductors and semiequipment, software and services, technology hardware and equipment (Figure 1).

We would like to use another classification of IT market segments. In our opinion the division of the IT market on segments of hardware, software and IT services is more appropriate.

1. Hardware segment includes personal computers (PC), notebooks, monitors, printers, multifunctional devices, servers and data storage systems, data centers, networking telecommunication equipment, structured cable systems, engineering systems (infrastructure) etc.

2. Software segment consists of graphic packages, office applications, computer-aided design, data security systems, core applications (software for certain industries), Enterprise Resource Planning (ERP), Supply Chain Management (SCM), Customer Relationship Management (CRM), Business Intelligence (BI) systems, Enterprise Content Management (ECM) and others.

3. IT services may include services concerning introduction of IT infrastructure, applications, design of applications, IT outsourcing, IT consulting, IT education, virtualisation, “clouding” computing, lease of applications or hardware- “Software as a Service” (SaaS), “Infrastructure as a Service” (IaaS) respectively and others.

### **3. Response of the Ukrainian IT market to the world financial crisis**

Ukraine has been a pioneer in the computer industry. A small-scale computer, the first in continental Europe and the third in the world after the United States and Great Britain, was designed in Kyiv in 1951. By 1982, the V.Glushkov-led Cybernetics Institute and Design Bureau developed and released 30 types of different computers, computer complexes, as well as networks and equipment, and designed the respective software. Kyiv and Kharkiv designed and released on-board computers for nuclear submarines, ships and missile systems. The traditions of the world’s leading scientific schools that have formed over many years have been preserved until today, and the potential of computer specialists still corresponds to the level of major IT-producing countries.

The Ukrainian IT market belongs to the market ray with great prospects. Communication systems, e-commerce and electronic payment systems are developing very rapidly here. The Ukrainian IT sector is represented by almost 4,000 companies employing over 47,000 people. The software supply and development segment is represented both by Ukrainian companies and by representative offices of international IT corporations. Nowadays IT services account for more than 13% of the entire Ukrainian market, while computer hardware and equipment supplies account for the rest. That is why experts predict that this market segment will experience the most rapid growth, both due to increased domestic consumption and increased exports. Ukrainian specialists are sufficiently qualified to implement the most difficult projects. By various estimates, there are 30,000-50,000 highly-qualified programmers in Ukraine. Almost half of them are employed with companies taking orders from international corporations. Ukrainian outsourcing companies develop software used, in particular, by the world’s leading financial institutions. So far, Ukrainian exports of IT products and services account for about 1% of the world market [15].

The Ukrainian economic system is integrated into the world economy closely enough to be involved in the global processes. During 2000-2008, high growth in Ukraine was supported by favourable external conditions and was mainly demand-driven. Due to the massive decline of external demand and the reversal of capital flows during the global financial crisis some factors that have underpinned growth since 2000 have been exhausted. The terms of trade have already deteriorated and foreign credits granted to households and enterprises, which fuelled the consumption boom, have already strongly declined [6].

The world financial crisis of 2007-2008, as any other, has influenced the development of IT industry in Ukraine. The sharp decline in trade, foreign direct investment and access to international financing poses a risk to the global supply chains that underpin innovation of IT companies. These supply chains are critical sources that provide IT companies with technical expertise, knowledge of foreign markets, business contacts and international partners. The decline of trade and investment flows could have severe consequences for the transfers of information technologies and for innovation process at the global level. Since trade binds economies closely together, it helps to spread developments from one country to another, the negative developments as well as positive.

The crisis has been unfolding in several waves. The first wave rose in 2007, when stock indices of the world's leading banks and financial institutions went down. Under the circumstances, risk capital looking for stable yet high-profitability markets moved from developed to emerging markets, which continued to show high growth rates and profitability. As a result, stock markets in respective countries grew in 2007. China and Ukraine were leaders of such growth. The inflow of credits was also substantial: in 2007, Ukrainian economy borrowed USD 24.3 billion in the middle- and long-term credits [13]. In 2006–2007 the Ukrainian IT market's growth rate stood at 40–45%. This was the highest growth rate among Central Eastern European countries. With over 3.4 billion USD in volume, the Ukrainian IT market ranked fourth after Russia, Poland and the Czech Republic [15]. In 2008 the Ukrainian IT market has expanded to 3.9 billion USD [14].

The second wave started at the beginning of 2008, when the ongoing fall in the world stock markets re-directed cash flows from one class of assets to another, in particular to commodities (inclusive hardware) and energy resources. These assets became more marketable, and commodity prices soared up. The average metal and oil prices rose [1].

Ukraine's economy responded to the above challenges in the following way. The overall inflationary background intensified. Inflationary spiral, set spinning in 2007, has been in motion in 2008. Political instability affected economy. The convergence factor (resulting from openness of the Ukrainian economy to global trends, e.g. to the 2008 consumer price rise in most countries of the world) also accelerated inflation processes in the domestic consumer markets. In September CPI amounted to 101.1% (in January-September it amounted to 116.1%). The overall inflation was driven, first and foremost, by rising prices for services. The role of export-oriented production in the country's economic growth increased. At the beginning of 2008,

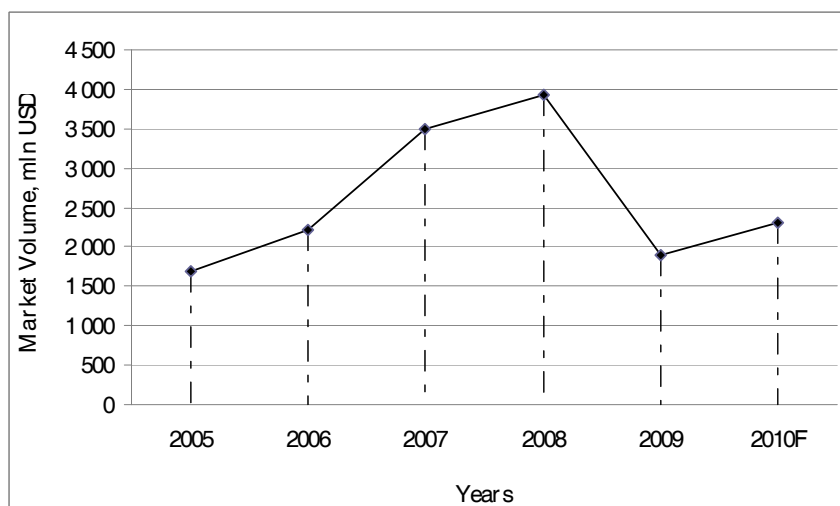


Fig. 2. Volume of the Ukrainian IT market in 2005-2010, million USD [14].

production growth in export-oriented sectors accelerated, and the financial resources of the national economy were re-distributed, in particular through the banking system, from other sectors into commodities and export-oriented ones. The second wave of the global financial crises set off ripples in the Ukrainian stock market. The PFTS index lost 43.5% in the first seven months of 2008, primarily

due to the withdrawal of some foreign investors from Ukrainian, as well as from the global, markets and to political instability in Ukraine.

The third wave of the global financial crisis has already caused a series of bankruptcies of the world's leading financial companies and financial crisis rollover to the real economy sector, drop in demand on global markets and, plummeting commodity prices and stagnation of economies [13]. In 2009 the Ukrainian market of information technologies has fallen approximately 50-52%, to 1.8 billion USD (Figure 2).

Before the crisis IT market of Ukraine showed rapid growth among the countries of Central and Eastern Europe. Since exchange rate of national currency has deteriorated, the sales to customers have greatly decreased in their volume. Pro tanto the commodity overabundance on storages has become a sharp problem. For its decision the row of market players have set to sell out IT products on the understated prices. This process has violated the natural cycle of novelty receipt. As a result, the last year was not marked by appearance of some brand new technologies and innovations in the IT industry. Rather it has caused the necessity to analyze the impact of economic crisis on the IT industry in Ukraine, to find accessible opportunities to withstand the crisis and to preserve the competitiveness of IT companies.

The hardware segment has declined in 2009 for 55 % to 1.5 billion USD (Figure 3). According to the IDC, the import of computers and laptops in Ukraine has decreased on 41 % in 2009 as compared with 2008 and reached 1.36 million devices. The share of notebooks has remained practically on the same level of 46 % in the import. 95 % of deliveries were held in Q3 and Q4 of 2009 due to overstocked storages of distributors and the low market activity in the first half of the year. In 2008 the volume of mobile PC market segment has declined on 56 % as against 2008 to the point of 345 million USD. The share of netbooks among the mobile computers has tripled to 11.3 %. In 2009 the volume of Ukrainian monitors segment was estimated in 500 thousand units that is almost twice less in comparison with 2008. The market share of Samsung and LG is over 70%. Acer and ASUS have approximately 10% both and Philips - about 5%. The technological tendency of 2009 was the transition to widescreen monitors that accumulated 86 % of the monitor segment. The demand softness for IT products has also caused the reduction of average price in the market segment.

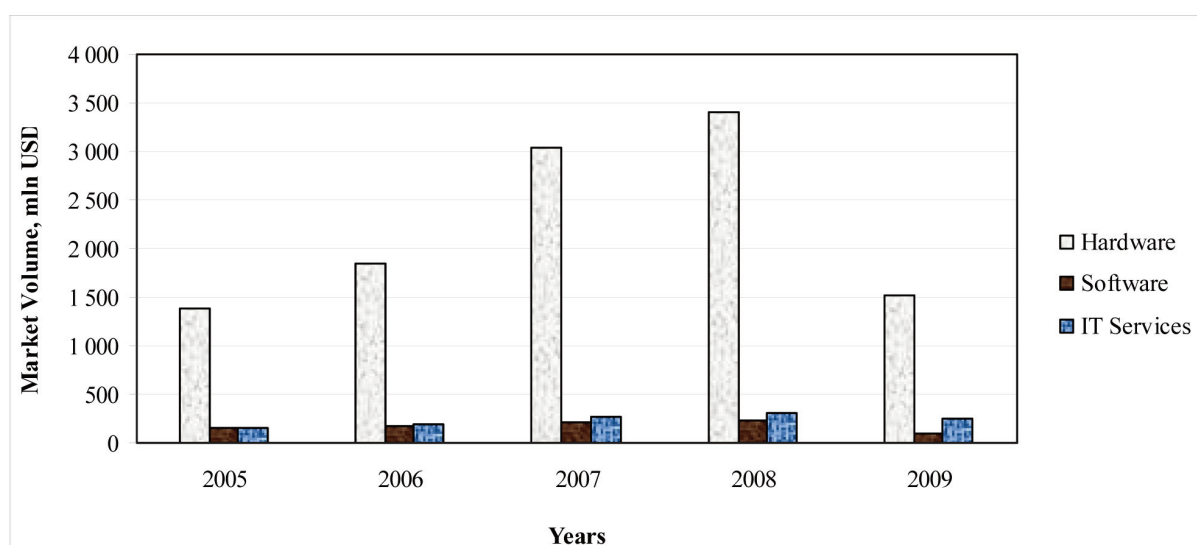


Fig. 3. Segments of Ukrainian IT market: hardware, software, IT services in 2005-2009, million USD [14].

The economic crisis has also influenced the domestic market segment of printing techniques. In 2009 their import in Ukraine equaled 422 thousand devices, that is only 45 % of the



previous year rate. The tendency is the further growth of the multifunction devices in the market segment.

In 2009 the sales of servers and data storage systems have deteriorated on 58 % to 50 million USD as compared to 2008. The leaders of this market segment have remained unchanged: Hewlett Packard, Dell and IBM.

The sales dynamics of hi-tech products was changing variously depending on a device class. In some segments, such as printing technique, a failure was about 80% in separate months. The falling proceeded up to the middle of 2009 for the market segment of notebooks.

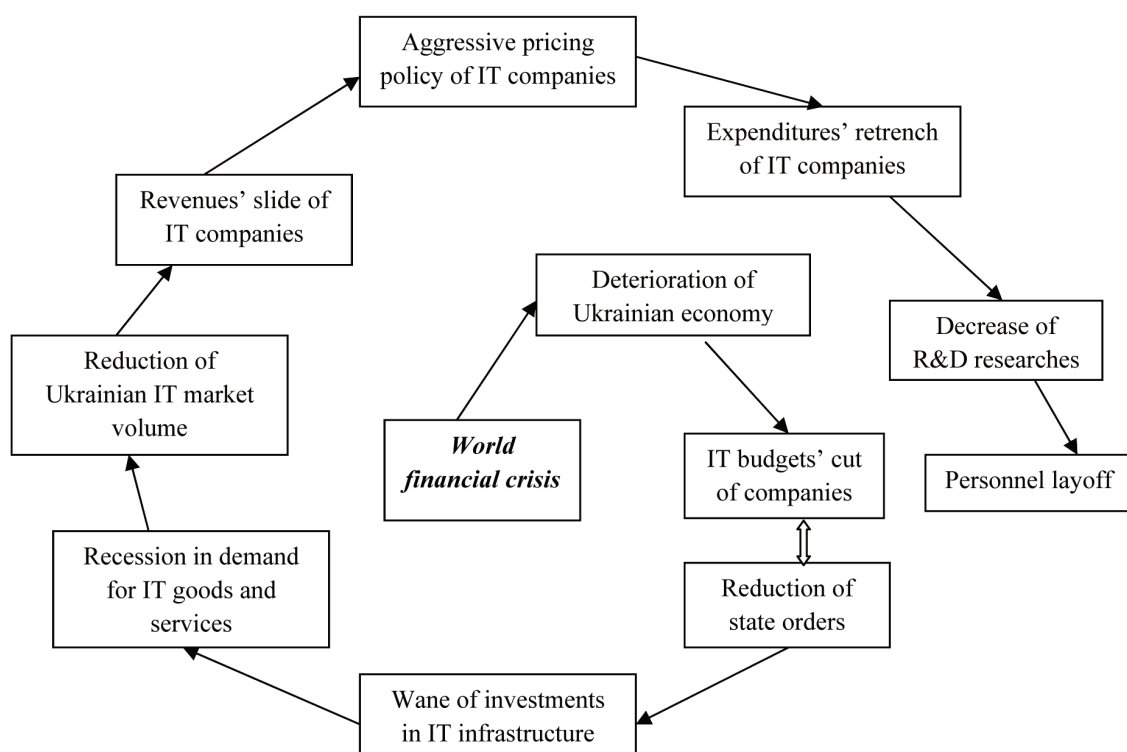
In 2009 the software sales in Ukraine fell approximately on 40 % up to 90-100 million USD. Thus, the dynamics differed strongly depending on a category. The demand for office applications has fallen down on 50 %, for graphic packages and computer-aided design – on 30%, the segment of data security systems has increased on 10 %, of virtualisation systems - has grown about 50 %. The reason of general decline is obvious – in the period of IT budgets' contraction the demand for licensed software has declined. Most of the companies displaced accents from development to support and optimisation of present infrastructure, to protection of internal resources.

According to estimations of market participants, the segment of business-applications has fallen down on 60-80%, within the limits of 10-20 million USD, and that is a level of 2004-2005. Suppliers and integrators used the unprecedented discounts, offered different variants of purchase, payments for services by instalment. The customers expended their funds foremost on support of current projects and sometimes on instruments and measures, which contributed to efficient growth of enterprises. Being not able to sell ERP applications to new customers, suppliers began to offer applications with additional functionality, generally the instruments of business analytics. So, during the crisis the demand for BI systems began to rise, especially for branch-wise systems and quickly implemented products such as QlikView. The demand for CRM systems in Ukrainian IT market is comparatively low. One of the greatest events was the introduction by Microsoft of the Dynamics CRM on a stadium Donbass Arena [18].

In 2009 the revenues of system integrators have fallen on 55-60 % as compared to results of 2008 and made about 400-500 million USD. Practically all projects were frozen in the first six months of 2009, except those that were set to be completed in the Q1 2009 [17]. Retail business, industry and state sector have greatly cut their IT budgets. In this period integrators were forced to restrict their business, to reduce the costs, to sell off the storage and enable the repayment of debts. The majority of IT companies have focused on separate priority directions in the range of products and key customers. Telecommunication companies and large banks have become the most active customers. The revenues of system integrators were earned mainly due to off-load of optimisation applications for IT infrastructure, construction of data centers, CRM decisions, analytical and information security systems.

Against the recession in demand for hardware and software the market segment of business applications remains rather stable. At the same time the demand for outsourcing and IT consulting has slightly grown [16]. In 2009 demand for the services of IT educational centers went down more than twice in comparison with a previous year. The economic situation in Ukraine forces loads of companies to diminish and even mop up the financing of educational programs for personnel. Such IT services as information security providing, design of business processes automation systems, management of resources, relations with customers and corporate content, IT outsourcing, virtualisation remain perspective. In 2009 the client base structure of system integrators did not have noticeable changes. Its basis is still formed by corporate customers (over 70 %) in financial, telecommunication, transport, industry and energy sectors.

We propose to reckon the influence of the world financial crisis on the Ukrainian IT market as a spiral model stated below (Figure 4). The world financial crisis deteriorated greatly the economic situation in Ukraine. Thus state and loads of companies were forced to cut their budgets for renewal of information technologies.



**Fig. 4.** Impact of the world financial crisis on the Ukrainian IT-market

The wane of investments in IT infrastructure has caused the recession in demand for IT goods and services and so, the volume of Ukrainian IT market has reduced. The most severe situation for IT companies was in Q1 2009. The majority of customers has mopped up large-scale IT projects and has financed only the current support of IT infrastructure. This has led to the sharp slide of revenues earned in the Ukrainian IT market. The overstocked storages, aggressive pricing policy of IT companies have caused the intensification of competition in the IT market. The majority of the companies have also faced with the liquidity problems [4].

The banking system was not able to finance the cash spreads and also large-scale projects. As a result IT companies have cut their expenditures in all directions, research and development inclusive (R&D). The IT companies were forced to announce layoffs. This human capital depreciated quickly because the downturn protracted. Some IT companies were not able to withstand such a severe situation and have withdrawn the IT market of Ukraine.

R&D is declining because it is mainly financed from cash flow (retained earnings), which contracts in downturns. At the same time, as banks, markets and investors have become more risk averse; firms face difficulties in tapping into external sources of funding to support their investments in R&D.

Business R&D is also being re-oriented towards short-term, low-risk innovations, while longer term, high risk innovation projects are being cut first [5, p. 6]. Small, innovative enterprises are particularly hard hit because in many cases their primary asset is intangible in nature (e.g. an idea or a patent) and difficult to value, making it hard to borrow against, or sell, to stay afloat. The crisis can, however, magnify the competitive advantage of research-intense IT com-

panies who seize the opportunity to reinforce market leadership through increased spending on innovation and R&D. Many of today's leading firms such as Microsoft or Nokia were born or transformed in the "creative destruction" of economic downturns.

#### **4. Development prospects of the IT market in Ukraine**

We suggest that the world financial crisis should influence the further renewal of Ukrainian IT market due to:

- optimisation of expenditures;
- diversification of IT goods and services by IT companies;
- optimisation of customers' network structure;
- active and rapid decision-making;
- quality improvement of IT goods and services;
- amelioration of competition in the IT market;
- market share's decline of hardware in the total IT market structure;
- growth of demand for IT outsourcing, "cloud computing", "green technologies".

IT market of Ukraine still has the low level of saturation. Thus, its potential is very large. Moreover, IT companies as well as individuals began to invest heavier in the appropriate fundamental IT education and training that significantly adds to the general trend. Ukraine will definitely keep the appreciation of the customers from all over the world for yet another decade. It will attract new clients by professionalism of the experts, low labor cost as well as by geographical vicinity and cultural connection to the Western Europe.

Ukraine is conspicuous among the international IT community, judging from the observation that almost every Ukrainian company has a western project in its portfolio. According to the Global Outsourcing Report, the leading forces in the IT outsourcing market worldwide are now quality and speed to market, not just cost of services. It is commonly known that Ukraine has inherited a scientific base along with its various technological and scientific establishments, mathematics schools and centers of computing technologies. Another fact is that 30,000 computer students graduate each year, who are praised for their analytical and creative skills. Employers are not satisfied, however, as graduates do not have good command of English, management skills and solid knowledge of the software development process. Thus, despite the large number of capable young workforce the industry experiences a shortage of IT specialists. At the moment, the percentage of professionals trained by higher educational institutions is growing, but is still low.

As a result, the business community calls on the state to reform the educational system. Companies suggest that the content of curriculum should undergo change, as the quality of IT-education in Ukraine cannot satisfy modern market demands and challenges. Industry observers also point to the problem that educational institutions do not employ practitioners to teach new courses in computer sciences. Consequently, more potential employees go abroad for education.

The representatives of the educational field bring up an argument that national universities should give a good basic foundation, and the rest of skill tailoring is to be done by the industry players, because IT industry evolves rapidly. Nevertheless, most recently Ministry of Education and Ministry of Transport and Communication have started to pay attention to this issue by organizing several conferences, which called for brainstorming solutions to the problem of educational service in IT discipline, the practical outcome of which is still to be seen.

Any industry cannot stay competitive long enough just based on the inherited factors of production and without support from the government in the form of favorable policies. Of course

each state has its own tradition and blindly duplicating policies in order to gain competitive advantage can lead to unexpected outcomes [11].

Germany is the biggest market for IT services in Europe. It is also among the late adopters of global sourcing options, because German customers prefer dealing with local partners. The supply of IT skills from countries with overheated IT labour markets like Czech, Poland, Hungary, Slovakia, Latvia, Estonia or Lithuania is not an option to increase the competitiveness of the German IT service providers facing competition from India and China. Economically, it is obviously not in the interest of the German IT services industry to deal with outsourcing companies from Eastern EU member states like Czech, Hungary or Latvia which will themselves subcontract parts of the work to outsourcing companies in Ukraine or Belarus. Thus, Ukraine may become an integrated part of cross-border value chain for the German and Swiss IT services sector. These delivery models combine nearshore and onshore service components and go along with a high organisational maturity level. As an example, Ukrainian outsourcing market leader Infopulse with their partner REVACOM from Germany deliver software management services “Made in Ukraine” to customers around the globe. Successful worldwide projects uniting IT engineers from Ukraine and delivery managers from Germany have already become reality and it mainly depends on the direction of the educational policy of Ukraine if the country will become the leading Eastern European supplier of outsourcing services to the German-speaking markets [2]. Investing in technology, in life science will be more competitive than any other field [3].

As for the IT industry, acquisitions of outsourcing companies have been happening in Ukraine for a few years. In the portfolio of US outsourcing company Exigen Group is Starsoft, a Ukrainian company. US- and India- based Global Logic merged with Ukrainian Bonus Technologies, whilst Kharkivbased Telesens was sold for 2.7 million USD to NASDAQ-listed TTI Telecom in December 2007. Earlier that year Norwegian IT giant EDB bought Miratech and Infopulse, two Ukrainian outsourcing companies. The consolidation of the IT industry is set to continue [8].

The information technology sector is the one which is the least regulated. It requires the lowest number of permit documents, and therefore it is a great deal easier for a foreign investor to come here and make a “Greenfield investment”, i.e. register a company, recruit personnel and organise the production of a software product which will be resold as a lot “at premium” for a specific consumer of the software product in developed markets. Therefore experts forecast no boom of mergers and acquisitions in the Ukrainian IT market. IT companies which are involved in programming in Ukraine – so called offshore programming – are companies which are not of interest from the point of view of a takeover; it is much easier to work with them on a contractor basis. This turns out to be less expensive. And there are fewer operational problems connected with management and with entry and purchase [9, p. 39].

Ukraine’s economy is emerging from a deep recession, benefiting from global economic recovery, a good harvest and a favourable base effect. In 2010, growth is forecast to be supported by improved external trade prospects. In addition, consumer demand is likely to remain resilient on the back of pre-election social spending increases and a large informal economy. Public investments related to preparations for the Euro 2012 football championship will also contribute. At the same time, as credit will continue to remain scarce (some revival is expected only in the second half of the year) and export prices are unlikely to increase as fast as in pre-crisis years, real GDP growth is forecast at a relatively moderate 3% in 2010 [7]. In 2010 the Ukrainian IT market will grow more than 25 % up to 2.3 billion USD [14].



### **5. Governmental policies**

As it is impossible to imagine any innovative advancement without IT, officials have declared information technology among priorities for national development. Thus, at the beginning of 2007 the Ukrainian Parliament adopted the Law of Ukraine "On the Foundations of the Development of Ukrainian Information Society in 2007-2015", which was followed by the Action Plan on Implementing the Tasks Envisaged by the Law of Ukraine. The goal of the law and the subsequent documents is to promote an information society in Ukraine, hence strengthening basis for IT sector development.

The growth of the IT market is conditioned also on improvement of investment climate. In this domain, was issued a decree at the end of 2005 which created a State Agency for Investment and Innovations (SAII). Two more additional bodies were brought into existence in 2006, such as the Ukrainian Center for Investment and the State Company for Innovations, which later were brought under the auspices of SAII. In May 2007, thanks to initiative of SAII and the National Technical University "Kyiv Polytechnic Institute" a special corporation was born, Science Park "Kyiv Polytechnic", which now brings together academia, science researchers and manufacturers to reinforce innovative and informational development of the country. The key effort needed to improve the situation is the development of a sustainable strategy in creating legislation that would help build institutional infrastructure in the IT industry.

Explanation for the absence of a concrete strategy on behalf of the state is mentioned by business community. They argue that if the IT industry is considered per se, then its current share of GDP is only 3%, whereas the threshold figure is 10%. Thus when IT industry in Ukraine reaches this point, it would be difficult to neglect it, and then it could be more realistic to expect assistance from the state. Thus, the IT market has to grow by at least 3 times before the state will take notice of it. Yet, this poses a puzzle, as it seems that such support is already badly needed, especially when it comes to intellectual property rights (IPR) protection laws and their enforcement, alleviation of taxes, custom rules, changes in copyrights, etc. Such influential companies, as Microsoft, Intel, and Oracle, repeatedly engage in discussions with the government to take necessary steps in this direction.

The root problems can also be eliminated by Ukraine's accession to WTO, which imposes certain sets of laws, standards and society's awareness of IPR issues. Accession to WTO serves as a positive boost for export-oriented industries, which is also a feature of Ukrainian IT at the moment. Consequently, an additional optimistic prospect for the Ukrainian economy will be the launching of a Free Trade Area with the European Union as a part of the upcoming agreement, which is currently under negotiation. These two milestones are the chances for Ukraine to bring its regulations into compliance with international standards.

When reviewing factor conditions, it becomes apparent that favorable and timely governmental policies still play a significant role in improving the country's image needed for international investment and for normal functioning of domestic industry players. In this respect, Ukraine can learn from regional leaders, which in turn emulated best practices of mature international IT nations. First, a clear-cut and balanced state strategy is needed in Ukraine to support the growing market, which, on the one hand, has a critical set of attraction factors, but, on the other hand, suffers from a weak business environment. Then, links with international markets can be more easily achieved due to improved credibility rating. Thus, work is to be done on two fronts: domestic and international, because a combination of strong players both local and foreign-owned is more beneficial for the country's economy as a whole. While international companies serve as drivers most of the time (for policies, collaboration initiatives, etc), local firms are perceived as necessary for development of high-value added national products needed to



maintain competitiveness in future. While Ukraine rates better in terms of market size, salary level, and potential for growth, it still has to catch up with mature IT states when it comes to relevant educational policies, share of services and infrastructure to maintain favorable local and international demand. Therefore, the key to success is to be ready when the opportunity comes [11].

Effective support of the national IT business is needed. In order to make this process less declarative, it should be based on corresponding regulatory and legal framework. It is, first of all, government and business partnership plan and also legislative enablers. In practice it is expedient to begin with a common solution of the problem of super high debts of national companies and with overcoming the situation of possible corporate defaults. Ukraine has low credit ratings and vague prospects of export revenue renewal. As a result, access of national companies to international capital market is limited. Thus, independent restructuring of leading Ukrainian companies' debts is next to impossible. The government should join negotiation in order to regulate the problem of international debts and to avoid corporate defaults, sometimes by giving government guarantees with the condition of restructuring the debts [10].

The new policies should include incentives to establish knowledge-based operations; growth of the education spending, stable economic and political environment. Inevitably the long-term outsourcing industry should flourish.

## **6. Conclusions**

The world financial crisis has prompted an immediate response by Ukrainian government to avoid a collapse of the financial and banking systems and limit the economic effects of the credit crunch. Such policies aim at stabilizing the economy and initiating a rapid recovery. But policies also need to ensure that the recovery is durable, i.e. based on sustainable growth. For Ukraine it is the question of vital importance to shift to knowledge-based service economy where investment into information technologies is of equal magnitude as investment in machinery, equipment and buildings.

The current economic situation poses new questions and choices for Ukrainian government. It offers an opportunity to strengthen the medium and long-term potential of IT industry. Government should incorporate forward-looking structural measures that inject information technologies into the mix of policies being adopted to tackle the economic downturn. Some of these may add to demand for IT in the short term, but most are more likely to offer benefits in the longer term.

It is important to provide favourable investment terms for Ukrainian IT industry, especially to reduce risks of potential investors by development of weighed macroeconomic policy and functional legislative field. At the same time the state should provide the sufficient level of economic freedom for activation of IT market development mechanisms. There are highly skilled specialists in the IT sphere; their wage rate is much lower than the world rate. In spite of this the Ukrainian IT market is competitive neither in regional nor in global scale. Basic development obstructions for IT industry such as: low level of investment attractiveness, absence of the legal base in the IT field, per se the high level of the shadow IT segment, especially for software and also rapid rate of intellectual emigration from Ukraine can result in the irretrievable loss of perspective IT industry. So the domestic high tech field needs national development programs, balance of the world integration processes and objective national interests, balance between interests of foreign and local business.

Economic crisis is the time of industrial renewal. Less efficient IT companies fail while more dynamic ones emerge and expand. Creative destruction is an essential engine of long term

efficiency in the market economy. New business models and new technologies, particularly those allowing a reduction in cost, often arise in downturns. As some players in the Ukrainian IT market weaken, they open space for new players and innovators.

Information technology industry has a chance to outgrow due to an orientation on the off-shore programming. The prior state vocation is to support the knowledge-intensive, value-added production based on the brand new information technologies. This will add up to the competitiveness growths for Ukrainian IT companies in the regional and the world market of information technologies.

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Lytvyn O.\*

## BASIC DETERMINANTS OF CRISIS RESPONSE ECONOMIC POLICY OF UKRAINE

**Annotation** *This paper is aimed at anti-crisis economic policy peculiarities' formation of Ukraine. The relevance is the analysis of macroeconomic development of the country, fiscal and monetary policy, banking regulation, structural reforms and pillars of crisis resolution.*

**Key words:** determinants, anti-crisis policy, Ukraine.

**Анотація** *Ця стаття присвячена особливостям формування антикризової економічної політики України. Актуальність полягає в аналізі макроекономічного розвитку країни, фінансової і монетарної політики, банківського регулювання, структурних реформ і стратегічних шляхів виходу із кризової ситуації.*

**Ключові слова:** детермінанти, антикризова політика, Україна.

**Аннотация** *Эта статья посвящена особенностям формирования антикризисной экономической политики Украины. Актуальность состоит в анализе макроекономического развития страны, фискальной и монетарной политики, банковского регулирования, структурных реформ и стратегических путей выхода из кризисной ситуации.*

**Ключевые слова:** детерминанты, антикризисная политика, Украина.

### Introduction

Ukraine is one of a number of emerging markets to have experienced increased financial market stress in recent years, though local factors, notably corporate governance concerns, the rise in the gas price, presidential elections 2010 grew in importance. Net private capital inflows have receded, the value of equity collateral has fallen and confidence in counterparties has weakened, causing interbank rates to jump. Deterioration of economic situation in Ukraine was in some sort a result of global liquidity fall and deceleration of economic development in the majority of countries. It limited the access of the real sector enterprises and banks to foreign lending on the one hand, and, on the other hand, there was reduction of demand for the traditional Ukrainian export goods due to the unfavourable situation.

The core of this article is practical recommendations of macroeconomic policy optimizations of Ukraine as a factor of stabilization and development of structural reforms in the country. The fundamental scientific contribution into investigation of general theoretical and special problems of crisis-response policy of Ukraine is made by the following scholars and economists as: A. Åslund, M. Balston, B. Danylyshyn, A. Kapteyn, V. Korneev, Y. Lissovolik, O. Paskhaver, O. Pogarska, E. Segura. N. Shvets', T. Vakhnenko and others. Despite their basis, the author of the article thoroughly investigates pre-crisis and post-crisis macroeconomic development of the

\* Postgraduate student of the Ukrainian State University of Finance and International Trade

country, fiscal and monetary policy, banking regulation, structural reforms and pillars of crisis resolution.

### **1. Pre-crisis macroeconomic development and structural reforms**

During the years of 2000-2007, Ukraine enjoyed high economic growth and reasonable stability. An upward rating trajectory was interrupted by the “Orange Revolution” of late 2004 and subsequent political and economic disappointments in 2005. However, the evidence of growing stability of the democratic regime, supplemented by more balanced macroeconomic growth, the country’s accession to the WTO in May 2008, and various factors that combine to stimulate much-needed microeconomic restructuring and energy-efficiency measures, prompted a strong growth of the country.

For the past eight years (with the exception of 2004), Ukraine ran either a consolidated budget surplus or else a small deficit. The final deficit for 2007 was only 1.1% gross domestic product (GDP). Taxes provided for over 73% of all revenues. Starting in 2004, successive governments have increased social expenditures and public sector wages in an effort to raise living standards and gain political support. Social transfers including pensions rose from 15% GDP (2002-2003) to 20% GDP (2005-2007). Budget deficits remained contained because increased social transfers have been countered by cuts in capital expenditures. Also, it has not proved possible to lower various tax rates as much as had been envisaged by various governments, due to populist social welfare expenditure trends [Schiffer J. 2008, p. 5].

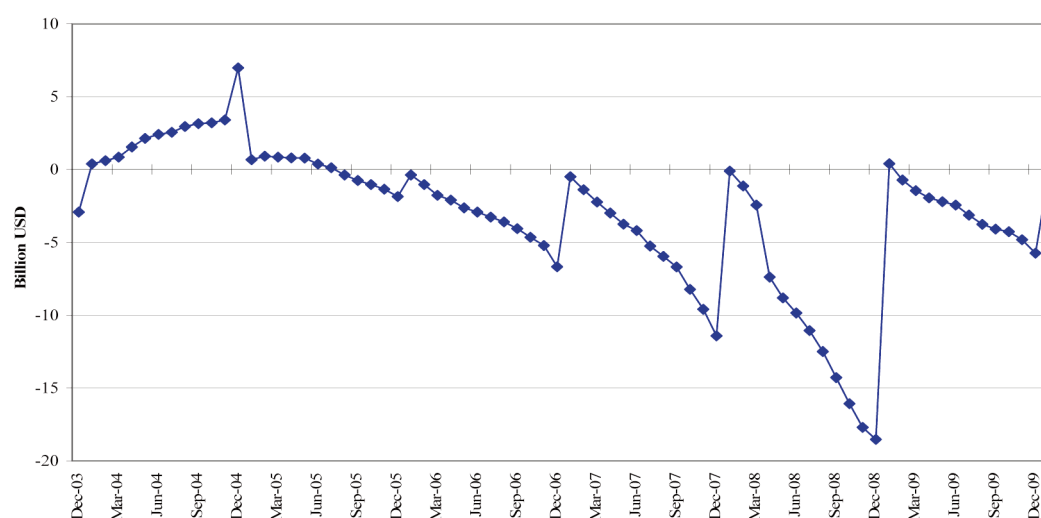
Ukrainian authorities are usually fiscally conservative with the level of budget deficit. Ukraine’s technical default in 2000, which stemmed from carelessly loose fiscal policies in the 1990s, made policy-makers cautious about public debt and budget deficits. Only in 2004 fiscal authorities broke the 2.5% ceiling of GDP for deficit level. However, on the heels of aggravating economic problems the government attempts to resurrect the poor practice of an unsustainable budget deficit (-1.5% of GDP in 2008).

Although the deficit by itself was not a problem in 2008, public finances suffered extremely high levels of recurrent expenditures. On-going outlays account for more than 80% of the annual budget leaving very little funds to invest. The problem stems from Soviet privileges and the continued social policy by the authorities. In fact more than 60% of recurrent spending was public sector wages and social transfers. Although there was a positive tendency to reduce the recurrent outlays beginning in 2006 through 2008, the result was not a real improvement. Broadly speaking, the authorities just cut the excessive social outlays which increased during the ‘post-revolutionary’ period of 2004-2005. For significant reductions in recurrent spending the government needs to address social privileges reform and pension reform; however, little progress had been observed in these areas for many years.

Ukraine has exhibited a strong improvement in terms of its external vulnerability ratio – which has dropped from 593% (2000) to 76% (2007), due to a sharp growth of foreign currency reserves. However, its ratio was still above the median for B1 – C category rating peers (63%) [Schiffer J. 2008, p. 2]. Net foreign direct investment (FDI) grew robustly in 2007, totalling over USD 9 billion. Cyprus, representing recycled Ukrainian assets, and Germany were the largest country sources of foreign investment. Both have total stocks of FDI of almost USD 6 billion out of a net FDI total stock of USD 33.5 billion at end-2007.

Growing diversification in production and exports was matched by growing diversification in export markets. During the years of 2000-2007 the main export market shares were the CIS – 38%, EU – 30%, Asia – 21%. Russia took 26% of all exports, Turkey – 7.3%, Germany – 3.4%, Poland – 3.4%, Kazakhstan – 2.9%, Hungary – 2.5%. Ukraine’s trade balance deteriorated significantly in 2007 growing by 71% year-on-year. Imports (up 29% yoy) outpaced ex-

ports (up 25% yoy) (see chart 1), due to surging domestic demand (retail trade grew at an annual rate of 29%; disposable household income grew 13%).



**Chart 1** Foreign trade Balance of Ukraine  
Source: State Statistics Committee of Ukraine

Much of import growth was prompted by serious industrial restructuring (machinery imports were up 48% yoy), as well as a substantial rise in the price of imported gas from Russia. Russian gas giant Gazprom raised the price of gas 37%, to USD 130/1000 cubic meters. This made the gas import bill USD 6.6 billion in 2007 as opposed to USD 4.9 billion in 2006. The service balance was in surplus, rising to over USD 4 billion in 2007. Large increases in imports of services provided by non-residents were registered in financial services (up over 100%) and transportation services (up over 40%), both indicating greater involvement by Ukrainian companies in international trade-related services. Export services continued to be dominated by pipeline transportation, which yielded over 25% of overall service exports. The transit price charged by Naftogaz has risen from USD 1.09/1000 cubic meters/100 kilometers in 2005 to USD 1.70 in 2008.

Strengthening the banking sector's capacity and share of bank claims on long-term credits has constantly grown since 2000 and constituted almost 70% of bank credit portfolios as of July 2008, whereas the share of long-term liabilities has grown at a substantially lower rate reaching 45%. At the same time, between 2000-2008 (and, especially, 2006-2008) bank credits grew at higher rates than borrowed funds implying growing liquidity risks and lack of effort by banks to address the issue. The very rapid growth of credit portfolio (174% in 2007 compared to 2006) was a concern by itself. Usually a high growth implied deterioration of credit quality unless accompanied by a more stringent screening process of potential borrowers, which raised substantial concerns about the future level of non-performing bank loans.

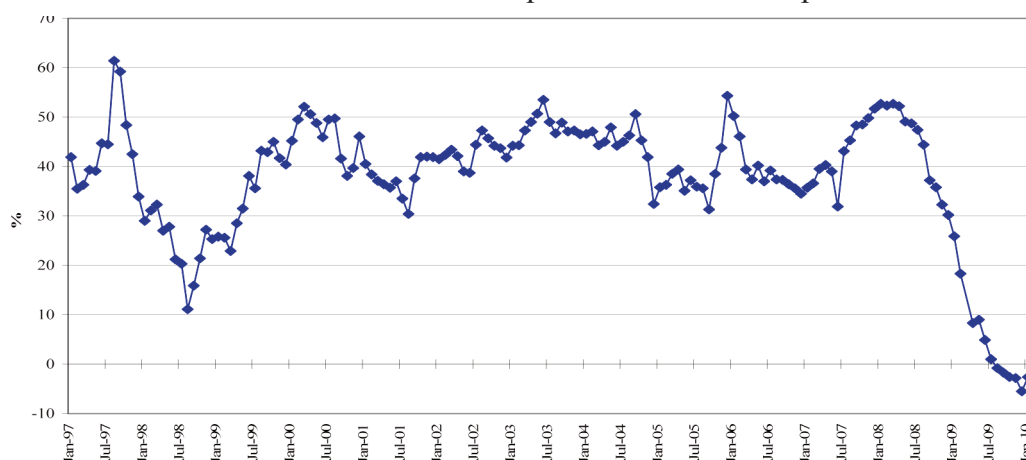
For many years Ukraine pegged its exchange rate to the US dollar. The original purpose of the peg was to have a nominal anchor to contain inflation. However, from 2003 to 2008 inflation rose gradually, eventually reaching a very high rate. In effect, Ukraine was importing inflation in terms of rising food and energy prices through its dollar peg. According to the World Bank's Government Effectiveness Index – that rates governments from -2.50 to +2.50, Ukraine (-0.57 in 2006).

All along, the Ukrainian public kept a large share of its savings in dollars and as the exchange rate remained stable it felt no need for a switch into Hryvnia (UAH). At the same time, bank loans denominated in dollars were cheaper than those in Hryvnia, as they carried consid-



erably lower interest rates. Households and enterprises did not fear a rise in the dollar as the exchange rate of the Hryvnia had remained unchanged for years. As a consequence, the Ukrainian economy was highly dollarized with the public insisting on maintaining a fixed exchange rate.

From 2000 until 2008, Ukraine went through a tremendous monetization. The volume of money (M3) rose from 15% to 54% of GDP at the end of 2008 (see chart 2). Most of this was bank lending from private banks to Ukrainian corporations and consumers. This big credit boom was the one of the drivers of Ukraine's high economic growth years. It has been especially strong in the past four years, with real GDP increasing by an average of 7.4%. Thanks to strong income growth, private households have reached a level of solvency that has allowed them to apply for bank loans and an increased level of savings has helped banks to expand their deposit bases. Similarly, banks have benefited from increased corporate income and deposits.



**Chart 2** Money Supply M3 of Ukraine (YoY)

Source: National Bank of Ukraine

The degree of banking system penetration has been steadily growing, as reflected by significant deposit and credit expansion. Banking assets represented 84% of GDP at year-end 2007 compared with 63% in 2006 and 48% in 2005. However, this is still a considerably lower ratio than the average for Central and Eastern Europe, excluding Russia, of approximately 100%, according to Moody's estimates. The share of banks' income generated from retail and SME lending is increasing. This is expected to bring more stability to their earnings. The share of retail loans in total loans granted to the private sector rose to 36% in October 2008 from 13% in 2003. Moreover, retail deposits increased faster than corporate deposits in 2008. According to the National Bank of Ukraine (NBU), between January and October 2008, retail deposits increased by 19.2% while corporate deposits increased by 16.6%. Income from retail banking was relatively stable compared with income from wholesale banking where banks were often exposed to developments affecting large corporate customers [Robeck K. et al. 2009, p. 6-8].

High interest rates on Hryvnia deposits combined with the fixed exchange rate fuelled an increase in exchange rate risks throughout 2008. The relative proportion of Hryvnia-denominated liabilities was steadily rising, as were interest rates on deposits in Hryvnia. At the same time, in the structure of credit portfolio one observed Hryvnia denominated loans being replaced by loans issued in foreign currencies (primarily, US dollar) and stable, sometimes falling, credit interest rates. Given the fixed exchange rate or appreciation of the domestic currency vis-à-vis the US dollar in the mid of 2008, the described currency compositions of credits and deposits implied increasing liability coupled with the same or decreasing assets.

The external debt of the state and finance metrics were much improved, thanks to several years of large current account surpluses and prudent fiscal policy, previous debt restructuring, and continued inflows of foreign capital that have raised foreign currency reserves and improved liquidity ratios substantially. However, these indicators compared unfavourably to rating peers because of heavy external borrowing by the private sector.

The booming Ukrainian economy has attracted substantial foreign investment in the banking sector. As of October 2008, 50 Ukrainian banks were at least partly foreign-owned and 18 banks were 100% foreign-owned. Between January 2007 and October 2008, the share of foreign capital in total registered capital rose to 38% from 28%. The share of foreign currency liabilities on banks' balance sheets was 29.5% in September 2008, according to the NBU data.

Foreign-owned banks were in a comparatively good position as they could pick up market shares from privately owned banks. During the past few years of robust economic growth in the EU, a number of foreign owned banks in Ukraine have benefited from earnings that parent banks had generated at home and invested in their subsidiaries. Given that capital markets were relatively underdeveloped in Ukraine with significantly lower stock market capitalisation, parent capital has been a vital source of growth for banks.

To sum up, despite a political turbulence the Ukrainian economy continued to demonstrate remarkable performance during the years of 2000-2007. From 2003 to 2007 Ukraine had one of the fastest growing economies among other CIS countries. This growth was supported by booming domestic demand and strong exports. From January to September 2008, Ukraine continued to enjoy good economic results, such as: real GDP grew by 6.3%, inflation decreased, the fiscal budget was in surplus, public debt declined, exports grew by 50%, the current account deficit was being met by capital inflows, international reserves reached USD 37 billion (see chart 3). Ukraine has a market-based economy, in which total government expenditure, including consumption and transfer payments, was high. Ukraine promoted foreign investment with national treatment, except in select sectors.

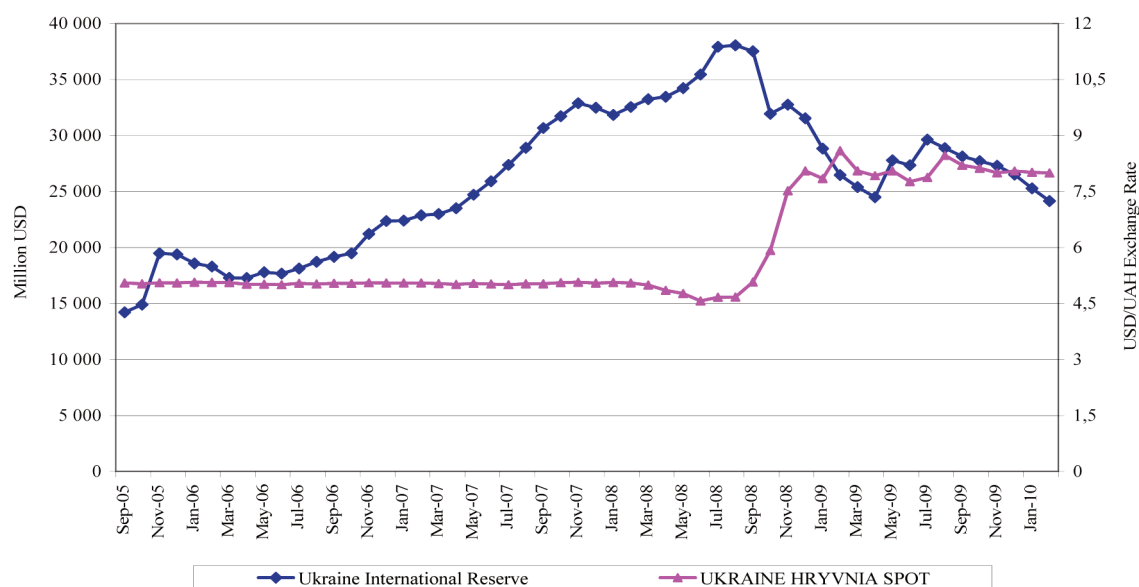
## **2. The crisis impact on the Ukrainian economy**

Ukraine has been one of the countries in the world most severely hit by the crisis. In 2008 there was the collapse of macroeconomic stability in the country. The steadily rising inflation peaked out, while the current account deficit became excessive, rendering a large depreciation of the currency necessary. In late September 2008, global liquidity froze, and Ukraine was completely excluded from global finance. Several industries – construction, metallurgy, mining, and machine-building – saw their output falling momentarily by about half. Only agriculture escaped the crisis, especially grain sector.

Ukraine suffered badly during the crisis for several reasons. The fundamental problem was Ukraine's exchange rate policy. The country had maintained a fixed exchange rate to the US dollar for years. By 2008 the persistently high inflation and even higher wage increases, left Ukraine with a very high cost level, making it difficult for the country to compete on the international market, as reflected in a widening gap between imports and exports. When international credit dried up on account of the global financial crisis, Ukraine's large current account deficit could no longer be financed. This left no choice but to devalue the overvalued currency. Being the only sensible solution, the need for a lower exchange rate was incorporated in Ukraine's letter of intent containing its request for a credit from the International Monetary Fund (IMF)

Therefore, currency inflows increased the money supply excessively (see chart 2), resulting in inflation. Ukraine had experienced double-digit inflation from 2004, and in May 2008 in-

flation peaked practically at 31% year over year. As a consequence, Ukraine priced itself out of the market. Imports rose more than exports (see chart 1), and the current account deficit expanded to 7% of GDP in 2008. At the same time Ukraine's foreign debt rapidly accumulated to USD 103 billion or 57% of GDP in 2008, adding to the country's vulnerability.

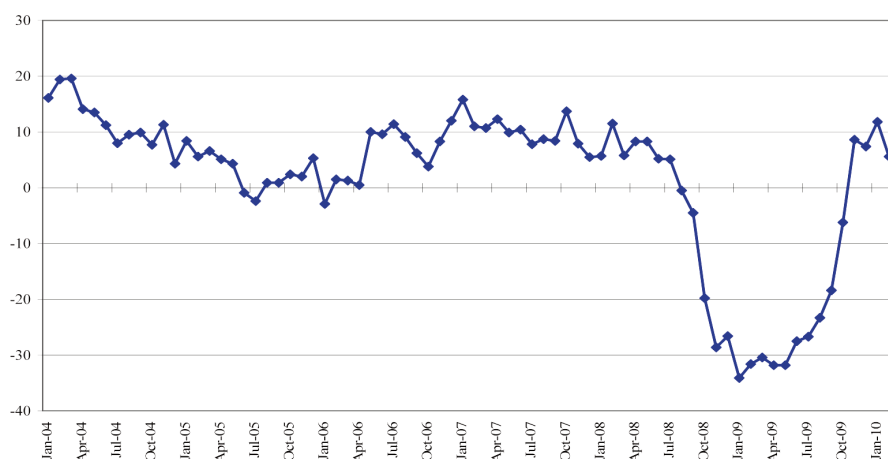


**Chart 3** International Reserve Level of Ukraine vs USD/UAH Exchange Rate

Source: National Bank of Ukraine

In Q4 2008 the reduction of long-term capital inflow and outflow of short-term capital resulted in the negative aggregate balance of payments (USD 3.1 billion). Consumer Price Index made 122.3%, as a result of both global increase in the world prices (in particular, food prices) and internal factors, such as: macroeconomic imbalances, deterioration of inflationary expectations of households [Council of NBU, 2009]. The macroeconomic conditions for implementation of the monetary policy became rather complicated with regard to the risks of unfolding recession processes in the real sector due to forecasted deceleration of the world economy development and reduction of domestic demand, as well as to complicated access to external and internal sources of financing.

In the real sector of the economy, the industrial production of Ukraine fell down in November 2008 and reached the worst situation in January 2009 (see chart 4). Ukraine witnessed



**Chart 4** Industrial Production of Ukraine (YoY)

Source: State Statistics Committee of Ukraine

a notable improvement in the dynamics of industrial production in October 2009, which declined by 6.2% yoy, with month-on-month growth reaching 5%. Overall, in January-October 2009 industrial production declined by 26.4% yoy. A decline in investor sentiment towards emerging market, political uncertainty and a

fall in steel prices led to the depreciation of the Hryvnia with adverse affects for inflation, debt servicing, and the asset quality of the banking system as the majority of foreign currency borrowings are on-lent in foreign currency-denominated loans.

To sum up, there were three main channels of the financial crisis influence, more deeply-felt by the Ukrainian economy [Danylyshyn, B. 2008]. The first channel was foreign trade. Widespread financial problems have already undermined demand in the international markets. Recession in the world's leading economies was accompanied by the decreasing investment demand in the metallurgy and machine building products. Since the Ukrainian economy was highly dependent on exports making up more than 47% of the country's GDP, the above trends in the global markets were harmful for the development of export-oriented sectors, with subsequent repercussions on industries relying on exports directly and indirectly.

In 2008, exports grew fast at 33%, but imports grew even faster at 39%. As a result, the current account deficit reached around USD 13 billion in 2008, or 7.2% of GDP. Although the net inflow of foreign direct investment (FDI) comprised a substantial USD 9.7 billion, it did not cover the current account deficit. To absorb the gap, Ukraine used reserves and depreciated the Hryvnia.

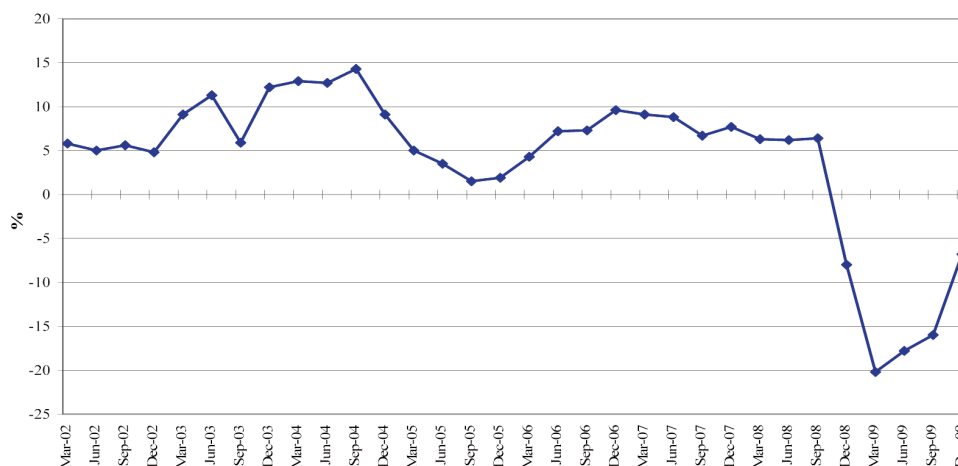
The second channel was the banking system. The financial sector was one of the national leaders in attracting foreign direct investments (19% of total accumulated foreign capital). Given the large share of transnational financial corporations on the Ukrainian banking sector, the global financial crisis had an indirect adverse impact if mother companies suffered great losses or had liquidity problems. In this context, the investments and development of Ukrainian manufacturing companies hinge more on lending than on the stock market: 16% of investments in fixed assets were funded from loans. The most credit-dependent sectors were agriculture, construction, processing industries, including the chemical and petrochemical industry, the food industry, coke production and oil refining.

Over the last several years, the banking sector had been experiencing an extraordinary, albeit unsustainable, expansion, as bank lending grew by over 70% per year. This growth was supported by better access to global capital markets, the entrance of many foreign owned banks and loose domestic monetary policy. However, the global financial crisis closed the main source of this expansion Ukrainian banks' access to international credit markets. As a result, local banks faced elevated liquidity and credit risks, as rollover of maturing foreign debt became hard to obtain, while the volume of nonperforming loans (NPLs) started to grow.

According to the NBU, the share of doubtful and loss loans grew from 2.5% at the beginning of 2008 to almost 9% at the end of June 2009. Including substandard loans, the share of NPLs stood at 14.5% in 2008, much higher than in other peer countries. Moreover, with more than half of all outstanding loans in the Ukrainian banking system denominated in foreign currencies, both borrowers and commercial banks were exposed to currency risks. This combination of increasing risks in the banking sector stoked fears of banks' insolvencies, which led to an erosion of public confidence in the banking system and runs on bank deposits. As a result, the banking sector lost almost 25% of its deposits from October 2008 to April 2009, making it even more difficult for banks to roll over foreign short term debt and causing an abrupt halt in credit activity.

The third channel of influence was debt. In June 2008, gross foreign debt made up 59.9% of GDP at USD 100.06 billion. Almost 85% of this debt was that of the private sector. Deteriorating liquidity in global financial markets slowed up lending to the Ukrainian economy. As a result, Ukrainian borrowers had difficulty refinancing their credit liabilities in external markets. During the years 2006-2008, Ukraine's total external debt doubled, growing from USD 53 billion to USD 103 billion by the end of 2008. Amounting to 60% of the country's GDP, Ukraine's

external debt ranked above the median value for similar countries. In the last quarter of 2008, net external debt outflow from Ukraine amounted to USD 6.6 billion and was among the main sources of Hryvnia depreciation pressures.



**Chart 5** GDP of Ukraine (Real, YoY)

Source: State Statistics Committee of Ukraine

In Q3 2009 GDP dynamics started improving. The decline in the economy reached 15.9% yoy, compared to declines of 20.3% yoy and 17.8% yoy in Q1 2009 and Q2 2009 respectively (see chart 5). The official forecast of the government is for a fall of 12% in 2010, while the IMF projects a 14% fall [Balston et al. 2009, p. 120]. The recovery is expected to be slow in 2010 and next year, with base effects accounting for a significant part of the improvement in growth dynamics. Fitch downgraded Ukraine to 'B-' / Negative in January 2010, Moody's – to 'B1' / Negative, S&P – to 'CCC+' / Positive.

In February 2010 an industry growth achieved 5.6% comparing to the respective period in previous year. Increase of the production output was observed almost in all branches of the industrial activity. The total export volume in January 2010 was USD 376.5 mln. and grew by 23.6% comparing to the respective period in 2009. The total volume of import in January 2010 was USD 415.0 mln. and grew by 63% comparing to the respective period in 2009. Consumer price index (CPI) in February 2010 was 101.9%, since the beginning of 2010 – 103.7%. Production price index (PPI) was 101.9%, since the beginning of 2010 – 103.8%.

Economic policy of Ukraine in the short run should be based on a clear understanding that the pre-crisis achieved stability and early signs of economic recovery remain fragile. Monitoring of national economic developments needs to be reinforced to detect and identify problems early on, making it possible for the authorities to react appropriately to them. For the same reason, economic policy should be based on realistic forecasts of no more than a moderate economic recovery in Ukraine, implying severe limitations on the country's ability to meet its financing needs.

### 3. Post-crisis macroeconomic development and reaction of authorities

In 2010 Ukrainian economy has appeared to be slowly rebounding but significant political uncertainty, the remaining restructuring in the banking sector, and the lengthy delay in bringing the IMF program back on track all cloud the outlook. The government was virtually out of cash raising the risk of arrears, an interruption in gas payments and monetization of the deficit that increased pressure on the Hryvnia.

The reaction of Ukrainian authorities to the crisis should not be restricted to launching measures to improve its current economic situation but should also include reforms to secure the



foundations for sustainable long-term growth. These policies should take into account elements such as a major rethinking of the role of the state in the economy, the appropriate degree and format of state regulation, and forms of state support for specific industries. The present circumstances are very challenging for the authorities, but at the same time they provide an all-important opportunity for implementing a set of reforms that could lastingly improve Ukraine's economic position.

### **3.1 Fiscal policy**

Current Ukrainian fiscal policy is characterized by short-term planning and spontaneous changes to revenues and spending plans. Special Fund and earmarking specific revenues for some specific needs (mainly social) serves to protect selected spending during stormy political times. In 2010 presidential elections made it harder to implement austerity measures in Ukraine. This was fertile territory for political shocks. Officially, Ukraine ended 2009 with a relatively small consolidated budget deficit of UAH 21.6 billion, which was equivalent to 2.3% of estimated 2009 GDP. A relatively small budget deficit was achieved amid a 15% yoy contraction in real GDP and virtually unchanged consolidated budget expenditures. Indeed, consolidated budget expenditures amounted to UAH 307.3 billion in 2009, which was only 0.6% lower in nominal terms than in 2008. Moreover, the decline was achieved mainly on account of a 50% yoy reduction in capital spending, while current expenditures (wages to public sector employees, social transfers) actually grew by 7% yoy.

Officially, consolidated budget revenues fell by only 3% yoy in nominal terms and stood at UAH 289.5 billion. To some extent, such a relatively small decline in budget revenues was the result of an increase in excises on tobacco and alcohol and an introduction of a 13% temporary import duty mark-up. In addition, the degree of budget revenue deterioration was veiled by advanced collection of taxes and charges to the budget, accumulation of VAT arrears, and extensive reliance on one-off receipts.

The overall fiscal deficit, however, was estimated at about 11% of GDP as a number of expenditures were not included in the official statistics. Thus, government spending on bank recapitalization and the Naftogaz capital injection accounted for an additional 5.2% of GDP. Furthermore, Ukraine's Pension Fund looked alarmingly unbalanced. According to Ukrainian legislation, the pension fund deficit is covered by the state budget funds. The 2009 State Budget Law envisaged a Pension Fund deficit at about UAH 14 billion, or 1.5% of GDP. However, the actual deficit turned out to be twice as high. To cover the expenditures, the Pension Fund received credits from the unified Treasury account, equivalent to about 1.8% of GDP. Increasing pension expenditures, which reached about 18% of GDP in 2009, amid a rapidly aging society became the heavy burden on public finances, urging for radical and comprehensive pension sector reform [Pogarska et al. 2010, p. 3-4].

Obtaining sufficient budget deficit financing is likely to remain a difficult task in 2010. For Ukraine reliant on IMF-led programmes for fiscal and external financing and for underpinning economic confidence, failure to stick to programme conditions poses additional risks to macroeconomic stability.

Ukraine concluded its stabilization program with the IMF in October 2008 because the crisis was dire. Initially, the IMF posed its standard demand of a balanced state budget, but over time it has accepted a consolidated state budget deficit of as much as 6% of GDP in 2009. The second IMF demand was a realistic exchange rate, which meant that the exchange rate would float and the Hryvnia thus be depreciated. In effect, the NBU did so in November. The third key condition was bank restructuring and bank recapitalization. In return, the IMF committed a very large amount of \$16.4 billion in financing over two years, and this financing was heavily front-

loaded and made available at very low interest rate. By extending large loans and pressing for fiscal reforms the IMF became the external anchor for the stabilization of the Ukrainian economy. Ukraine has been able to draw three tranches of a total of nearly USD 11 billion by the end of 2009.

One of the key issues in Ukraine after the elections was the fiscal situation, which was crucial for the resumption of IMF financing. At that stage the government was out of cash (in December 2009 cash balances dropped below USD 200 million). Otherwise, the fourth tranche of the IMF was discussed to be given for the state in June 2010. The IMF gave Ukraine quite clear requirements. Firstly, the adoption of the budget that was in April 2010, secondly – putting things in order in the banking system on the principles agreed between the NBU and the IMF (further capitalization of banks, the use of government bonds exclusively for banks, but for state monopolies).

At the same time with Yanukovich's victory there was a greater possibility of Russia's financial support to Ukraine, including possibly via the Eurasian anti-crisis fund facility. Ukraine signed with Russia a new gas contract in April 2010 that allowed reducing the gas price for 30%. At the same time Ukraine resumed talks with the EU about creating Free trade area and visa abolishing for Ukrainians to the European zone towards the end of 2010.

The negative effects of the financial and economic crisis in Ukraine are expected to gradually diminish in 2011. Following the stabilisation of the economic environment the operating revenue of local and regional governments (LRGs) will recover slowly. However, due to the crisis they will have higher, albeit still moderate, debt and much weaker liquidity positions. The problem of refinancing remains and increasing debt servicing will increase expenditure pressure as most new debt has much higher interest rates than in the past. Ad hoc financial aid from the state budget will be less expected, so regions will rely more on their own resources. Prudent public financing policies remain crucial for the regions. The credit quality is expected to be sustained by those regions that maintain a positive balance between the budget's current revenue and expenses, and avoid deterioration of operating performance.

The most urgent fiscal task is to close the budget deficit in the next 2011-2012 by cutting unjustified and wasteful public expenditures. Three groups of public expenditures stand out. One is the price subsidies for gas, electricity, and coal, which are aggravating Ukraine's energy dependence, wastage of energy, and corruption. The second one is the large public pension expenditures of 16% of GDP. A third is enterprise subsidies that are unjustified. Ukraine has no room for larger social expenditures, and any attempt to raise them will only reduce economic welfare.

Another important fiscal task is to improve the tax administration for corporations as a matter of improved governance. Ukraine should adopt the draft Tax Code that will bring clarity and stability to the tax system and facilitate tax administration. The number of tax payments must be radically reduced and simplified. It should be possible to do tax returns as well as pay taxes electronically. The government should further expand the tax base by reducing tax privileges, especially for agricultural producers and wealthy individual entrepreneurs. In particular, the new unified social tax should also apply to these subjects.

### **3.2 Monetary policy**

In light of the escalating global financial crisis, the government and the NBU have taken a number of measures allowing for the reduction of the risk of its profound destructive influence. They included a package of anti-inflation initiatives, steps to enhance banking sector stability and to minimize the impact of the global financial crisis on Ukraine's economy. In early 2008,

the NBU passed a resolution toughening requirements to calculating the banks' regulatory capital adequacy (long-term asset transactions with time of floatation exceeding the time of funding should be additionally risk adjusted at 50% rate and so on), which enabled banks to adjust and improve their position

The fundamental cause of Ukraine's financial crisis was that the NBU of Ukraine kept the Hryvnia de facto pegged to the US dollar under circumstances that called for a change in the exchange rate regime. Ukraine was caught in the "impossible trinity" of trying to combine a fixed exchange rate, free capital flows and an independent monetary policy. But if the exchange rate is fixed and capital moves relatively freely, a country cannot pursue an independent monetary policy, because a tightening of monetary policy by raising interest rates will attract capital inflows, rather than cooling the economy. An example may illustrate this process. Commercial banks in Ukraine could borrow at 6% in euros, while they could charge interest of over 50% for certain consumer loans in Hryvnia, thanks to a fixed exchange rate. Moreover, the NBU maintained a negative real refinancing rate which further stimulated monetary expansion.

In the conditions of tensed situation in the money market in 2008 there was a deceleration trend of money supply and base money growth, which reflected a discreet character of monetary policy. The base money increased by 31.5%, money supply – by 29.9%, while in 2007 they showed an increase by 46% and 51.7% respectively [Council of NBU, 2009].

International reserve level of Ukraine reached a peak level in May 2008 due to the stable financial situation in the country. But USD/UAH exchange rate changed and Hryvnia extremely devaluated in November 2008 (see chart 3). The absence of funding for the government was increasing pressure on the NBU to monetize the deficit that led to renewed FX reserve losses and pressure on the Hryvnia. Abolishing the foreign exchange transaction tax can help deepen the foreign exchange market. As a consequence, foreign exchange transaction tax was decreased from 1% to 0.5% in February 2008 as determined in the Law "On the State Budget for the Year 2008." [BRAAC 2009, p. 48-51].

In accordance with the agreement with the IMF, the NBU allowed the exchange rate to fall from 5.1 Hryvnia to 8.4 Hryvnia per dollar in 2008. In an attempt to avoid a too rapid depreciation, the NBU continued to intervene by buying the Hryvnia for dollars from its currency reserves. The free market exchange rate touched 10 Hryvnia per dollar in January 2009, but the rate recovered gradually and stabilized at around 8 Hryvnia, without the NBU having to intervene [Korneev V. 2009, p. 30-31]. The depreciation was sufficient to restore Ukraine's competitiveness following which the current account turned around swiftly and was almost eliminated. But the depreciation also involved substantial costs. Ukraine's debt in foreign currencies rose sharply in the Hryvnia and many Ukrainian companies defaulted on their foreign debts.

Since Q1 2010, spot USD/UAH has moved from 8.10 to 7.90 and the NDF was moving to the left as well (3m contracts shifting from 8.60 to the current 8.25). This compares with 5y CDS spreads. From a medium-term perspective, there are some key technical factors that are helpful to the Hryvnia: external debt rollover ratios have surprisingly held up. According to the NBU, during the first nine months of 2009 external debt stock levels rose modestly implying high debt rollover ratios. The private sector in Ukraine has already built up substantial long FX positions ahead of the presidential elections and if these flows dissipate, the drain on FX reserves should ease as well.

Regular NBU interventions on the interbank market to support Hryvnia exchange rate (USD 10.4 billion in 2009), tightening of commercial banks' formation of credit provisions, active use of the NBU deposit certificates as well as sizable placements of domestic T-bills resulted in monetary base growth easing to just 4% yoy in 2009, compared to a 32% yoy increase in 2008.

Money supply fell by about 5% yoy in 2009, reflecting the decline in credit activities of the commercial banks. The NBU continued to sell international reserves to support the Hryvnia, extract liquidity from the banking system through its certificate of deposits facility (UAH 16.6 billion in January 2010) and provide limited refinancing resources (UAH 1.4 billion) causing the monetary base to decline by 2.8% mom in January 2010. As a result, the stock of commercial banks' credit fell by 2% mom over the period [Pogarska et al. 2010, p. 4-5].

Despite the election campaign, the Ukrainian foreign exchange market was calm during Q1 2010. Over the period, the exchange rate was virtually stable at about UAH 8.0 per USD. The stability was the result of tight liquidity in the banking sector, continuing NBU support, but mainly due to an improving current account balance and easing external debt financing needs. The strained situation with public finances and limited sources of fiscal deficit financing were the largest risks for exchange rate and inflation developments in 2010. However, assuming the IMF program is back on track in mid-2010, these risks were likely to be successfully controlled. According to the NBU, in March 2010 Ukraine's total foreign debt (state and corporate) has reached UAH 912.563 billion (93.5% of the GDP).

The main objective of the monetary policy in the following years is to remain, in accordance with the Constitution of Ukraine, securement of the national monetary unit stability, being the basis for balanced economic development, promotion of population employment and real income of households. In making the monetary decisions the NBU should be guided by forecasts of development of the real economy sector, balance of payments and financial market based on careful analysis of a wide spectrum of macroeconomic, fiscal and monetary indicators, their interrelation and impact on the Hryvnia stability with taking into account probable changes in the future.

### **3.3 Banking regulation**

Ukrainian banks were successful in attracting deposits between January and October 2008, liquidity indicators have deteriorated in the final months of the year. Banking system liquidity has fallen and interest rates in the money market have risen significantly [Shvets' N. 2009, p. 35]. The average weighted interest rate in the interbank market rose to 30.1% in November 2008 from 15.4% in June 2008 and 4.6% in December 2007.

The National Bank of Ukraine and the government have taken a number of measures to support liquidity specifically during the recent financial market turbulence. But these for the most part benefit the country's larger banks and liquidity might not always flow through to help smaller institutions. Some of the latter have faced severe liquidity constraints and have failed to become subject to state-supported takeovers.

The resolution of the NBU No 319 "On Additional Measures in Respect of Banking Activities" was a quick reaction to a rapidly deteriorating macroeconomic environment and a bad liquidity situation in the banking system. The resolution intended to neutralize the impact of the global financial crisis and minimize the possibility for domestic bank runs and a potential liquidity crisis. The follow-up Law No. 639-VI "On Priority Measures to Prevent Negative Impacts of Financial Crises and Changes to Selected Legislation", the so called "anti-crisis package", substantially expanded the possibilities for the Ukrainian government to intervene into the economy and markets. Most of the law provisions were quite controversial and created easy possibilities for abuse of power and manual steering of the banking system.

Despite the discretionary nature of the provisions, the Law did not stipulate the conditions under which the government and the NBU could implement those measures or their restrictions in such an administration. Also, the Law created loopholes allowing government interference



with the NBU mandate, which might poorly impact the bank's operational independence. On the other hand, the preliminary steps specified in resolution No 319 and undertaken by the Ukrainian government to address the growing uncertainty and liquidity crises were quite adequate, including the temporary freeze on before-term deposit withdrawals helped to avoid massive bank runs and panic. Other measures in the resolution proved less appropriate and, possibly, detrimental for the long-run development of the domestic financial sector [BRAAC 2009, p. 55-57].

Rapid lending growth in Ukraine has long been highlighted as a concern, and this has remained relatively strong in 2008 to end-July notwithstanding the reduced availability of capital market funding. However, loan growth was likely to slow significantly in Q4 2008 and into 2010 in light of a further tightening of funding constraints and – at least in the near term – banks' focus on protecting their liquidity. In this environment, the main threat to asset quality was the tighter liquidity position of much of the corporate sector, which had already manifested itself in several defaults of smaller issuers on the domestic bond market, rather than banks continuing to add risk to their books at a rapid pace. Most Ukrainian banks had little direct exposure to the equity market, although indirect exposure through credit facilities secured by shares is considerable in some cases and could be a source of losses.

Confidence in the Ukrainian banking system declined after the imposition of a six-month suspension by the NBU on the early withdrawal of household term deposits from the commercial banking system on 13 October 2008. The NBU's action was taken to prevent a full-scale bank run after depositors withdrew more than USD 1.3 billion from their accounts in less than two weeks.

Devaluation of Hryvnia comprised a number of risks to the Ukrainian banking sector. First, asset quality deterioration and write-downs were likely as unhedged corporate and retail customers that have borrowed in foreign currency faced a relative increase in the amount of their debt, while economic growth was slowing at the same time. Second, borrowers chose to withdraw local currency savings to transfer them into more stable foreign currency, which reduced the funding base of Ukrainian banks. Finally, the capital ratio of banks with large foreign currency exposure fell as a consequence of currency devaluation-related losses. Approximately 53% of loans by Ukrainian banks rated by Moody's and 47% of their liabilities were denominated in foreign currencies [Robeck K. et al. 2009, p. 4].

The NBU has also taken preventive measures against speculative transactions against the Hryvnia in case of further significant devaluation. Banks were only allowed to buy foreign currency, firstly, to balance their open currency positions to meet the regulator's requirements and, secondly, to settle foreign currency denominated obligations that become due. The new measures came into force on 26 October 2008, except for some provisions concerning foreign currency loans to Ukrainian banks, which came into force on 1 January 2009. Finally, the NBU decided to ease its reserve requirements for banks on 26 November 2008. Mandatory reserves for raising funds in the national currency have been cancelled and the reserves for foreign currency have been reduced to 3% from 4% for call deposits and to 4% from 5% for term deposits. The new reserve requirements came into effect on 5 December 2008 [Robeck K. et al. 2009, p. 12].

In Q4 2008, total national currency deposits reduced by 13.7%, and foreign currency deposits (in dollar equivalent) – by 8%. During this period, the official exchange rate of the Hryvnia against US dollar decreased by 58.4% and by 52.5% from the year start [Council of NBU, 2009]. Actions of the NBU were, first of all, aimed at ensuring timely execution of settlements by banks, preventing funds outflow from the banking system and stabilizing the situation in the market foreign exchange segment. The implemented additional measures were as follows: support of banks' liquidity; limits on certain transactions of banks with the assets in foreign currency;



prevention of outflow of clients' funds from the banking system; continuous execution of payments; temporary limitation of deviations between the buying and selling prices of foreign exchange in cash; mitigation of terms and conditions in use of the foreign currency loans received from non-residents. The above mentioned actions facilitated reduction of pressure in the money market, which was reflected in a gradual decrease of money outflow from the banking system, increase of banking system liquidity, ensuring continuous execution of settlements.

In order to stabilize the situation in the foreign exchange market segment, as well as to consolidate positive trends of stabilization in the banking system the NBU moved to the second stage of stabilization measures at the beginning of December, which provided, inter alia, for the following: limitation of banks' liquidity support, growth of the national currency value, adjustment of the requirements to creation of the mandatory reserves, strengthening of some prudential requirements. In order to reduce the foreign exchange deficit and devaluation pressure on Hryvnia, active interventions were performed by selling of foreign currency, the amount whereof reached USD 10.3 billion in Q 4 2008. The net negative balance of foreign currency interventions made USD 3.9 billion in 2008 [Korneev V. 2009, p. 27-28]).

Indeed, severe deposit runs during October 2008-April 2009 reduced the resource base of the commercial banks. Although the withdrawal of deposits ceased in mid-2009, commercial banks saw rather shallow 3% growth in the stock of deposits in the second half of the year. Overall, the stock of commercial bank deposits fell by 8.4% yoy in 2009. High external indebtedness of commercial banks and a rising share of non-performing loans also undermined credit creation. The total stock of bank loans to the economy of Ukraine declined by only 2% yoy in 2009 compared to an average growth of about 70% over the last five years. An abrupt reduction in credit was one of the main reasons for Ukraine's hard lending in 2009 [Pogarska et al. 2010, p. 4-5].

In 2009 there were only three establishments extending mortgage credits for clients. It was possible to get a credit under 21-41% annual and under condition of making an advance payment amounting to 30-50% for 1 year, 4, 5, 10, 15, 20 and 25 years. At the same time, the latter term was only proposed by Pravex-Bank. In Q 2010 credits for purchase of housing on the secondary market was issued by BTA Bank, Folksbank, Universal Bank, Kredobank, Index-Bank, BM Bank, Ukrsotsbank, Forum, Pivdennyi, Pravex-Bank, Ukreximbank, Bank of Cyprus and the All-Ukrainian Bank of Development.

The Supreme Council of Ukraine amended the law of Ukraine "On financial services and state regulation of financial services markets", with Law No. 1822-VI dated 21 January 2010, pursuant to which financial institutions are prohibited from unilaterally increasing interest rates or other costs under facility agreements or debt repayment schedules. Financial institutions are also prohibited from requiring early repayment of outstanding debt and from unilaterally terminating facility agreements if the borrower does not agree to the financial institution's increase in interest rates or other costs under the facility agreement or debt repayment schedule.

Monetary sector data for Q1 2010 demonstrated a slow renovation of credit activity in the Ukrainian banking sector. Affected by political instability, the stock of deposits fell by 1% month-over-month in January 2010. Moreover, by placing domestic debt securities for relatively short-term and high yields (though lower than in October-December 2009), the government kept crowding out commercial banks' credit to the economy.

The NBU reacted promptly to the financial crisis by introducing new regulatory requirements that render the banking sector more stable. However, significant room for further improvement remains. Recently nationalized banks should be privatized. The Ukrainian state became the owner of Ukrhazbank (84.21% after investing UAH 3.2 billion), Rodovid Bank

(99.97% after investing UAH 2.809 billion) and Bank Kyiv (99.93% after investing UAH 3.563 billion) early June 2009 [UNA, 2009].

Subsided political tensions after the presidential elections should have positive impact on inflow of foreign investments, and, consequently, on the national payment balance. Despite the fact that in Q1 2010 the regulator continued to withdraw free resources from the banking system, the amount of funds on the banks' correspondent accounts remained stable. The cost of inter-bank resources remained low too, which was prompted by absence of necessity for their urgent substitution. In January 2010 the trend of gradual return of population's funds withdrawn earlier, has retained. The growth in the amount of deposits was fuelled by the national currency which was prompted by higher rates by this type of deposits and stabilization of Hryvnia's exchange rate.

In the midst of the crisis, the state banks have assisted the government in various rescue operations. This should not remain a practice after the crisis has abated, and the authorities should wind down these emergency measures and let the two old state banks, Oshchadbank and Ukreximbank, revert to their old roles of being specialized state banks. The government should restructure the banks that have been de facto nationalized because of default and prepare them for early privatization after the crisis.

Much remains to be done to move the legal framework closer to standards in more developed countries, especially as regards: transparency; consolidated supervision, the domination of financial industrial groups in the economy and significant related-party lending; and the perception of a high level of bureaucratic obstacles and corruption. Until these difficulties are largely removed, the financial strength and deposit ratings of Ukrainian banks are expected to remain at lower levels than those of banks in the CIS.

Stabilization of the resource base of Ukrainian banking system and strengthening of the monetary market control should be facilitated by the measures to develop cashless settlements, extended use of special payment tools, introduction of new technologies and extension of the range of operations, coordination of banks' efforts to create a unified infrastructure, widen the sphere of application of multifunctional banking smart-cards and realization of accompanying projects in the social sphere.

#### **4. Exit strategies**

The beginning of post-crisis recovery growth in Q4 2009 underlined Ukrainian economy adjusted to the open market economy at a low-tech level. It is an economy of low productivity, with little diversification, high energy consumption, and dependent on external energy monopolies. To overcome these dangerous trends Ukraine needs to build an economic system that is capable of delivering fast economic growth. The state budget is overloaded with paternalist functions of the unreformed Soviet state, most of all social expenditures but also direct support of the traditional industrial and agrarian sectors (coal mining, metallurgy, and agriculture) and natural monopolies in exchange for prices administratively set below the market level.

Critically weak links in state capacity need to be strengthened: improvement of the legislative, executive, and judicial branches of government, not least to improve the institutional ability to combat pervasive corruption. To accomplish this, the country requires reform of the gas sector; a sensible exchange rate policy; reform of budget and tax policies; comprehensive market deregulation; administrative and judicial reform; reinforcement of market competition and a fundamental improvement of governance; completion of privatization; improved efficiency in the social sector; and further integration with the European Union. Taken together the reforms aim to improve the standard of living of Ukrainians and utilize their human capital, thus unleashing the country's potential of self-development [Åslund et al. 2010, p.12-16].

For improving fiscal policy in Ukraine, first of all, it is necessary gradually eliminate revenues earmarking, and over time, integrate General and Special Funds into the budget. These steps would increase budget management efficiency and improve the implementation of public investment programs. Second, improve local government borrowing, consistent with good international practice. In particular, incorporate local government debt in public debt statistics. Third, design and implement a medium-term department management strategy, based on a systematic approach under different economic and financial assumptions, to reduce risk exposure and debt servicing costs, provide medium-term fiscal planning to make the best use of fiscal space. It is also necessary to tighten a fiscal stance; reduce wage and transfer increases, reduce subsidies, concentrate income support where most needed; gradually reduce the ratio of recurrent spending to GDP.

The fiscal framework also needs strengthening. Further improving macro-fiscal analysis would clarify the macroeconomic impact of fiscal policy, and integrating it into the budget process would help to prevent the procyclical stance that has characterized fiscal policy in recent years. A multi-year fiscal framework, including spending ceilings, would facilitate monetary-fiscal coordination and help to guide budgets toward medium-term fiscal goals (for example, gradually reducing the size of government, or implementing pension reform). Broader fiscal coverage and closer monitoring of public enterprises would identify and contain fiscal risks. Reducing the use of administered prices would improve the fiscal position and economic efficiency. In particular, gas price increases should be passed through fully to final users, with vulnerable groups protected by better targeted social programs.

The Ukrainian government should provide the NBU with a clear mandate to pursue price stability as its primary objective, as well as with operational independence to attain this objective; enhance macroeconomic forecasting capacity and prepare statistical sources; strengthen operational and political independence of the National Bank, approve changes to legislation to increase the governor's term and immunity to political pressures; reform the NBU council transforming it into a narrower technical body; fully abolish the foreign exchange transaction tax; elaborate the long-term vision defining the government's role in the domestic securities markets as the market regulator and a market participant [BRAAC 2009, p. 53].

The IMF welcomes recent NBU policies to tighten monetary conditions, including by stepping up sterilization and broadening reserve requirements. Until inflationary pressures ease, the NBU should continue such efforts to the extent feasible. As this will be costly, the government should accept profit transfers from the NBU that deviate from budget targets. However, at some point short-term capital inflows and strains on financial institutions will limit the scope for further tightening in the current policy framework.

Ukraine must not peg its exchange rate again. The only sensible exchange rate regime for Ukraine appears to be inflation targeting, that is, the exchange rate will float and monetary policy will aim at keeping inflation low and stable. The NBU can undertake limited currency interventions to smoothen fluctuations, but it must not target one specific exchange rate any longer. The dollarization of the Ukrainian economy should be reduced by the NBU through a combination of a floating exchange rate, an inflation target and an adequate regulation and supervision of banks. This has been done successfully in many other post-communist economies. Poland, the only European country of significant size maintaining economic growth in 2009, provides a good example of a successful monetary and exchange rate policy, combining a floating exchange rate with inflation targeting managed by a fully independent central bank. A precondition for inflation targeting is that the NBU be truly independent from daily political vagaries.

The NBU, with the government support, should as a first step establish and fully use an exchange rate band that allows more scope for active monetary policy. The 2010-2011 monetary

policy guidelines should indicate that the band will be progressively widened as circumstances permit and policy needs require, without specifying bands or timing in advance. The NBU should continue its welcome efforts to strengthen its analytical capacity and integrate macroeconomic analysis into its policy decisions. Communication with the public and the markets needs to be improved, including through publication of inflation reports and regular, transparent announcements of policy intentions and actions.

In view of actual and possible strains, the NBU should continue to intensify its supervision of banks. Key measures are consolidated supervision, increased transparency of bank ownership, encouragement to banks to enhance their risk management capabilities, strong guidance regarding stress testing, and intensified on-site examinations. Bank secrecy provisions should be brought into line with Basel II standards. Prudential measures might include, in addition to the recent welcome increase in minimum statutory capital, greater risk weights for assets that pose higher credit risk (notably unhedged foreign currency denominated lending) and stronger prudential requirements for banks with deteriorating liquidity positions. Finally, nonbank supervisors should be strengthened, which would also foster the development of insurance and capital markets.

The greater attention should be paid to bank resolution and crisis management. On the former, problem banks need to be identified earlier and bank exit options expanded to include rapid resolution mechanisms, notably by increasing incentives of owners of weak banks to agree to mergers. On the latter, contingency planning should be further developed and refined, to ensure an effective response in the event of unforeseen turbulence.

For improving the banking sector a government has to amend the banking law to require the identification of ultimate bank owners and to allow the NBU to assess the suitability of direct and indirect bank shareholders; strengthen banking supervision in order to eliminate opaque and risky lending and deposit practices; strengthen prudential and supervisory norms by introducing prudential limits for banks on loan-to-value and debt-service-to-income ratios for mortgage loans; increase the political and financial independence of the State Commission for Regulation of Financial Services Markets (SCRFSM) and the State Securities and Capital Market Commission (SSCMC); provide capacity of the regulator needed for carrying out risk based supervision of the NBF institutions; improve the NBF institutions' regulation on activities related to attracting financial assets and deposits in order to reduce risks and prevent illegal operation in credit unions, investment funds, and building societies; develop a sustainable Credit Guarantee Fund facilitating access of small and medium-size enterprises to loans.

The new wave of institutional reforms should remove these lingering contradictions. Strategic reforms are needed to fundamentally improve the quality of the state and economy. The development of society, as well as the current economic and political dynamics, appears to have created favourable preconditions for a new wave of institutional reforms. It should also help improving the business climate and attract more domestic and foreign investment.

## **5. Conclusions**

In order to ensure accomplishment of the tasks elucidated above the Ukrainian government should make use of available institutional mechanisms and operation levers, securing consistency and transparency of the policy, combining in an organized way its independence in exercise of the main constitutional duty with coordination of its actions with the macroeconomic and financial measures of all authorities. With these factors in mind, the resolution of the crisis in Ukraine on the successful implementation comprises of the following measures: establishing strong organizational arrangements to confront the crisis, securing substantial foreign financial



assistance, implementing a comprehensive program for troubled banks and their borrowers, implementing a macroeconomic stabilization program and structural reforms to revive economic and export growth of the state.

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*Chernetska O.\**

## **APPLICATION OF NEOLIBERAL THEORY IN THE ENERGY SPHERE OF UKRAINE IN A POST-CRISIS PERIOD**

**Neoliberalism** is a label for economic liberalism or (in older terminology) "Laissez-faire". The term "Neoliberalism" came into use in the 1960s by Marxists. The term refers to economic policies based on neoclassical theories of economics that minimizes the role of the state and maximizes the private business sector. The term is most often used on the left to criticise the policies and ideologies of modern governments and leading international economic institutions.

"Neoliberalism" is a term used by opponents of the policies; supporters prefer terms like "free market" or "liberal trade."

### **Policy implications**

Broadly speaking, neoliberalism seeks to transfer part of the control of the economy from public to the private sector, under the belief that it will produce a more efficient government and improve the economic health of the nation. The definitive statement of the concrete policies advocated by neoliberalism is often taken to be John Williamson's "Washington Consensus," a list of policy proposals that appeared to have gained consensus approval among the Washington-based international economic organizations (like the International Monetary Fund (IMF) and World Bank). Global spread.

Chronic economic crisis throughout the 1980s, and the collapse of the Communist bloc at the end of the 1980s, helped foster political opposition to state interventionism, and in favor of free market reform policies. Changes occurred from the 1970s to the 1980s. Started off with most of the democratic world governments focused primarily on the primacy of economic individual rights, rules of law and roles of the governments in moderating relative free trade. It was almost considered national self determination at the time.

**The instruments of neoliberalism as good as possible can have application for the exit of Ukraine from an economic crisis. Observing in particular power industry, it follows to notice that the instruments of neoliberal policy used the governments of the European countries and Russia.**

To investigate the possibility of using instruments of neoliberalism in the energy sphere of Ukraine, it is necessary to study foreign experience. Optimally display energy sphere of Ukraine examples of countries-neighbors, which joined the European Union, and gradually began to reform the energy sector.

### **Energy liberalization in the European Union**

Energy liberalization in the European Union (EU) is occurring as a result of Directives, and policy papers and national initiatives, though this liberalization is occurring inconsistently and at various paces in the different member states. Energy liberalization is also being implemented in the context of initiatives to encourage renewable energy and energy efficiency.

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\* Applicant of International economic relations Department, Institute of International Relations, Kyiv National Taras Shevchenko University. Kyiv City State Administration.

### ***The reform of EU energy markets***

Industries and private households are in theory able to freely choose their energy supplier following the entry into force of EU directives in 2004 and 2007, but many obstacles remain, with a single European energy market still far from reality. To make up for the shortcomings, the European Commission has made further legislative proposals, including controversial plans to separate the production and distribution arms of large integrated energy firms such as France's EDF and Germany's E.ON.

#### ***Milestones of the EU energy market liberalization***

July 2004: Industrial market opens up to competition.

10 Jan. 2007: Commission issues progress report on the internal energy market and final results of a competition enquiry which confirmed "serious problems" in the liberalised gas and electricity markets.

8-9 March 2007: EU Summit adopts conclusions on energy liberalisation, calling for:

Full implementation "in letter and spirit" of existing EU directives, and;

"effective separation of supply and distribution activities from network operations (unbundling)".

July 2007: Household market opens up to competition.

19 Sept. 2007: Commission presented its 'third liberalisation package' (EurActiv 20/09/07)

23 Nov.: Commission delivers impact assessment on the Internal Energy Market package.

May 2008: Vote in Parliament's Industry (ITRE) and Internal Market (IMCO) Committees (EurActiv 07/05/08).

6 June 2008: Energy Council reached broad political agreement on the Commission's third liberalisation package.

Mid-June 2008: Vote in Parliament plenary (first reading) (EurActiv 19/06/08).

12 Jan. 2009: EU Council of Ministers adopts common position on third energy liberalisation package.

23 March 2009: Parliament and Czech Presidency reach agreement on the third energy package (EurActiv 25/03/09).

22 Apr. 2009: Parliament endorses compromise agreement (EurActiv 23/04/09).

25 June 2009: Council adopts internal energy market package.

The first electricity and gas directives were adopted in the late 1990s, with the objective of opening up the electricity and gas markets by gradually introducing competition. The Commission has consistently argued that liberalisation increases the efficiency of the energy sector and the competitiveness of the European economy as a whole. But a number of stakeholders and member states, notably France and Germany, vehemently disagree with this assessment.

While most member states had implemented the electricity and gas directives by September 2000, a 2001 Commission inquiry concluded that further measures were necessary in order to complete the internal energy market and to reap its benefits.

The second gas and electricity directives, adopted in June 2003, include 'unbundling', whereby energy transmission networks have to be run independently from the production and supply side.

According to the directives, markets for all non-household gas and electricity customers are to be liberalised by July 2004. For private households, the deadline is July 2007. After these dates, businesses and private customers would theoretically have been able to choose their power and gas suppliers freely in a competitive marketplace.

But a competition enquiry in the electricity sector, published in January 2007, revealed some "serious malfunctions" in the market for industrial consumers (EurActiv 11/01/07).

For example, market concentration still reflects the 'old' market structure, characterised by national or regional monopolies - usually dominated by vertically integrated companies - which control electricity prices in the wholesale market and block new entrants to the market. In the gas sector, "incumbents tend to control imports and/or domestic production," according to the Commission.

Corrective action was promised by the EU executive, which tabled a further package of proposals in September 2007. After long negotiations, the Parliament and the Czech Presidency struck a compromise deal on the legislative package on 23 March 2009.

The Commission put forward its 'third energy package' on 19 September 2007. The package provided companies in the member states with two options for separating gas and electricity production from supply provision. A third option was later added at the insistence of France and Germany.

During the negotiations, the issue of unbundling emerged as the biggest bone of contention between the Parliament and governments, as MEPs insisted on full separation of production and transmission assets as the only option for the electricity market. The final compromise offers companies all three options.

### **1. Ownership unbundling**

Under the Commission's preferred option, companies that control both energy generation and transmission would be obliged to sell part of their assets. Investors would be able to keep their participation in the dismantled groups via a system of 'share-splitting', whereby two new shares are offered for each existing share.

"This does not mean that a person or company cannot hold shares in both a network operator and a supply undertaking," the Commission explained. "For example, an individual investor [...] could still have a minority stake in both supply undertakings and network operators." However, this would be only allowed "as long as these shares represent a non-controlling minority interest".

### **2. Independent System Operator (ISO)**

The ISO option was a Commission compromise proposal whereby companies involved in energy production and supply would be allowed to retain their network assets, but would lose control over how they are managed. Crucially, commercial and investment decisions would be left to an independent company (ISO), to be designated by national governments with the Commission's prior approval, to ensure a sufficient level of independence.

Regarding the question of ownership, the ISO option was also designed to fend off criticism that the Commission is trying to privatise energy utilities such as EDF. "It is up to each country to decide if the transmission network is privately or state-owned," said a Commission official, "but they have to prove that they are completely independent from the state".

During the negotiations, it emerged that the ISO option was unattractive to many member states, with most opting for full unbundling or the 'third option' (see below).

### **3. Independent Transmission Operator (ITO)**

EU ministers introduced the so-called 'third way' in response to the successful efforts of France and Germany to build a coalition against full unbundling. They obtained the right for former state monopolies - such as EDF and GDF in France and E.ON and RWE in Germany - to retain ownership of their gas and electricity grids, provided that they are subjected to outside supervision.

Like the ISO option, the ITO model allows integrated companies to retain ownership of their gas and electricity grids. However, they would have to give up daily management of the grids to an independent transmission operator.

Crucially, companies can retain commercial and investment decisions, but will have to set up a framework for ensuring the independent operation of the transmission network by:

- setting up a supervisory body made up of company representatives, third-party shareholders and representatives of the transmission system;
- agreeing a compliance programme setting out measures that prevent the ITO from discriminating against suppliers using the grid;
- appointing a compliance officer with powers to ensure non-discrimination, and;
- introducing a mandatory cooling-off period for management staff who move between the supply and generation company and the transmission operator.

### **More powers for national regulators and new EU agency**

A lack of coherence in the powers and remits of national energy regulators was identified as one of the biggest hurdles in creating a functioning EU energy market. The third liberalisation package aims to resolve this by:

- harmonising and strengthening the powers and duties of national regulators so that they are able to issue binding decisions on companies and impose penalties on those that fail to comply;
- ensuring that all national regulators are truly independent of industry interests and government intervention, meaning that they will have authority over their own budgets and that strict rules apply for management appointments, and;
- mandating all national regulators with a binding requirement to co-operate with each other.

Co-operation between national transmission system operators (TSOs) for gas and electricity, which currently only takes place on a voluntary basis, will be formalised through the establishment of a European Network for Transmission System Operators. The purpose of the network is to harmonise standards for pipeline and grid access, and co-ordinate and ensure proper network planning and investments in order to prevent blackouts.

A new European agency will also be created to oversee and improve cross-border regulatory cooperation for gas and electricity transmission between member states. The agency would not have any direct regulatory authority at national or European level, but it would have the power to intervene in the event that national regulators fail to cooperate effectively.

### **Reciprocity clause**

Under the agreed text, all non-EU countries will be required to comply with the same unbundling requirements as EU companies before they are certified to operate in the common market. Moreover, member states must refuse certification if it is deemed to "put at risk the security of energy supply of the member state and the Community".

When introduced by the Commission, this so-called 'reciprocity clause' was widely interpreted as being directed at the Russian state-controlled energy giant Gazprom, which is seeking to increase its share of the EU market (EurActiv 20/09/07).

The clause gives sufficient scope for member states to decide whether to let a third-country company enter its market, acknowledging that member states have the right to "national legal controls to protect legitimate public security interests".

The clause has caused consternation in Moscow, and the EU and Russia have agreed to set up a new expert group to discuss the matter.

The European Commission has made clear that it favours splitting up energy firms' production and distribution activities as the best way to ensure fair competition and lower prices for consumers. Speaking in February 2007, Competition Commissioner Neelie Kroes said full 'ownership unbundling' would solve the "inherent conflict of interest" that she says inevitably occurs when incumbents are told to grant access to their network to new competitors entering the market. Their self-interest, she said, is to impede access in order to protect their market share.

However, a majority of member states, led by France and Germany, have so far rejected the Commission's calls, saying that splitting up energy firms "is only one of a number of measures for accelerating the dynamics of competition". In particular, unbundling "is not a cure-all", said Germany's Economy Minister Michael Glos in a statement following a meeting of EU energy ministers in June 2007 (EurActiv 7/06/07). The UK, Denmark and the Netherlands, on the other hand, are active promoters of 'ownership unbundling'.

Eurelectric, the union for the EU electricity industry, says the liberalisation process has brought "considerable benefits" to Europe in terms of price and cost reductions as well as labour productivity gains. However, Eurelectric believes that it is vital to maintain the momentum and reinforce trust in the liberalisation process.

In particular, the power industry calls for the full and effective implementation of the liberalisation package by member states. Moreover, it says that regulation should be completed with guidelines on congestion management, harmonisation of transmission tariffs and a compensation mechanism for transmission system operators (TSOs).

The association of European Transmission System Operators (ETSO) has also called on member states to fully implement the electricity directive. In addition, ETSO says member states should ensure the provision of adequate electricity generating capacity to meet demand.

ETSO argues for consistent (although not necessarily identical) regulatory principles and practice between member states in order to promote the development of the internal market and economic efficiency. It also encourages the Commission to put in place draft guidelines on cross-border trade and congestion management.

The European Chemical Industry Council (Cefic), which claims to be the largest energy consumer in the EU manufacturing sector, said: "Progress in opening up markets [...] since the entry into force of the liberalisation directives has been disappointing and small."

Cefic thus calls for "rigid and coordinated actions from the European Commission, member states, regulators and producers" to remedy the situation. It also points out that lack of liberalisation in the electricity market allows power utilities to pass on the additional costs entailed by compliance with the EU CO<sub>2</sub> emissions trading scheme (ETS).

It says the scheme offers electricity utilities the potential to pass on all or part of the 'market price' of [CO<sub>2</sub>] allowances to electricity consumers by increasing power prices. Cefic warns that this unintended consequence of the ETS is damaging the EU's international competitiveness, especially for energy-intensive industries.

The metal industry trade association Eurometaux also says liberalisation has not prevented electricity prices from rising. As a consequence, Eurometaux says that the metal industry, which is a heavy consumer of electricity, has experienced a sharp deterioration in its competitiveness. "Plant closures and disinvestments have already been announced, attributable primarily to this unaffordable cost of electricity," it points out.

In Eurometaux's opinion, this situation is caused by distortions in the ill-functioning European electricity market. Electricity producers, it says, have adopted commercial practices allowing them to indicate prices that do not reflect cost fundamentals. Producers, it argues, have created the illusion of competition through wholesale trading, but in reality, the large producers continue to dominate the market.



"The current power-exchange model should be replaced by a true market design that allows cost fundamentals to be properly reflected and gives equal weight to all market participants," it says. Eurometaux also stresses the importance of freeing up existing capacity and opening markets to new entrants.

The European Federation of Public Service Unions (EPSU) says that the Commission's approach to energy liberalisation "contradicts the need for an energy policy that ensures more independence and is focused on achieving sustainable development."

EPSU Deputy Secretary-General Jan Willem Goudriaan notes that "serious issues of employment loss (300,000 over the last ten years), the emergence of a lack of qualified staff or the impact of competition on vulnerable users have not been addressed. More competition will not bring more investment to a sector that needs a very stable framework, not a policy that has a yo-yo effect. The result will be higher prices and a serious impact on all users."

The European Renewable Energy Council (EREC) calls effective competition in the European power markets a "myth". According to EREC, unless the existing distortions in the conventional energy markets are overcome, there will be no effective internal market for renewables to compete in. In addition, EREC criticises current unfair market conditions which favour conventional energies, such as through the Euratom treaty or failure to apply the 'polluter pays' principle.

## **Key measures of the EU Energy Directives**

### **1 Vertical unbundling**

A central element of the EU policy is to rule out the possibility that a firm which controls the whole value chain can preclude other firms from entering the market by denying them access to network infrastructure. To achieve this, all member states are obliged to unbundle the vertically integrated firms that operate in their energy sectors. Initially, the directives allowed for 3 possible forms of unbundling:

- 1) Separation of accounts;
- 2) Legal separation of business units into different firms; or
- 3) Ownership change.

In principle, vertical unbundling reduces potential barriers to competition and promotes transparency in the energy sector. Theoretically, the more activities are unbundled from a vertically integrated monopoly the more this will stimulate competition. However, excessive governmental intrusion into the firms' property structure and operation is technically difficult to implement and – even more important – conflicts with other EU legislation such as protection of private property. Hence, to limit the scope of governmental intrusion, unbundling obligations are limited to the most important potential barriers to competition, the operation of transmission and distribution networks as well as gas storage facilities. As initial minimum requirement the directives established that those operations had to be conducted within separate accounts. In 2003, requirements were further tightened by demanding at least legal unbundling.

### **2 Third Party Access (TPA)**

The second cornerstone of the EU energy policy is to allow for access of third parties to transmission and distribution networks in order to remove possible bottlenecks for competition and to create a level playing field for all market participants. In general, the EU commission has defined two different possibilities of how individual member states can ensure third party access (TPA) on their national markets:

- Negotiated TPA foresees that third parties can negotiate the terms and conditions of network access with the system operator, who is required to publish an indicative range of prices for network access based on average prices agreed in negotiations during the previous year;

- Regulated TPA means that terms and conditions of network access are under the control of a regulatory body, which is independent from all market participants.

Initially, the directives allowed national governments to choose one of the two options to guarantee TPA on their national markets. Since 2003, the EU Commission requires Member States to provide regulated TPA.

### **3 Market opening**

A necessary condition for the creation of a competitive market is that consumers can freely choose their suppliers of gas and electricity, which requires the creation of a level playing field for incumbents as well as new entrants. To achieve this, the directives oblige EU Member States to authorize all relevant activities such as transmission, distribution, supply, storage or generation in accordance with objective, transparent and non-discriminatory criteria, e.g. by license, permission, concession, consent or approval<sup>1</sup>. Moreover, Member States are required to create conditions that allow consumers to switch their suppliers, including specification of contract details and duration, definition of contract termination procedures including prohibition of additional charges etc. Finally, market opening also requires that network access (TPA) is sufficiently guaranteed.

Since at the time when the directives were issued, energy markets of all Member States were rather closed and authorization procedures were not subject to objective criteria, a stepwise opening process was foreseen, starting from generation and wholesale market activities and then gradually moving forward to retail supply. As a benchmark, Member States were required to open up energy markets for non-household consumers by 2004, and for all consumers by 2007.

### **4 Interconnection**

The objective of creating a single internal energy market requires the possibility for cross-border flows of electricity and gas in order to link different national markets and to create competitive pressure on incumbent firms through imports. To achieve this objective, the EU Commission requires countries to coordinate their activities in congestion management, as well as to harmonize legal, institutional and technical barriers to cross-border flows such as different norms and standards or business rules and contract types<sup>2</sup>. As a benchmark, the commission requires that the interconnecting capacity of each member state should be at least 10% of the country's domestic consumption. Regulatory bodies are required to monitor the necessary harmonization of cross-country trade.

Two separate EU regulations for electricity and gas specify the requirements for stimulating interconnection between different national networks<sup>3</sup>. They foresee inter alia that capacity of electricity interconnectors has to be sold through transparent auctions, as well as the harmonization of congestion management and balancing mechanisms of network system operators.

### **Poland energy markets and liberalization**

In September 1996, Poland first approved guidelines for implementing reforms in the energy sector. These guidelines establish an energy regulatory authority and allow third party access to the Polish electricity transmission grid. The objective was to create a competitive energy

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<sup>1</sup> If Member States decide to apply tendering procedures for new electricity generation capacity the directives again require the same objective, transparent and non-discriminatory criteria.

<sup>2</sup> In countries such as Germany where e.g. electricity markets are even regionally fragmented, interconnection requirements not only concern cross-country but also interregional flows between different network system operators.

<sup>3</sup> 24 Regulation 1228/2003/EEC on cross-border trade in electricity and regulation (EC) 1775/2005 on access conditions to the gas transmission network.

market through the privatization of the energy industry, and to attract the investment necessary for industrial modernization and environmental protection.

While emphasis is placed on the increased use of oil and natural gas, coal remains the dominant fuel, particularly for the electric power sector.

Poland's Energy Law went into effect in December 1997. Under the law, large electricity users can negotiate directly with generators of power. The Polish Power Grid Company, or Polskie Sieci Elektroenergetyczne (PSE), is obliged to provide transmission for the buyer and seller if it is technically feasible. The remainder of the electricity is sold under agreements that PSE signed with 35 power plants from 1994 to 1998. In December 1999, the Gielda Energii S.A. was established to set up an energy exchange in Poland. It is a consortium of several energy companies, including Endesa of Spain. The Polish energy exchange started operation on July 1, 2000. The schedule for phasing in third party access to electricity and natural gas started with the largest users and will eventually cover all customers by the end of 2005. The natural gas timetable follows a similar pattern.

Oil product pipelines and crude oil storage in Poland are run by the Oil Pipeline Exploitation Enterprise (PERN), a joint stock company wholly owned by the State Treasury. The Polish government has considered privatizing PERN, and if privatized, it would be expected to attract investors as it is one of the most profitable enterprises in Poland, unless otherwise noted, is derived from a Country Overview provided by the US Department of Energy, under the supervision of Richard Lynch, and Poland. Oil shipments via railroad tank cars are handled by a separate company, DEC., which transports 14 million tons of products annually.

Polish Oil and Gas Company (POGC) is responsible for construction and operation of gas transmission and distribution system, and has a well-developed natural gas transmission system for supply of the increasing number of its customers in Poland. The number of residential and commercial gas customers is about 6.8 million, and the transmission and distribution network is 107,000 kilometers. By 2010, Poland expects to add 43,000 to 58,000 kilometers of new distribution pipelines. POGC constructs and operates underground gas storage facilities in Poland. There are seven underground gas storage sites available, and POGC also leases storage capacity in the Ukraine and Belarus.

POGC's privatization process will occur over the next few years, and include POGC's pipeline network as well as its upstream gas production and storage facilities. The first step was the division of POGC into six different entities: four regional gas distribution companies, a company to handle gas production and storage, and the "mother" company (POGC) which would import and market most of the gas consumed in Poland.

Despite concerns over energy dependency on the Russian Federation, larger imports of Russian natural gas will occur via the Yamal-Europe Transit Gas Pipeline which is being constructed across Poland and western Europe. The Yamal pipeline is expected to cost \$35 billion, and will transport 13 billion cubic meters of natural gas annually into Poland.

It is expected that the entire project will be completed in 2010. POGC has also signed an agreement with the Danish Natural Gas Company to build a natural gas pipeline across the Baltic Sea which would carry 10 billion cubic metres annually.

In 1999, Poland began to privatize companies involved in the production and distribution of electricity. This privatization plan involves selling shares in electric generating and distribution companies to investors. The electricity industry has been reorganized into three layers of companies dedicated to the generation, transmission, and distribution subsectors. The generation subsector consists of large power stations and combined heat and power facilities. Generating capacity is expected to be adequate for the next several years, due to lower economic growth and transition to a less energy-intensive economy.

The Polish electric power sector needs to replace 16 gigawatts of obsolete installed capacity and to satisfy stricter environmental standards, and a substantial portion of the modernization cost will be covered by the privatization.

Once part of the POKOJ power distribution system, which was the former power distribution system of the Ukraine and Eastern European countries, CENTREL (the new power distribution system of Poland, the Czech Republic, Slovakia, and Hungary) is fully integrated into the Western European UCPTE system. Poland also maintains very strong links with distribution systems in the Ukraine and Belarus. These links provide Poland with an exchange potential with Western Europe and these former Soviet Union states.

As of the year 2000, the Polish power grid consists of about 200 kilometers of 750 kilovolt (kV) lines, about 4,700 kilometers of 400 kV lines, and about 7,900 kilometers of 220 kV lines, and is interconnected using more than 80 large substations.

The Polish Power Grid Company - Polskie Sieci Elektroenergetyczne (PSE) - was created in August 1990 by the Polish Ministry of Trade and Industry as a joint-stock company, wholly-owned by the Polish state treasury. PSE is the owner of Poland's high voltage electricity grid and is responsible for grid operations and power dispatching. The distribution subsector consists of 33 distribution companies, all of which are joint-stock companies, and utilizes 110 kV, 15 kV, and 0.4 kV lines to supply electricity to customers. Distribution companies represent approximately 40 per cent of all Polish electricity sector assets.

General rules for competitive markets for gas and electricity are contained in the Energy Law, with secondary rules for tariff, connections and non-conventional energy source being found in ordinances of the Ministry of the Economy. The Electricity Regulatory Agency is authorized under law to licence and set prices for monopoly activities.<sup>40</sup> The privatization process in Poland falls under the Council of Ministers, with the Minister of the Treasury having the legal authority and obligation to prepare yearly programs of privatization of state-owned assets and to manage those programs approved by the Council. The Regulator has played a supportive but background role in the Polish privatization process. The Ministries of Treasury, Economy and Finance first adopted a plan for the electricity market in 1999. In December 2000, the framework of that market was introduced in the policy document, "Operational Rules for the Polish Electricity Market for the Year 2000 and Beyond."

The Polish Power Grid Company operates as a transmission system operator. Its primary activities are power dispatch, the operation of a national power system, power transmission through a high voltage system, generation of electricity, trading in electricity and energy system services both nationally and internationally, and developing a national electricity system through planning and research.<sup>41</sup> The Energy Law guarantees third party access for energy producers within Poland, but does not provide this guarantee for external parties, though this is likely to change as a result of EU requirements. New transmission tariffs are being prepared for the Polish Power Grid Companies and distribution companies.

A Power Exchange has been designed but only small amounts of electricity are sold there, in the range of 3 per cent. The Power Exchange was established without specific legislation, and is a joint company with shares held by the State Treasury. Prices on the exchange are exempt from approval by the Energy Regulatory Agency. The exchange operates a day ahead market, where distribution companies and large customers bid the price at which they will buy, and generators and wholesalers bid a price at which they will sell supply. A clearing house price is then established for each hour of the subsequent day. Bilateral short and long term contracts are also permitted, and are the majority of the market.

The Energy Regulatory Agency may have some problems in promoting market development because of pre-existing long-term energy contracts for the delivery of electricity. Although



these contracts have facilitated financing equipment, they have complicated the development of competitive markets, and there is a concern that long-term contracts might interfere with the establishment of a Power Exchange. Specifically, most energy is sold pursuant to the long-term contract and very little energy is available to trade on the Power Exchange. Further, such long-term contracts might be used to effectively exclude other future potential entrants into the market.

The restructuring of Poland's downstream oil industry began in 1994 with the establishment of Nafta Polska, the joint stock holding company for Poland's oil industry, which is ultimately responsible for the privatization of Poland's oil and gas sectors. Nafta Polska is comprised of Poland's two major refineries, five smaller refineries, and the Central Distribution Company (CPN). At the end of 1996, CPN was to be divided into three companies: CPN (the gas station company), DEC Ltd. (the railway tank company), and Naftobazy Ltd. (the oil storage company). Poland's downstream petroleum sector consists today mainly of PKN Orlen, which is the Plock refinery and the former CPN Gas station network, and the Gdansk refinery. Gdansk is to be sold by Nafta Polska and PKN Orlen might be the buyer.

Environmental impacts from energy production are a major concern. Energy-related environmental problems include air pollution from burning coal in power and district heating plants, water pollution from coal mine dumping of saline water into the Vistula and Oder rivers and refinery effluents of insufficiently treated water, and solid waste from coal mines and power plants. Poland's three largest coal mines are among the largest sources of pollution.

Large power plants and combined heat and power facilities have been equipped with high stacks and electrostatic precipitators, or at least bag filters, allowing for the capture of increasing amounts of fly ash particulates. Flue gas desulfurization and low-NO<sub>x</sub> technology were only introduced in the 1990s. Because of this, and the use of lower sulfur coal, the environmental performance of many power plants has improved considerably. However, under environmental regulations adopted in 1990, new emission standards for existing plants came into effect in 1998 that are in line with EU standards.

Additionally, all plants will need low-NO<sub>x</sub> burners and improved fly ash particulates removal.

The Energy Regulatory Authority has indicated its intention to put more emphasis on the spot market for short term contracts for electricity and less emphasis on long term

contracts. At the present time, it is not clear how this policy change will be implemented. If the balance shifts to short term contracts, this might tend to favor new generation sources, municipal combined heat and power, and "green" power sources that have a legally privileged status. Poland has signed a number of international agreements and accords on the environment, including adopting all obligations from the Convention on Climate Change, as well as other agreements to control transboundary emissions.

### **Czech Republic energy markets and liberalization**

The Czech Republic has an energy strategy that includes market energy prices; state-owned energy enterprises being restructured and privatized; the production of safer, more efficient, and less polluting forms of energy; the encouragement of energy conservation; increased and diversified connections to international oil and gas pipelines and electricity networks; and more efficient domestic oil and gas production. The Czech government is focusing on harmonizing Czech energy sector standards with those in the EU. This means decreasing Czech dependence on solid fuels as a primary energy source. Coal will gradually be replaced as a source of heat, or will be increasingly used for co-generation.



Improvements are also planned for legislation, business conditions, statistics and reporting standards in the energy sector to conform Czech standards with those of the EU.

On 1 January 2001 a new energy regulatory authority began operating in the Czech Republic. Its responsibilities include determining rates that customers will pay for energy and setting up the framework for third party access to the electrical grid. The schedule for phasing in third party access to electricity starts with the largest users and will eventually cover all customers by the end of 2006. The natural gas timetable will follow a similar pattern with the largest customers getting access first. Transgas, the Czech gas pipeline utility, phased out its subsidies to customers in 2003.

Energy audits by government-approved auditors are now mandatory for all government facilities with energy uses of more than 1,500 gigajoules per year. Energy audits are also required for non-government energy users, but the threshold is much higher as any energy user who consumes at least 35,000 gigajoules per year must have an energy audit.

The purpose of these audits is to encourage energy conservation and also outside investment by energy services companies for making any economically-feasible improvements in energy usage. Oil policies are part of the Czech Republic's bid to be admitted to the EU, particularly building a 90-day state oil reserve. In 2001, the EU agreed to the Czech Republic's request to extend the deadline for building this reserve to December 2005.

### **Ukraine's energy sectors**

Taking the cornerstones of the EU energy policy towards welfare through competition as a benchmark, this section assess the extent to which Ukraine's gas and electricity sector comply with EU standards.

Since the early 1990s, an energy policy intending to create a competition-driven energy market has been implemented by the European Union (EU). Accordingly, Ukraine's recently stated intention to harmonize its energy policy with EU standards appears to be a useful starting point for redefining its energy policy. Against this background, the present paper describes the main elements of the EU energy policy in its design and progress, assesses the extent to which the Ukrainian energy sector complies or not complies with the main principles of the EU energy policy and gives recommendations as to how Ukrainian policy-makers should further proceed with the intended harmonization.

### **Gas sector**

Although the different functions such as gas extraction, transmission system operation, wholesale trade and retailing are performed by separate legal entities, Ukraine's gas sector still has a monopoly structure because with the exception of retailing, each task is almost exclusively performed by a single firm all of which are owned and controlled by a central, state-owned holding, NAK "Naftogaz Ukraine"<sup>4</sup>. In particular, Naftogaz has full control over transmission systems and gas storage facilities through its subsidiary Ukrtransgaz, and it also owns large parts of the distribution networks, which are given to gas retailers (Oblgazes) for operation under management contracts. The national energy regulator NERC sets consumer tariffs based on governmental instructions.

Taking the requirements of the EU energy directives as a benchmark, Ukraine's gas sector performs as follows:

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<sup>4</sup> In fact, the market shares of the few independent firms which operate in either gas extraction or wholesale trader are negligible.

- Unbundling. Despite the role of Naftogaz as central holding, the operation of transmission systems is legally unbundled from gas extraction, wholesale trade or retailing. In contrast, distribution systems are operated by Oblgazes, which also perform as retailers. Relatively, full compliance with the EU directives requires the unbundling of distribution systems from Oblgazes<sup>5</sup>.

- TPA. Access of third parties to networks is not effectively guaranteed. Although regulatory body (NERC) sets tariffs for network access, there are no procedures or legally binding norms in place, according to which third parties can enforce access to transmission or distribution systems owned by Naftogaz. In fact, NERC operates so far only on the basis of a presidential decree. As a result, its role in the gas sector is highly politically dependent and has so far been limited to the execution of politically determined decisions.

- Market opening. Licenses for all types of operation in the gas sector are issued by NERC.

While a specific law defines licensing criteria<sup>6</sup>, NERC has only limited possibilities to act independently<sup>7</sup>. Similar problems as for licensing apply to other necessary conditions for market opening such as well-defined contract termination procedures that would allow customers to switch suppliers. Hence, Ukraine's gas sector so far only poorly complies with the market opening criteria of the EU energy directives.

As preliminary conclusion, two urgent improvements are necessary for a better compliance with the EU energy directives:

a. Guarantee regulated TPA to network systems and storage facilities by:

- Expanding NERCS competences in the setting of system tariffs (including the use of incentive-stimulating methodologies);

- Defining appropriate legal procedures or legally binding norms to enforce TPA; and

- Strengthening the role of NERC in enforcing them.

b. Improve market opening by:

- Specifying objective and transparent licensing criteria for new entries into the gas market;

- Determining contract termination procedures; and

- Strengthening the role of NERC in enforcing them.

Nevertheless, all these measures are unlikely to stimulate competition in the gas sector unless prices are raised to internationally comparable levels. In fact, the monopolistic structure of the gas market reflects the intention of the state to limit and control various types of arbitrage opportunities that arise from import prices for gas at rather low levels. With the current increase of import prices, such arbitrage opportunities strongly diminish. Accordingly, a sensitive energy policy should now seek to ensure that price increases are not higher than necessary by stimulating the full use of efficiency potentials by stimulating competition on the domestic gas market. In addition to the steps listed above, this also requires the abolition of socially motivated tariff setting for households and a gradual replacement of consumer price regulation by competition on wholesale as well as on retail markets. Eventually, this will also require that access tariffs and TPA to distribution networks are ensured and sufficiently regulated and that the operation of distribution systems are unbundled from retail activities of Oblgazes<sup>8</sup>. In the long run a strategy to foster competition must also include privatization.

<sup>4</sup> This situation resembles the average performance of the EU-15 Member States, of which only half have so far achieved full unbundling of transmission and distribution systems.

<sup>6</sup> Law of Ukraine on licensing of certain entrepreneurial activities.

<sup>7</sup> In fact, the recent market entry of a second wholesale trading company (UkrGazEnergo) as part of the January 6 gas agreement with Gazprom licensing has been strongly based on government interventions.

<sup>8</sup> For a sequencing of reform steps necessary to foster competition on Ukraine's gas markets see our Advisory Paper U3: Ukraine's gas sector: Time for reforms. May 2005.

Finally, it must be stressed that fostering competition on wholesale and retail markets in Ukraine does not worsen the bargaining position vis-a-vis the Russian supplier because the gas transit system as well as storage capacities still remain under the control of a regulating agency, which could e.g. be used in setting up a framework agreement for gas imports.

### **Electricity sector**

The Ukrainian electricity sector is structurally more open to competition than the gas sector. The market functions along the British pool model, where electricity generators submit bids into a common pool from which retail companies and eligible, large-scale power consumers purchase their electricity. The operator of this wholesale pool, the state-owned company Energoynok, balances supply and demand and determines wholesale prices. Price setting of generators is regulated for several generators<sup>9</sup> while in particular operators of thermal power plants can submit independent bids, which allows for some degree of competition. Most electricity consumers including households are supplied by regionally separated distribution companies (Oblenergos) at regulated tariffs, but industrial consumers are free to choose alternative suppliers without tariffs being regulated<sup>10</sup>.

Against the benchmark of the EU energy directives, the electricity sector performs as follows:

- **Unbundling:** Transmission systems are operated by Ukrenergo, a legally independent, state-owned company. Distribution systems belong to and are operated by Oblenergos, the electricity retailers. Hence, as for gas, unbundling requirements are only partially satisfied<sup>11</sup>.

- **TPA:** Third party access to the networks is guaranteed by the Law on Electricity Sector and its implementation is observed by NERC. Tariffs for the network access are regularly published. While Oblenergos as retailers and operators of distribution systems can try to block new entrants, there are mechanisms in place to solve such disputes.

- **Market opening:** Licenses in the electricity sector are issued by NERC based on an explicit legal basis<sup>12</sup>. Together with the provisions on third-party access, the market appears to be sufficiently open to new entrants. Some degree of competition is present in the market. Nevertheless, regulated household tariffs, which are set at below-cost levels, preclude new entries into the retail market. Also, switching procedures are not clearly defined for all relevant customer groups including small-scale businesses. Power generation is competitive within the thermal power plant segment, in which plants compete in the wholesale market through bidding.

- **Tariff regulation:** In contrast to the gas sector, NERC plays a prominent role in electricity by regulating tariffs of distribution and transmission networks, bid prices for CHPs, wind- and hydropower as well as nuclear power plants and prices of most retailers. For the latter, NERC sets household tariffs on levels below their costs and cross-subsidizes sales to households by setting industry tariffs accordingly. For all price regulation, the regulator uses standard cost-plus approaches, which do not comply with the standards set by the EU directives because they fail to provide incentives to regulated firms to reduce their costs and increase efficiency levels.

- **Interconnection:** The state-owned company Ukrinterenergo effectively controls as monopoly exporter of electricity the degree of interconnection of Ukraine's power grid with its neighboring countries. This constellation is necessary due to the low levels of electricity prices

<sup>9</sup> This includes hydropower as well as nuclear power plants, CHPs and wind power.

<sup>10</sup> The market share of independent suppliers has more than doubled over recent years, from about 6% in 2002 to 14% by the end of 2004.

<sup>11</sup> Again, we stress that this assessment is fairly in line with average performance of EU-15 member states.

<sup>12</sup> Law of Ukraine on licensing of certain entrepreneurial activities.

in Ukraine, which in turn are caused by the regulation of end-user prices as described above. However, denying power generators the possibility to enter into direct contracts with foreign parties creates a main barrier to investment and new entries and hence, competition in the sector.

Hence, Ukraine's electricity sector more clearly complies with the EU directives. However, although the regulator effectively plays a much stronger role than in the gas sector, it still lacks a sufficient legal basis, implying that the overall regulatory environment is still subject to considerable uncertainty. Accordingly, with the exception of thermal power generators who submit competitive bids to Energorynok, competition in the electricity sector has remained fairly low. In fact, Oblenergos have maintained their predominant position as regional monopolies on the retail market, mainly because of a rigid regulation of final consumer prices aiming at the cross-subsidizing household tariffs, which in turn reduces overall profitability in the retail segment. This regulatory strategy was possible with gas prices at the levels that prevailed until 2005 (about USD 50 per tcm). However, the dramatic recent increase will also raise the costs of electricity generation significantly<sup>13</sup> and will therefore also force increases in electricity prices. In this new situation, it will be important that all possible efficiency gains are realized so that price increases are no higher than absolutely necessary. At the same time, continuing the cross-subsidization of lower household tariffs by higher industry tariffs will cause even stronger distortions and increasingly hurt industrial production.

Against this background, policy makers should:

- a. Cancel the cross-subsidization of household tariffs and redefine NERC's methodology to use incentive-stimulating approaches leading regulated firms to increase their efficiency.
- b. Stimulate competition in the retail segment by regulating access tariffs and TPA to distribution networks thorough NERC and eventually, unbundling distribution systems from retail activities of Oblenergos.
- c. Stimulate the integration of Ukraine's electricity system with its neighboring countries by allowing electricity generators to directly conclude export contracts with foreign customers. Besides these measures the state could consider further privatization in the energy sector, which was recently stopped.

### **Conclusion**

As we point out in the assessment of Ukraine's electricity and gas sector, compliance with EU standards can be achieved if more emphasis is placed on ensuring third party access to transmission and distribution networks, as well as on market opening. In addition, we argue that it will also be possible to bring energy prices up to internationally comparable levels so that companies will have sufficient incentives to operate in Ukraine's energy markets. Finally, the position of the regulatory agency, NERC, must be strengthened by creating an appropriate legal basis for its operations.

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<sup>13</sup> Gas units account for about a third of Ukraine's electricity generation, and the costs of gas-based power generation determine marginal costs in the merit order at least during peak hours. Assuming an energy efficiency of 30% for a 20 years old OCGT generation unit and variable O&M costs of about USD 5 per MWh, a 60% increase of gas prices will raise the variable costs of gas-based electricity generation by about 40%.

*Конотон М.В.\**

**ПРОБЛЕМА ДЖЕРЕЛ ТА ЧИННИКІВ ІНФЛЯЦІЇ  
В ВАЛЮТНИХ СОЮЗАХ  
ПРОБЛЕМА «БЕЗКВИТКОВОГО ПРОЇЗДУ»  
Частина I**

З дев'яностих років зріс інтерес до формування валютних союзів – груп політичних одиниць (країн, держав або провінцій), які наділені певним рівнем незалежності у впровадженні фіскальної та інших типів немонетарної політики, але мають спільний кредитно-грошовий орган, який є незалежною інституцією, що встановлює єдину валютну політику для всіх членів союзу. На практиці деякі валютні союзи працюють погано, в той час як інші – добре. Аргентина є прикладом неуспішного валютного союзу; Сполучені Штати – успішного, а успіх Європейського Союзу до сих пір є невирішеним. Чому ж деякі валютні союзи успішні, а інші – ні? Далі пропонується теорія, яка дає відповіді на задані питання.

Проблема часового протиріччя [1] в монетарній політиці є основою і цієї теорії. Будемо стверджувати, що за деяких обставин ця проблема монетарної політики викликає нову проблему «безквиткового проїзду» в немонетарних політиках членів союзу. «Безквиткові» члени союзу впроваджують недієві немонетарні політики, які є вигідними лише цим членам, але провокують грошово-кредитний орган проведення політики, яка збільшує рівень інфляції для всього союзу.

Способом подолання обох проблем є безпосереднє вирішення проблеми часового протиріччя саме в монетарній політиці. Відомо, що, принаймні, в теорії, цю проблему можна вирішити шляхом накладання обов'язків (визначення таргетів) на грошово-кредитний орган, або впливом на його репутацію. Якщо задіяний один з цих механізмів, не виникає проблеми «безквиткового проїзду», таким чином, безпосереднє вирішення проблеми часового протиріччя водночас вирішує проблему «безквиткового проїзду». Звичайно, на практиці важко змінити ступінь ефективного зобов'язання, скажімо, шляхом розвитку репутації. Для себе припустимо необхідним, що грошово-кредитний орган або має, або не має проблему часового протиріччя.

Більш того, що шляхом вирішення проблеми «безквиткового проїзду» можна зменшити проблему часового протиріччя в монетарній політиці. Проблема «безквиткового проїзду» можна вирішити шляхом накладання обмежень на немонетарні політики в союзі в цілому, таких як, наприклад, впровадження правил ведення політики на ринку праці, боргових обмежень у фіскальній політиці та регулюванні банківського сектору. Коли варіанти немонетарних політик членів союзу обмежені, менша вірогідність того, що грошово-кредитний орган залучатиметься до дій, які викликають зростання рівня інфляції. Таким чином, обмеження можуть, хоча, і неповністю вирішувати проблему часового протиріччя, або, принаймні, пом'якшити її.

\* аспірант кафедри світового господарства та міжнародних економічних відносин Інституту міжнародних відносин Київського національного університету імені Тараса Шевченка  
Еуаковий керівник проф. Шнирков О.І.



Спочатку доведемо зазначені положення в загальній теоретичній схемі. До даної моделі входять уряди, які впроваджують немонетарні політики некооперативно, конкурентоспроможні приватні агенти та прихильний грошово-кредитний орган, який обирає рівень інфляції. Оптимальний рівень інфляції залежить від рішень приватних агентів та від окремих немонетарних політик уряду. Приватні агенти приймають рішення, прогнозуючи вибір грошово-кредитного органу. Уряди обирають свої немонетарні політики, передбачаючи вибір як приватних агентів, так і кредитно-грошового органу.

Тут проблема «безквиткового проїзду» відрізняється від тієї, яку описано в існуючій літературі. В стандартному визначенні проблеми «безквиткового проїзду» сторони, які приймають рішення, мають прямий зв'язок; дії кожної сторони мають безпосередній вплив на прибуток інших. В той же час, як в даній схемі не простежуються такі прямі зв'язки. Тут немонетарна політика кожного уряду впливає на загальний рівень інфляції і, таким чином, безпосередньо впливає на прибуток інших урядів. Однак, цей непрямий зв'язок недостатній для виникнення проблеми «безквиткового проїзду».

Тут джерелом проблеми «безквиткового проїзду», швидше за все, є поведінка далекоглядних приватних агентів, якщо грошово-кредитний орган не здатний дотримуватися визначеної політики. Без такої зобов'язаності грошово-кредитний орган зміни в немонетарній політиці урядом одного з членів союзу підштовхує приватних агентів прогнозувати зміни в рівні інфляції на всій території союзу, та прогнозована зміна примушує їх змінювати свої рішення. Оскільки кожний уряд піклується про рішення своїх приватних агентів, зміни в немонетарній політиці будь-яким урядом-членом впливають на загальний добробут. Такий непрямий зв'язок призводить до проблеми «безквиткового проїзду». За умов дотримання свого зобов'язання грошово-кредитний органом, не виникає проблеми «безквиткового проїзду» навіть за наявності далекоглядних приватних агентів в моделі.

Для позначення ролі приватних агентів у виникненні проблеми «безквиткового проїзду», спочатку розглянемо валютний союз без них, тобто лише з урядами та грошово-кредитним органом. В такому середовищі, якщо грошово-кредитний орган прихильний, не існує проблеми «безквиткового проїзду».

Після детального вивчення теорії як з, так і без приватних агентів, розглянемо її застосування відносно трьох стандартних немонетарних політик: політики ринку праці, фіскальної політики та банківського регулювання.

Спочатку застосуємо дану теорію до політики на ринку праці. Для цього модифікуємо класичну модель часового протиріччя в монетарній політиці [1].

В модифікації цієї класичної моделі уряди країн в валютному союзі встановлюють природний рівень безробіття шляхом впровадження відповідної політики ринку праці. На такій схемі проблема «безквиткового проїзду» провокує уряди до впровадження політик, які викликають занадто високий рівень інфляції та безробіття. Обмеження, встановлені такою політикою ринку праці, вирішують проблему «безквиткового проїзду» та допомагають зменшити проблему часового протиріччя.

Далі застосуємо дану теорію до фіскальної політики, де розглянемо просту динамічну модель, в якій багато країн поєднані в валютний союз. Фіскальний орган кожної країни фінансує урядові витрати шляхом випуску номінальних боргових зобов'язань для її резидентів. За цим грошово-кредитний орган встановлює загальний рівень інфляції, урівноважує прибуток від інфляції зі збитками від неї. Зростання рівня інфляції приносить прибуток, оскільки інфляція зменшує реальне значення номінального боргу і, таким чином, зменшує суму податків, які мають підвищуватися урядом кожної країни для погашення заборгованості. Зростання рівня інфляції також приносить збитки, бо інфляція ви-

кривляє розподіл і, рівень виробництва, таким чином, може знизитись. Тут з ростом заборгованості прибуток від інфляції підвищується швидше, ніж збитки. Таким чином, чим більша заборгованість фіскального органу, тим вищий рівень інфляції, який буде встановлювати грошово-кредитний орган.

Встановлюючи рівень урядових витрат, фіскальний орган кожної країни урівноважує прибуток від урядових витрат зі збитками від майбутніх викривлень, разом із примусовими витратами від росту інфляції на власне виробництво, ігноруючи витрати через інфляцію на продукцію інших країн. Таким чином, подібно до кооперативного підходу, кожний фіскальний орган випускає забагато боргових зобов'язань, що приводить до того, що грошово-кредитний орган встановлює завищений рівень інфляції, а це, в свою чергу, призводить до неефективно низького рівня виробництва у всіх країнах союзу.

Взагалі, якщо грошово-кредитний орган здатний ефективно дотримуватися своєї політики, у фіскальних органів не виникає стимулу випускати забагато боргових зобов'язань, та в союзі не виникає проблеми «безквиткового проїзду». Однак, на практиці це часто неможливо, та валютні союзи борються з проблемою «безквиткового проїзду» напругу. Одним з таких способів є накладення обмежень на суму боргу, які можуть встановити уряди членів союзу. В наведеному прикладі належним чином підібрані обмеження вирішують проблему «безквиткового проїзду».

Нарешті, застосуємо дану теорію до банківського регулювання. В аналізі застосовується проста динамічна модель, в якій багато країн поєднані в валютний союз. Уряд кожної країни регулює ризикованість портфелів своїх банків. Якщо банки не спроможні повністю виплатити свої депозити, грошово-кредитний орган друкує гроші для покриття нестачі ліквідності та, таким чином, підвищує інфляцію. Отже, уряд кожної країни урівноважує витрати на регулювання, зменшуючи банківські ризики зі змушеними витратами через ріст інфляції, яка виникає в результаті екстреної допомоги банкам. При цьому, кожний уряд ігнорує витрати інших країн в союзі через вимушену інфляцію. Ці ж сили провокують проблему «безквиткового проїзду» в союзі, через яку регулювання банків слабшає, екстрена допомога банкам надається занадто часто, а рівень інфляції завищений. Якщо не існує механізму для безпосереднього вирішення проблеми часового протиріччя, тоді проблему «безквиткового проїзду» в цій моделі можна зменшити шляхом спільної згоди щодо банківського регулювання.

Наведений нижче аналіз та три шляхи прикладного застосування пропонують відповідь на питання, чому деякі валютні союзи успішні, а деякі – ні. Валютний союз, скоріш за все, не буде успішним, якщо виникає проблема часового протиріччя в монетарній політиці, а також немає ефективних заходів контролю немонетарних політик його членів.

Аргентина перенесла високі та непостійні рівні інфляції [2], немонетарні політики неефективно регулювалися центральним урядом, та центральний банк регулярно допомагав місцевим урядам. Аргентина, схоже, є прикладом валютного союзу з серйозною проблемою часового протиріччя в монетарній політиці, яка не здатна була контролювати немонетарні політики своїх провінцій. В цьому розумінні неуспішність валютного союзу в Аргентині узгоджується з теорією.

Сполучені Штати мали більш стабільний та низький рівень інфляції, ніж інші валютні союзи, незалежність Федеральної резервної системи, вочевидь, зменшує часове протиріччя в монетарній політиці та цим ізолює грошово-кредитний орган від тиску державного уряду. В цьому сенсі, успіх валютного союзу Сполучених Штатів також узгоджується з теорією.

Згідно даної теорії успіх Європейського валютного союзу ще не є остаточним. Статут Центрального Європейського банку був розроблений, як статус високої незалежності з

метою подолання проблеми часового протиріччя. Якщо Центральний банк зможе подолати цю проблему, Європейський валютний союз буде успішним. Навіть якщо Центральний банк не зможе подолати цю проблему, союз все одно зможе стати успішним за умови накладання обмежень на немонетарні політики завдяки Маастрихтським критеріям та Пакту Стабільності та Росту. Але є побоювання, що центральний банк не зможе протистояти інфляції, та в союзі не буде бажання підсилити контроль немонетарних політик.

В цьому контексті слід зазначити, якщо обмеження, які посилюють кооперативний результат, узгоджуються між урядами, то в кожному уряді з'являється стимул уникати надалі цих обмежень. На практиці, Європейському Союзу досить важко встановлювати посилені обмеження у фінансовій політиці кожної з країн-членів. Спостереження, що деякі країни-члени свідомо ухиляються від виконання умов договору ще не значить, що договір було погано укладено. Це, навпаки, узгоджується з даною теорією, і трапляється, коли договір укладено добре.

Поведінка валютних союзів також узгоджується з даною теорією. Центральні уряди схильні накладати обмеження на фінансові політики урядів, близьких до центру[3]. Такі обмеження узгоджуються з переконанням центральних урядів, що їм не вдалося успішно вирішити проблему часового протиріччя в монетарній політиці.

Узагальнюючи та розширюючи аналіз, проведений в попередніх роботах [4] треба викласти загальні принципи аналізу проблеми «безквиткового проїзду» в валютних союзах та застосувати їх відносно трьох типів немонетарної політики. Інший приклад застосування має відношення до аналізу, коли припускається, що уряди беруть в борг у кредиторів, які знаходяться за межами валютного союзу, для того, щоб з часом згладити витрати. Таким чином, інфляція приймає форму інфляційного податку на номінальні боргові фонди цих зовнішніх кредиторів. Отже, уряди фінансують свої витрати, беручи позику у власних резидентів, та виплачують борги через викривлені податки. В цій ситуації грошово-кредитний орган використовує інфляцію як засіб зменшення реальної вартості боргу та, як наслідок, викривлених податків.

Фінансовий аспект даної проблематики привертає увагу на здатності валютного союзу дисциплінувати проблеми політичної економії серед членів союзу[5, 6], тобто проблеми, яких немає в нашому союзі. Тут проблема «безквиткового проїзду» виникає, як наслідок проблеми часового протиріччя, в інших роботах на задану проблематику підкреслюється[7,с], що проблема «безквиткового проїзду» зникає, коли грошова політика союзу здатна максимізувати добробут резидентів членів союзу.

Досягнення від спільного ведення країнами фінансової політики широко обговорювалися, та зрозумілі всім. Було доведено, що така кооперація бажана, якщо фінансові політики країн впливають на світові ціни та реальні відсоткові ставки [8,с]. Така кооперація, однак, не завжди має відношення до країн, які входять до валютного союзу. Таким чином, доводиться абстрагуватись від цього аспекту, та припустити, що країни, поєднані у валютний союз, не впливають на світові ціни та реальні відсоткові ставки.

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# **АКТУАЛЬНІ ПРОБЛЕМИ МІЖНАРОДНИХ ВІДНОСИН**

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Тел. 483–11–25