

## LESSONS OF MARKET TRANSFORMATION IN UKRAINE

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***Resume:** The article deals with the issues of market transformation model in Ukraine. The author describes the current economic model in the country, highlights the preconditions for effective economic model implementation for the development of Ukraine, assesses the factors influenced the economic growth and social life. A new system of economic policy, that based on the effective use of productive potential of the country and that is aimed at targeting the rates of GDP and eventually will lead to the stable economic development has been offered in this research.*

***Key words:** market transformation, economic model, an effective mechanism of accumulation investment recovery, economic incentives, transition, credit support, stabilization of the national economy.*

### **1. Introduction**

First of all, it is necessary to mention that the market transformation in Ukraine began with the introduction of institutions and management practices in the economy, which were developed by previous experience of market transformation and recorded in the „Washington Consensus.” These new declared institutions were weakly interacting with the structure of the economy and management of the traditions inherited from the period of Soviet planned economy.

Initially, the ideologists of reforms intended to create a model of a market economy where a competitive relationship for ensuring the effective allocation and the use of resources, rapid and sustainable economic growth, balance and openness in foreign trade, a stable fiscal and monetary system would exist. The achievement of these goals involved some stages. But within a few years (at least for 10-15 years for sure) it was proposed to form a solid foundation of civilized business model.

What is the result? As a result of the reformist actions a system of the fundamentally different nature has been created, in which none of the tasks has been resolved.

The country has not developed a mature environment for intra- and inter-industry competition, as well as the accumulation of capital effectively. The necessary set of incentives for the efficient and effective use of resources has not been developed and there are no effective institutions providing civilized forms of relations between economic agents. The national economy has no mechanism to promote a sustainable growth. The structure of the economy is not improving, and vice versa – is becoming more destructive.

According to expert estimates in 2014, the share of savings remains at the same low level (above 14%) in, which does not meet the requirements of the growing economy and the size of investment is several times lower. The country has not created any fiscal or monetary systems, capable to perform its primary function – to support the efficient investment program in the economy.

It is necessary to highlight several reasons, eventually influenced the formation of the economic model that has developed in our society. The first reason is a misunderstanding of the nature of the Soviet economy (i.e. the basic conditions for the formation of the national economic system). The second reason is the mistakes, made in carrying out reforms. The third reason – ignorance of the truth, not declared desires of the authorities, which were not interested in a „transparent” and the competitive market environment and social protection.

Consequently, the economic model, developed in the 1990s and the first 15 years of the new century – a combination of relations and institutions of various types and levels: market and non-market, legal and non-legal etc. This strange combination is stipulated by the presence of „institutional continuity”, i.e. institutions, established in Soviet period, in the „informal” economy, fell into a new economic system and then newly emerged in the conditions of market transformation.

## **2. Modern economic model as a reproducing system**

Economic growth in 2000-2008, proved to be unsustainable. It doesn't mean only the extremely high dependence of the Ukrainian economy on the world price situation in the markets. Such dependence has certainly been a serious problem. However, there are other factors which also limit the parameters of economic growth and social life of the citizens.

Firstly, the current economic model is based on the infrastructure and technological bases created during the Soviet period. Over the past 25 years, investments in this material and the real system have been reduced sharply and they have limited economic growth and led to a deterioration of transport and social infrastructure. Secondly, the lack of structural re-

forms is beginning to have a negative impact on current production plans of large enterprises. Since the economy hasn't any strategic and medium-term development program, it is becoming a major obstacle to investment plans implementation. Thirdly, the economic model has no incentive to the formation of the effective accumulation mechanism. Compared to the Soviet period, the rate of accumulation in the Ukrainian economy declined significantly. Even taking into account the investment recovery in 2000-2008, its value, calculated according to exchange rates was about 9.3%, which does not meet the needs of modernization of the real sector of the economy.

As a result of the crisis in 2008-2009, the situation in the Ukrainian economy has changed dramatically. The decrease in the main indicators of its economic development was influenced not only by the global recession, but the drop in demand for exports, rising gas prices, foreign debt. This influenced budget issues and companies that depend on gas consumption. Since the second half of 2012, the country was plunged into a new economic crisis. The pace of quarterly GDP growth became a negative trend and remains the same at present. The indicators of industrial production, exports, capital investment have the same dynamics. It is necessary to draw attention to the fact that the rate of decline in investment is higher than the rate of decline of GDP.

Thus, according to international experts, for the 1990-1996, the volume of investments decreased by 85%, and the second half of 1990 was described with zero net investment in Ukraine, that meant: everything was produced and directed to meet only the necessary recovery needs. Even after the economic growth of the 2000s, the volume of investments into the economy of the country was less than 40% in comparison with the level of the 1990, and after the crisis of 2008-2009 drop in investments by 2014 reached 20%. During the years of market transformation, a steady decline in the savings rate occurred: in 2004 it was 31% of GDP, and in 2008, despite the rise in GDP it dropped to 21%, whereas in the period of the second wave of the crisis in 2014 – only by 6% of GDP. Low savings rate shows serious macroeconomic imbalances in the Ukrainian economy. This savings rate is several times lower than the global average (25%) and less common European indicators, which in Western Europe make up 17-19% of GDP, and in the Eastern Europe – 21-22% of GDP. As it is known, the low savings rate affects the size of the investment: for example, in 2014 investment per 1 inhabitant amounted to about 423 dollars in Ukraine, while in Poland – 2.8 thousand and in Romania – 2,2 thousand dollars .

Therefore, under such low rates of savings and accumulations in the country there are no sources of investment, which will provide the necessary growth of 4-6%, that is higher than 3.5% of global GDP growth. Such

growth rates are determined firstly by the terms of the expanded reproduction (i.e. the creation of new industries and employment), and secondly, the necessity to start a two-fold reduction in the backlog of Ukraine from the GDP figure of neighboring countries per one inhabitant.

Consequently, a gradual increase in basic reproductive imbalances to ensure the transition of the acute phase of the crisis into the long period of stagnation, which covers the last 8 years.

This development has been unacceptable because it will lead to a further reduction in the level and living standards of citizens, as well as the generation of social problems in the country. In order to prevent this, the development of the economic policy formation should focus on the attempt of the national economy to be out of stagnation period. The solution of these tasks should be the basis of a strategic goal-setting as the main element of economic policy.

However – due to a fundamental change in the vector of political and economic development through the signing of the Agreement on Association between Ukraine and the EU, as well as the memorandum in connection with the threat of default on foreign debts – the Ukrainian authorities have committed themselves to the IMF to stabilize the macroeconomic situation in the country in exchange for a credit support in the amount of 17 bln. dollars.

Thus, Ukraine externally has set new goals of socio-economic movement in the near future.

### **3. The outlines of the new economic policy**

For the transition to sustainable economic growth, it is necessary to build a new economic policy. However, due to political and economic situation of recent years, the system of strategic goal-setting as a key element of economic policy has become blurred. The object of attention of management are short-term challenges, which are aimed at solving them and anti-crisis government program agreed with the IMF. For example, the government's actions for ensuring macroeconomic stability, according to the memorandum Art.3. has led to budgetary and credit restrictions, which ultimately affected the reducing public investment activity and the overall economic dynamics. It is connected with the largest Ukrainian public corporations or corporations with government participation. However, if the government through state-owned companies reduces investment activity, this action influenced all types of businesses as a kind of negative signal regarding the implementation of public investment projects. In fact, such projects should be supported through the activation of forms of public and private partnership.

But, in addition to macro-economic stabilization, the main challenge in the short term is to provide the real sector of the economy with not only many investment resources but also with the necessary working capital. This means the establishment of crediting of the real sector companies, and above all – export, which could, for example, fill the allocated by EU quota of Ukrainian export, as well as to ensure adequate export to other foreign markets. According to the results of Free Trade between Ukraine and the EU in 2015 the quota of cereals, honey, grape and apple juices was fully utilized, while the individual groups of goods (such as dairy products, pork, beef, butter, sugar syrups, mushrooms) quota was not filled at all production because of its low quality. There can be involved mechanisms of project financing through special state banks to provide loans under the program to improve product quality, which are connected with a shortage of competitive production capacities. The Central European countries acted similarly at the opening of EU markets for them.

In other words, there has been a positive situation in the Ukrainian economy, which involves the reaction of the necessary national production, but not by using additional capacity, but through either modernization, or the creation of new industries.

Due to budget constraints, the recovery of economic growth is possible if a significant part of the enterprises income will focus on the expansion of production through modernization, which is known to be cheaper than the building new facilities. In the short term prospects, it is important to form new sources of income in the economy. The real income sources can be the expansion of the share of domestic products in foreign consumer markets, as well as the subsequent expansion of exports of manufactured consumer goods.

It is necessary to mention another possibility of the potential increase in production volumes in Ukraine. Three times the collapse of the hryvnia has created certain preconditions for the displacement of imported goods in the domestic market. If the business is engaged in the production of domestic goods, it will be able to take advantage of the favorable situation, and it will also be a factor of economic growth. A key condition for the development of the internal domestic market is the stability of the exchange rate. If the domestic business does not respond to current circumstances, its further increase in import prices will be inevitable.

In such situations the state needs to participate in the public and private forms of partnerships as an actions to stabilize the consumer market, which is constantly decreasing due to the contraction in consumer demand. Therefore, in order to avoid further contraction of domestic demand in the short term period there should not be budget cuts and increase of the tax

burden on people and businesses. Next, the medium-term stage in the development of the national economy – the stabilization of consumer demand and the expansion of investment activity. These factors may be the most efficient in the process of economic growth recovery during the next 3-5 years. But the launch of production of investment goods will depend on its ability to run investment mechanism in industries which are targeted at producing export goods, i.e. competitive production. It does not have to function without an active industrial policy of developing the leaders of the national economy, capable to produce competitive products.

At this stage, the reproductive imbalance between the rate of accumulation and savings should be eliminated because they will not have the investment resources for the expansion of their investment activity. The financial and banking system and other institutions of development (including international) should launch the mechanism of redistribution of resources to the investment activity of enterprises. In the shortest possible time through intensive consultations with the business the public institutions (ministries) should create a list of investment projects that the state can support on a returnable basis: through loan guarantees or through the issuance and purchase of corporate bonds etc. The dissemination of these credit facilities will enhance redistributive function and effectiveness of the financial and banking system and it will create the market for corporate debt. The main criterion for the selection of projects should be a value-added growth by lengthening the chains of income by processing raw materials and sales of finished goods primarily for export in the next 5-10 years. In the medium-term period of economic growth and the expansion of investment activity the high level of employment and the improvement of living standards should be increased. Therefore, the increase of wages in the sectors of high quality should be the main factor in the growth of living standards of citizens. In order to ensure a sustainable economic growth, it is necessary to improve production efficiency by increasing the rate of accumulation of 25-30% of GDP, and as a result – to increase the investment component of economic dynamics.

### **Conclusion**

In conclusion – a few words about such an important element of economic policy, as the long-term forecasting. Its necessity arises when the country needs faster growth. In all countries where the strategy of „catching up” development (Finland, the „Asian tigers”, China), there were targeted strategies, managed and funded by their government bodies. During the period of market transformations in Ukraine, the goal-setting issues

were considered incompatible with the concept of a market economy where market forces dominate. The ideology of liberal marketers minimizes the role of the state in the economy. Since the beginning of the 1990s the understanding that the national economy should be part of the global market and it should fit into the logic of its development, borrowing the basic principles and mechanisms of functioning of the market has been developed and approved by the public administration. In other words, if to be part of the global market and to live according to the laws of the global market, then the national development strategy is meaningless.

It is approved in the society that all the difficulties of the economic development caused by the problems of integration of national economies into the civilized world market. In administration (because it is aimed at solving current problems) to form a „philosophy of survival” of the national economy, the essence of which is the formation of tactical thinking, not strategic. With this perception of the situation we have already lived 25 years.

In this case one important question arises: can we continue to live by „philosophy of survival”? The answer is evident – no. It is necessary to consider this issue.

Due to the world development trend over the next 15-20 years social and technological changes that can completely change the rules of the global markets functioning, where the global leaders of the race will even harder impose their models of the labor division and the „rules of the game” will finally happened. Currently, we are witnessing the replacement of regulation of commodity flows regulation standards and innovative products (example – export quotas to the EU). Therefore, qualitative changes in technology, and changes in economic paradigm are inevitable. The main factor for success in the future will be the ability of individual states to ensure stable economic and social development, to become attractive for investment, to find talented people for the national economy, who would develop the future of their country rather than go abroad. Starting a new stage of economic and social reforms, we cannot afford to make strategic mistakes again and spend inefficiently national resources – especially if they are not so great as 25 years ago. The country needs a long-term program for national development based on broad public dialogue about the future. Such long-term forecasting programs were adopted and successfully implemented in Finland, South Korea, Singapore and of course in China.

The main idea of the program should be based on economic growth of GDP higher than the average, i.e. at the level of 4-6%. Without such rates of the implementation, the strategy of „catching-up” development is impossible. We need a program for targeting the rate of economic growth

of GDP. Such goal-setting should be the basis for all actions of the authorities and business. Those who don't agree with this formulation of the question should, first of all, answer the question: „Why is it possible to target inflation (paragraph 1 of the memorandum signed with the IMF) but the rate of economic growth of GDP – is not”? As we have already mentioned, the strategic forecasting program itself should include short-, medium- and long-term stages. Each of these stages must deal with specific tasks that would have been the conditions for further decisions.

Large investment projects that could improve the competitiveness of individual sectors of the economy are not possible without a strategic goal-setting, aimed at developing a „catching-up” strategy. The analysis of market transformation in Ukraine leads to the conclusion that for the development of an effective model of sustainable economic growth is necessary to highlight the reasons that influenced the formation of the model that exists in society and which is fully exhausted for further development. Researches of the current economic model have shown that it combines relationships and institutions of various types and levels: market and non-market, legal and non-legal etc. The specific formation of this combination is stipulated by the „institutional continuity” i.e. the presence of the old institutions which were developed in the Soviet period in the „informal” economy, then fell into a new economic system and the newly emerged in the period of market transformation. In the current political and economic model there is no mechanism for effective utilization of productive capacities, ensuring steady economic growth, and creation of effective market institutions which can be preconditions for the development of civilized forms of relations between economic agents have not been created. All this taken together led to the formation of basic reproductive imbalances and contribute to the transition of the acute phase of the crisis to a long period of stagnation.

The analysis of results of socio-economic transformation has shown, that the continuously worsening the social and economic situation in the country requires a transition to a new model of national development. The basis of this model has to be another mechanism of economic growth, the formation of which involves building a new economic policy. The main element of this policy should be a system of strategic goal setting. Catching-up growth is not possible without such a goal-setting strategy. The development of a long-term national development program involves a broad public dialogue on the future of the country. The specific strategic forecasting program should include short -medium - and long-term stages.