

Coming Out of the Crisis: Caucasus, Moldova and Ukraine

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Topics and sources

- Macro-Economic Performance (GDP, private sector, capital formation, FDIs, fiscal balance)
- Business climate (barriers to entry, costs of dealing with the government, costs of crime, and business internationalization)
- The last few years seen in a perspective.
- The sources used are reviews and forecasts of *UniCreditGroup (on Ukraine)*, *IMF*, *IBRD*, *EBRD* and *Index Mundi*

Armenia macro: 2008 GDP – \$11.9 bln

	2005	2007	2008	2009
GDP Growth (%)	9	13.4	13.7	-15
Private sector share in GDP (%)	75	75	75	75
Gross Capital Formation (% of GDP)	30	38	41	10
Fiscal Balance (% of GDP)	-2.6	-2.3	-1.4	-1.8
Net FDI (\$ mln)	242	701	784	488

Armenia macro developments

- **Since independence** (1992) - 14-year period of economic growth (GDP at PPP grew on average by 10.8% a year; in real terms – more than 1.5 1989 GDP, more than any other FSU country except Azerbaijan); 2009 contraction is a record too.
- **Explanation:** Russia FDIs dropped by more 40%; remittances – typically 20% more than FDIs dried out; growth driving sectors (diamond processing, construction, retail) contracted output by 40%.
- **The bright side:** besides falling revenues fiscal balance and social sector kept afloat via new loans from IMF, WB; bank deposit base was not depleted, suspicious loans grew from 4.4% to only 10.2, while gov-debt-GDP ratio remaining manageable; Russia recovery helps investment and remittances (same with other neighbors).

Armenia business climate

- Business Credit is as Easy as in the Region
- Electricity somewhat better than the region; connectivity – 2 times better
- 30% more intl firms, 50% more intl patents
- 50% less external audits

[Source: BEEPS]

	Armenia	Region
Operating License (days)	20.03	26.05
Construction Permits (days)	26.34	79.30
Managers with Govmt (%of time)	10.25	10.54
Corruption (% of firms)	11.62	17.42
Pays for security (% of firms)	58.99	57.93
Losses due to crime (% of sales)	0.60	0.47

Georgia macro: 2008 GDP - \$12.9 bln

	2005	2007	2008	2009
GDP Growth (%)	9.6	12.4	2.1	-5.5
Private sector share in GDP (%)	65	75	75	75
Gross Capital Formation (% of GDP)	33	32	30	20
Fiscal Balance (% of GDP)	-0.7	0.4	1.4	0
FDI (\$ mln)	529	1,740	1,651	887

Georgia macro developments

- **Since independence** - 14 years of 8.9% on average; 2009 contraction of GDP is about the average in New Europe, in PPP terms GDP tripled but in real terms is 61% of 1989.
- **Explanation:** 2008 war with Russia, 80% of the BEEPS surveyed firms refer to political instability as major reason for disrupted operations, plus the global crisis. FDIs dropped by almost 80% (remittances – by 20%); lending to private sector dropped by (est.) 10%, non-performing loans increased to about 1/5 of all.
- **On the bright side:** Price liberalization, tax reforms are among the best in transition; fiscal deficit was financed by foreign assistance and its volume (\$5.7 bln) is 52% of GDP, which constitutes a risk of “false economy” in 2010 and 2011.

Georgia business climate

- Business Credit is as easy as in the Region
 - Electricity somewhat better than the region; connectivity – best in FSU
 - roughly the same number of foreign firms and patent as in the region
 - 20% more frequent use of external audits
- [Source: BEEPS]

	Georgia	Region
Operating License (days)	11.75	26.05
Construction Permits (days)	44.25	79.30
Managers with Govmt (%of time)	2.06	10.54
Corruption (% of firms)	4.08	17.42
Pays for security (% of firms)	65.02	57.93
Losses due to crime (% of sales)	0.73	0.47

Azerbaijan macro: 2008 GDP - \$ 46.4 bln

	2005	2007	2008	2009
GDP Growth (%)	24.3	23.4	10.8	5
Private sector share in GDP (%)	60	75	75	75
Gross Capital Formation (% of GDP)	42	22	20	18
Fiscal Balance (% of GDP)	2.6	2,4	25,5	9,2
FDI (\$ mln)	458	-5,201	-555	-871

Azerbaijan macro developments

- **Since independence** - in 1993-1995 GDP declined by average 16.7% a year 14 years of 8.9% on average; since 1995 the growth in terms of PPP at 15-16% a year; it is the only FSU country that almost doubled (180%) the level of GDP of 1989. 2009 growth is one of the best globally.
- **Explanation:** The economic slowdown is due to fall of the oil prices. The economy is resource dependent (oil = 60% of GDP), no diversified. Proven oil reserves are 1.2 bln barrels , annual production - 914,000 (2008), according to sources – the potential off-shore is up to 7 bln. Besides the oil sector, monopolies manage utilities.
- **The bright side:** Banking sector remained untouched by the crisis but lending growth is 15% in 2009, down from more than 80% in 2010. Corporate , individual entrepreneurs tax is cut to 20%, personal income – to 30%.

Azerbaijan business climate

-Business credit **twice faster** than the Region

- Electricity (utilities) supply – as the region; connectivity – **good in cell, bad in fixed** lines

- roughly **the same number of foreign firms and patents** as in the region

-Use of external audits as in the region (37% of firms)

[Source: BEEPS]

	Azerbaijan	Region
Operating License (days)	15.78	26.05
Construction Permits (days)	46.53	79.30
Managers with Govmt (%of time)	2.08	10.54
Corruption (% of firms)	32.08	17.42
Pays for security (% of firms)	61.96	57.93
Losses due to crime (% of sales)	0.32	0.47

Moldova macro: 2008 GDP - \$ 6 bln

	2005	2007	2008	2009
GDP Growth (%)	7.5	3.0	7.2	-8.5
Private sector share in GDP (%)	60	65	65	65
Gross Capital Formation (% of GDP)	31	38	37	18
Fiscal Balance (% of GDP)	1.3	-0.3	-1.0	-7
FDI (\$ mln)	199	481	679	75

Moldova macro developments

- **Since independence** - in 1994 GDP contracted by almost 30%, decline registered in 1996, 1998-99, since 2000 – growth by average 7-8% at PPP; worst historic record in FSU – 55% of 1989 GDP.
- **Explanation:** Not only the crisis but a combined impact of: domestic inefficiency, energy dependence, utilities' debts and political instability and the limited access of home banks to international funding. FDIs declined by 90% , this resulted in GDP decline, credit crunch, banks' liquidity challenge (deposits depleted by 25% in 2009), slowdown EU and Russia brought about decline in remittances and of industrial output – of 25%.
- **The bright side:** Resumed economic growth in Russia, Romania challenges and recovery in Turkey and EU would act as positive factor in 2010 and 2011. The country is technically easy manageable.

Moldova business climate

-Business credit **somewhat better** than the region

- Electricity (utilities) supply **worst** in region; connectivity – **as the average**

- **similar levels of firms' internationalization**

-Use of external audits – **55%** of regional average

[Source: BEEPS]

	Moldova	Region
Operating License (days)	13.90	26.05
Construction Permits (days)	48.93	79.30
Managers with Govmt (%of time)	7.02	10.54
Corruption (% of firms)	25.41	17.42
Pays for security (% of firms)	64.21	57.93
Losses due to crime (% of sales)	0.41	0.47

Ukraine macro: 2008 GDP - \$ 179 bln

	2005	2007	2008	2009
GDP Growth (%)	2.7	7.6	2.1	-15.1
Private sector share in GDP (%)	65	65	65	60
Gross Capital Formation (% of GDP)	23	24.8	4.2	-46.2
Fiscal Balance (% of GDP)	-2.3	-2.0	-3.2	-11.4
FDI (\$ mln)	7,533	9,218	9,683	4,000

Ukraine macro developments

- **Since independence** - between 1994 and 1998 the average rate of GDP contraction was about 10%, since then the growth was 8.5% per annum in PPP terms; compared to 1989 the GDP is 70%.
- **Explanation:** There is a combination of factors: a) financial crisis, b) standoff with Russia re gas supplies, c) commodity (ferrous metals) conjecture d) poor corporate governance. These scared out FDIs, a key bank collapsed in the fall of 2008, deposits depleted by ¼. By end 2009 three more banks failed and were nationalized.
- **The bright side:** The rest of the banking sector is foreign owned, commitments kept and backed by IFIs; fiscal and structural reforms are managed under IMF scrutiny. Exports improve as markets rebound. There is a prospect of political stability and it looks as if the gas monopoly will be managed by a Russian consortium. Consensus forecast is for 2-3% growth in 2010

Ukraine business climate

-Business credit **somewhat better** than the region

- Electricity (utilities) supply **better** (except for 2009) and connectivity – **as the region's average**

- **similar levels of firms' internationalization**

-Use of external audits – **70%** of regional average

[Source: BEEPS]

	Ukraine	Region
Operating License (days)	31.01	26.05
Construction Permits (days)	135.43	79.30
Managers with Govmt (%of time)	11.33	10.54
Corruption (% of firms)	22.9	17.42
Pays for security (% of firms)	55.22	57.93
Losses due to crime (% of sales)	0.63	0.47

Common denominators

Macro

- Government debts are manageable; GDPs – with a prospect to catch up
- Fiscal discipline well retained in Armenia, Georgia and Azerbaijan
- FDIs challenged by a mixture of external and domestic factors
- Financial sector either sound or moving towards prudence
- Foreign assistance is a double edge sword, except in Azerbaijan

Micro

- Land and capital markets restricted
- Internationalization of business has a vast room to improve
- Productivity is at 25% of the EU, less than new members states lagers
- Ukraine, Moldova and Azerbaijan have a vast room to improve corporate governance and business climate

Deterioration/Improvement of political climate

Deterioration

- No country is doomed

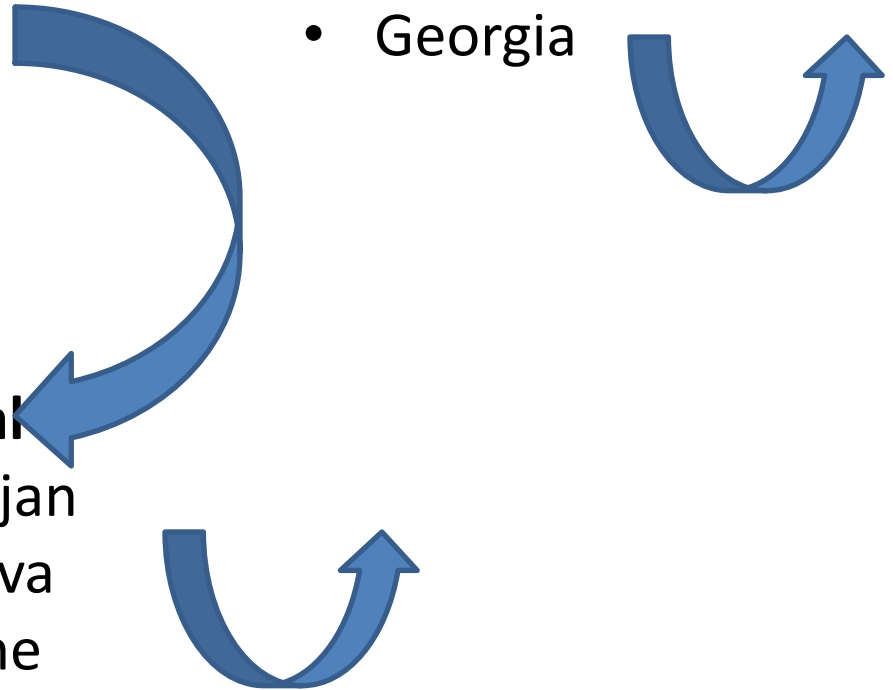
Improvement

- Armenia
- Georgia

Criteria – fiscal discipline, pro-liberalization, competition based public procurement

Neutral

- Azerbaijan
- Moldova
- Ukraine



Conclusions (1)

- The actual slowdown resembles **use of brakes amidst high speed driving, as it is visible in GDP performance from 2008 to 2009.**
- Global developments were exacerbated by domestic economic and political deficiencies.
- **The challenges moved to area of fiscal balances.**
- **Tax reforms** are not exhausted as policy factor but **quasi-taxes** (except Georgia and perhaps Armenia) could make a difference.,
- **New sources of savings and investment are needed (perhaps linked to pensions, healthcare and education).**

Conclusions (2)

- **Recovery in CEE, Russia and Turkey) is a positive factor**
- Anemic credit growth will keep GDP growth negative in 2010, beside Azerbaijan and, perhaps, Ukraine.
- **Domestic demand will remain weak over mid-term**, consumption is being hampered by accelerating unemployment, and frozen wages and government expenditures.
- **Time is needed to reallocate resources from previously overheated domestic-demand-oriented sectors to higher-value-added export driven activities**, to resume lending and stabilize housing market.

Conclusions (3)

- **Issues of privatization are still on the agenda**, both as unfinished business and a room to maneuver, given fiscal challenges and decline in FDIs.
- **Another room to maneuver is quasi-taxes**
- **Diversification is a key problem for Azerbaijan**
- Reforms that would **boost saving require time are difficult amidst fiscal challenges and low employment rates**

Sources

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- UniCredit CEE Quarterly Report (on Ukraine and neighboring transition countries): <http://www.bankaustria.at/en/5295.html>
- National statistics and central bank websites, although statistics ones leave room to require better quality of the data
- On macro history: Economic Freedom of the World: www.greetheworld.org
- On segments related to competitiveness: <http://www.weforum.org/en/initiatives/gcp/Global%20Competitiveness%20Report/index.htm>