

IRYNA KRIUCHKOVA*

**MACROSTRUCTURAL SHIFTS AND ECONOMIC
DEVELOPMENT IN UKRAINE**

Transformational processes in Ukraine's economy took place on the background of a deep and protracted structural crisis caused not only by objective factors (breach of economic ties, skyrocketing prices of energy resources, rapprochement of domestic and world prices, etc.) but also by a series of erroneous actions of the Government. This resulted in the breach of the balance between income and expenditures of the institutional sectors of economy, decline of investments into industrial and human development, waste of funds on budget support for unprofitable enterprises, conservation of the obsolete energy-consuming structure of industry.

For more than eight years deep crisis was observed and then came eight years of "restorative" growth in the conditions of forming of fragmentary market, which brought very moderate results, in terms of growth of the national economic potential and international competitiveness. The reducing growth of GDP took place up to 2007 within the reserves of old productions capacities in the conditions of export increase and fixing of raw materials industry structure. As a result of 2007, the pre-crisis volume of profit and demand of population and government will be exceeded, however the economy on the whole is still far from the pre-crisis level because of the lag of investment component. Ukraine's main weaknesses remain: the level of economy innovation, its technological level, low level of scientific potential and insufficient professionalism of labour resources. The crisis inflicted sledge-hammer blow exactly on the innovative constituent of development. The low demand on the innovations in Ukraine freeze's switch to innovative model of development. Simultane-

* Iryna Kriuchkova is Doctor of Science (Economics), Head of Department at the Institute for Economics & Forecasting of the National Academy of Sciences of Ukraine.

ous increasing of the foreign borrowings became the ponderable source of heating up of the internal market. Today the old reserves are already outspent, and the new cycle of development needs cardinal modernization of production potential and increase of technological level of production, that is why the investment-innovative model of development is necessary.

The transition to the investment-innovative model of development can not take place under conditions of permanent political instability, governmental decisions which aim at popularity only and the absence of strategic development goals. The permanent change of government, the activity without strategy and the absence of clear goals and steps how to achieve them leave economic processes out of control. The whole activity is based upon the reaction to various events and lays no foundation for macroeconomic stability and steady development. Such fundamental factors include macrostructural factors of stable development which must harmonize the interests of main market participants and create favourable terms for investments into innovations and development. Taking into account the openness of the Ukraine's economy, it is important to provide the gradual substitution of the economy's price competitiveness that had been grounded on the relative cheapness of labour resources, by the price competitiveness based on innovative advantages. The latter is accompanied by the increase of population welfare due to new labour efficiency, instead of the creation of consumer economy model on the background of the national debt increase.

The world science of economics had mostly researched the following structural development factors: the levels of savings and gross capital formation, the division of factor profits, the differentiation of the households' income, and the innovative component of development. The investigation of dynamic structural components was the important scientific achievement of R. HARROD (1936) in the general economic system. As a result, some structural components of development entered the traditional growth patterns, in which the level of savings and investments determined productivity and growth dynamics.

The use of classic models proved that, by the existing technical conditions, the economy growth is determined by marginal propensity for savings and dynamic equilibrium can be reached in the conditions of underemployment. And the neo-classical models take into account not only the factor of diminishing the boundary capital productivity, but also the permanent return from the profit scale and norm (SOLOW 1956). Realising that the proportion between the savings and consumption must be harmonized, E. PHELPS (1967) set the dependence between the savings norm and the increase of consumption level, and A. HANSEN (1951) analysed the connection between economic and investment cycles and the dependence of the latter on the boundary efficiency of capital investments.

Neoclassical scientists made conclusion that development is a harmonious process with the division of profit between the market participants, where all the participants depend on each other and mutually compete. V. PARETO (1987) drew attention to the dependence of development on structuring the population income. He combined the principle of income division and optimum, found conformities to the law of differentiation of population profits and came very closely to formulating the Universal Law of economic structuring (the Law of Golden Section).

S. KUZNETS (1966) most widely and comprehensively analyzed the structural components of development on the basis of empiric information. *He defined the dependence of economic dynamics on macrostructures in the different countries of the world and defined that the economic growth is based on the protracted structural changes which depend on many factors, and there is inequality in the division of income on the different stages of cycles.*

Empiric researches show that the creation of dynamic investment model highly depends on fundamental proportions in the gross disposable income between the institution sectors of economy (KRYUCHKOVA 2004a). The harmonized structure of the gross disposable income will, on the one hand, provide the balance of interests of all the market participants, and on the other hand, promote the permanent economy growth. The optimal inter-sectoral distribution of disposable income is the guarantee and precondition for steady economic growth.

The analysis of the basic macrostructural factors which influence the development and market transformation of Ukraine's economy identifies the reasons for the transformational crisis and the possibilities in the phase of the stable economy growth.

In the period of Ukraine's transformational crisis one of greatest deformations in the macrostructural proportions of GDP became the substantial changes in the division of primary and disposable income between the institutional sectors of economy for the benefit of the sector of general government, which was not able to become the effective manager of those resources and widely sent them to support bankrupt enterprises. It resulted in the direct losses of national savings and sharp disinvestment of the economy. The scale of resources losses was striking and became one of main preconditions of the prolonged economic crisis in the country (KRYUCHKOVA 2004b).

The analysis of structural processes during the crisis allowed to make conclusion about the importance of harmonization of income division, both, between the basic institution sectors of economy and inside each of them. Thus the sector structure of gross disposal income is the fundamental factor of optimization of reproduction model. The profit differentiation in each sector influences the amplitude of the created market signals. E. g., the more equally the profit in the sector of households is divided, the wider and greater becomes the spectrum of consumer demand which stimulates market. The more varied by its size the corporate sector is, the better economy adapts to economic shocks, and the more mobile is the reaction of producers to market signals.

The experience proved that it was the deformation of macrostructural proportions in the period of transformational breakdown in Ukraine which made negative influence on the depth of crisis, because it violated the "architecture" of the most important economy components and, accordingly, the process of GDP recreation.

The results of modelling proved that such a liaison exists, where the indexes of absolute deviations from the theoretic levels of gross disposable income of the households, the non-financial corporations and general government were used together with such factors as the changes of the real effective exchange rate and of the outside demand, in order to explain the variables of GDP dynamics. The estimation of general adequacy of the econometric models confirmed their high analytical and forecasting quality, reliability and the proper amount of the factors that had been taken into account (KRYUCHKOVA 2007).

Models calculations confirmed that Ukraine's resumption of economic growth began after the harmonization of income distribution among the institutional sectors of the economy. It determined the ability of GDP reproduction and progress on the path of market reforms.

However, the mass impoverishment of broad strata of the population before 2002 was replaced by the policy of unrestrained populism which results in rapid growth of households income against GDP growth. Besides, the salary growth exceeds considerably the growth of the labour productivity. That broke of the proportions in income allocation between the institutional sectors of economy, and provoked the growth of consumer demand and imports. The process of transition to the investment model of development and modernization of out-of-date capital assets was blocked. New sharp macrostructural defects on the internal market were compensated by the inflows of foreign loans. However, the heating of internal market by using the external financial resources on the background of low using them as investment of capital leads only to the promissory pyramid and the risk of a financial crisis. Resources incoming in a country heat up demand and result in negative foreign trade balance, but do not create the fundamental factors for further growth. Those processes continue to exert negative influence on the prospects of establishment of highly developed and socially oriented economic system in Ukraine and the possibilities for the country's international competitiveness.

The available statistical data of gross disposable income by sectors of some countries testify some differences in the sector structures of gross disposable income appeared due to a number of systems factors, to the level of the developed institutional environment and to the phase of market development. The average data for the period 1991–2003 (2004) are presented in the *Table 1*.

The comparison of evolution of gross disposable income by sectors in different countries demonstrates their relative stability for many years. Though international comparison shows certain variations, especially in the level of households' incomes (*Table 2*). That is related to the level of market liberalization and participation of the state in the economy.

According to the level of GDI in the sectors of households with the non-profit institutions serving households, the countries can be distributed into three groups. The first group will contain such countries as Greece, Italy, Germany, United Kingdom and Portugal, where more liberal models concentrate large parts of GDI in the sector of households, but at the same time the level of individual state services in these countries is relatively low, and consequently, the problems of education and health protection are partly financed by the population.

The second group of countries has the average level close to the level of gold proportion (KRYUCHKOVA 2005) and is represented by Austria, France, Iceland, Japan, Belgium, as well as Ukraine and Slovakia. In the majority of European countries belonging to this group the optimum models of recreation GDP are combined with high quality of life, but moderate level of the general government. At the same time, the solution of social problems doesn't bring strong pressure upon the citizens' profit.

Table 1
The structuring of gross disposable income (GDI) by institutional sectors of economy (average for period, %)

Table 2
Gross disposable income households with non-profit institutions
serving households, % to GDI¹

	1995 -1999	2000	2001	2002	2003	2004	2005	2006
Austria	67.8	67.6	67.4	66.9	67.2	67.0	67.1	65.6
Belgium	64.3	62.3	63.9	62.8	62.0	60.4	59.7	59.4
Czech Republic	58.6	58.0	57.2	57.6	57.8	55.4	54.3	53.9
Finland	57.3	54.1	54.0	54.3	57.3	56.5	56.1	54.5
France	65.6	65.4	66.3	67.7	67.4	67.5	67.5	67.5
Germany	69.1	70.0	71.0	70.8	71.2	70.0	70.0	68.9
Greece	80.2	75.3	73.9	72.7	72.9			
Italy	74.4	69.9	70.4	70.8	70.8	70.2	70.3	69.8
Japan	66.7	65.7	64.6	65.0	65.0			
Korea	66.7	64.9	63.2	60.6	59.9			
Netherlands	55.3	52.7	55.0	54.2	52.8	51.5	51.4	49.7
Norway	54.2	47.9	47.2	51.1	53.3			
Portugal	68.1	70.3	70.9	70.3	70.6	70.8		
Slovakia	59.9	63.4	63.0	63.3	63.7	63.3	63.5	61.3
Spain	68.4	67.5	67.4	66.8	66.3	66.4	66.0	
Sweden	53.2	51.0	53.8	54.1	53.4			
United Kingdom	68.9	69.2	70.3	68.5	67.7			
Ukraine	58.9	59.4	59.3	62.8	60.8	61.3	67.4	
Middle	64.6	63.0	59.5	59.6	59.6	57.8	56.9	53.9

The third group consists of the countries with the most socially oriented models (*Figure 1*). The relatively low level of gross disposable households income is combined here with the high level of public services, high investments in the human capital with the effect of high innovative activity. The countries like Finland, Czech Republic, the Netherlands, Sweden and Norway belong to this group. On the whole, Scandinavian countries have the highest level of GDP socialization among the European countries, which is accompanied by the high quality of public services.

¹ Source: Calculated on the basis of data provided by OECD and the State Statistics Committee of Ukraine.

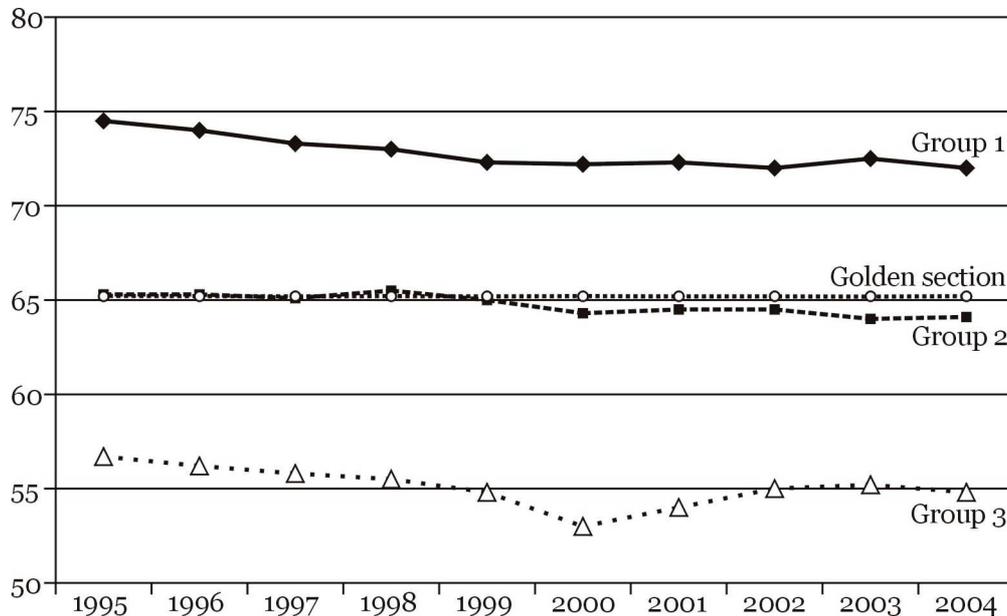


Figure 1

The groups of the countries with close to level households gross disposable income, %

By the level of households gross disposable income and public services Ukraine is closer to the second group of countries. However, the efficiency of the government turns out quite low compared to other countries.

Thus, according to the data of Ukrainian respondents survey published by Lausanne Competitiveness center, the majority of Ukraine's lowest ratings are concentrated at the criteria which characterize government effectiveness. Ukraine holds the lowest positions out of 55 countries at the estimation how effectively the state decisions are implemented (54), how dependent state officials are on political influences (54), inconsistency of state politics (53), bribes and corruption (53), state adaptability to economic changes (53), life quality (54). Despite high government expenses for education and public health, Ukraine holds low ratings for the public health problems (52), healthy life duration (49) and the presence of highly qualified engineers of the labour market (51). The considerable worsening of the individual services quality and the increase of corruption in this sphere definitely turned out free services into paid services. It also influenced the structure of the population consumer expenses where 6% fall on the education and public health which exceeds the average European level.

The own assets of enterprises are the basic source of investments into Ukraine's economy. That is why the level of the gross fixed capital depends mostly on the level of gross disposable income of the non-financial corporations (NC). Because of the critical decline of the enterprises profit, the economy can get into investment and promissory crisis similar to the economic situation which had been in Ukraine in 1991–1996. However, under the condition of the considerable DFI inflow into the

country, the NC disposable income level was relatively low (*Table 3*). DFI inflow held donor functions to the investments into the economy and helped to avoid system problems in the investment process which had taken place in Poland.

Table 3
Level of gross disposable income of the non-financial corporations, % GDI¹

Countries	1995	1996	1997	1998	1999	2000	2001	2002	2003
Poland	6.0	7.2	7.1	7.1	7.5	8.0
USA	11.4	11.4	11.6	10.5	11.1	10.3	10.8	11.6	...
France	8.8	8.6	8.7	9.4	9.2	8.6	8.6	8.5	8.1
Ireland	16.2	18.8	19.0	19.5	16.4	16.4	16.0
United Kingdom	10.2	10.6	10.2	10.6	9.9	10.0	8.9	9.6	10.2
Germany	9.9	9.9	9.4	9.7	7.8	7.2	7.8	8.3	8.5
Finland	15.8	15.2	16.7	16.3	16.0	15.6	16.3	14.8	14.5
Sweden	14.3	13.2	12.9	13.1	12.8	10.7	9.1	10.5	9.6
Japan	12.0	13.2	13.6	13.4	14.0	14.5	14.3	15.6	...
Korea	11.5	9.7	10.3	6.6	10.1	10.6	11.2	12.0	...
Ukraine	4.8	2.2	5.9	4.5	9.7	10.9	15.4	12.9	14.4

It can be observed from *Table 3* that this level fluctuates around 9–10% in such countries as France, Germany and United Kingdom, but there are countries where this level is considerably higher. The increase of non-financial corporations' gross disposable income substantially influenced the increase of net saving and fixed capital formation. Thus, the average annual increase of net saving in Ireland was more than 15% which resulted in quicker tempo of the fixed capital formation, increase of productivity, and, further, the GDP per capita growth.

The analysis of the previous transformations in Ukraine shows that the proportions which influence the process of GDP recreation, gradually twisted during the period of the most substantial structural deformations (1992–1996) and became deformed to the greatest extent in 1996 (KRYUCHKOVA 1999).

The “big gamble” on inflation and use of a dual foreign exchange rate created opportunities for making huge profit from the difference between the value of loans obtained and returned after devaluation or between the official and market exchange rates of freely convertible currency, and allowed some businessmen to earn huge profit. Among the institutional sectors, financial corporations also won: in 1992–1993 only they managed to increase their disposable incomes 4.3 times².

¹ Source: Calculated on the basis of OECD and State Statistics Committee of Ukraine.

² Calculated on the basis of State Statistics Committee of Ukraine (2007, p. 372).

Table 4
Sectoral distribution of gross disposable income in Ukraine¹

Gross disposable incomes	Non-financial corporations	Financial corporations	GG sector	Households	Non-profit institutions
1992	26.0	3.3	15.9	50.9	4.1
1993–1995	9.2	5.5	32.1	48.0	4.4
1996	2.2	0.9	38.1	54.4	4.5
1997	5.9	0.8	33.6	56.2	3.5
1999	9.8	1.6	30.0	56.1	2.6
2000	10.9	1.2	28.5	57.1	2.3
2001	15.1	1.9	23.8	57.3	2.0
2002	12.5	1.8	22.9	61.0	1.8
2003	13.2	2.2	23.8	59.1	1.7
2004	14.4	4.1	20.2	59.8	1.5
2005	9.2	2.7	20.7	66.2	1.2

The economic policy of that period (1992–1996) may be described as anti-market, its purpose was to support separate enterprises at the expense of others, and to create favourable conditions for initial capital accumulation by separate economic entities close to the authorities.

In the conditions of economic decline and hyperinflation of 1992, 1993 and 1994 (in those years consumer prices grew 21, 102 and 5 times, respectively) substantial inflationary redistribution of current income and devaluation of savings took place; those were the years of abnormal enrichment of separate business entities that had access to certain types of resources.

Another deformations factor was caused by the government's desire to retain budget revenues at any price through the increase of tax pressure. For instance, in 1993 net taxes increased 6.7 times. As a result, the share of GDP redistributable to the GG sector rose from 24.1% in 1992 to 43% in 1994 and 47.8% in 1996 (the highest level over the entire period).

Disposable income was excessively concentrated in the general government (GG) sector. The share of the GG sector in the gross disposable income hit 38.0% in 1996, and the year average in the period of 1994-1999 was 32.5%. For comparison: during the transformations period in Poland the GG sector share of disposable income did not exceed 17.2% (1995-1999), and amounted to the meagre 16.1% in 2000.

At that time, the disposable income of the public sector was used ineffectively; the significant share of budget losses was related to credits and subsidies given to

¹ Source: Calculated on the basis of State Statistics Committee of Ukraine (2007, p. 372).

enterprises of illiquidity goods. The government budget was widely used in the schemes of "feeding" separate enterprises and branches with state investments, credits under government guarantees, offsets combined with state order, reimbursement of value added tax (VAT) to intermediaries and pseudo-exporters, etc.

As a result, the reduction of real disposable income of households and enterprises (2.6 and 15 times less respectively) and the growth of disposable income in the GG sector by 40% led to strong distortions in the distribution of gross disposable income (*Table 4*).

The data presented in the *Table 4* show that before 1996, the share of disposable income of enterprises was rapidly falling to the level of 2.2%, while the GG sector increased its share to 38%. Excessive concentration of income in the GG sector distorted the processes of reproduction, led to substantial reduction of investments into fixed capital, the growth of "grey" income and the payments crisis.

The soft, protectionist and high-deficit budget policy created the situation where the income of effective working enterprises was used to fund ineffective ones (the deficit in 1992 was equal to 13.8% of the GDP, or 56.7% of the aggregate budget revenues; in 1993 it amounted respectively to, 5.1% and 15%; in 1994 it made 8.9% and 21%; in 1995 it was 6.6% and 13.1%; in 1996 it was 4.9% and 13.8%).

Because of this situation, the significant assets came out from circulation and transformed into the stockpiles of output. For instance, in 1992-1994, the circulating assets equivalent to 40% of the 2001 GDP were transferred from circulation to most illiquidity inventories.

It resulted in significant reduction of investments into fixed capital (by 75%), general shrinkage of domestic demand, delayed exit from the crisis and put off initiation of progressive structural changes in the economy.

Hence, the first stage of market transformation in Ukraine resulted in formation of the protectionist model of economic development, anti-market by its essence. Such a model made distribution of financial resources highly ineffective, ruled out the exit from the crisis on the basis of large-scale economy modernization, and conserved technological backwardness of the country for the long time. In such situation, the economic growth was possible only within the reserves of old capacities and surplus of labour resources of the old qualification, for instance, in export-oriented but technologically obsolete and energy-intensive industries.

The year of 1997 marked the beginning of gradual movement towards the harmonization of inter-sectoral distribution of income, the strengthening of enterprises and households' positions in that process, the growth of fixed capital investments. The state budget ceased to be a "feeding-rack" for ineffective enterprises, the taxes on production and direct taxes on enterprises decreased, prices and exchange rate became more stable (in course of the year consumer prices increased only by 10%; the official exchange rate of hard currency remained actually intact), which resulted in the growth of disposable income of enterprises, for the first time in the years of crisis, gross fixed capital formation increased.

The financial crisis of August 1998 destabilized the economic situation but at the same time created a new growth factor: Hryvnia devaluation raised price competitiveness of Ukraine's economy and therefore opened new opportunities for export growth. The overstatement of hard currency value and low domestic prices (the margin between domestic and world prices) made production for export profitable, and begin-

ning with May 1999, it began to grow rapidly. Price competitiveness jumped up (*Figure 2*) and became the dominant factor of economic growth together with foreign demand, while internal demand was a secondary one. In the meanwhile, the expensive hard currency produced a kind of economic "filter" for consumer goods import, and the national economy witnessed the beginning of the process of import substitution: domestic manufacturers drove importers out of the market of consumer goods.

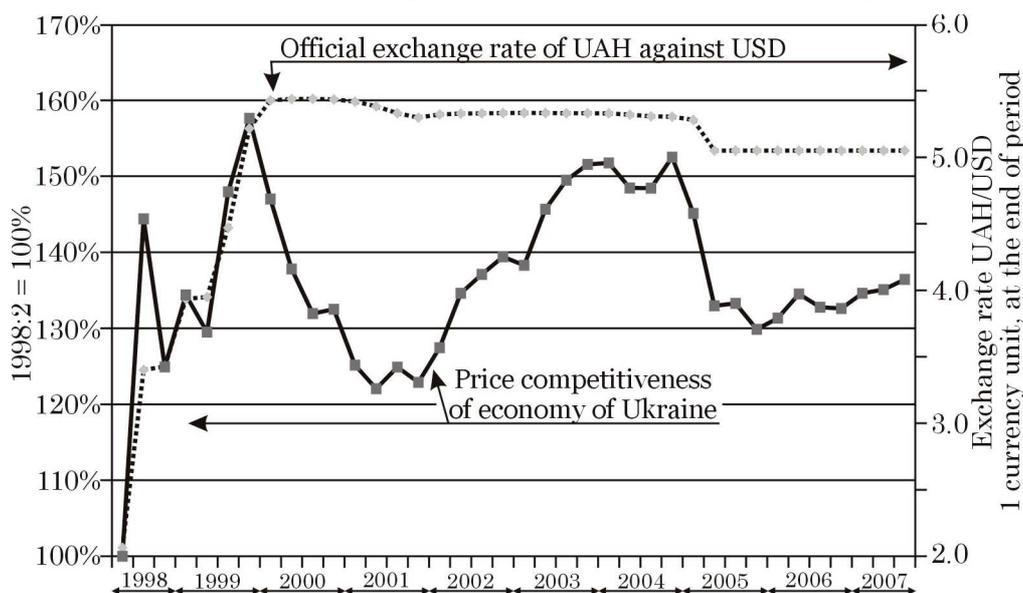


Figure 2

Price competitiveness of the economy of Ukraine, %, 1998:2q=100 (left scale) and official exchange rate of UAH against USD (1 currency units), end of period (right scale)¹

The share of enterprises' disposable income in 1999 reached the level of 9.7% that could be compared to the figures observed in developed countries (the standard is 9–10%), as a result, the investments into the enterprise sector stepped up in 2000 (the rate of fixed capital formation made up 117.7%), the domestic investment demand and GDP grew. The GDP rose by 5.9% in 2000 and by 9.2% in 2001.

The average level of enterprises' disposable income in 2001–2004 was close to 14%, and the prices stabilized, which encouraged not only the growth of investments into fixed capital but also loans for the real sector of economy. The investment segment at the Ukrainian market heated up, indeed, in this time, especially at the beginning of 2004. But when the elections campaign approached, the situation

¹ Sources: National Bank of Ukraine (http://www.bank.gov.ua/eng/Fin_mark/Kurs_mid/kurs_96-last.htm); State Statistics Committee of Ukraine <http://www.ukrstat.gov.ua/>; IMF Exchange Rate Archives by Month http://www.imf.org/external/np/fin/data/param_rms_mth.aspx; Banks of 37 countries - partners after export; State Statistics Offices of 37 countries - partners after export.

changed: the gross fixed capital formation declined in 2005, the level and volumes of gross disposable income of non-financial corporations fell abruptly.

On the whole, Ukraine experiences permanent political instability for the last four years. Numerous populist governmental decisions were adopted in relation to the increase of pensions (beginning with September 2004) and salaries in the budgetary sphere (2005–2006) which caused sharp changes in basic GDI proportions. Only during the period of 2004–2006 the income of population grew by 1,7 times, the social assistance grew by 2,2 times, while the GDP increased only by 23%¹.

While Ukraine held the lowest ratings on global competitiveness, it managed to occupy the first positions on the income growth indices and consumers expenditures of population, which arose the interest of foreign investors in building up Ukrainian trade. Though, the fact of extraordinary heating-up of the real estate market is by no means caused by the profit growth of pensionaries and budgetary workers – it happened as a result of income stratification of population and growth of foreign investors' interest to this profitable segment of Ukrainian market.

The external prices shocks and the increase of corporate debts influenced the structural GDI changes in 2007. As a result of the prices increase for the imported energy sources which were higher than Ukrainian export prices, the terms of trade worsened, especially in the second half-year (*Figure 3*).

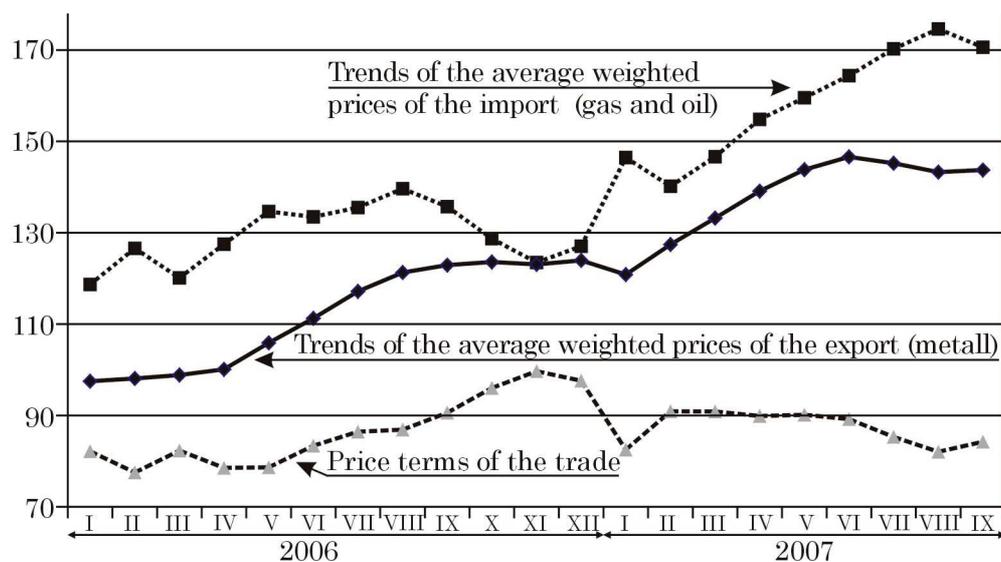


Figure 3
The price terms of the trade, % to December 2005²

However in spite of the terms of trade worsening, the preliminary estimations show that non-financial corporations managed to stop the decline of their primary profit in 2007 due to the prices increase of producers (EV annual 122%) The finan-

¹ Calculated according to the data of the State Statistics Committee of Ukraine.

² Source: Author's calculations.

cial results of the enterprises' activity outstripped GDP dynamics during 2007. But, *taking into account the tendencies of 2006 and 2007 one can expect that the property income will flow to the benefit of financial corporations and the other world which will reduce the level of enterprises' gross disposable income.*

As far as the households' income is concerned, the break between GDP growth rate and the increase rate of households' gross disposable income became smaller gradually (Figure 4). It resulted in the decline of GDP level from 67,6% in 2006 to 66.1% for 9 months of 2007, producing a decline of consumer expenditure level of the population.

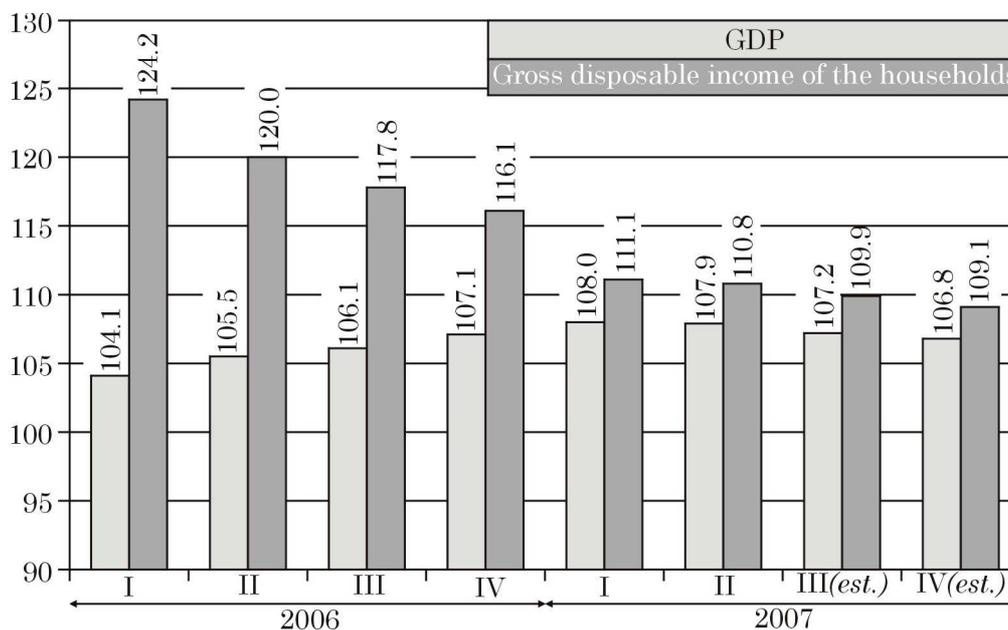


Figure 4

GDP and Gross disposable income of the households, cumulative growth in % to the corresponding period of the previous year²

For the first time for many years, the population tended to make savings and investments, and financed the *housing building almost four times more.*

Generally, the volumes and the structure of investment sources changed in 2007, having influenced the dynamics and level of gross fixed capital formation. Beside the households' investment, the overall increase of the gross fixed capital formation was effected by the saving of enterprises, banks loans and facilities of investment funds. At the same time, the state decreased its investments into the economy. *Though the investment activity during 2007 was greater than in 2006, it decreased closer to the elections. (Figure 5).*

¹ Calculated according to the data of the State Statistics Committee of Ukraine.

² Source: Author's calculations.

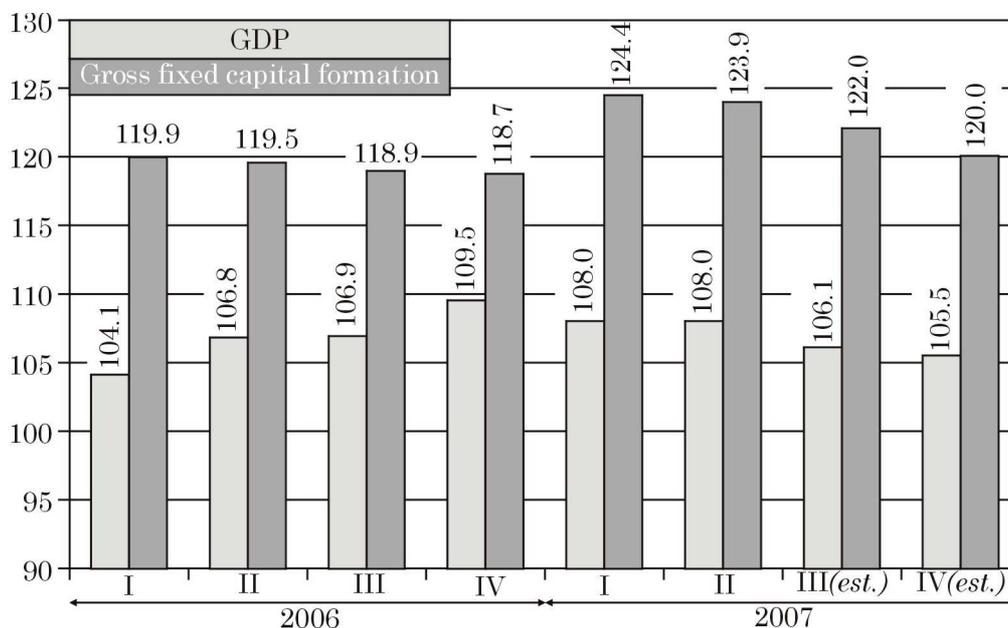


Figure 5
GDP and Gross fixed capital formation, growth %
to the corresponding quarter of the previous year¹

The economic growth in 2007 was accompanied by other interdependent structural changes. The following changes took place:

- *Considerable increase of external corporate debts.* During 9 months of 2007 the net inflow of middle- and long-term credits and euro-bonds to the banking and real sector made up 11.3 billion USD, that was 2.6 times more than the corresponding period of the previous year. The inflow of funds to Ukraine actually made 10.4 billion USD during January-September 2007 and consisted mainly out of long-term resources, while the financial account balance was close to the zero (-139 millions USD) in January-September 2006. The volume of net inflow was appraised at 6.8 billion USD for the 9 months of 2007, that was 1.6 times more compared to the nine months of 2006 (National Bank of Ukraine 2007a);
- *Sharp increase of the internal loans.* The general volume of loan investments (without taking into account profit) grew by 49.5% during January-September 2007 and reached 363 billion of UAH which was the greatest increase for the growth years (National Bank of Ukraine 2007b).
- *The increase of imports on the background of exports stability which influenced the growth of negative trade balance* (which made 2.6% GDP for nine months of 2007) (National Bank of Ukraine 2007a).

The Ukrainian internal market in 2007 was actually heated by the external funds inflow through the channel of direct foreign investments and debts. The National

¹ Source: Author's calculations.

Bank of Ukraine constantly bought surplus offer of foreign currency at the currency market, which influenced the growth of monetary aggregates and became one of factors for high inflation which made 114.8% for 10 months (at a year average level).

The manufacturing industry provided the greatest contribution to the increase of GDP out of the aggregated types of economic activity. The machine builders became the leaders, because they took advantage of the investment demand growth in Russia and grew the export. However, the Ukrainian export on the whole remains poorly diversified by products and markets, and concerns raw-materials. And the economy remains over-opened and creates permanent risks due to high dependence on the world trade.

The main resource which supported dynamic economy growth (as well as the increase of gold and currency reserves of the NBU) became net foreign capital inflow which made over 10 billion USD for 9 months. The considerable loan resources, which had been taken at the internal and world markets, actually played the role of stabilizers (like it had been in 2006), and enabled Ukrainian producers to solve the problem of insufficient investments and circulating resources and provide the increase of production. At the same time, financial corporations became more active in warming up of consumer market and the real estate market.

The internal and external resources cumulatively supported the increase of population consumer demand and financed the increase of investment demand of the enterprises. The prices shock stimulated the growth which sharpened competitive activity both on the external and internal markets.

CONCLUSIONS

Thus the saving of households and non-financial corporations became the basic source for the strengthening of investment activity in 2007. The role of net inflow of foreign capital financing the negative trade balance also increased. The following factors mostly affected the GDP growth: external prices shocks (which took place due to gas prices increase at the beginning of the year and oil prices growth throughout the year); growth of debts pyramid in corporate sector; the continuing misbalance between the rates of growth of salaries and labour productivity; strengthening of income outflow from non-financial corporations to financial ones, the government passivity in financing the infrastructure and economy's competitiveness.

The future financial risks are related to continuing intensive *increase of corporate debts* on the background of *highly probable profitability decline* of Ukrainian enterprises (due to the new wave of the prices increase for imported and domestic gas). Accordingly, the *internal financial resources aimed at return of the loans* will diminish and result in investors' mistrust. This will result in the raise of loans costs, and, afterwards, the lower inflow of funds into Ukraine and bring the *crisis of non-payments*. Taking into account the uneven net inflow of foreign capital and transfers from the external world, the absence of new incoming FDI engaged in privatization and the negative foreign trade balance, one can expect destabilization of foreign currency supply on the foreign exchange market parallel to growing demand for it, resulting in market pressure towards devaluation of the Hryvnya.

The improvement of financial situation in the real sector of economy can take place, if the production becomes more effective (but that needs investments and time), and if the profit will be redistributed (that envisages quicker price growth by producers).

The following threatening tendencies can potentially produce crises in 2008:

- the worsening of price terms of trade which had started in 2007 (the tendency of price rise for imported energy resources on the background of a price decrease on steel markets);
- sharp diminishing of receiving external resources for financing the negative foreign trade balance, because the value of the borrowed capital will grow;
- growing dependence of the real sector of economy on the situation at the inter-bank market with high probability of loans value increase;
- worsening of terms of the mortgage loans and of corporate debts maintenance will provide negative influence on the investment demand growth;
- lower growth rates of the labour productivity and, accordingly, of the salary dynamics;
- rapid increase of financial risks because of the gap between the growth rates of corporate loans and deposits;
- greater role of financial mediators who distribute the capital streams, the defects in distribution of gross disposable income for the benefit of financial mediators and the deficit of the real producers' own resources;
- overheated real estate market with overestimated property prices, and, accordingly the value of mortgaged property;
- the growth of grey import and forcing the domestic producers out of the internal market, where under proper financing it could be possible to grow domestic production;
- the end of a "restorative" growth on the base of existent production capacities, the absence of adequate changes in cardinal modernization of the fixed assets and the lack of improvement of the production pattern towards less power-consuming and more hi-tech kinds of economic activity.

The decrease of development risks will depend on the ability of new government to create the favourable macrostructural conditions for the development and strengthening of markets institutions by means of:

- budget consolidation and the change of budgetary expenses structure for the benefit of investments (what was not planned in the budget for 2008);
- the development of private-public partnership;
- the strengthening of competition on the financial markets and the expansion of innovative financial instruments and, at the same time, the NBU's control over the asymmetry between the banks' assets and liabilities;
- the encouragement of FDI in the sector of hi-tech export production (the perspective dynamic products, including software).
- the investors' rights defence and the transformation of the stock market into the active participant of positive structural changes in the economy.
- diminishing of unfair competition by importers (grey and black import) which now exerts negative influence on the internal market.
- lower market vulnerability due to the creation of the proper systems of protecting the market from rapid changes (especially from the quick capital outflow, etc.)

- the harmonization of the GDI base sector proportions.

Thus, the structural problems that arose in Ukraine in the period of transformation crises were caused by the absence of proven institutional market mechanisms that would provide for the harmonization of the interests of different agents of market economy and would co-ordinate them with the critical interests of the entire society. This situation resulted in distorted distribution of both primary and disposable incomes and brought out general instability and unsteadiness of the model of national economic development.

At the same time, the tendencies of the last years envision the sharp profit increase at the expense of lower profits of non-financial corporations (2005) and the reduction of budgetary investments, being not favourable for passing to the investment-innovative model of development. External prices shocks and lack of the own funds forces the enterprises to raise prices and to build the promissory pyramid, with growing expenses for its service. This tendency distracts national resources and makes it impossible to modernize cardinally the production and to realize the technological breakthrough. The economy of Ukraine functions under the conditions of uncertainty and extraordinary dependence on the external situation. It has no conditions for the transition from a price to non-price competitiveness and for the permanent growth in the future.

The development of this situation in Ukraine's economy proves that structural processes should be under the government's control, and the economic policy must be directed at the harmonization of those proportions taking into account the cyclic growth phase.

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