

**Ukraine: Fifth and Sixth Reviews Under the Extended Arrangement—Staff Report; Staff Supplement and News Brief on the Executive Board Discussion**

In the context of the Fifth and Sixth Reviews Under the Extended Arrangement, the following documents have been released and are included in this package:

- the staff report for the Fifth and Sixth Reviews Under the Extended Arrangement, prepared by a staff team of the IMF, following discussions that ended on **June 20, 2001**, with the officials of Ukraine on economic developments and policies. **Based on information available at the time of these discussions, the staff report was completed on August 31, 2001.** The views expressed in the staff report are those of the staff team and do not necessarily reflect the views of the Executive Board of the IMF.
- a staff supplement of September 18, 2001, updating information on recent economic developments.
- a News Brief summarizing the **views of the Executive Board as discussed during its September 20, 2001, discussion of the staff report on issues related to the IMF arrangement.**

The document(s) listed below have been or will be separately released.

Letter of Intent sent to the IMF by the authorities of Ukraine\*  
Technical Memorandum of Understanding\*

\*May also be included in Staff Report

The policy of publication of staff reports and other documents allows for the deletion of market-sensitive information.

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INTERNATIONAL MONETARY FUND

UKRAINE

**Staff Report for the Fifth and Sixth Reviews Under the Extended Arrangement**

Prepared by European II Department  
(In consultation with other departments)

Approved by Jorge Márquez-Ruarte and Michael T. Hadjimichael

August 31, 2001

Discussions for the fifth and sixth reviews of the economic program supported by an arrangement under the Extended Fund Facility (EFF) were held in Kyiv during January 25–February 7 and June 12–20, 2001, and in Washington during March 9–14, 2001.

The Ukrainian representatives included Prime Minister Kinakh, former Prime Minister Youshchenko, Vice Prime Minister Rohovoy, former First Vice Prime Minister Yekhanurov, Chairman of the Board of the National Bank of Ukraine (NBU) Stelmakh, Minister of Finance Mitiukov, and other senior officials of the government and the NBU, as well as representatives of parliament.

The staff representatives were J. Berengaut, E. De Vrijer, K. Elborgh-Woytek, M. Lewis, P. Löhmus, J. Odling-Smee, and E. Ruggiero (all EU2), M. Fouad (FAD), and C. Mulder (PDR). H. Ghesquiere and D. Orsmond of the Resident Representative Office in Ukraine participated in the discussions. Y. Yakusha, the Alternate Executive Director for Ukraine, attended some of the meetings. The staff team worked closely with parallel World Bank teams.

The EFF arrangement, in an amount equivalent to SDR 1,919.95 million, was approved by the Executive Board on September 4, 1998. The eight purchases made so far have amounted to SDR 902.2 million. The last purchase, amounting to SDR 190.07 million, was effected in December 2000, based on completion of the fourth review under the arrangement. At that time, the period of the arrangement was extended to September 3, 2002, and the remaining purchases were rephased accordingly. The undrawn amount under the EFF arrangement is SDR 1,017.7 million. At end-June 2001, Ukraine's total outstanding debt to the Fund was SDR 1,372.9 million, equivalent to 100 percent of quota.

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## EXECUTIVE SUMMARY

### Recent developments

- **Program implementation over the first half of 2001 has been satisfactory as regards macroeconomic policies, but was mixed in the structural area.** All performance criteria for end-December 2000 and for end-March 2001 were met. The indicative targets for end-June 2001 were also met, with the exception of the target for base money. There were concerns about the implementation of the fiscal program and delays in the implementation of the structural program; the structural benchmark on reducing the export tax on sunflower seeds was partly complied with.
- **Economic developments thus far in 2001 have been encouraging.** Real GDP growth reached 9 percent in the first six months of 2001, and is projected at 6.2 percent for the year as a whole. Inflation was brought down and is on track to achieve the annual target of about 12 percent. Following the sharp turnaround in the trade balance during 1999–2000, the external current account surplus is projected to narrow somewhat from 4.7 percent of GDP in 2000 to 2.7 percent in 2001. The exchange rate has remained stable, and gross international reserves have increased to \$2 billion, equivalent to five weeks of imports.
- **Fiscal policy in the first half of 2001 has been broadly on track, despite the granting of a wide-ranging tax amnesty.** At end-June, the budget recorded a small deficit of 0.2 percent of GDP against a deficit of 1¼ percent in 2000. In view of lower-than-expected privatization receipts for the year as a whole, the target for the cash deficit of the general government in 2001 was reduced from 3 percent of GDP to 1.7 percent, to be achieved largely through expenditure cuts. The draft budget for 2002 targets an overall deficit of 1.7 percent of GDP, financed by expected privatization receipts. A modern Budget Code was enacted in July.
- **The growth of monetary aggregates in 2000 and the first half of 2001 has been dominated by sizeable unsterilized foreign exchange intervention by the NBU.** The resulting strong monetary expansion accommodated an increase in money demand, and the authorities are committed to using the available money-market instruments to keep the growth of monetary aggregates in line with the inflation target. Bank Ukraina's banking license was withdrawn; however, only limited progress was made in restructuring a number of other large banks.
- **Despite some delays, the authorities have made progress in implementing their structural reform agenda.** The execution of the privatization program thus far in 2001 has proceeded largely as planned, with six oblenergos privatized in April in a transparent manner, although delays are expected in the sale of several other high-profile enterprises. In the energy sector, further progress was made in increasing payments discipline. The export tax on sunflower seeds was reduced from 23 percent

to 17 percent, instead of 10 percent as programmed, but other trade liberalization measures were also taken.

### Ukraine: Selected Economic Indicators, 1998–2002

|  | 1998 | 1999<br>Est. | 2000<br>Prel. | 2001 | 2002<br>Program |
|--|------|--------------|---------------|------|-----------------|
| (Annual percentage change)                     |      |              |               |      |                 |
| Real GDP                                       | -1.9 | -0.2         | 5.8           | 6.2  | 4.0             |
| Consumer price index (end of period)           | 20.0 | 19.2         | 25.8          | 12.3 | 9.8             |
| Broad money                                    | 25.3 | 40.4         | 45.4          | 23.7 | 14.8            |
| (In percent of GDP)                            |      |              |               |      |                 |
| General government budget balance (cash basis) | -2.8 | -2.4         | -1.3          | -1.7 | -1.7            |
| External current account balance               | -3.1 | 2.6          | 4.7           | 2.7  | 2.4             |
| Gross international reserves (end of period)   |      |              |               |      |                 |
| In weeks of current year imports of GNFS       | 2.2  | 3.7          | 4.2           | 6.8  | 8.7             |

Sources: Ukrainian authorities; and Fund staff estimates and projections

### Issues stressed in the staff appraisal

- The importance of maintaining sound economic policies to continue the broad-based expansion, in particular by consolidating the financial stabilization gains; strengthening payments discipline and transparency in key sectors of the economy; and promoting a conducive environment for private investment. The main risks for the growth and external reserves objectives relate to the state of external demand and the ability of Ukrainian exporters to increase their market share so as to offset the effects of the ongoing economic slowdown in some of Ukraine's major export markets.
- The need to maintain a tight fiscal policy by seeking corrective revenue and expenditure measures, in order to achieve the reduced 2001 budget deficit target in line with lower-than-expected privatization receipts. There is a strong necessity to accelerate efforts to build a social consensus under which tax amnesties and special tax privileges would not be seen as acceptable. The continuation of structural improvements in the fiscal area, notably the enactment of the Budget Code, is welcome.
- The need for the NBU to stand ready to expand its sterilization operations and allow greater exchange rate flexibility if foreign exchange inflows continue, in order to attain the inflation target.

- The importance of addressing vulnerabilities in the financial system; in particular by ensuring that the large state-owned banks adhere strictly to all prudential norms.
- The importance of accelerating structural reforms. Further efforts are needed to increase the fairness and transparency of the privatization process; to bring payments discipline in the energy sector to as close to 100 percent as feasible; and to improve the environment for private business, together with strengthening transparency and governance.

## I. INTRODUCTION

1. In the attached letter, the Ukrainian authorities describe the measures they have taken to keep the EFF-supported economic program on track and, on that basis, request the completion of the fifth and sixth reviews under the EFF-supported program, including the establishment of performance criteria and benchmarks for September and December 2001. In view of the delays in completing the reviews, the authorities also request a rephasing of the remaining purchases under the arrangement.

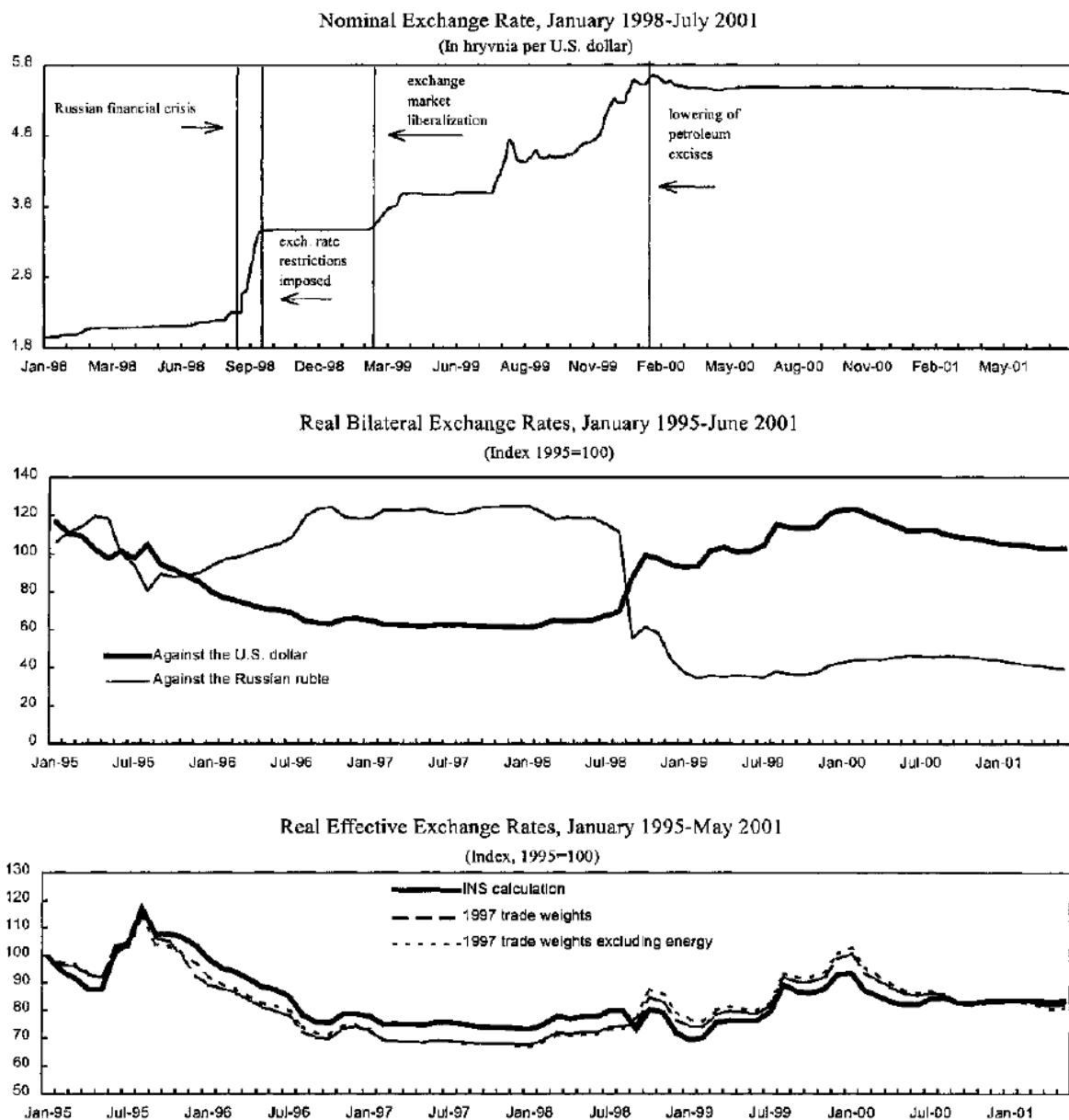
## II. RECENT DEVELOPMENTS

2. **Following real GDP growth of 6 percent in 2000 (Table 1), the broad-based recovery of the Ukrainian economy continued, with real GDP growth reaching 9 percent in the first six months of 2001.** The economic rebound was supported by: (i) strong growth in Ukraine's main export markets, in particular Russia; (ii) improved competitiveness of Ukraine's economy; and (iii) utilization of substantial idle capacity. The improved economic environment also contributed to an increase in private investment, including foreign direct investment. The external current account surplus reached 4.7 percent of GDP in 2000, up from 2.6 percent in 1999.

3. **The nominal exchange rate has remained broadly stable since April 2000 at around Hrv 5.4 per U.S. dollar** (Figure 1). NBU purchases of significant amounts of foreign exchange in the interbank market allowed a build-up of usable gross international reserves to a level equivalent to five weeks of imports by end-July 2001. Annual inflation, as measured by the consumer price index (CPI) on an end-of-period basis, fell to 5.3 percent in June 2001. This reflected the effects of the good harvest on food prices, which are expected to be partially reversed in the second half of the year. Mainly as a result of the annual inflation rate of almost 26 percent in 2000, the real effective exchange rate has appreciated by 12 percent between December 1999 and May 2001, partly reversing the real depreciation in 1998–99.

4. **Program implementation has been satisfactory as regards macroeconomic policies, but was mixed in the structural area.** All performance criteria for end-December 2000 and for end-March 2001 were met. The indicative targets for end-June 2001 were met, with the exception of base money, which also exceeded the indicative targets for end-December 2000 and end-March 2001 by a wide margin, reflecting the impact of the largely unsterilized foreign exchange purchases by the NBU. However, there were concerns about the implementation of the fiscal program related to the granting of a wide-ranging tax amnesty. Also, the structural program was implemented with delays. The finalization of a strategy to resolve the problems at Bank Ukraina took place only in June, and the export tax on sunflower seeds was reduced in June from 23 percent to 17 percent instead of to

Figure 1. Ukraine: Exchange Rate Developments 1/



Sources: Ukrainian authorities; and Fund staff estimates.

1/ An increase indicates depreciation.

10 percent, which was a structural benchmark for end-December 2000. At the same time, significant progress in other areas of trade liberalization was made, mainly in the context of the government's efforts to join the World Trade Organization. The targets for cash collection ratios in the electricity and gas sectors through June 2001, which constituted quantitative structural benchmarks under the program, were achieved, but there were delays in the provisioning of full data on the gas sector.<sup>1</sup>

5. **The consolidated budget deficit (cash basis) in 2000 was limited to 1½ percent of GDP, below the program target of 1½ percent of GDP (Table 2).**<sup>2</sup> This was achieved primarily through strict expenditure control. Tax revenue was higher than projected in nominal terms, although it was ¼ of one percentage point of GDP below program. The December 2000 target for nonearmarked state cash revenue, a performance criterion under the program, was exceeded by Hrv 678 million (½ of one percent of GDP). Expenditure was kept in check throughout the year but was increased in the last quarter, in line with available financing, including from privatization and the World Bank. Social arrears were reduced by 1 percent of GDP, Hrv 256 million more than programmed, with payments arrears on pensions eliminated at end-August. Energy and utility arrears were reduced as well, and the recourse to non-cash offsets was eliminated, as programmed.<sup>3</sup>

6. **Budget execution in the first half of 2001 has been broadly on track.** Revenue performed very strongly in the first quarter but started to weaken in May, as a result of the implementation of a broad tax amnesty (see Annex I, para. 6). At the same time, privatization receipts were higher than projected, allowing expenditure to take place broadly as planned. At end-June, the budget recorded a small cash deficit of 0.2 percent of GDP, within the program ceiling. Social arrears were sharply reduced through March, but local governments accumulated new arrears on wages starting in April; the relevant end-June benchmark was met with a margin of Hrv 1 million.

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<sup>1</sup> Monetary data is compiled on the basis of monthly reports provided by the NBU, and fiscal data is compiled on the basis of data provided by the Ministry of Finance, the Treasury, and the NBU. The Ministry of Fuel and Energy provides data on cash collection ratios for electricity, which is verified by the monthly audits of the central transit account and regional settlement accounts. All gas sector data is provided by Naftogaz, and is not independently verifiable, although the key variables are published.

<sup>2</sup> The deficit includes a reduction in interest arrears of about ½ of one percent of GDP that were refinanced in the context of the September 2000 agreement between the Ministry of Finance and the NBU on restructuring government debt. Excluding this operation, the deficit would have been more than ½ of one percentage point of GDP below program.

<sup>3</sup> A fiscal data issue arose regarding the reporting of actual disbursements on government-guaranteed credit to nongovernmental units. The authorities have now assembled most of the required data, which the staff is currently reviewing.

7. **Monetary policy in 2000 and the first half of 2001 has been dominated by sizable, largely unsterilized foreign exchange interventions by the NBU.** As a result, base and broad money increased during 2000 by 40 percent and 45 percent, respectively, significantly more than programmed (Tables 3 and 4, and Figure 2), and have continued to expand during the first half of 2001, rising by 13 percent and 15 percent, respectively. The NBU bought about \$1.6 billion in the foreign exchange market in 2000 and about \$1.1 billion in the first seven months of 2001, boosting gross usable reserves to the level of \$2 billion at end-July (Figure 3). These purchases were made possible by the current account surplus, as well as significant private sector inflows to finance purchases of state enterprises and the monetization of the economy. By the end of 2000, the NBU had strengthened its capability to absorb liquidity through reverse repurchase operations and the sale of certificates of deposit (CDs). The extent of sterilization remained modest and varied from \$170 million in January 2001 to close to zero in April. The first half of 2001 has also been marked by a further sharp expansion of bank credit to the economy, which rose by 25 percent over the period December 2000–June 2001, driven in large part by increased lending to the agriculture sector.

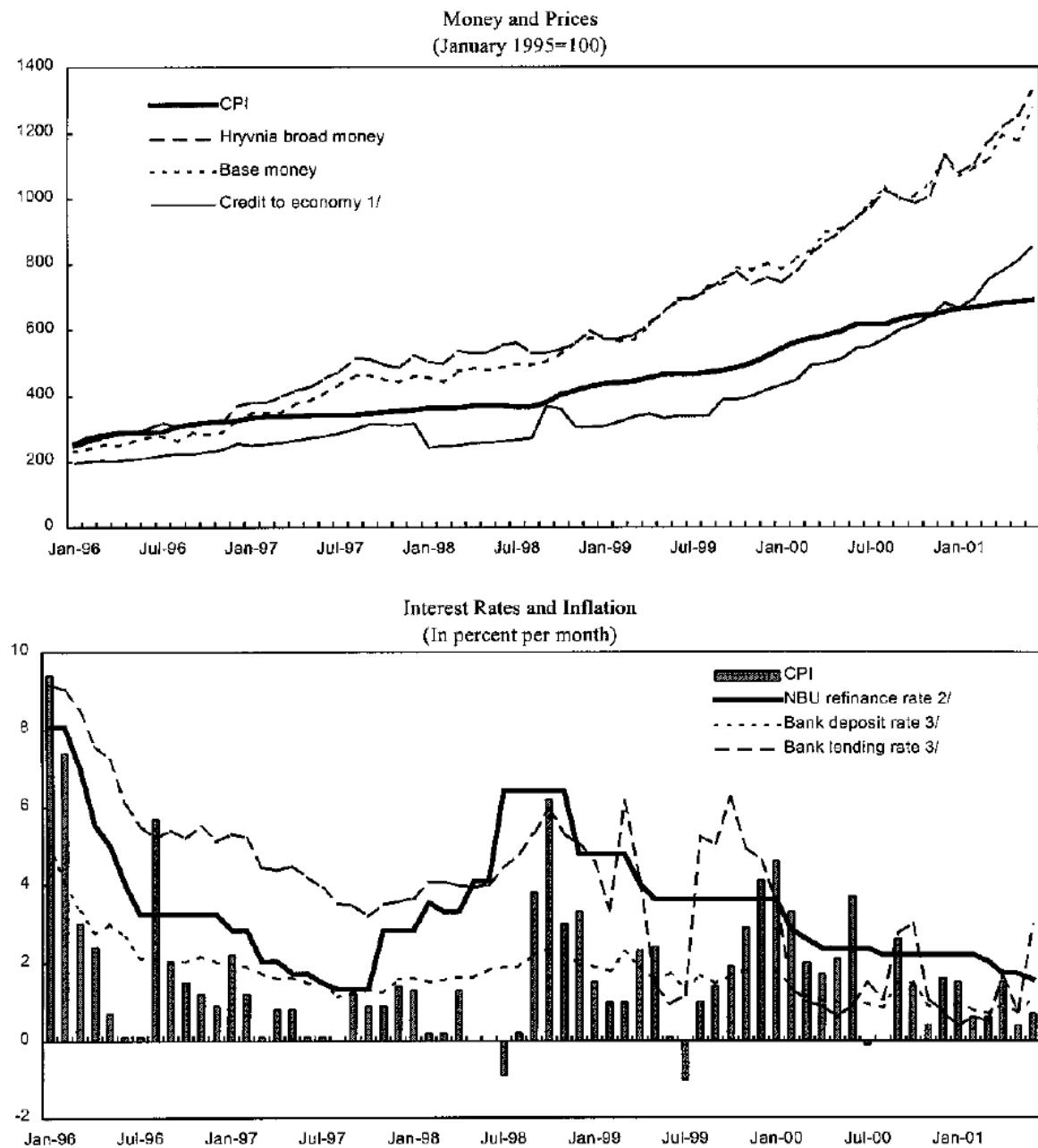
8. The authorities' decision to undertake only limited sterilization efforts reflected their judgment that the strong monetary expansion accommodated an increase in money demand, because of the real economic growth and the increasing importance of cash transactions. The share of industrial production, including energy, sold for cash increased from 48 percent in 1999 to around 72 percent in 2000, and the share of industrial production sold on barter agreements declined from some 33 percent to around 17 percent. Also, the prevalence of barter agreements in international trade declined considerably in 2000. In view of the slowdown in annual inflation from October 2000, the NBU progressively lowered the rediscount rate from 27 percent at end-September 2000 to 17 percent as of August 9, 2001. The NBU also continued its policy of gradually reducing reserve requirements (Annex I, para. 13) and, despite concerns voiced by the staff, introduced a system of multiple reserve requirements.<sup>4</sup>

9. **Despite some delays, the authorities have made progress in implementing their structural reform agenda.** The pace of privatization picked up considerably in 2000, with receipts from the sale of enterprises totaling Hrv 2.3 billion, equivalent to 1.3 percent of GDP, as compared to Hrv 820 million (0.6 percent of GDP) in 1999. However, no large enterprise was sold using financial advisors and sales of minority stakes on the stock

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<sup>4</sup> As of January 16, 2001, reserve requirements ratios ranged from 11 percent on long-term household deposits in national currency to a maximum of 15 percent on other liabilities. On April 15, 2001, the reserve requirements ratio on long-term household deposits was reduced to 9 percent.

Figure 2. Ukraine: Monetary Indicators, January 1996-June 2001

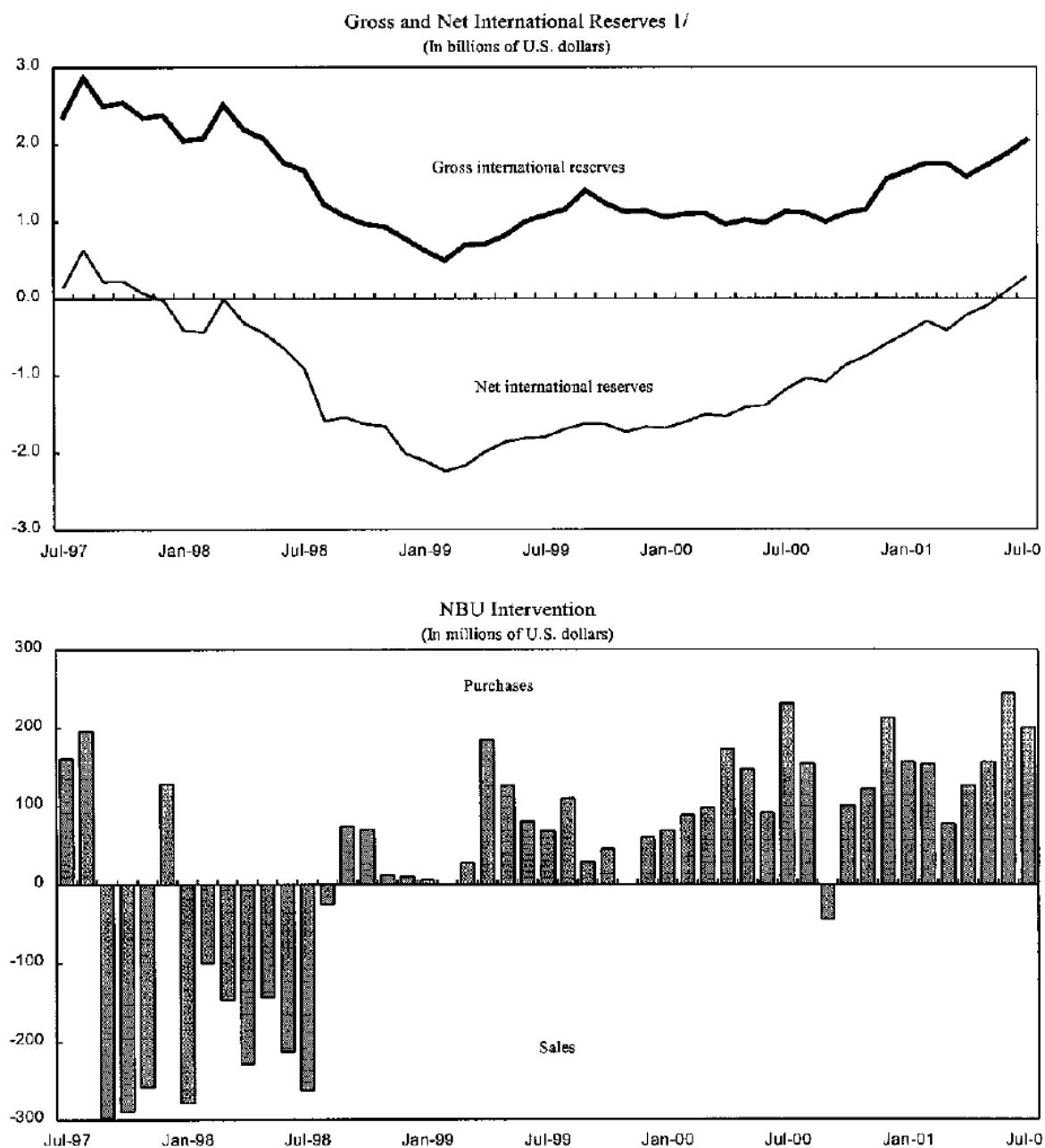


1/ New accounting standards introduced January 1, 1998.

2/ End of month observations; yearly rate deannualized.

3/ End of month observations; yearly rate divided by 12.

Figure 3. Ukraine: International Reserves and NBU Intervention,  
July 1997-July 2001



Sources: Ukrainian authorities; and Fund staff estimates.

1/ From December 1998 defined as gross usable reserves.

exchange accounted for more than a third of total privatization receipts.<sup>5</sup> Thus far, execution of the 2001 privatization program has proceeded largely as planned, and six regional electricity distribution companies (oblenergos) were privatized in April in a transparent manner. However, the sale of several other high-profile enterprises has been marred by political disputes, bidders for a significant number of enterprises could not be found, and further sales of oblenergos have been temporarily suspended pending an assessment of previous oblenego sales. To enhance the transparency of the privatization process, an ex-post review of operations in 2000, carried out by independent experts, was completed, providing recommendations for strengthening procedures. In addition, comprehensive information on privatizations covering the same period has been placed on the website of the State Property Fund (SPF). The SPF law, which would clarify the legal framework governing privatization, was adopted by parliament in July, but vetoed by the President citing constitutional concerns relating to the issue whether the SPF would report to the legislative or executive branch of government.

10. In the **energy sector**, further progress was made in increasing payments discipline. The trend toward greater cash payments, which had slipped in the latter part of 2000 and in January 2001, has since picked up again and average cash collection ratios for electricity and gas in the first half of 2001 reached 59 percent and 85 percent, respectively. A strict policy of cutoffs of nonpayers has contributed to this improved performance. The agreement between the government and Naftogaz on regular payments by Naftogaz of gas transit royalties and by budgetary organizations of their bills for gas consumption is being partially implemented as of mid-February 2001.

11. **Bank Ukraina's banking license was finally withdrawn on July 16, 2001.** However, only limited progress was made in restructuring a number of other large banks, which do not meet many prudential and regulatory requirements (Box 1). The new Law on Banks and Banking Activities was enacted in January 2001, providing the legal base for strengthening the supervisory capacity of the NBU and its ability to deal with problem banks.

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<sup>5</sup> The use of financial advisors provides some assurances of the fairness of the privatization process; however, they are expensive and for that reason more widespread recourse to their services has been controversial.

#### **Box 1. Banking Sector Developments**

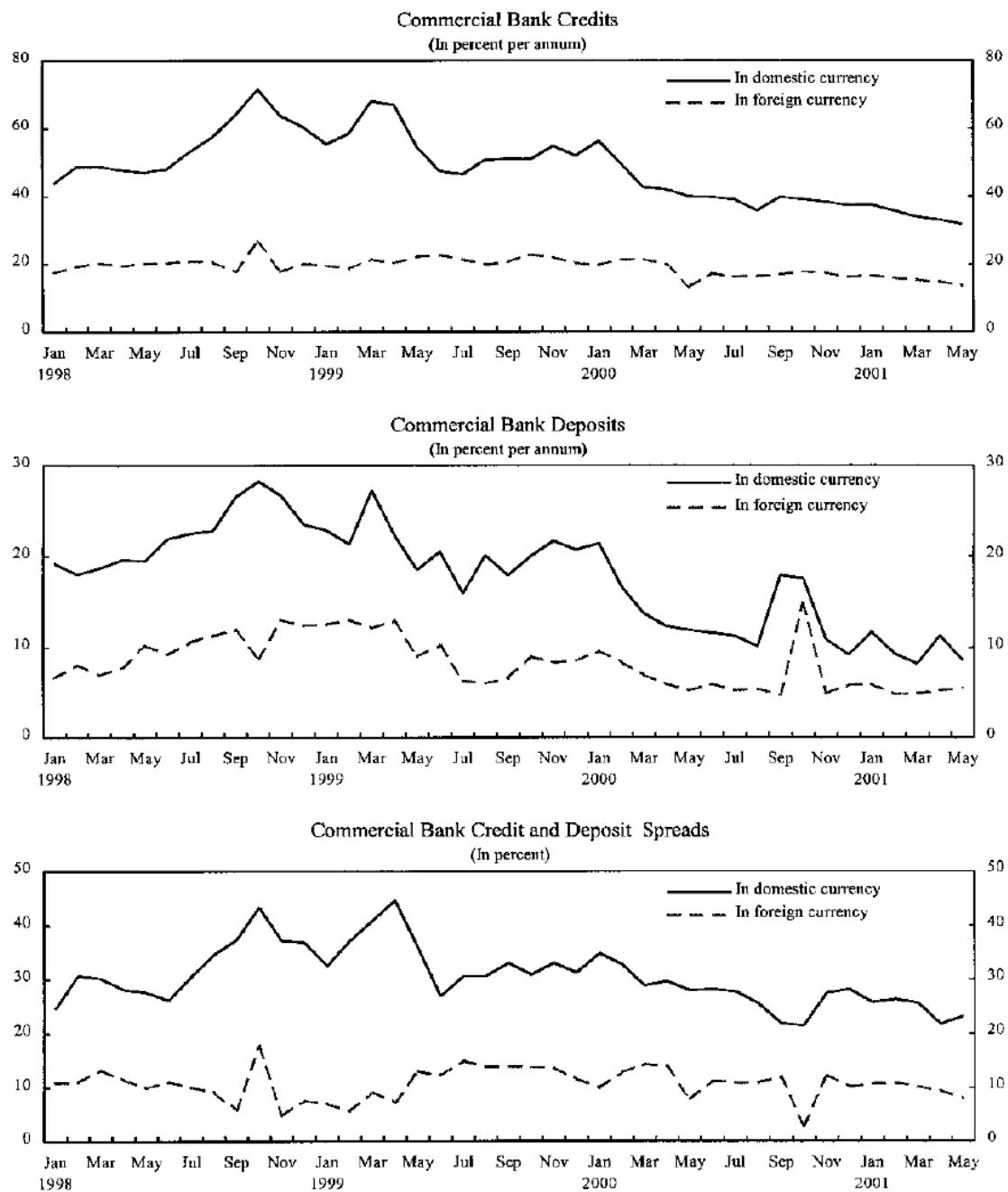
As of June 1, 2001, the Ukrainian banking system consisted of 192 banks, 153 of which were operating, while the remaining 39 were under rehabilitation schemes monitored by the NBU. The eight largest banks comprise more than 50 percent of net assets of the sector, almost 20 percent of deposits, and about 60 percent of outstanding loans. The banking system shows increasing competition from new private-owned banks. There are seven foreign-owned banks that mainly serve foreign corporations. Partly because of complex foreign exchange regulations, the banking sector's access to foreign financing is, however, constrained. The improved macroeconomic situation in combination with monetary easing has contributed to the expansion of the banking sector, as indicated by the growth of the credit portfolio of the banking system by 60 percent on a yearly basis in June 2001. However, the level of financial intermediation remains low, with total net assets of the banking system standing at only 22 percent of GDP, while total bank lending equals about 13 percent of GDP.

The health of the banking system is weak, mainly because of the adverse impact of past government interference in the operations of former state banks. Bank Ukraina was declared insolvent and its license removed on July 16, 2001. The two remaining state-owned banks, Savings Bank and State Export-Import Bank, are undergoing major rehabilitation programs. As of end-June 2001, 25 banks were not complying with one or more prudential regulations. Nonperforming loans amounted to 11 percent of the total loan portfolio, concentrated in the group of large banks, including the former state-owned banks. Although the reported overall capitalization of the sector is strong, the two large state-owned banks did not comply with the minimum capital requirements. While the weighted average interest rate for hryvnia loans dropped from 40 percent in June 2000 to 32 percent in June 2001, interest rate spreads remain high, at 20 percentage points (Figure 4).

### **III. POLICY DISCUSSIONS**

12. **The policy discussions focused on measures that could enable the authorities to keep the 2001 fiscal program on track, ensure that the monetary expansion remains non-inflationary, and accelerate the execution of the structural program.** The discussions earlier in the year took place against the background of mounting political unrest and uncertainty. In late April, parliament voted out the government, and a new government was appointed in late May. The political situation has subsequently calmed somewhat, and relations between the government and parliament have generally improved. The president and the presidential administration appear to have assumed a more active role in policy making than was the case under the previous government. Political activity may pick up again later in the year in anticipation of the next parliamentary elections in March 2002.

Figure 4. Ukraine: Interest Rates on Commercial Bank Credits and Deposits,  
January 1998-May 2001



Source: National Bank of Ukraine; and Fund staff estimates.

13. **The macroeconomic framework for 2001 envisages a continued broad-based recovery.** Real GDP is projected to grow by 6 percent, reflecting the expected slowdown of export growth in the second half of the year, and a strengthening of domestic demand driven by recent wage and pensions hikes, further repayments of social arrears, and increasing investment. Economic growth will also be supported by further market-oriented reforms, notably in the agricultural and energy sectors. With prudent fiscal and monetary policies, the annual inflation rate is targeted not to exceed a level of about 12 percent. The external current account surplus is expected to narrow to some 2½ percent of GDP in 2001, as exports are projected to grow at a somewhat slower rate in the second half of the year in light of projected lower growth rates in Ukraine's main trade partners (Table 5). The current account surplus is projected to decline to about 1 percent of GDP by 2005. The public external debt is projected to stabilize in dollar terms in the coming years, implying a decline from a level of more than 30 percent of GDP at end-2000 to 23 percent of GDP by 2005. The composition of public debt is programmed to continue to shift from commercial to multi-lateral and bi-lateral debt.

#### A. Fiscal Policies

14. **The 2001 consolidated government budget targets a deficit of 3 percent of GDP** (Annex I, para. 4). Compared with the 2000 outcome, revenues were projected to decline by more than 3½ percentage points of GDP,<sup>6</sup> while expenditure was targeted to decline by more than 2 percent of GDP, partly due to lower domestic interest payments and lower social arrears clearance. At the same time, the budget provided for a basic wage increase of 25 percent for budgetary employees as of March 1, 2001, and a pension increase of 5–13 percent starting in February.<sup>7</sup> In addition, starting this year, expenditures include project loans that are on-lent to enterprises. The budget deficit is to be fully financed by privatization receipts, originally projected at Hrv 5.9 billion, or 3 percent of GDP.

15. **Based on developments so far in 2001, the authorities have revised their fiscal projections.** The main revision is related to privatization receipts, which are now projected to amount to Hrv 3.5 billion, or 1.3 percent of GDP below the budgeted amount, due to expected delays in the execution of the privatization program. Since the program does not allow for any additional net domestic financing other than to offset net external financing,

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<sup>6</sup> A decline of 1½ percentage point is on account of the abolition of the innovation fund tax and other nuisance taxes, as well as the absence of profit transfers from the National Bank of Ukraine (NBU); the remainder largely reflects the authorities' rather conservative revenue projections.

<sup>7</sup> Pensions were further increased as of August 1, 2001 (Annex I, para. 4).

**the deficit target was revised to 1.7 percent of GDP.<sup>8</sup>** Revenue is projected at 0.5 percentage point of GDP above the budget target, largely on account of strong economic activity and targeted tax administration measures. The remaining gap of close to 1 percent of GDP will be closed through expenditure cuts, mainly in capital spending and sectoral subsidies, that were projected in the original program to take place in the fourth quarter, as well as lower-than-projected interest payments.

16. **The discussions on the 2002 budget focused on the need to ensure medium term sustainability, in order to end as soon as possible the recourse to privatization proceeds for deficit financing, and to improve the structure of expenditures in line with the government's program of meeting the population's basic social needs.<sup>9</sup>** Against this backdrop, it was agreed that the budget to be submitted to parliament would target a deficit of no more than 1.7 percent of GDP, financed by privatization receipts. The staff will discuss with the authorities 2002 budget contingencies in the context of the next program review. The proposed deficit would fit within a three-year strategy under which privatization proceeds will be used solely to retire debt starting in 2003.

17. In the **structural fiscal area**, the Budget Code was enacted on July 11, 2001, thus introducing a modern and effective budget management tool, defining expenditure and revenue assignments of lower level governments, and regularizing intergovernmental financial relations (see Box 2). Legislation was enacted in February to modernize tax collection procedures by replacing the distortionary Kartoteka II system by a number of judicially-based provisions that allow the State Tax Administration (STA) to seize assets of delinquent taxpayers. However, other parliamentary acts, which were often enacted in defiance of government wishes, worsened the structural basis of the budget. As part of the replacement of the Kartoteka II system, parliament passed a wide ranging tax amnesty; it also continues to enact exemptions.<sup>10</sup> The government acknowledged that the granting of the tax amnesty was a reason for concern, but noted that attempts to limit the scope of the amnesty had been rejected by parliament. The Ministry of Finance has taken a number of specific

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<sup>8</sup> The program includes an adjustor to the deficit for any excess in privatization receipts up to the amount envisaged in the enacted budget.

<sup>9</sup> The usual schedule of work on the budget envisages the submission by the Ministry of Finance of a draft budget to the Cabinet of Ministers by mid-August, the submission by the Cabinet of a draft budget to parliament by mid-September, and the final parliamentary approval (third reading) by mid-December.

<sup>10</sup> For example, a law extending the exemption of the agricultural sector from VAT to 2004 was enacted which will result in an annual revenue loss of about Hrv 600 million (about 0.3 percent of GDP); the same law also puts taxes on diesel imports for the sector to zero on a seasonal basis. In addition, exemptions continue to be granted to a range of industries and economic sectors.

## Box 2. The Budget Code

The Budget Code of Ukraine, signed into the law by the President on July 11, 2001, introduces a number of key reforms consistent with a model Organic Budget Law:

### Macroeconomic management

- *Distributing budgeting powers between the executive and legislative branches.* The government submits the guidelines for the macroeconomic and budgetary policies for the next year to parliament on June 1, the beginning of the budgetary cycle.
- *Setting a three-year financial planning horizon with clearly defined targets.*
- *Promoting prudent fiscal management.* The government is required to carry out economic surveys and reports on budget execution on a monthly basis and, if need be, to initiate changes to the annual budget law which then need to be approved by parliament.
- *Explicit legislative constraint on the size of public debt, equal to 60 percent of nominal GDP.*
- *Extrabudgetary accounts* are banned. Special funds are allowed, but the government is required to explain their rationale in advance.
- *Increasing parliament's responsibility for sound fiscal policies.* Bills proposed by the budget committee with a potential fiscal impact require an accompanying statement from the Ministry of Finance (MoF).

### Budgetary process

- *The role of the MoF in the budget process* is substantially increased, and relations between the MoF and line ministries are clearly defined.
- The Code defines the key elements of the *appropriation process*.
- The Treasury is expected to play the key role in *budget execution*, including at the local level. Further, only the MoF has the right to defer tax payments.
- *Program-based budgeting* is introduced.
- *Transparency.* The government is required to publish the draft annual budget law not later than one week after its official submission to parliament.
- *Time frame of the budget process.* The annual budget law should be passed by December.

### Intergovernmental finance reform.

The Budget Code defines the expenditure responsibilities of all levels of government, and matches them with the revenue assignments. Transfers from the central government are allocated on a formula basis and are made directly to the 700 local budgets. The major modification in revenue assignments is the significant strengthening of the revenue base of local budgets by assigning them the land tax.

### Assessment

The Budget Code is in line with the key requirements for effective budget management laws. It enforces responsible macroeconomic management; protects the role of the executive in the budget process; increases its transparency; and launches intergovernmental reform. The main weakness is the absence of clear provisions regarding compliance, accountability, and sanctions. To complete the reform, legislation in these areas should be adopted.

administrative measures to offset, at least partly, the adverse impact of the amnesty. In addition, it has undertaken a comprehensive inventory of all existing tax exemptions and privileges, as part of the government plan to gradually phase them out. Efforts to improve the tax administration are also underway, and the STA is planning to establish two new Large Taxpayers Offices by year-end, including in Kyiv. On the expenditure side, the single treasury account is being implemented with technical assistance from the Fund, and should be in place by the end of the year. The implementation of the formula-based intergovernmental transfer system has partially begun in the context of the 2001 budget, and should be fully operational as of 2002, following the adoption of the new Budget Code.

## **B. Monetary and Exchange Rate Policies**

18. **The NBU will closely monitor monetary aggregates with a view to ensuring that the annual inflation target is met, and credit policy will be guided primarily by the program ceiling on the net domestic assets of the NBU (Annex I, para. 3).** While the authorities underlined the importance of a stable hryvnia to their stabilization efforts, they noted their intention to manage the exchange rate flexibly and let foreign exchange market intervention be guided primarily by the external reserves target of the NBU. The targets for net international reserves have been increased to take account of the overperformance in 2000, recent economic developments, and in view of the need to strengthen further the external reserves position of the NBU. In this context, the NBU is committed to using the available money market instruments at its disposal to ensure that the impact of foreign exchange purchases on money supply is consistent with programmed inflation.

19. **The NBU has initiated the implementation of measures to enhance the effectiveness and transparency of its operations, financial reporting framework, and internal control system.** The internal audit department has started implementation of a program to audit most headquarter-based departments and functions, with priority assigned to those operations and units that may pose higher risks. The foreign exchange department has already been audited and the audit report, which includes recommendations for remedial actions and a follow-up plan, has been presented to the governor. In the area of risk management, an independent risk management unit, reporting directly to the governor, became operational in April of this year and presented its first report in early July. Regarding NBU budgeting and accounting, dividends will be distributed to the Treasury only after the audited NBU accounts for 2000 are approved by the NBU Council. The externally-audited 2000 financial statements of the NBU and the auditor notes were published in early August 2001.<sup>11</sup> Although currently the NBU does not fully provide for impaired and doubtful assets in its own financial statements, it intends to achieve full provisioning for nongovernment

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<sup>11</sup> The financial statements were prepared in accordance with International Accounting Standards (IAS), except that NBU holdings of government debt are not fully provisioned for. However, an estimate of fair value of government debt is included in the auditor notes.

loans by end-2002. The full implementation of these measures would further enhance the safeguarding of Fund resources (see also Box 3).

#### **Box 3. Safeguards Assessments—Summary of Conclusions**

Under its current arrangement with the Fund, Ukraine is subject to the transitional procedures governing safeguards assessments. These procedures require the NBU to demonstrate that it publishes annual financial statements that are independently audited in accordance with internationally accepted auditing standards. The NBU cooperated fully in providing Fund staff with the required documentation needed to make such an assessment.

The staff has reviewed the documentation provided and noted that the NBU publishes annual financial statements that are audited by an international accounting firm in accordance with International Standards on Auditing. Based on this review, the staff has concluded that the Bank of Ukraine's external audit mechanism meets internationally accepted standards.

The documentation provided by the NBU includes information on other areas of control and governance. The external auditor's management letter—dated October 11, 2000—noted several weaknesses in the National Bank of Ukraine's financial reporting framework and internal controls system, including the internal audit mechanism. Under the safeguards framework, the identification of vulnerabilities in these areas is not the primary purpose of the staff's review for countries subject to the transitional procedures. Nevertheless, the weaknesses identified in the documentation suggest that safeguards in these areas may not be adequate. The authorities have taken steps to address many of these concerns in conjunction with the current EFF program. However, in light of these vulnerabilities, for the time being the staff supports the continuing commitment by the authorities to keep Fund disbursements in Ukraine's SDR account.

### **C. Structural Policies**

20. **The authorities are committed to moving ahead forcefully in the area of privatization** (Annex I, para. 8 and Box 4). The initial target for privatization receipts in 2001 has been revised downward in light of anticipated delays in finalizing the sale of the national telecommunications company (Ukrtelecom) in 2001 and the temporary suspension of further oblenenergo sales. At the same time, a financial advisor to assist in the privatization of the remaining state-owned oblenergos has been selected and preparations for their sale continue. Preparations for the sale of Ukrtelecom are also proceeding, following the selection of a financial advisor in June; meanwhile, the authorities are considering to separately put up for sale Ukrtelecom's stake in the mobile telephone company UMC.

21. **Open and transparent privatization procedures form an important element of the policy agenda.** Although important strides have been made in improving the privatization process in the context of the 2000–02 privatization program, the difficulties in successfully privatizing larger and profitable enterprises demonstrate that more progress is

needed. Ongoing efforts to strengthen privatization procedures will be undertaken in consultation with the World Bank, and will preserve the central role of the State Property Fund (SPF) in managing all sales. Open bidding procedures, independent tender commissions, and the use of financial advisors are central to ensuring transparent privatizations, and the authorities are aware of the need to clearly define the role of the government and minimize undue political interference in the privatization process to bolster its credibility. To this end, a system of semi-annual reviews to be carried out under the supervision of the privatization advisory group, which includes the World Bank, will be continued, as will measures to improve the investment climate in general, in order to enhance interest in enterprises to be privatized.

22. In the **energy sector**, sustained improvement in payments discipline is essential to ensure the financial viability of the sector, reduce the fiscal burden, contribute to the normalization of financial transactions in the economy, and ensure external viability. To this end, cash collection ratios are targeted to rise further this year; full payments by budgetary organizations for energy in 2001 should contribute to this enhanced payments performance. To ensure progress in this area, the authorities intend to resist recent legislative initiatives to restructure the wholesale electricity market.

23. To improve transparency in the gas sector, Naftogaz has finalized the terms of reference for the second stage of its audit, which is now underway. This stage will include audits of the three key subsidiaries of Naftogaz, and will provide an estimate of Naftogaz's production and transportation costs. In the electricity sector, monthly audit reports are being prepared of the central distribution account and the regional distribution accounts.

24. The discussions on the **banking sector** focused mainly on efforts to resolve the problems at Bank Ukraina. The authorities originally intended to transfer household deposits, which total about Hrv 270 million, to other banking institutions; however, this has been stalled by parliament's refusal to approve the government's issuance of T-bills to back these deposits. Deposits up to Hrv 500 (which cover more than 90 percent of depositors) will be reimbursed by the deposit insurance fund at a cost of about Hrv 60 million. In the meantime, the authorities are moving ahead on implementing bankruptcy procedures for Bank Ukraina. In addition, the authorities intend to set up a new financial institution to service the agricultural sector, including the distribution of government subsidies. Staff have urged the authorities to work closely with the World Bank on this issue.

25. Limited progress has been achieved in restructuring a few large banks, and significant concerns remain as to the long-term sustainability of these banks. For one of these banks, the NBU has prepared several resolutions imposing additional measures to safeguard its operations, but the ceilings on its exposure to the energy sector have been exceeded. The authorities were largely satisfied with the pace of restructuring efforts in other large banks. However, the high interest rate spreads and operating costs of banks in an environment of rapidly declining inflation, as well as the substantial bad loans portfolio pose

#### **Box 4. Structural Conditionality Streamlining Assessment**

##### **1. Coverage of Structural Conditionality under the Current Program**

Structural conditionality under the program is set out in the Letter of Intent (Annex I, Table 10). The measures are critical for achieving the macroeconomic objectives of the program and cover the following areas:

- *Fiscal reform*: A performance criterion on formula-based transfers to local governments and a benchmark on the single treasury account support the fiscal objectives of the program. The authorities will avoid any recourse to non-cash offsets;
- *Financial sector*: A prior action on the withdrawal of the banking license for Bank Ukraina sends a strong signal that the authorities will deal firmly with financial sector weaknesses;
- *Trade liberalization*: A prior action on the liberalization of trade in agriculture products supports the efficiency of markets and promotes agriculture output;
- *Transparency*: A prior action on full provision of data (in particular regarding the gas sector), and benchmarks on the posting of the NBU's financial statements and the completion of the audit of Naftogaz will promote improved transparency in these areas;
- *Privatization*: A benchmark on publishing information on privatizations in 2000 aims to enhance transparency of the privatization process;
- *Energy Sector*: Quantitative targets are set for cash collection ratios for electricity and gas.

##### **2. Status of Structural Conditionality from Earlier Reviews**

The only structural condition from the fourth review under the EFF that was not implemented was the reduction in the export tax on sunflower seeds. The tax was lowered to 17 percent rather than 10 percent, but “give-and-take” or tolling schemes for sunflower seeds were eliminated, increasing trade restrictiveness.

##### **3. Structural Areas Covered by World Bank Lending and Conditionality**

Recent World Bank adjustment operations have included conditionality in the financial and coal sectors. The Programmatic Adjustment Loan (PAL), which is currently being finalized, will include conditionality in the following areas: payments discipline; improvements to the business environment; strengthening the legal framework; agriculture sector reform; intergovernmental finance; public administration reform; improvements to the delivery of social services; and the environment. The PAL will also include conditionality on audits of Naftogaz, and on a defined number of transparent privatizations. In addition, the EBRD maintains substantial conditionality in the electricity sector.

##### **4. Structural Conditions not Included in the Current Program**

The current program does not include conditionality on communal tariffs, which were raised in 2000. The areas of private sector development and the agriculture sector are covered by World Bank conditionality. Conditionality related to specific privatization operations has not been included.

serious vulnerability risks for the financial sector. These issues are particularly important in light of the rapid increase in credit to the economy in 2000 and the first half of 2001.

26. **In other structural areas**, although the reduction of the export tax on sunflower seeds was not what had been envisaged, the authorities have also taken a number of further trade liberalization measures (Annex I, para. 17). The authorities reported that communal tariffs are now close to cost recovery levels in almost all areas of the country, and that a mechanism is in place to ensure that tariffs are adjusted on a regular basis. The review of Free Economic Zones and Special Investment Regimes called for the closure of one zone and the restriction of activities in a number of others. In the meantime, the government will resist recent initiatives to establish new special zones. Efforts to strengthen the climate for private sector development continue; in this context, the draft laws on certification and standardization have been enacted. The ongoing reform of the agriculture sector, which is transforming land ownership and liberalizing the sector, will be continued.

#### **IV. MEDIUM-TERM OUTLOOK AND PROGRAM FINANCING**

27. **The authorities have made significant steps towards achieving a sustainable external position.** Following the rescheduling of public debt to commercial banks in early 2000, Ukraine has now also been granted a rescheduling of its official bilateral debt by Paris Club creditors. An agreed minute was signed on July 13, 2001 in which creditors committed to reschedule principal in arrears and falling due during the period of the Extended Arrangement in the amount of \$580 million (for details, see Annex I, para. 20). The government has also entered discussions with other bilateral creditors, notably Turkmenistan, in order to seek rescheduling on similar terms, while taking into account that some of this debt was previously rescheduled. On the basis of these agreements, external debt service payments in the medium term are projected to remain broadly constant at a level of about 6 percent of exports of goods and services. Progress is also being made with regard to rescheduling of the large payments arrears for gas imports. The outstanding arrears are being treated as private sector arrears.

28. **Another cornerstone for achieving external viability involves further increasing external reserves.** Over the medium term, the program targets an increase in gross foreign reserves to about 3 months of imports (excluding transit gas) through gradual but significant purchases of foreign exchange by the NBU. This target is also expected to ensure adequate coverage of short-term external debt obligations. To help the NBU achieve this target, the government will commence to repay in 2002 a \$1.3 billion loan from the NBU. Moreover, to the extent privatization receipts and foreign budgetary assistance would be higher than the budgeted amounts, the government intends to reduce its net indebtedness to the NBU, thereby allowing a more accelerated reserve buildup. Close coordination between the government and the NBU is needed to achieve the inflation and reserve targets of the program.

29. **The program is fully financed for the remainder of 2001, while the higher level of external reserves indicates some strengthening in Ukraine's capacity to repay the Fund** (Tables 6 and 7). The ratio of payments to the Fund to gross reserves in the next few years is now lower than at the time of the fourth review but nonetheless remains high. Continued implementation of the program should keep the risks for the Fund manageable, although the situation needs continued close monitoring.

## V. TRANSPARENCY AND GOVERNANCE

30. **The authorities have expressed their commitment to boosting transparency and strengthening governance in Ukraine.** Progress continues to be made in these areas, notably through the greater use of audits and wider dissemination of information by public institutions. The general reduction in non-cash transactions in the economy at large provides some evidence of a shift toward more transparent payment mechanisms. At the NBU, external audits of the international reserves continue to be carried out on a quarterly basis, and internal accounting and auditing have been considerably strengthened. The NBU's annual financial statements are audited by an external auditor and published.

31. In the **fiscal area**, transparency in budgetary operations should be greatly enhanced with the recent adoption of the Budget Code. For the first time, the Ministry of Finance has submitted annual government finance statistics (GFS) for publication in *IMF GFS Yearbook*. Additional work is being undertaken to develop a new functional classification of expenditure for the 2002 budget in line with the GFS classification. The staff was concerned that some extrabudgetary funds were excluded from the budget as of 2001, but the authorities indicated that they will continue to report data on the financial operations of these funds, which are also included in the definition of the consolidated fiscal deficit. On the other hand, only limited progress has been made in the area of reporting on tax arrears and amnesties.

32. In the **electricity sector**, audits of the central transit account and regional settlement accounts will continue, and for the **gas sector**, the second stage audit of Naftogaz should be completed later this year. Naftogaz has proved somewhat resistant to providing information, however, opposing an independent assessment of its reserves and physical assets (which was to be used in the second stage audit). In addition, Naftogaz has provided much of the data called for in the Technical Memorandum of Understanding with considerable delay, in particular monthly data on cash collections and payments arrears on imported gas. In the **agriculture sector**, the State Material Reserve has recently refrained from interfering in markets, and its transactions have been carried out in a largely transparent fashion and at market prices.

## VI. STAFF APPRAISAL

33. Ukraine's economic situation has continued to improve—so far in 2001, showing an impressive combination of strong economic growth, moderating inflation, and a strong external position. The favorable economic environment in 2000–01 can be traced to a range

of factors: the strong external demand; the improvement in external competitiveness following the devaluation in 1998–99; the utilization of substantial idle capacity in the aftermath of the collapse of output during 1992–99; progress on some structural reforms; and reasonable macroeconomic policies.

34. While the improved economic situation was understandably welcomed by the authorities, it also contributed to a sharp policy debate in the political arena. Initially, it appeared that the high rate of growth strengthened the arguments of the opponents of reforms (primarily the various vested interests) in favor of the status quo. At the same time, the arguments of the reformers, warning against counting on positive exogenous factors and stressing the need for structural changes to ensure the sustainability of output recovery and the objective of integration with Western Europe, seemed at risk of being overshadowed.

35. Against this backdrop, the authorities' program as outlined in the attached letter and described in the staff report (as well as the program being discussed in the context of the IBRD's Programmatic Adjustment Loan) indicates that the momentum seems to have shifted in favor of pro-reform policies. The authorities intend to use the favorable economic environment to provide a basis for accelerating reform efforts, in the hope that a virtuous policy cycle would result. The staff's view is that the program is appropriately strong and deserves Fund support.

36. The authorities' priorities are to consolidate the financial stabilization gains, to continue the strengthening of payments discipline and transparency in the key sectors of the economy, especially the energy sector, and to promote private sector investment through accelerating privatization, improving the business climate and integration with the rest of the world economy. The staff endorses these priorities as appropriate for the period ahead.

37. The macroeconomic framework for 2001 envisages economic growth of 6 percent, annual inflation of about 12 percent, and an increase in the official reserve position to almost seven weeks of imports. While these objectives appeared ambitious earlier in the year, they now seem achievable based on the results through end-June. The main risks for the growth and external reserves objectives relate to the state of external demand and the ability of Ukrainian exporters to increase their market share sufficiently so as to offset the effects of the ongoing economic slowdown in some of Ukraine's major export markets. On the inflation front, care will need to be exercised to ensure that the growth of monetary aggregates is not a source of inflationary pressures.

38. Judging by the inflation outcome in 2001, the NBU has so far skillfully implemented its monetary program for 2001. The substantial purchases of foreign exchange by the NBU—the main factor behind the rapid growth of monetary aggregates—were the primary mechanism for the remonetization of the economy. While the policy of using Ukraine's strong external position to improve the external reserve position of the NBU—at the same time maintaining a stable exchange rate—has worked so far, the staff would stress the need for the NBU to stand ready to expand its sterilization operations and allow greater exchange rate flexibility if the foreign exchange inflows continue but the inflation target appears at

risk. The staff would also stress that, while exchange rate stability has probably contributed to greater business confidence, there is a significant risk that the private sector would see the current level of the exchange rate as an important government objective in its own right and thus count on it being defended at the cost of other objectives. Such beliefs could prove destabilizing, including by impeding prudent risk management and the development of hedging instruments and markets.

39. The original budget deficit target for 2001 of 3 percent of GDP was predicated on the expectation that privatization receipts would reach the same level. Given the likelihood of substantial shortfalls in privatization receipts, the staff welcomes the government's intention to seek corrective measures on both the revenue and expenditure sides of the budget, in line with the lower financing and reduced deficit target.

40. The situation on the revenue side requires particular attention. The wide-ranging tax amnesty that was unexpectedly passed by parliament early in 2001 had several adverse effects on the government's ability to collect taxes. Most directly, it wiped out at least some potentially collectible claims on tax arrears, especially those accumulated prior to end-1999. Less directly, but perhaps more perniciously from the point of view of developing a culture of treating tax obligations seriously, the amnesty punished those who had complied voluntarily with their tax obligations and rewarded those who had not. The staff strongly urges the government to do all it can to ensure that amnesties and special privileges are no longer seen as acceptable. Another area which demands government vigilance is the payments of tax and nontax obligations by large state enterprises such as Naftogaz.

41. The quarterly expenditure plan for 2001 was prepared under the assumption of significant uncertainty about the size and timing of privatization proceeds. This forward looking approach now allows the authorities some degrees of freedom in dealing with the likely shortfall in privatization receipts. The available room for maneuver should also be used to ensure that expenditure cuts, which seem inevitable, are carried out in a way that supports medium-term fiscal adjustment and protects the most vulnerable groups in the society.

42. The staff welcomes the continuation of structural improvements in the fiscal area. In this context, the promulgation of the Budget Code, which provides a legal underpinning to the transfer process between the state and local budgets, is very important. The continuing forbearance from noncash offset operations has greatly improved the transparency and integrity of the budget process. Progress towards implementing the single treasury account by end-2001 is also welcome. On the other hand, the persistence of the problem of local government arrears, especially with respect to wages, points to the need for greater oversight of local governments' financial operations.

43. While the Ukrainian financial system is relatively underdeveloped and, as such, unlikely to become a major source of macroeconomic instability in the near future, the staff urges the NBU to pay very close attention to the need to reduce its vulnerabilities. In this context, the staff supports the authorities' request to participate in the Financial Sector Assessment Program. Further improvements are needed in banking supervision, including the

enforcement capabilities of the NBU. The process of re-licensing of all commercial banks, which is required under the new Law on Banks and Banking Activity, could be an effective instrument in strengthening the NBU's oversight role. The removal of the banking license from Bank Ukraina was a significant step in this direction. The staff urges the authorities to refrain from creating a new state-owned bank and to cooperate closely with the World Bank in setting up a new financial institution for agricultural development, if considered necessary. Everything should be done to ensure that other banks adhere strictly to all prudential norms. The staff also argues for uniform reserve requirement ratios.

44. While the likely shortfall in the targeted privatization proceeds is regrettable, the staff commends the authorities for their efforts to improve the basic fairness and transparency of the privatization process. The greater emphasis on using tenders and financial advisors, and on selling majority stakes to strategic investors has improved perceptions in general and given greater credibility to the privatization program. However, further efforts in this direction will be necessary; at this stage, the staff would urge the authorities to ensure that the improved processes apply without exception, especially in respect to the major privatizations which are in the pipeline—the remaining electricity distribution companies and Ukrtelecom.

45. The problems of systematic nonpayments in the energy sector had, for many years, represented a major threat to macroeconomic stability. The staff commends the government for the substantial progress to date in improving the record of cash payments from consumers to distributors, from importers to suppliers, and from the energy companies to the State Tax Administration. The staff urges the government to continue its efforts in the direction of bringing payments discipline to as close to 100 percent as feasible. The authorities should also stand ready to resist any legislative initiatives which would reduce the transparency of transactions in the energy sector.

46. The staff welcomes the consistent implementation of Ukraine's strategy for rescheduling its sovereign debt to private and official creditors. The July 13 decision by the Paris Club to reschedule debt service obligations (including arrears) falling due during the program period is an important step towards the full regularization of Ukraine's relations with official creditors. The staff encourages Ukraine to intensify its efforts to reach a rescheduling agreement with other non-Paris Club creditors (i.e., Turkmenistan). In this general context, the regularization of commercial arrears of Naftogaz to Gazprom and other energy suppliers should also be a policy priority.

47. Despite the delays in concluding the fifth review, it is proposed to maintain access under the arrangement for 2001 (Table 8). This is warranted on the basis of the still low level of external reserves and to maintain the catalytic role of Fund lending vis-à-vis the Paris Club and other official creditors.

48. As was noted on previous occasions, the main downside risks to the program include shortfalls and timing uncertainties of privatization receipts; a worsening of the external environment, especially the possible impact of the growth slowdown in some markets for

Ukraine's exports; potential volatility in capital movements against the backdrop of underdeveloped sterilization instruments; and the legislative unpredictability ahead of the March 2002 parliamentary elections. However, the relatively favorable economic situation and the steady, albeit slow, improvements in the authorities' policy implementation capability give some confidence that these risks, were they to materialize, would be dealt with by a strengthening of policies. The risks of nonpayment to the Fund are modest as repayment obligations form a small proportion of exports. Accordingly, the staff recommends the completion of the fifth and sixth reviews under the EFF arrangement.

Table 1. Ukraine: Selected Economic Indicators, 1997-2002

|   | 1997   | 1998    | 1999<br>Est. | 2000    |         | 2001    |         | 2002<br>Proj. |
|---|--------|---------|--------------|---------|---------|---------|---------|---------------|
|   |        |         |              | Prog.   | Prel.   | Prog.   | Proj.   |               |
| <b>GDP</b>  |        |         |              |         |         |         |         |               |
| Nominal GDP (in millions of hryvnia)                          | 93,365 | 102,593 | 130,451      | 165,959 | 172,952 | 196,082 | 210,000 | 244,427       |
| Nominal GDP (in millions of U.S. dollars)                     | 50,142 | 41,823  | 31,569       | 30,351  | 31,792  | ...     | ...     | ...           |
| Real GDP (annual change in percent)                           | -3.0   | -1.9    | -0.2         | 4.2     | 5.8     | 4.0     | 6.2     | 4.0           |
| <b>Consumer prices</b>  |        |         |              |         |         |         |         |               |
| Percent change, period average                                | 15.9   | 10.5    | 22.7         | 28.4    | 28.2    | 18.1    | 14.4    | 11.4          |
| Percent change, end of period                                 | 10.1   | 20.0    | 19.2         | 27.1    | 25.8    | 13.2    | 12.3    | 9.8           |
| <b>Public finance (in percent of GDP)</b>                     |        |         |              |         |         |         |         |               |
| Consolidated government budget balance                        |        |         |              |         |         |         |         |               |
| Cash basis  | -5.4   | -2.8    | -2.4         | -1.5    | -1.3    | -3.0    | -1.7    | -1.7          |
| Of which: Primary balance                                     | -3.6   | -0.4    | 0.0          | 1.5     | 1.8     | 0.1     | 0.6     | 0.2           |
| Commitment basis 1/   | -5.0   | -3.0    | -1.4         | -0.7    | 0.2     | -2.8    | -1.3    | -1.5          |
| Revenue   | 38.8   | 36.0    | 33.9         | 34.4    | 34.5    | 31.9    | 31.1    | 30.7          |
| Expenditure   | 44.2   | 38.7    | 36.3         | 35.9    | 35.8    | 34.9    | 32.8    | 32.4          |
| Net domestic financing 2/                                     | 5.1    | 1.0     | 2.2          | 1.9     | 1.6     | 3.2     | 1.5     | 1.8           |
| Net external financing  | 0.3    | 1.8     | 0.2          | -0.4    | -0.3    | -0.2    | 0.2     | -0.1          |
| <b>Money and credit (annual change in percent)</b>            |        |         |              |         |         |         |         |               |
| Credit to nongovernment                                       | 2.4    | 16.7    | 38.6         | 43.5    | 63.0    | 21.8    | 23.7    | 18.2          |
| Credit to government  | 35.7   | 76.9    | 37.5         | 7.0     | -1.9    | -1.1    | -4.7    | -10.7         |
| Base money  | 44.6   | 21.9    | 39.2         | 30.3    | 40.1    | 12.0    | 18.6    | 17.2          |
| Broad money   | 33.9   | 25.3    | 40.4         | 35.8    | 45.4    | 17.8    | 23.7    | 14.8          |
| Velocity (M3) 3/  | 8.5    | 7.3     | 6.9          | 6.4     | 6.4     | 6.0     | 5.9     | 5.7           |
| <b>Balance of payments</b>                                    |        |         |              |         |         |         |         |               |
| Current account balance (in millions of U.S. dollars)         | -1,511 | -1,296  | 834          | 1,470   | 1,481   | 686     | 1,008   | 988           |
| Current account balance (in percent of GDP)                   | -3.0   | -3.1    | 2.6          | 4.8     | 4.7     | 2.1     | 2.7     | 2.4           |
| <b>Gross reserves (end of period)</b>                         |        |         |              |         |         |         |         |               |
| In weeks of current year imports of GNFS                      | 5.6    | 2.2     | 3.7          | 3.0     | 4.2     | 4.2     | 6.8     | 8.7           |
| Public external debt (in percent of GDP) 4/ 5/                | 19.0   | 27.5    | 39.4         | 36.2    | 32.6    | 33.7    | 28.5    | 27.5          |
| Debt service ratio (in percent of exports of GNFS) 6/         | 7.0    | 11.2    | 16.6         | 13.4    | 10.1    | 11.8    | 6.3     | 5.9           |
| Interest payments (in percent of exports of GNFS)             | 3.1    | 5.8     | 5.8          | 4.5     | 3.2     | 3.9     | 2.8     | 3.0           |
| Export volume (annual change in percent)                      | -2.7   | -12.4   | -10.2        | 19.1    | 24.5    | 3.0     | 6.3     | 5.7           |
| Import volume (annual change in percent)                      | -3.2   | -14.3   | -14.3        | 9.2     | 6.6     | 5.1     | 6.8     | 7.7           |
| Terms of trade (annual change in percent)                     | -0.3   | 4.7     | 9.2          | -8.2    | -9.3    | -0.5    | -0.8    | 1.2           |
| <b>Savings and investment (in percent of GDP) 7/</b>          |        |         |              |         |         |         |         |               |
| Gross domestic savings  | 18.4   | 17.7    | 22.9         | 25.4    | 29.3    | 23.8    | 27.4    | 27.2          |
| Nongovernment   | 21.9   | 18.7    | 23.3         | 24.9    | 28.6    | 24.8    | 27.2    | 27.1          |
| Government  | -3.5   | -1.0    | -0.4         | 0.5     | 0.7     | -1.0    | 0.2     | 0.1           |
| Gross domestic investment                                     | 21.4   | 20.8    | 20.3         | 20.6    | 24.6    | 21.7    | 24.7    | 24.8          |
| Nongovernment   | 19.6   | 19.0    | 18.3         | 18.6    | 22.7    | 19.7    | 22.9    | 22.9          |
| Government  | 1.8    | 1.8     | 2.0          | 2.0     | 1.9     | 2.0     | 1.9     | 1.8           |
| Resource balance  | -3.0   | -3.1    | 2.6          | 4.8     | 4.7     | 2.1     | 2.7     | 2.4           |
| <b>Memorandum items:</b>                                      |        |         |              |         |         |         |         |               |
| Exchange rate   |        |         |              |         |         |         |         |               |
| Hryvnia per dollar, end of period                             | 1.9    | 3.4     | 5.2          | ...     | 5.4     | ...     | ...     | ...           |
| Hryvnia per dollar, period average 8/                         | 1.9    | 2.5     | 4.1          | 5.4     | 5.4     | ...     | 5.4     | ...           |
| Real effective exchange rate (annual change in percent) 9/    | 7.3    | 2.3     | -23.0        | 7.4     | 11.6    | ...     | 0.0     | ...           |
| Nominal effective exchange rate (annual change in percent) 9/ | 10.0   | 35.3    | -14.4        | 0.1     | -1.2    | ...     | 3.8     | ...           |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Cash balance adjusted for the net accumulation of payments arrears on wages, pensions, and social benefits, and, in 2000, for the settlement of interest arrears to the National Bank of Ukraine (NBU).

2/ Domestic financing includes purchases of treasury bills by nonresidents, and privatization proceeds.

3/ Annual GDP divided by period-average broad money.

4/ Includes Black Sea Fleet debt swap and repayments, and debt stock and actual payments under the commercial debt rescheduling of April 2000.

5/ Historic debt data are preliminary.

6/ After rescheduling.

7/ From 1999 onward, the savings-investment balance reflects revised gas prices.

8/ For the year 2001: January-July.

9/ For the year 2001: January-May.

Table 2. Ukraine: Consolidated Government Finances, 1998-2002  
(In millions of hryvnia)

|   | 1998    | 1999    | 2000    |             | 2001      |           |         | 2002          |            |         |
|---|---------|---------|---------|-------------|-----------|-----------|---------|---------------|------------|---------|
|   |         |         | Program | Preliminary | Jan.-June | Jan.-Dec. | Program | Rev. proj. 1/ | Rev. proj. |         |
|   |         |         |         |             |           |           |         | Jan.-June     | Jan.-June  |         |
| Revenue and grants                        | 36,892  | 44,060  | 57,021  | 24,792      | 59,717    | 62,466    | 62,055  | 65,354        | 32,062     | 75,087  |
| Tax revenue                               | 35,236  | 41,791  | 48,901  | 21,581      | 50,574    | 54,092    | 53,347  | 56,127        | 27,766     | 64,865  |
| Taxes on income and profit                | 9,696   | 11,584  | 14,380  | 6,144       | 14,812    | 16,372    | 16,370  | 18,172        | 8,583      | 21,151  |
| Taxes on payroll                          | 10,803  | 12,839  | 14,585  | 6,666       | 15,224    | 16,486    | 15,770  | 15,770        | 8,718      | 18,292  |
| of which: Pension Fund                    | 8,930   | 10,804  | 12,300  | 5,617       | 12,890    | 14,041    | 13,223  | 13,223        | 7,450      | 15,391  |
| Property taxes                            | 1,105   | 1,090   | 1,303   | 541         | 1,376     | 1,487     | 1,487   | 1,404         | 721        | 1,634   |
| Domestic taxes on goods and services      | 11,605  | 14,340  | 16,360  | 7,226       | 16,847    | 17,151    | 17,008  | 18,021        | 8,473      | 20,688  |
| Taxes on international trade              | 972     | 1,238   | 1,503   | 649         | 1,561     | 1,716     | 1,726   | 1,889         | 887        | 2,199   |
| Other taxes                               | 1,054   | 699     | 770     | 355         | 754       | 879       | 985     | 871           | 383        | 902     |
| Nontax, capital revenue, and grants       | 1,656   | 2,269   | 8,120   | 3,210       | 9,142     | 8,374     | 8,709   | 9,227         | 4,297      | 10,222  |
| of which: Service fees                    | ...     | ...     | 4,626   | 2,059       | 5,386     | 5,280     | 5,876   | 5,076         | 2,370      | 5,908   |
| Expenditure (cash basis)                  | 39,714  | 47,150  | 59,553  | 25,100      | 61,891    | 68,366    | 67,955  | 68,854        | 32,524     | 79,242  |
| General public services                   | 1,875   | 2,035   | 4,150   | 1,924       | 4,746     | 4,739     | 4,550   | 4,550         | 2,028      | 5,068   |
| Defense                                   | 1,338   | 1,558   | 2,408   | 869         | 2,295     | 2,796     | 2,727   | 2,727         | 1,271      | 3,038   |
| Public order and safety affairs           | 1,602   | 1,777   | 2,600   | 1,226       | 3,015     | 3,288     | 3,237   | 3,237         | 1,813      | 3,606   |
| Education affairs and services            | 4,483   | 4,720   | 6,200   | 2,905       | 7,085     | 7,747     | 8,231   | 8,231         | 3,972      | 9,169   |
| Health affairs and services               | 3,620   | 3,861   | 4,619   | 2,075       | 4,976     | 5,518     | 5,599   | 5,599         | 2,702      | 6,237   |
| Social security and welfare affairs       | 14,411  | 16,600  | 20,200  | 10,085      | 22,780    | 27,042    | 26,384  | 26,384        | 12,293     | 29,392  |
| of which: Pension Fund                    | 8,801   | 10,757  | 12,300  | 5,903       | 13,105    | 14,041    | 13,223  | 13,223        | 6,900      | 15,391  |
| pension arrears repayment                 | ...     | 759     | 1,007   | 496         | 1,149     | 0         | 0       | 0             | 0          | 0       |
| Housing and community services            | 1,582   | 1,420   | 1,367   | 495         | 1,430     | 1,346     | 1,371   | 1,371         | 666        | 1,527   |
| Recreational, cultural, religious affairs | 521     | 615     | 839     | 351         | 887       | 654       | 678     | 678           | 474        | 755     |
| Energy, agriculture, and industry         | 4,225   | 4,446   | 3,533   | 1,502       | 4,377     | 4,615     | 4,957   | 4,957         | 2,247      | 5,522   |
| Interest payments                         | 2,424   | 3,087   | 5,091   | 2,177       | 5,292     | 6,122     | 5,755   | 4,722         | 1,884      | 4,590   |
| Domestic interest payments                | 1,663   | 1,251   | 1,706   | 288         | 2,385     | 2,030     | 1,694   | 1,793         | 802        | 1,833   |
| Foreign interest payments 2/              | 761     | 1,837   | 3,385   | 1,889       | 2,907     | 4,092     | 4,061   | 2,929         | 1,081      | 2,757   |
| Other 3/                                  | 3,633   | 7,032   | 8,546   | 1,491       | 5,007     | 4,499     | 4,468   | 6,399         | 3,175      | 10,338  |
| Overall cash balance                      | -2,822  | -3,090  | -2,532  | -308        | -2,175    | -5,900    | -5,900  | -3,500        | -462       | -4,155  |
| Net social arrears accumulation 4/        | 285     | -1,250  | -1,489  | -727        | -1,745    | -400      | -400    | -681          | -582       | -400    |
| Interest arrears accumulation             | 0       | 0       | 0       | 0           | -724      | 0         | 0       | 0             | 0          | 0       |
| Commitment balance 4/                     | -3,108  | -1,840  | -1,043  | 419         | 294       | -5,500    | -5,500  | -2,819        | 120        | -3,755  |
| Financing                                 | 2,822   | 3,090   | 2,532   | 308         | 2,175     | 5,900     | 5,900   | 3,500         | 462        | 4,155   |
| Net external                              | 1,867   | 268     | -609    | -834        | -584      | -399      | 697     | 494           | 132        | -181    |
| Disbursements                             | 4,650   | 2,263   | 381     | 0           | 381       | 2,607     | 2,586   | 2,430         | 659        | 2,326   |
| Amortization                              | -2,783  | -1,996  | -990    | -834        | -965      | -3,006    | -1,889  | -1,936        | -527       | -2,507  |
| Net domestic                              | 484     | 2,001   | 942     | 9           | 469       | 399       | -697    | -494          | -1,606     | -1,478  |
| Net nonbank borrowing                     | ...     | -280    | 340     | 32          | 133       | 77        | -79     | 345           | 513        | ...     |
| Net bank borrowing                        | ...     | 2,281   | 601     | -23         | 336       | 322       | -618    | -839          | -2,119     | ...     |
| Privatization                             | 471     | 822     | 2,200   | 1,133       | 2,290     | 5,900     | 5,900   | 3,500         | 1,936      | 5,814   |
| <i>Memorandum items:</i>                  |         |         |         |             |           |           |         |               |            |         |
| End-period stock of social arrears        | 4,339   | 3,089   | 1,600   | 2,363       | 1,344     | 1,200     | 944     | 663           | 762        | 263     |
| Primary balance                           | -398    | -3      | 2,559   | 1,868       | 3,117     | 222       | 222     | 1,222         | 1,422      | 435     |
| Earmarked revenue                         | 13,782  | 17,398  | 21,134  | 9,694       | 23,728    | 25,480    | 24,500  | 26,264        | 14,454     | ...     |
| Unearmarked cash                          | ...     | 20,567  | 35,887  | 14,820      | 35,988    | 36,986    | 37,555  | 39,090        | 17,611     | ...     |
| Nominal GDP                               | 102,593 | 130,451 | 165,959 | 172,952     | 172,952   | 196,082   | 203,056 | 210,000       | 210,000    | 244,427 |

Table 2 (Cont'd). Ukraine: Consolidated Government Finances, 1998-2002  
(In percent of GDP)

|   | 1998 | 1999 | 2000    |             | 2001      |           |         | 2002          |            |      |
|---|------|------|---------|-------------|-----------|-----------|---------|---------------|------------|------|
|   |      |      | Program | Preliminary | Jan.-June | Jan.-Dec. | Program | Rev. proj. 1/ | Rev. proj. |      |
|   |      |      |         |             |           |           |         |               | Prel       |      |
|   |      |      |         |             |           |           |         | Jan.-June     | Projection |      |
| Revenue and grants                        | 36.0 | 33.8 | 34.4    | 14.3        | 34.5      | 31.9      | 30.6    | 31.1          | 15.3       | 30.7 |
| Tax revenue                               | 34.3 | 32.0 | 29.5    | 12.5        | 29.2      | 27.6      | 26.3    | 26.7          | 13.2       | 26.5 |
| Taxes on income and profit                | 9.5  | 8.9  | 8.7     | 3.6         | 8.6       | 8.3       | 8.1     | 8.7           | 4.1        | 8.7  |
| Taxes on payroll                          | 10.5 | 9.8  | 8.8     | 3.9         | 8.8       | 8.4       | 7.8     | 7.5           | 4.2        | 7.5  |
| of which: Pension Fund                    | 8.7  | 8.3  | 7.4     | 3.2         | 7.5       | 7.2       | 6.5     | 6.3           | 3.5        | 6.3  |
| Property taxes                            | 1.1  | 0.8  | 0.8     | 0.3         | 0.8       | 0.8       | 0.7     | 0.7           | 0.3        | 0.7  |
| Domestic taxes on goods and services      | 11.3 | 11.0 | 9.9     | 4.2         | 9.7       | 8.7       | 8.4     | 8.6           | 4.0        | 8.5  |
| Taxes on international trade              | 0.9  | 0.9  | 0.9     | 0.4         | 0.9       | 0.9       | 0.9     | 0.9           | 0.4        | 0.9  |
| Other taxes                               | 1.0  | 0.5  | 0.5     | 0.2         | 0.4       | 0.4       | 0.5     | 0.4           | 0.2        | 0.4  |
| Nontax, capital revenue, and grants       | 1.6  | 1.7  | 4.9     | 1.9         | 5.3       | 4.3       | 4.3     | 4.4           | 2.0        | 4.2  |
| of which: Service fees                    | ...  | ...  | 2.8     | 1.2         | 3.1       | 2.7       | 2.5     | 2.4           | 1.1        | 2.4  |
| Expenditure (cash basis)                  | 38.7 | 36.1 | 35.9    | 14.5        | 35.8      | 34.9      | 33.5    | 32.8          | 15.5       | 32.4 |
| General public services                   | 1.8  | 1.6  | 2.5     | 1.1         | 2.7       | 2.4       | 2.2     | 2.2           | 1.0        | 2.1  |
| Defense                                   | 1.3  | 1.2  | 1.5     | 0.5         | 1.3       | 1.4       | 1.3     | 1.3           | 0.6        | 1.2  |
| Public order and safety affairs           | 1.6  | 1.4  | 1.6     | 0.7         | 1.7       | 1.7       | 1.6     | 1.5           | 0.9        | 1.5  |
| Education affairs and services            | 4.4  | 3.6  | 3.7     | 1.7         | 4.1       | 4.0       | 4.1     | 3.9           | 1.9        | 3.8  |
| Health affairs and services               | 3.5  | 3.0  | 2.8     | 1.2         | 2.9       | 2.8       | 2.8     | 2.7           | 1.3        | 2.6  |
| Social security and welfare affairs       | 14.3 | 12.7 | 12.2    | 5.8         | 13.2      | 13.8      | 13.0    | 12.6          | 5.9        | 12.0 |
| of which: Pension Fund                    | 8.6  | 8.2  | 7.4     | 3.4         | 7.6       | 7.2       | 6.5     | 6.3           | 3.3        | 6.3  |
| of which: pension arrears repayment       | ...  | 0.6  | 0.6     | 0.3         | 0.7       | 0.0       | 0.0     | 0.0           | 0.0        | 0.0  |
| Housing and community services            | 1.5  | 1.1  | 0.8     | 0.3         | 0.8       | 0.7       | 0.7     | 0.7           | 0.3        | 0.6  |
| Recreational, cultural, religious affairs | 0.5  | 0.5  | 0.5     | 0.2         | 0.5       | 0.3       | 0.3     | 0.3           | 0.2        | 0.3  |
| Energy, agriculture, and industry         | 1.4  | 3.4  | 2.1     | 0.9         | 2.5       | 2.4       | 2.4     | 2.4           | 1.1        | 2.3  |
| Interest payments                         | 2.4  | 2.4  | 3.1     | 1.3         | 3.1       | 3.1       | 2.8     | 2.2           | 0.9        | 1.9  |
| Domestic interest payments                | 1.6  | 1.0  | 1.0     | 0.2         | 1.4       | 1.0       | 0.8     | 0.9           | 0.4        | 0.7  |
| Foreign interest payments 2/              | 0.7  | 1.4  | 2.0     | 1.1         | 1.7       | 2.1       | 2.0     | 1.4           | 0.5        | 1.1  |
| Other 3/                                  | 6.0  | 5.4  | 5.1     | 0.9         | 2.9       | 2.3       | 2.2     | 3.0           | 1.5        | 4.2  |
| Overall cash balance                      | -2.8 | -2.4 | -1.5    | -1.5        | -1.3      | -3.0      | -2.9    | -1.7          | -0.2       | -1.7 |
| Net social arrears accumulation 4/        | 0.3  | -1.0 | -0.8    | -0.8        | -1.0      | -0.2      | -0.2    | -0.3          | -0.3       | -0.2 |
| Commitment balance 4/                     | -3.0 | -1.4 | -0.7    | -0.7        | 0.2       | -2.8      | -2.7    | -1.3          | 0.1        | -1.5 |
| Financing                                 | 2.8  | 2.4  | 1.5     | 1.5         | 1.3       | 3.0       | 2.9     | 1.7           | 0.2        | 1.7  |
| Net external                              | 1.8  | 0.2  | -0.4    | -0.4        | -0.3      | -0.2      | 0.3     | 0.2           | 0.1        | -0.1 |
| Disbursements                             | 4.5  | 1.7  | 0.2     | 0.2         | 0.2       | 1.3       | 1.3     | 1.2           | 0.3        | 1.0  |
| Amortization                              | -2.7 | -1.5 | -0.6    | -0.6        | -0.6      | -1.5      | -0.9    | -0.9          | -0.3       | -1.0 |
| Net domestic                              | 0.5  | 1.5  | 0.6     | 0.6         | 0.3       | 0.2       | -0.3    | -0.2          | -0.8       | -0.6 |
| Privatization                             | 0.5  | 0.6  | 1.3     | 1.3         | 1.3       | 3.0       | 2.9     | 1.7           | 0.9        | 2.4  |
| <i>Memorandum items:</i>                  |      |      |         |             |           |           |         |               |            |      |
| End-period stock of social arrears        | 4.2  | 2.4  | 1.0     | 1.0         | 0.8       | 0.6       | 0.5     | 0.3           | 0.4        | 0.1  |
| Primary balance                           | -0.4 | 0.0  | 1.5     | 1.5         | 1.8       | 0.1       | 0.1     | 0.6           | 0.7        | 0.2  |
| Earmarked revenue                         | 13.4 | 13.3 | 12.7    | 12.7        | 13.7      | 13.0      | 12.1    | 12.5          | 6.9        | ...  |
| Unearmarked cash                          | 0.0  | 15.8 | 21.6    | 21.6        | 20.8      | 18.8      | 18.5    | 18.6          | 8.4        | ...  |
| Noninterest expenditures                  | 36.3 | 33.8 | 32.8    | 32.8        | 32.7      | 31.8      | 30.6    | 30.5          | 14.6       | 30.5 |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Revised budgetary projection discussed with the authorities during the February 2001 mission.

2/ After debt rescheduling.

3/ Includes the discrepancy between above-the-line and financing data.

4/ The commitment balance is the cash balance adjusted for the net accumulation of arrears on wages, pensions, and benefits (social arrears), and, in 2000, for the settlement of interest arrears to the NBU.

Table 3. Ukraine: Monetary Survey, 1998-2002

|  | 1998<br>Dec | 1999<br>Dec | 2000<br>Dec | 2001            |        | 2002           |              |
|--|-------------|-------------|-------------|-----------------|--------|----------------|--------------|
|  |             |             |             | Mar<br>Estimate | Jun    | Sep<br>Program | Dec<br>Proj. |
| (In millions of hryvnia)                           |             |             |             |                 |        |                |              |
| Net foreign assets                                 | -5,340      | -6,334      | -428        | 823             | 2,767  | 3,317          | 4,154        |
| Net domestic assets                                | 21,059      | 28,403      | 32,513      | 32,203          | 34,186 | 32,539         | 35,544       |
| Domestic credit                                    | 23,464      | 32,369      | 39,966      | 40,604          | 43,064 | 40,940         | 43,945       |
| Net credit to government                           | 14,336      | 19,718      | 19,348      | 17,801          | 17,229 | 17,244         | 18,447       |
| Credit to nongovernment                            | 9,128       | 12,651      | 20,618      | 22,803          | 25,835 | 23,696         | 25,498       |
| In domestic currency                               | 5,431       | 6,768       | 12,082      | 13,639          | 15,578 | 13,835         | 15,636       |
| In foreign currency                                | 3,697       | 5,883       | 8,537       | 9,164           | 10,257 | 9,862          | 9,862        |
| Other items, net                                   | -2,405      | -3,967      | -7,453      | -8,401          | -8,878 | -8,401         | -8,401       |
| Broad money  | 15,719      | 22,069      | 32,084      | 33,026          | 36,953 | 35,856         | 39,698       |
| Hryvnia broad money                                | 12,377      | 16,532      | 24,627      | 25,507          | 28,844 | 28,338         | 32,180       |
| Foreign currency deposits                          | 3,342       | 5,537       | 7,457       | 7,519           | 8,109  | 7,519          | 7,519        |
| (Percentage change from end of previous period) 3/ |             |             |             |                 |        |                |              |
| Broad money  | 25.3        | 40.4        | 45.4        | 2.9             | 11.9   | -3.0           | 23.7         |
| Hryvnia broad money                                | 13.9        | 33.6        | 49.0        | 3.6             | 13.1   | -1.8           | 30.7         |
| Net domestic credit                                | 47.3        | 38.0        | 23.5        | 1.6             | 6.1    | -4.9           | 10.0         |
| Credit to nongovernment                            | 16.7        | 38.6        | 63.0        | 10.6            | 13.3   | -8.3           | 23.7         |
| Real broad money 1/                                | 4.5         | 17.8        | 15.6        | 0.2             | 8.9    | -5.0           | 10.2         |
| Real credit to nongovernment 1/                    | -2.8        | 16.3        | 29.5        | 7.7             | 10.3   | -10.2          | 10.2         |
| (Ratio)  |             |             |             |                 |        |                |              |
| Velocity of broad money 2/                         | 7.3         | 6.9         | 6.4         | 5.3             | 5.4    | 6.4            | 5.9          |
|  |             |             |             |                 |        |                | 5.7          |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Deflated by the CPI.

2/ Annual average; for March, June, and September 2001, annualized quarterly GDP divided by the average stock of money during the quarter.

3/ Figures for March, June, and September 2001 refer to changes from previous quarter.

Table 4. Ukraine: Accounts of the National Bank of Ukraine and of Deposit Money Banks, 1998-2002

|   | 1998<br>Dec      | 1999<br>Dec      | 2000<br>Dec    | 2001            |           |                | 2002         |              |
|---|------------------|------------------|----------------|-----------------|-----------|----------------|--------------|--------------|
|   |                  |                  |                | Mar<br>Estimate | Jun       | Sep<br>Program | Dec          | Dec<br>Proj. |
| (In millions of hryvnia)                                    |                  |                  |                |                 |           |                |              |              |
| <b>1. National Bank of Ukraine</b>                          |                  |                  |                |                 |           |                |              |              |
| Net international reserves<br>(In millions of U.S. dollars) | -6,892<br>-2,011 | -9,367<br>-1,674 | -3,244<br>-596 | -2,288<br>-421  | 475<br>87 | 792<br>146     | 1,629<br>299 | 4,833<br>889 |
| Net domestic assets   | 15,496           | 21,345           | 20,022         | 19,031          | 18,519    | 17,285         | 18,263       | 18,475       |
| Net domestic credit   | 14,381           | 20,834           | 20,972         | 19,833          | 19,582    | 18,088         | 19,066       | 19,278       |
| Net credit to government                                    | 13,479           | 19,121           | 19,937         | 18,765          | 18,313    | 18,058         | 19,012       | 17,399       |
| Net credit to nongovernment                                 | 49               | 83               | 92             | 100             | 87        | 100            | 100          | 100          |
| Claims on banks   | 853              | 1,630            | 943            | 969             | 1,182     | -70            | -45          | 1,779        |
| Other items, net  | 1,115            | 511              | -950           | -803            | -1,062    | -803           | -803         | -803         |
| Base money  | 8,604            | 11,978           | 16,777         | 16,742          | 18,995    | 18,077         | 19,892       | 23,308       |
| Currency in circulation                                     | 7,158            | 9,583            | 12,799         | 12,736          | 14,487    | 14,736         | 16,444       | 19,446       |
| Banks' reserves   | 1,447            | 2,395            | 3,978          | 4,007           | 4,508     | 3,341          | 3,449        | 3,862        |
| <b>2. Deposit Money Banks</b>                               |                  |                  |                |                 |           |                |              |              |
| Net foreign assets  | 1,434            | 2,677            | 2,503          | 2,333           | 1,549     | 2,333          | 2,333        | 2,333        |
| Net domestic assets   | 7,981            | 11,448           | 17,725         | 18,926          | 22,099    | 18,718         | 20,876       | 25,574       |
| Domestic credit   | 9,883            | 13,133           | 19,880         | 21,691          | 24,607    | 22,149         | 24,200       | 28,484       |
| Net credit to government                                    | 858              | 597              | -590           | -964            | -1,084    | -814           | -564         | -932         |
| Credit to the economy                                       | 9,025            | 12,535           | 20,469         | 22,655          | 25,691    | 22,963         | 24,764       | 29,416       |
| Banks' reserves   | 1,447            | 2,395            | 3,978          | 4,007           | 4,508     | 3,341          | 3,449        | 3,862        |
| Other items net   | -3,349           | -4,079           | -6,133         | -6,772          | -7,015    | -6,772         | -6,772       | -6,772       |
| Banks' liabilities  | 9,415            | 14,125           | 20,228         | 21,259          | 23,648    | 21,051         | 23,209       | 27,907       |
| Credit to banks from NBU                                    | 853              | 1,640            | 943            | 969             | 1,182     | -70            | -45          | 1,779        |
| Deposits  | 8,561            | 12,485           | 19,285         | 20,290          | 22,466    | 21,121         | 23,254       | 26,127       |
| (Percentage change from end of previous period) 1/          |                  |                  |                |                 |           |                |              |              |
| Base money  | 21.9             | 39.2             | 40.1           | -0.2            | 13.5      | -4.8           | 18.6         | 17.2         |
| Net domestic assets of the NBU                              | 117.9            | 37.7             | -6.2           | -4.9            | -2.7      | -6.7           | -8.8         | 1.2          |
| (Ratio)   |                  |                  |                |                 |           |                |              |              |
| Money multiplier  | 1.83             | 1.84             | 1.91           | 1.97            | 1.95      | 1.98           | 2.00         | 1.96         |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Figures for March, June, and September 2001 refer to changes from previous quarter.

Table 5. Ukraine: Medium-term Balance of Payments, 1998-2006  
(In millions of U.S. dollars)

|   | 1998    | 1999    | 2000    | 2001       | 2002    | 2003    | 2004    | 2005        | 2006    |
|---|---------|---------|---------|------------|---------|---------|---------|-------------|---------|
|   |         |         | Prel.   | Rev. Proj. |         |         |         | Projections |         |
| Current account balance 1/  | -1,296  | 834     | 1,481   | 1,008      | 988     | 818     | 634     | 498         | 308     |
| Merchandise trade balance   | -2,584  | -482    | 779     | 642        | 564     | 484     | 403     | 362         | 361     |
| Exports   | 13,699  | 12,463  | 15,722  | 16,879     | 18,011  | 19,236  | 20,607  | 22,073      | 23,641  |
| Imports   | -16,283 | -12,945 | -14,943 | -16,237    | -17,447 | -18,751 | -20,205 | -21,711     | -23,280 |
| Of which: Energy  | -5,854  | -5,163  | -5,770  | -5,701     | -5,735  | -5,905  | -6,082  | -6,188      | -6,378  |
| Nonfactor services  | 1,377   | 1,479   | 627     | 224        | 179     | 129     | 76      | 20          | -38     |
| Investment income   | -871    | -869    | -942    | -967       | -985    | -1,050  | -1,125  | -1,191      | -1,247  |
| Of which: Interest on public debt 2/                                      | -1,026  | -948    | -834    | -652       | -712    | -668    | -652    | -659        | -681    |
| Current transfers   | 782     | 706     | 1,017   | 1,109      | 1,231   | 1,255   | 1,280   | 1,306       | 1,232   |
| Financial and capital account   | 510     | 336     | -689    | -328       | -285    | 83      | 424     | 668         | 1,080   |
| Direct investment (net) and capital transfers                             | 744     | 479     | 587     | 795        | 850     | 750     | 700     | 683         | 612     |
| Portfolio equity  | 225     | 118     | -135    | -86        | -42     | 20      | 71      | 125         | 182     |
| Bonds and MLT loans   | -510    | -52     | -28     | 156        | 129     | 468     | 792     | 913         | 1,251   |
| Of which: MLT loans and bonds (official)                                  | 1,257   | 493     | -384    | -312       | -73     | 54      | 304     | 396         | 705     |
| Disbursements   | 2,287   | 884     | 190     | 485        | 584     | 803     | 1,111   | 1,204       | 1,535   |
| Repayments 2/   | -1,030  | -391    | -574    | -797       | -657    | -749    | -807    | -807        | -831    |
| Currency and deposits   | -125    | -117    | -       | -124       | -136    | -149    | -164    | -180        | -198    |
| Other short-term capital (includes net payables)                          | 176     | -92     | -1,113  | -1,069     | -1,086  | -1,005  | -975    | -872        | -767    |
| Of which: Gas arrears (net) 3/  | 679     | 662     | 161     | -          | -       | -       | -       | -           | -       |
| Errors and omissions  | -815    | -943    | -188    | -188       | -188    | -188    | -188    | -188        | -188    |
| Overall balance   | -1,601  | 227     | 604     | 492        | 515     | 713     | 870     | 978         | 1,200   |
| Financing   | 1,601   | -227    | -604    | -492       | -515    | -713    | -870    | -978        | -1,200  |
| Gross official reserves (- is increase) 4/                                | 1,324   | -308    | -379    | -1,172     | -973    | -530    | -615    | -721        | -663    |
| Net use of IMF resources  | 277     | 81      | -599    | 279        | 374     | -183    | -255    | -257        | -537    |
| Purchases   | 382     | 638     | 251     | 736        | 552     | -       | -       | -           | -       |
| Repurchases   | 105     | 557     | 850     | 457        | 178     | 183     | 255     | 257         | 537     |
| Official arrears to bi-lateral creditors                                  | --      | --      | 374     | -          | -       | -       | -       | -           | -       |
| Clearance of official arrears to bi-lateral creditors                     | --      | --      | -       | -374       | -       | -       | -       | -           | -       |
| Rescheduling 5/   | --      | --      | -       | 775        | 85      | --      | --      | --          | --      |
| Memorandum items:   |         |         |         |            |         |         |         |             |         |
| Total public external debt 2/ 6/  | 11,483  | 12,438  | 10,350  | 10,733     | 11,112  | 10,871  | 10,865  | 10,866      | 10,907  |
| Public external debt as percent of GDP 2/ 6/                              | 27.5    | 39.4    | 32.6    | 28.5       | 27.5    | 24.9    | 24.4    | 23.1        | 22.3    |
| Stock of external gas arrears 3/  | 754     | 1,416   | 1,577   | ...        | ...     | ...     | ...     | ...         | ...     |
| Current account as percent of GDP   | -3.1    | 2.6     | 4.7     | 2.7        | 2.4     | 1.9     | 1.4     | 1.1         | 0.6     |
| Debt service ratio (exports of GNFS), before rescheduling                 | 11.2    | 16.6    | 10.1    | 7.9        | 6.4     | ...     | ...     | ...         | ...     |
| Debt service ratio (exports of GNFS), after rescheduling 5/               | 11.2    | 16.6    | 10.1    | 6.3        | 5.9     | 6.5     | 6.1     | 5.8         | 6.2     |
| Interest payments as percent of exports of GNFS,<br>after rescheduling 5/ | 5.8     | 5.8     | 3.2     | 2.8        | 3.0     | 2.6     | 2.6     | 2.4         | 2.4     |
| Exceptional financing 7/  | 340     | 452     | 70      | 349        | 318     | 300     | 350     | 350         | 350     |
| Gross international reserves 4/   | 782     | 1,090   | 1,469   | 2,641      | 3,614   | 4,144   | 4,759   | 5,481       | 6,144   |
| In weeks of imports of GNFS   | 2.2     | 3.7     | 4.2     | 6.8        | 8.7     | 9.3     | 10.0    | 10.7        | 11.2    |
| Gross reserves over official debt service                                 | 0.4     | 0.6     | 0.7     | 1.4        | 2.3     | 2.6     | 2.8     | 3.2         | 3.0     |
| Net reserves  | -1,911  | -1,706  | -632    | 349        | 949     | 1,662   | 2,532   | 3,510       | 4,710   |
| Net reserves over official debt service excl. repurchases                 | -0.9    | -1.3    | -0.4    | 0.2        | 0.7     | 1.2     | 1.7     | 2.4         | 3.1     |
| Export growth rate  | -11.1   | -9.0    | 26.1    | 7.4        | 6.7     | 6.8     | 7.1     | 7.1         | 7.1     |
| Import growth rate  | -17.0   | -20.5   | 15.4    | 8.7        | 7.5     | 7.5     | 7.8     | 7.5         | 7.2     |
| Export volume growth  | -12.4   | -10.2   | 24.5    | 6.3        | 5.7     | 5.6     | 5.9     | 5.9         | 5.9     |
| Import volume growth  | -14.3   | -14.3   | 6.6     | 6.8        | 7.7     | 5.9     | 6.0     | 6.1         | 5.5     |
| Terms of trade (percent change)   | 4.7     | 9.2     | -9.3    | -0.8       | 1.2     | -0.3    | -0.5    | -0.1        | -0.5    |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Before 1999, the imports of gas are reported at a decreed price rather than actually observed price.

2/ Includes Black Sea Fleet debt swap and repayments; and debt stock and actual payments under the commercial debt rescheduling of April 2000.

3/ As reported by Naftogaz; creditors claim larger arrears. Those are considered private arrears.

4/ The definition of gross reserves excludes unusable reserves. Gross reserves at end-1998 were reported as US\$949 million before this exclusion.

5/ Rescheduling by the Paris Club and other bilateral creditors (on comparable terms).

6/ Historic debt data are preliminary.

7/ Official external program financing, largely from the World Bank and the European Union.

Table 6. Ukraine: Medium-term External Financing Requirements, 1998-2006  
 (In millions of U.S. dollars)

|   | 1998   | 1999   | 2000   | 2001   | 2002   | 2003   | 2004   | 2005   | 2006   |
|---|--------|--------|--------|--------|--------|--------|--------|--------|--------|
| Merchandise trade balance   | -2,584 | -482   | 779    | 642    | 564    | 484    | 403    | 362    | 361    |
| Services balance  | 506    | 610    | -315   | -743   | -806   | -922   | -1,049 | -1,170 | -1,285 |
| Of which: Interest payment on official MLT debt to bilateral creditors 1/ | ...    | ...    | 63     | 48     | 26     | 17     | 11     | 9      | 7      |
| Amortization of medium- and long-term credits                             | -1,030 | -391   | -574   | -797   | -657   | -749   | -807   | -807   | -831   |
| Of which: Amortization of official MLT debt to bilateral creditors 1/     | ...    | ...    | 345    | 380    | 172    | 112    | 55     | 47     | 35     |
| Other short-term capital (including errors and omissions)                 | -639   | -1,035 | -1,301 | -1,257 | -1,274 | -1,193 | -1,163 | -1,060 | -955   |
| Increase in official reserves (- is increase)                             | 1,324  | -308   | -379   | -1,172 | -973   | -530   | -615   | -721   | -663   |
| Gross financing needs (-)   | -2,423 | -1,606 | -1,790 | -3,327 | -3,147 | -2,910 | -3,231 | -3,397 | -3,373 |
| Current transfers   | 782    | 706    | 1,017  | 1,109  | 1,231  | 1,255  | 1,280  | 1,306  | 1,232  |
| Foreign direct investment, and portfolio equity                           | 969    | 597    | 452    | 709    | 808    | 770    | 771    | 807    | 794    |
| Gross medium- and long-term credit before exceptional financing           | 180    | -113   | 476    | 604    | 468    | 918    | 1,249  | 1,370  | 1,732  |
| Currency and deposits   | -125   | -117   | 0      | -124   | -136   | -148   | -164   | -180   | -198   |
| IMF repurchases   | -105   | -557   | -850   | -457   | -178   | -183   | -255   | -257   | -537   |
| Gross financing gap (-)   | -722   | -1,090 | -695   | -1,486 | -954   | -300   | -350   | -350   | -350   |
| IMF purchases   | 382    | 638    | 251    | 736    | 552    | ...    | ...    | ...    | ...    |
| Program financing (World Bank, EU)  | 340    | 452    | 70     | 349    | 318    | 300    | 350    | 350    | 350    |
| Arrears (build-up and clearance) and rescheduling                         | 0      | 0      | 374    | 401    | 85     | 0      | 0      | 0      | 0      |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ This reflects scheduled debt service. Excludes Black Sea Fleet debt swap and repayment.

Table 7: Ukraine: Indicators of Fund Credit, 1998-2006

|   | 1998    | 1999    | 2000    | 2001    | 2002    | 2003    | 2004    | 2005    | 2006    |
|---|---------|---------|---------|---------|---------|---------|---------|---------|---------|
| <b>Outstanding Fund credit 1/</b>       |         |         |         |         |         |         |         |         |         |
| In millions of SDRs                     | 1,985.0 | 2,044.6 | 1,591.2 | 1,811.6 | 2,107.0 | 1,962.5 | 1,760.7 | 1,557.9 | 1,133.5 |
| In percent of:                          |         |         |         |         |         |         |         |         |         |
| Exports of goods and nonfactor services | 15.3    | 17.2    | 10.8    | 10.9    | 12.0    | 10.5    | 8.8     | 7.3     | 5.0     |
| Total public external debt              | 22.9    | 22.0    | 20.3    | 25.8    | 23.5    | 22.3    | 20.0    | 18.8    | 14.2    |
| Gross official reserves 2/              | 344.4   | 256.5   | 143.0   | 86.8    | 73.8    | 59.9    | 46.8    | 36.0    | 23.3    |
| GDP                                     | 6.4     | 8.9     | 6.6     | 6.1     | 6.6     | 5.7     | 5.0     | 4.2     | 2.9     |
| Quota                                   | 199.0   | 149.0   | 116.0   | 132.0   | 153.6   | 143.0   | 128.3   | 113.5   | 82.6    |
| <b>Debt service due 3/</b>              |         |         |         |         |         |         |         |         |         |
| In millions of SDRs                     | 162.1   | 487.8   | 740.7   | 432.9   | 223.7   | 231.8   | 281.9   | 274.3   | 485.6   |
| Of which: repurchases                   | 77.3    | 407.0   | 643.5   | 361.2   | 140.7   | 144.5   | 201.8   | 202.8   | 424.4   |
| In percent of:                          |         |         |         |         |         |         |         |         |         |
| Exports of goods and nonfactor services | 1.2     | 4.1     | 5.0     | 2.6     | 1.3     | 1.2     | 1.4     | 1.3     | 2.1     |
| Public debt service due                 | 11.2    | 24.8    | 43.6    | 30.1    | 20.1    | 18.9    | 23.2    | 26.3    | 37.5    |
| Gross official reserves 2/              | 28.1    | 61.2    | 66.6    | 20.7    | 7.8     | 7.1     | 7.5     | 6.3     | 10.0    |
| GDP                                     | 0.5     | 2.1     | 3.1     | 1.5     | 0.7     | 0.7     | 0.8     | 0.7     | 1.3     |
| Quota                                   | 16.3    | 35.6    | 54.0    | 31.6    | 16.3    | 16.9    | 20.5    | 20.0    | 35.4    |
| <b>Memorandum item:</b>                 |         |         |         |         |         |         |         |         |         |
| Quota                                   | 997     | 1,372   | 1,372   | 1,372   | 1,372   | 1,372   | 1,372   | 1,372   | 1,372   |

Source: Fund staff estimates and projections.

1/ End of period.

2/ From 1998, this refers to gross usable reserves.

3/ Includes early repurchase on account of misreporting of SDR 72.5 million in 2000.

Table 8. Ukraine: Timetable of Purchases and Reviews under the Extended Fund Facility,  
September 2001-September 2002

| Amount of purchases<br>(in millions of SDRs) | Earliest expected dates of purchases | Conditions for purchases  |
|--|--------------------------------------|---|
| 290.78                                       | End-September, 2001                  | Completion of fifth and sixth reviews   |
| 290.78                                       | December 15, 2001                    | Observance of end-September performance criteria and completion of seventh review |
| 145.39                                       | February 15, 2002                    | Observance of end-December performance criteria and completion of eighth review   |
| 145.39                                       | May 15, 2002                         | Observance of end-March performance criteria and completion of ninth review       |
| 145.39                                       | August 15, 2002                      | Observance of end-June performance criteria                                       |

Sources: IMF Treasurer's Department; and Fund staff estimates and projections.

**Ukraine: Fund Relations**  
 (As of June 30, 2001)

**I. Membership Status:** Joined 09/03/1992; Article VIII

| <b>II. General Resources Account:</b>       | <b>SDR Million</b> | <b>Quota</b>        |
|---|--------------------|---------------------|
| Quota                                       | 1,372.00           | 100.0               |
| Fund holdings of currency                   | 2,744.89           | 200.1               |
| Reserve position in Fund                    | 0.00               | 0.0                 |
| <b>III. SDR Department:</b>                 | <b>SDR Million</b> | <b>% Allocation</b> |
| Holdings                                    | 13.56              | N/A                 |
| <b>IV. Outstanding Purchases and Loans:</b> | <b>SDR Million</b> | <b>% Quota</b>      |
| Stand-by arrangements                       | 159.01             | 11.6                |
| Extended arrangements                       | 902.22             | 65.8                |
| Systemic transformation                     | 311.66             | 22.7                |

**V. Financial Arrangements:**

| Type     | Approval Date | Expiration Date | Amount Approved (SDR million) | Amount Drawn SDR Million) |
|----------|---------------|-----------------|-------------------------------|---------------------------|
| EFF      | 09/04/98      | 08/15/02        | 1,919.95                      | 902.22                    |
| Stand-by | 08/25/97      | 08/24/98        | 398.92                        | 181.33                    |
| Stand-by | 05/10/96      | 02/23/97        | 598.20                        | 598.20                    |

**VI. Projected Obligations to Fund:** (SDR million; based on existing use of resources and present holdings of SDRs):

|                  | <b>Overdue</b>    | <b>Forthcoming</b> |             |             |             |             |
|------------------|-------------------|--------------------|-------------|-------------|-------------|-------------|
|                  | <u>06/30/2001</u> | <u>2001</u>        | <u>2002</u> | <u>2003</u> | <u>2004</u> | <u>2005</u> |
| Principal        | 0.0               | 142.9              | 140.7       | 144.5       | 201.8       | 202.8       |
| Charges/interest | 0.0               | 29.4               | 50.1        | 44.3        | 37.1        | 28.6        |
| Total            | 0.0               | 172.3              | 190.8       | 188.8       | 238.9       | 231.4       |

**VII. Exchange Arrangements:**

In September 1996, the authorities introduced the hryvnia (Hrv) at a conversion rate of karbovanets (Krb) 100,000 to Hrv 1. The rate was initially informally pegged to the dollar. In September 1997, the peg was replaced by a formal band of Hrv 1.7–Hrv 1.9 per U.S. dollar. The limits of the band were moved on several occasions, most recently on February 9, 1999, to Hrv 3.4–4.6 per U.S. dollar. Since March 19, 1999, the exchange rate for the hryvnia has been allowed to be determined by the interbank market for foreign exchange. On February

22, 2000, the NBU officially confirmed its intention of allowing the free float of the hryvnia. On August 2, 2001 the hryvnia stood at Hrv 5.35 per U.S. dollar.

On September 24, 1996, Ukraine accepted the obligations of Article VIII, Sections 2, 3, and 4 of the Fund's Articles of Agreement, and two remaining restrictions were eliminated in May 1997. A number of new restrictions were introduced in September 1998. The restrictions on current international transactions introduced in September 1998 were removed in March 1999.

**VIII. Article IV Consultation:**

Ukraine is on the standard 12-month consultation cycle. The staff report and the statistical appendix were considered by the Executive Board on December 19, 2000.

**Ukraine: Fund Technical Assistance Missions, July 1998–2001**  
 (As of July 31, 2001)

| Department      | Type of Mission  | Timing  |
|-----------------|--|---|
| <b>Missions</b> |  |   |
| <b>FAD</b>      | Treasury project   | September 14–18, 1998<br>April 25–30, 1999<br>October 15–20, 2000<br>April 6–29, 2001 |
|                 | Tax administration   | July 6–16, 1999<br>May 9–26, 2000<br>October 2000                                     |
|                 | Tax policy   | September 21–October 2, 1998  |
|                 | Fiscal management  | November 14–20, 1999  |
|                 | Expenditure policy and management  | January 28–February 11, 2000  |
|                 | Treasury and budget reforms  | April 16–29, 2001   |
| <b>MAE</b>      | Banking supervision, reserve management, operations, foreign exchange market | October 22–November 3, 1998   |
|                 | Joint MAE/World Bank mission on bank restructuring                           | February 2–12, 1999   |
|                 | Bank restructuring   | October 4–14, 1999  |
|                 | Bank restructuring, accounting   | January 2000  |
|                 | Banking reform, reserve management, accounting                               | March 28–April 12, 2000   |
|                 | Internal audit, reserve management, accounting                               | May 24–June 13, 2000  |
|                 | Bank restructuring   | June 20–29, 2000  |
|                 | Accounting and internal audit  | October 30–November 10, 2000  |
|                 | Accounting and internal audit  | May 3–18, 2001  |
| <b>STA</b>      | Producer price index   | October 26–30, 1998   |
|                 | National accounts  | October 5–23, 1998  |
|                 | National accounts  | May 17–28, 1999   |
|                 | Monetary and banking statistics  | February 23–March 7, 2000   |
|                 | Consumer price index   | March 12–22, 2001   |
|                 | Monetary and banking statistics  | May 16–30, 2001   |
| <b>INS</b>      | Financial programming and macroeconomic policy                               | August 25–September 4, 1998   |
| <b>LEG</b>      | Article VIII   | November 1–5, 1998  |

**UKRAINE: FUND RESIDENT REPRESENTATIVES AND ADVISORS, 1998–2001**

| <b>Purpose</b>  | <b>Representatives/Advisors</b>               | <b>Assignment</b>   |
|---|---|---|
| <b>Resident Representatives</b>                         |   |   |
| Senior Resident Representative                          | Mr. Lenain<br>Mr. Ghesquiere<br>Mr. Figliuoli | January 1997–February 1999<br>March 1999–August 2001<br>Since August 2001 |
| Resident Representative                                 | Mr. Kwon<br>Mr. Orsmond<br>Mr. Lissovnik      | July 1997–July 1998<br>July 1999–July 2001<br>Since July 2001             |
| <b>Advisors</b>   |   |   |
| Macroeconomic Policy Advisor to the Ministry of Finance | Mr. Marion<br>Mr. Robertson                   | October 1998–April 2001<br>Since May 2001                                 |
| Tax Enforcement Adviser                                 | Mr. McDonald                                  | November 1999–April 2001  |
| General advisor at National Bank of Ukraine             | Mr. Ehlers                                    | April 1996–April 1998   |
| Banking Supervision Advisor at National Bank of Ukraine | Mr. Herron<br>Mr. Lopes                       | July 1998–July 2000<br>Since March 2001                                   |
| Treasury Advisor  | Mr. Platais<br>Mr. Lepage                     | July 1998–June 2001<br>Since July 2001                                    |
| Multisector Statistics Advisor                          | Mr. Piche                                     | Since March 2000  |

## UKRAINE: RELATIONS WITH THE WORLD BANK

(As of August 2001)

### General

Since Ukraine joined the World Bank in September 1992, the Bank has been assisting Ukraine with its transition to a market-based economy through lending, policy dialogue, and assistance in resource mobilization and aid coordination. As of July 14, 2001, the World Bank commitments to Ukraine totaled \$2,892.5 million and net disbursements amounted to \$2,222.3 million.

### Country Assistance Strategy

The World Bank Board of Executive Directors approved a new Country Assistance Strategy (CAS) for Ukraine on September 12, 2000. Its main objective is to assist the Government and civil society in obtaining sustained growth and poverty reduction in Ukraine. To do so, the strategy addresses the institution-building challenges faced by Ukraine both from the demand side (civil society) and supply side (government). It proposes a \$1.8 billion Base Case lending program to support structural reforms and a \$461 million Low Case lending program for investment support in environment, private sector development, health, education, agriculture title distribution, and social mitigation of coal sector restructuring.

A distinct feature of the new Ukraine CAS is its intensified focus on social issues as well as areas that address globally important issues (tuberculosis, HIV/AIDS, environment). The strategy also relies on a stronger civil society as a key component for progress in institutional reform and poverty reduction.

The CAS presents a two-legged strategy:

- the first (under the *Low Case*) aims to support civil society in its demand for better governance, and addresses globally sensitive areas; and
- the second (which would be added under the *Base Case*) aims to support opportunities to strengthen institutions that foster sustainable development, when these opportunities present themselves.

The *Base Case* lending scenario requires, in addition to a sustainable macroeconomic framework (e.g., full resumption and timely subsequent implementation of the IMF's Extended Fund Facility (EFF) program), achievement of agreed-upon benchmarks under the first Programmatic Adjustment Loan (PAL) in the five cross-sectoral areas mentioned below. Ukraine has already met these benchmarks and is likely to move into the base case once the EFF program is resumed.

## World Bank Program

The current project portfolio consists of approximately 22 operations. The **public sector reform** program includes the Treasury System Project (\$16.4 million) currently under implementation, designed to help the government in creating an efficient budget management system. The Programmatic Adjustment Loans (PALs) are conceived as a sequence of three separate operations, totaling up to \$750 million, with disbursements depending entirely on performance. The PAL will cover five cross-sectoral issues: (i) financial accountability, (ii) regulatory framework, (iii) property rights, (iv) public sector accountability and (v) social sustainability. Negotiations for PAL I (a total of \$250 million to be disbursed in two tranches of \$150 and \$100 million) were completed in July and its presentation to the World Bank Board of Executive Directors is scheduled for September 2001. Another operation under preparation is the Tax Administration Modernization Project (\$100 million) for which the Bank approved a \$2 million PPF, pending signing by the Government. Two new projects are planned for the fiscal years 2002 and 2003—Public Administration Incentives Reform (\$60 million) and Statistics Modernization (\$30 million).

The **agriculture sector** program includes a Rural Land Titling Project (\$100 million), which will support the distribution of land titles to new land owners and a Title Registration Project that would support the development of a modern title registration system. A Rural Finance Project (\$100 million) is envisaged in fiscal year 2003.

Good progress has been made in **energy efficiency and district heating**. Two District Heating Projects (a \$200 million Kyiv District Heating Project and an \$18.3 million Kyiv Energy Efficiency Project) are under implementation. A new project, Sevastopol Heat Supply Improvement Project (\$28.1 million), was approved by the Board of Directors in March 2001. In **the coal sector**, negotiations for the Coal Sector Social Mitigation Project (US\$100 million) to provide continued support to mine closures have been postponed.

The Lviv Water and Wastewater Project (\$24.2 million) was approved in June 2001.

**Privatization and financial sector reform** have been receiving strong attention in the Bank's program. To promote a stronger banking system, a Financial Sector Adjustment Loan (FSAL; \$300 million) was approved in September 1998, which is complemented by an Export Development Project (\$70 million). All three tranches of the FSAL have been disbursed. However, due to delays with the implementation of the third tranche program, this tranche was restructured in February 2001 and US\$40 million out of US\$100 million was cancelled. Negotiations for the first phase of the APL for Private Sector Development (\$30 million) are scheduled for the fall of 2001. The World Bank has been helping the Ukrainian government to develop a restructuring plan for Bank Ukraina (10 percent of the banking system). The license of the Bank Ukraina has been removed and formal foreclosure procedures have started with the appointment of a liquidator. The Bank team has been providing active support to the Government with the development of a detailed restructuring plan, the work on which is still continuing. Finally, in order to attract private investment, the Commercial Sea Launch guarantee operation (\$100 million) was approved by the Bank in 1997.

In the **social sector**, the Bank is currently developing several new projects—a Social Investment Fund (\$30 million), which will provide support to poor communities and a TB/AIDS Control Project (\$40 million) aimed at fighting these epidemics and improving prevention systems. Further operations will be developed in the areas of health and education and a Social Sector Adjustment Loan is planned for fiscal year 2003.

**Environmental** work is proceeding well, with a GEF project that is addressing the problem of Ozone-Depleting Substances. A new GEF grant on preserving the Azov-Black Sea wetlands (\$8 million) was negotiated in July 2001 and will be presented to the Board this year. Two new projects on climate change and environmental pollution will be prepared during the next two fiscal years.

The Bank is also providing significant **nonlending support**. Specific economic and sector work (ESW) to date include: a Country Economic Memorandum (CEM) (FY99), an Expenditure Review in Health and Education (FY99), and a Farm Restructuring Note (FY00). A Financial Sector Note and a Poverty Update have also been completed recently. A new Public Expenditure/Institutional Review is currently under preparation in addition to two policy sector notes in Health and Education, as well as a Climate Change Study. The Bank has launched a study on Regional Development and Regional Policy in Ukraine.

Two reports, the draft Country Procurement Assessment Report (CPAR) and the Country Financial Accountability Assessment (CFAA), were submitted to the Government for comments. The Government requested a Learning and Innovation Loan (LIL) for the amount of \$5 million for an E-development project and submitted a draft Concept Paper. The Global Distance Learning Center, managed by the Bank and financed through a Canadian Government grant, opened in March and is the first in the ECA region.

**UKRAINE: RELATIONS WITH THE EBRD**  
(As of July 2001)

Ukraine joined the EBRD in 1992 and since then the Bank has been active in supporting Ukraine's transformation toward a market economy, promoting the business environment and improving the investment climate for all investors. This has been primarily through its contribution to the funding of projects in both the public and private sectors, some equity investments, a range of technical co-operation activities and by engaging in policy dialogue with the government, especially through its membership of the Foreign Investment Advisory Council.

The EBRD's first country strategy for Ukraine was approved in October 1992 and was revised in November 1993. These two documents underlined the need for financing private sector projects, developing the financial sector and rehabilitating existing infrastructure. A revised strategy was proposed in March 1995 to respond to the needs of transition and this guided the EBRD's activities during 1995 and 1996. In June 1997, the Board of Directors approved a new strategy for the Bank's activities in Ukraine which included the development of the private sector, restructuring the energy sector, strengthening the financial sector, reform of key infrastructure sectors and continued efforts to improve nuclear safety in the context of the Bank's Energy Operations Policy.

This period saw a considerable expansion of the Bank's activities in Ukraine. However, it was apparent that the investment climate remained difficult, which deterred foreign direct investment and led to part of the growing private sector operating in the informal economy. In proposing its latest strategy for Ukraine, which was discussed by the Board in July 2000 and formally approved a month later, the EBRD proposed a more coordinated approach. There would be greater emphasis on policy dialogue with the Ukraine authorities, other IFIs and donor agencies to advance the country's immediate transition objectives and support the Bank's operational strategy. Thus over the last year the Bank's strategy has been to focus on four key areas of the economy, and it will continue to do so for the remainder of the current strategy. These key areas are:

1. Strengthening of the financial sector and supporting the needs of SMEs;
2. Promoting the commercialization and structural reform of public utilities, services and improving energy efficiency;
3. Improving nuclear safety through the Nuclear Safety Account and the Chernobyl Shelter Fund initiatives, and ensuring a clear understanding of the outstanding conditions to be fulfilled in respect of the K2R4 project financing to cover the completion of two nuclear power plants(the project having been presented to the EBRD Board in December 2000 and conditionally approved); and

4. Supporting the transition of the enterprise sector, especially in agribusiness, consumer products, and intermediate goods.

The EBRD's ability to implement the strategy and explore new business opportunities in the private sector will be enhanced by the decision, put into effect in 2000, to strengthen the EBRD's local office in Ukraine, including the appointment of the Director for Banking Operation's in Ukraine, based in Kyiv.

The Bank's portfolio in Ukraine has increased from 5 projects in 1994 to 47 by the end of July 2001. These amount to a net business volume of EUR1,273 million. Of this amount EUR 977.8 million represented Portfolio (Operating Assets plus undrawn commitments). Operating Assets amounted to EUR345 million at the end of July 2001. Thirty-six projects are with private borrowers and investors with a corresponding commitment of EUR 698 million. There are a further 11 projects with the state sector to which EUR 575 million of funds are committed. The Bank's Portfolio ratio was estimated at 47 percent to the private sector (EUR455.0) and 53 percent to the state sector (EUR522.8) at the end of July 2001.

The outstanding commitments to Ukraine represent almost 8 percent of the total of the Bank's commitments to all its countries of operation. There are in addition Technical Cooperation activities in Ukraine and these currently include 187 projects with a total value of commitments of almost EUR 41 million. These are mainly related to project preparation and implementation.

Projects in the financial sector account for slightly over 24 percent of the Bank's commitment to Ukraine, with much of this represented by the loans provided under sovereign guarantee to support the development of small and medium size companies in Ukraine through lending via participating banks. The first of these loans (for EUR 143 million) was signed at the end of 1994, and is now almost fully disbursed. A second credit line (for EUR 52 million) was signed at the time of the Bank's Annual Meeting in Kyiv in May 1998, although was only approved by the Rada in early 2000. The energy sector accounts for a further 25 percent of all commitments. The largest single project in this category is in the power sector; other projects include the development of oil and gas resources, gas transit and energy efficiency. Projects in manufacturing, including agribusiness, account for 27 percent, transport 14 percent, telecommunications 8 percent, with tourism, property and shipping accounting for most of the remaining 2 percent of all commitments.

August 31, 2001

Mr. Horst Köhler  
Managing Director  
International Monetary Fund  
Washington, D.C. 20431

Dear Mr. Köhler,

1. Since the completion of the fourth review under the Extended Arrangement in December 2000, economic and financial developments in Ukraine have been encouraging. In particular, economic growth was stronger than foreseen while inflation was below target. All performance criteria under the program for end-December 2000 and for end-March 2001, as well as the indicative targets for end-June 2001 were met. However, base money exceeded its indicative targets, and there were some slippages in implementing the structural program (Table 9). We have decided to take a number of measures to keep the program on track, as described below. Our main priorities are to consolidate the financial stabilization gains, to strengthen payments discipline and transparency in the key sectors of the economy, and to underpin the current recovery by private sector investment through privatization, improvements in the business climate, and trade liberalization.
2. For 2001, we expect real GDP growth to increase by more than 6 percent, on account of a strengthening of domestic demand. The annual inflation rate is targeted to drop to about 12½ percent from almost 26 percent in 2000. The external current account surplus is projected to narrow from 4¾ percent of GDP in 2000 to about 3 percent in 2001, in light of the expected return of export growth to a more moderate pace and a further increase of imports. Despite significant foreign exchange inflows, the exchange rate has remained stable since April 2000 at slightly above Hrv 5.4 per U.S. dollar. At end-July 2001, usable gross external reserves of the NBU amounted to about \$2 billion, some \$700 million more than expected at the time of the fourth review under the arrangement.
3. Money growth in the last quarter of 2000 and the first half of 2001 exceeded the targets envisaged under the program, largely reflecting substantial purchases of foreign exchange by the NBU in the interbank market. The liquidity inflow was partly absorbed by issuance of certificates of deposit by the NBU and by a temporary accumulation of government deposits at the central bank. In view of the decline in inflation, it is our judgement that the monetary expansion accommodated an increase in the demand for hryvnia, driven by the real economic growth and the increasing share of cash transactions in the economy. For the remainder of 2001, the NBU recognizes the need to keep monetary

aggregates under control, in order to avoid inflationary pressures. Therefore, monetary policy will be guided primarily by the net domestic assets target for the NBU. Intervention in the foreign exchange market will be guided by the need to safeguard the external reserves objectives of the program, and the NBU will manage the exchange rate flexibly in both directions. The excess liquidity created by the external reserves build-up will be absorbed by the NBU through reverse repos and placement of certificates of deposit. In case privatization receipts and external budgetary financing exceed the originally programmed amounts, the government will further reduce the public debt, primarily its net debtor position vis-à-vis the NBU.

4. The 2001 government budget targets a consolidated government deficit of no more than 3 percent of GDP to be financed by privatization receipts. Notwithstanding the revised outlook for privatization receipts in 2001 (from 3 percent of GDP to an estimated 1½ percent), we remain determined to have no net recourse to domestic and foreign financing (other than privatization receipts) of the consolidated government budget. Taking account of lower-than-foreseen external interest payments, this will be achieved, if necessary, by additional expenditure cuts. Given the uncertainties over the timing and size of divestiture receipts, the implementation of the privatization program will be monitored very closely, in order to allow the timely undertaking of any additional corrective actions that may be required. The budget provides for an increase of 25 percent of basic wages in the budgetary sphere, starting March 1. We will reduce the number of budgetary positions by 25 thousand to a maximum of 4,363 thousand by end-2001. As of December 1, 2000, pensions were increased by 13 percent on average; pensions were further raised as of February 1 and August 1, 2001, by 22 percent on average. Building on last year's progress, the budget law bans netting and noncash operations, as well as government loan guarantees other than for loans from multilateral organizations, and contains adequate allocations for energy consumption. The budget also provides for the continued reduction of social payments arrears; strict measures will be taken to prevent the accumulation of other payments arrears, especially at the local level. All payments obligations resulting from the September 2000 agreement to restructure the stock of treasury bills, issued in the year 2000 and held by the NBU, will continue to be strictly respected. Profit transfers from the NBU will be based on its audited financial statements, and will only be effected upon approval by the NBU Council.

5. The draft 2002 government budget that will be submitted to parliament in September will contain a consolidated budget deficit of not more than 1.7 percent of GDP. Reductions in tax rates from the current levels will be included in the draft budget only if these are offset by simultaneous elimination of tax privileges and exemptions. In general, total noninterest expenditures will only be increased in line with expected inflation. The tentative 2002 privatization program foresees receipts amounting to about Hrv 5.8 billion (2½ percent of GDP), which would partly be used to reduce the government's net indebtedness to the NBU. This is a first step towards ending the reliance on privatization receipts to finance current budgetary expenditures.

6. In an effort to resolve our long-standing problem of controlling tax arrears, legislation was recently enacted to replace the Kartoteka II system with modern collection procedures. Article 18 of this law, however, also contained provisions for granting tax write-offs (for tax arrears and related fines that arose prior to January 1, 2000) and deferrals (for tax arrears accumulated during the year 2000). Tax arrears and fines which have been written off amount to Hrv 18 billion, or 72 percent of outstanding arrears at end-2000. In order to counter the adverse impact of the tax amnesty on taxpayer compliance and improve collection enforcement, we have taken administrative measures, regularized the payments by Naftogaz of royalties for domestically produced gas and gas transit fees and of VAT payments by the wholesale electricity market, and modified interest charges and penalties on tax arrears. In addition, the State Tax Administration has established 6 pilot large taxpayers offices in 2000 and is in the process of expanding their number to 8, including Kyiv, by end-2001. A full inventory of tax exemptions and privileges, by sector or enterprise, was conducted in April 2001; it indicates the legal status of each exemption and the amount of foregone revenue by type of tax. This inventory has been submitted to parliament with a view to ensuring revenue neutrality of new tax legislation. In the meantime, we will refrain from undertaking ad hoc cuts in tax rates, including in the draft budget for 2002, unless accompanied by simultaneous equivalent reductions in tax exemptions. The government has initiated bankruptcy procedures against the 50 largest tax debtors, starting with nine of these at end-July.

7. To improve expenditure management, the government is firmly committed to fully putting in place the single treasury account by end-2001, with technical assistance from the Fund. The recently enacted budget code envisages full implementation of the formula-based intergovernmental transfer system beginning in 2002. Finally, we have initiated work on developing a multi-year budget framework.

8. As regards to privatization, the sale of a first group of six electricity distribution companies (oblenergos) was successfully completed in April. With a view to conducting an assessment of the results of this operation, the second phase of privatizing oblenergos has been temporarily suspended. In the meantime, the financial advisor for the sale of the remaining oblenergos was selected in May. Regarding Ukrtelecom, the commission that will carry out its privatization has been established, and a financial advisor was selected in June, slightly later than planned. We are also committed to expanding the scope of the privatization program. In particular, the negative list is being reduced, and decrees will be passed shortly that will release blocked government shares in a number of enterprises.

9. We attach great importance to the efficient and transparent implementation of the privatization program. To ensure that privatizations are carried out in an appropriate manner, the State Property Fund (SPF) will remain responsible for managing all sales, using open tender procedures and financial advisors for privatization of large enterprises. The Law on the State Property Fund was approved by parliament in July 2001, but vetoed by the President. In making any revisions to privatization procedures, we will work closely with the recently-established advisory group on privatization, which includes representatives of the World Bank and other donors. Comprehensive information on privatizations carried out in

2000 has been provided to parliament, and has been placed on the website of the SPF. In addition, under supervision of the privatization advisory group, a review was undertaken of privatizations carried out in 2000, which included an assessment of the legal framework and regulations. The implementation of the recommendations of this review will be discussed between the SPF and the advisory group on privatization; such assessments will be repeated periodically if donor support can be secured. Moreover, in the context of the World Bank's Programmatic Adjustment Loan, tender privatizations are being reviewed to meet the minimum standards established by the World Bank.

10. In the energy sector, the targets for the cash collection ratios in the electricity and gas sectors at end-December 2000, as well as at end-March and end-June 2001 were met. The improvement in the cash collection ratios can be attributed to two major policy initiatives: (i) prompt and virtually complete settlement of energy bills by budgetary organizations, based on full budgeting of their energy costs; and (ii) a strict policy of cutting off nonpayers. The strict cut-off policy for nonpaying energy users will be maintained. At end-May 2001, more than 24,000 out of almost 32,000 industrial, agricultural, and residential electricity debtors were cut off.

11. The authorities consider that the current structure of the wholesale electricity market has been an indispensable instrument for enhancing payments discipline in the energy sector. Therefore, we continue to oppose legislative initiatives that alter prematurely the functioning of the wholesale electricity market, which would undermine the gains achieved, and threaten a return to barter and other forms of noncash settlement. To improve the transparency of the electricity market, monthly audits of the central distribution account and the regional distribution accounts have begun, and the first results have been widely distributed. Regarding the audit of Naftogaz, the government is ensuring the implementation of the corrective measures recommended in the first stage to address weaknesses in accounting standards and internal controls. The terms of reference for the second stage of the audit have been finalized and the audit is underway. The government will ensure that the audit includes accurate estimates of Naftogaz's production and transportation costs.

12. In the financial sector, progress is being made in reducing vulnerabilities. In February 2001, we reached agreement with the World Bank on a strategy for Bank Ukraina. In this connection, effective July 16, 2001: (i) Bank Ukraina's banking license was revoked by the National Bank of Ukraine; (ii) the procedure for its bankruptcy was set in motion consistent with Ukraine's legislation; and (iii) the reimbursement of the guaranteed part of deposits at Bank Ukraina was initiated by the Household Deposit Guarantee Fund. Concerning the Savings Bank, we will accelerate the implementation of the restructuring plan agreed with the NBU in 1999 and updated earlier this year, in consultation with the World Bank, in particular by modernizing risk management practices and reducing operational costs. The NBU will continue to enforce the ceiling on the loan exposure of the Savings Bank to the energy sector. We are considering, in consultation with the World Bank, policy issues related to agricultural financing. Finally, we will continue to refrain from influencing or directing credits extended by the banking system.

13. We have made some progress in strengthening banking sector supervision, including by rationalizing the requirements for provisioning and by closing some banks that continued to fail to meet prudential regulations. The new Law on Banks and Banking Activities that was enacted on January 17, 2001, will better enable the NBU to improve compliance with the Basel Core Principles for banking supervision. Furthermore, the NBU will take effective measures to develop, over a period of two years, a regulatory framework with a view to implement the Core Principles for Effective Banking Supervision published by the Basel Committee on Banking Supervision. In order to lower the costs of undertaking banking activities in Ukraine, the NBU has progressively reduced the reserve requirements ratios from a uniform rate of 15 percent to a weighted average rate of 14.4 percent as of January 16, 2001.

14. The NBU continues to enhance the effectiveness of its organization and operations, including the full separation between front- and back-office functions in the foreign exchange department. The conclusions and recommendations of the internal audit of the foreign exchange department of the NBU are being reviewed by the management of the bank. The work plan of the internal audit department also includes audits of several other head-office units, and a number of issue-oriented audits chosen on the basis of operation-specific risks. An independent risk management unit, reporting directly to the Chairman of the NBU Board, has become operational, and submitted its first report in early July. The NBU will achieve full provisioning for impaired and doubtful assets before end-2002. The externally audited financial statements of the NBU for 2000 have been posted on the NBU website, together with the auditor letter and notes prepared in accordance with International Accounting Standards.

15. In the context of our efforts to improve the contribution of the financial sector to the modernization of the economy, we would be interested in participating in the Financial Sector Assessment Program (FSAP), in cooperation with the Fund and the World Bank.

16. To further strengthen transparency and governance, the authorities are taking steps to associate themselves with the OECD-based Financial Action Task Force (FATF), and Ukrainian laws on money laundering will be amended to align with FATF guidelines. Moreover, efforts are underway to allow Ukraine to subscribe to the Special Data Dissemination Standards (SDDS) by end-2001.

17. As regards trade policy, the export tax on sunflower seeds was reduced from 23 percent to 17 percent instead of to 10 percent, which was a structural benchmark under the program. We continue our efforts to obtain approval of this measure by parliament. At the same time, however, and against the backdrop of our efforts to join the World Trade Organization (WTO), we have moved on several fronts to liberalize further the trade regime: (i) laws on standardization and certification, and accreditation of certification agencies have been enacted and are expected to reduce significantly technical obstacles to foreign trade; (ii) the Law on the Customs Tariff was enacted and the new Harmonized Tariff System was introduced on July 1; (iii) laws on copyright and allied rights, on inventions, and on the enforcement of responsibility for violation of intellectual property were approved;

(iv) documentation requirements concerning the domestic and external trade in grains have been simplified, and registration fees at the exchanges have been reduced; (v) the requirement to register domestic grain transactions has been abolished; and (vi) the mandatory declaration of grain stocks has been suspended.

18. We recognize the risks inherent to the liberalization of the capital account of the balance of payments, and will proceed in this direction only after careful consideration. In the meantime, no additional licenses to residents for acquiring Eurobonds will be granted, except after adequate consultation, including with the IMF staff.

19. The review of existing Free Economic Zones and Special Investment Regimes has been completed, and is being considered with a view to reducing tax exemptions, in order to limit fiscal losses. In agriculture, the parliamentary ban on bankruptcy procedures for agricultural enterprises was removed and we will step up our efforts to obtain parliamentary approval of the land code, a public system of title registration, and mortgage laws. We will continue the practice of no government interference in the provision of agricultural inputs and the marketing of outputs. The new law on joint-stock companies is also expected to be passed this year.

20. The regularization of Ukraine's relations with foreign creditors is one of our key policy objectives. In this context, the government reached agreement with the Paris Club on a rescheduling of principal in arrears and falling due during the remaining period of the EFF Arrangement with the Fund, with a grace period of three years and a maturity of 12 years, and amounting to \$580 million. The agreement pertains to loans contracted before December 31, 1998. Interest arrears and interest due during the remaining period of the Extended Arrangement will be paid over a two-year period. Other bilateral official creditors have been approached to discuss debt rescheduling on comparable terms. Any agreements involving government guarantees on the existing stock of non-sovereign debt or arrears will not include repayments terms more preferential for creditors than those obtained for other rescheduled debt.

21. Progress is also being made in normalizing Naftogaz's financial relations with its external suppliers. A memorandum of understanding covering delivery of transit gas in 2001 has been agreed with the government of Russia. Naftogaz has also been charged to negotiate an agreement with Gazprom on the outstanding stock of gas arrears, which we regard as private sector arrears.

22. We believe that the policies described in this letter are adequate to achieve the objectives of the economic program supported by the Fund, but we stand ready to take any additional measures that may be necessary for this purpose. The specific prior actions for the fifth and sixth program reviews are listed in Table 10. On this basis, we request completion of the fifth and sixth reviews under the Extended Arrangement, as well as the establishment of performance criteria and benchmarks for September and December 2001 as set forth in Tables 9 and 10. We also request a rephasing of the remaining purchases under the arrangement. The seventh review under the Extended Arrangement, based on end-September

2001 performance, will give particular attention to fiscal measures to compensate for possible shortfalls in revenue or privatization receipts; the parliamentary approval of the 2002 budget with a consolidated government deficit of no more than 1.7 percent of GDP; the transparent implementation of the privatization program; the continuing improvement in payments discipline in the energy sector; and progress in reducing vulnerabilities in the financial sector. The seventh review is scheduled to be completed by end-December 2001.

/s/

Anatoliy Kinakh  
Prime Minister

/s/

Volodymyr Stelmakh  
Chairman  
National Bank of Ukraine

Table 9. Ukraine: Quantitative Performance Criteria, Indicative Targets, and Quantitative Structural Benchmarks for September 2000-December 2001  
 (End-of-period; in millions of hryvnia, unless otherwise indicated; cumulative changes from September 29, 2000, unless otherwise indicated)

|   | 2000                |         |                                 |        | 2001             |                     |                 |         | September              |                        |          | December                     |                             |
|---|---------------------|---------|---------------------------------|--------|------------------|---------------------|-----------------|---------|------------------------|------------------------|----------|------------------------------|-----------------------------|
|   | September<br>Actual | Program | December<br>Program<br>Adjusted | Actual | March<br>Program | Program<br>Adjusted | March<br>Actual | Program | Revised<br>Program 12/ | Rev. Prog.<br>Adjusted | Estimate | September<br>Revised Program | December<br>Revised Program |
| <b>Performance criteria 1/</b>  |                     |         |                                 |        |                  |                     |                 |         |                        |                        |          |                              |                             |
| Ceiling on the deficit of the consolidated government budget 2/ 3/  | -231                | 2,532   | 2,488                           | 2,175  | 320              | 265                 | -810            | 1,250   | 362                    | 498                    | 462      | 732                          | 3,500                       |
| Floor on nonearmarked state cash revenue 3/   | 17,808              | 25,341  | 25,341                          | 26,019 | 4,400            | 4,400               | 5,950           | 11,004  | 12,097                 | 12,997                 | 12,129   | 18,891                       | 26,413                      |
| Ceiling on stock of budgetary arrears on wages, pensions and benefits 4/  | 1,681               | 1,600   | 1,600                           | 1,344  | 1,500            | 1,500               | 727             | 1,400   | 763                    | 763                    | 762      | 763                          | 663                         |
| Ceiling on noncash netting operations on consolidated government obligations arising after December 31, 1999 3/                 | 265                 | 290     | 290                             | 269    | 0                | 0                   | 0               | 0       | 0                      | 0                      | 0        | 0                            | 0                           |
| Ceiling on the net domestic assets of the NBU 5/ 6/   | 20,812              | 563     | 535                             | -790   | 761              | 600                 | -1,781          | -30     | -1,790                 | -1,803                 | -2,293   | -3,527                       | -2,548                      |
| Floor on net international reserves of the NBU (in millions of U.S. dollars) 6/ 7/  | -1,089              | 28      | 33                              | 493    | -27              | 3                   | 668             | 96      | 1,029                  | 1,031                  | 1,176    | 1,235                        | 1,288                       |
| Accumulation of external arrears by the government and the NBU 8/   | 0                   | 0       | 0                               | 0      | 0                | 0                   | 0               | 0       | 0                      | 0                      | 0        | 0                            | 0                           |
| Ceiling on nonconcessional external debt contracted or guaranteed by the government or the NBU (in millions of U.S. dollars) 9/ | 0                   | 1,500   | 1,500                           | 100    | 2,500            | 2,500               | 100             | 2,500   | 2,500                  | 100                    | 2,500    | 2,500                        | 1                           |
| Maturity over one year  | 0                   | 100     | 100                             | 0      | 150              | 150                 | 0               | 200     | 200                    | 0                      | 250      | 300                          | 47                          |
| Of which: credit lines  | 0                   | 100     | 100                             | 0      | 150              | 150                 | 0               | 200     | 200                    | 0                      | 250      | 275                          | 1                           |
| Maturity of one to three years  | 0                   | 150     | 150                             | 100    | 200              | 200                 | 100             | 200     | 200                    | 100                    | 250      | 275                          | 1                           |
| Of which: credit lines  | 0                   | 25      | 25                              | 0      | 80               | 80                  | 0               | 75      | 75                     | 0                      | 100      | 125                          | 1                           |
| Maturity up to one year   | 0                   | 0       | 0                               | 0      | 0                | 0                   | 0               | 0       | 0                      | 0                      | 0        | 0                            | 0                           |
| <b>Indicative targets</b>   |                     |         |                                 |        |                  |                     |                 |         |                        |                        |          |                              |                             |
| Base money 6/   | 14,888              | 718     | 718                             | 1,889  | 616              | 616                 | 1,854           | 492     | 3,808                  | 3,808                  | 4,107    | 3,189                        | 5,004                       |
| <b>Quantitative structural benchmarks</b>   |                     |         |                                 |        |                  |                     |                 |         |                        |                        |          |                              |                             |
| Total cash collection ratio for electricity 10/   | 49                  | 50      | 50                              | 51     | 50               | 50                  | 53              | 55      | 55                     | 55                     | 59       | 60                           | 65                          |
| Total cash collection ratio by Naftogaz 11/   | 31                  | 40      | 40                              | 49     | 50               | 50                  | 66              | 55      | 55                     | 55                     | 85       | 60                           | 65                          |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Unless otherwise noted, targets for end-December 2000, end-March 2001, end-September 2001, and end-December 2001 are performance criteria, while targets for June 2001 are indicative targets.

2/ For the purpose of calculating the adjustor to the deficit defined in the Technical Memorandum of Understanding (TMU) for arrears in the payment of scheduled interest on domestic debt instruments issued by the government, the levels of scheduled interest payments are the following (in millions of hryvnia): 1,191 (December 2000); 524 (March 2001); 834 (June 2001); 1,351 (September 2001); and 1,794 (December 2001).

For the purpose of calculating the adjustor to the deficit for deviations in the level of project loans, the levels of programmed project loans are the following (in millions of hryvnia): 0 (December 2000); 171 (March 2001); 197 (June 2001); 272 (September 2001); and 461 (December 2001). For both adjustors, 2000 figures are cumulative from January 1, 2000; 2001 figures are cumulative from January 1, 2001.

3/ The figures for 2000 are cumulative from January 1, 2000, and the figures for 2001 are cumulative from January 1, 2001.

4/ Ceilings established on the stock. Includes arrears with maturity of less than one month.

5/ For the purpose of calculating the adjustor to NDA for deviation in foreign financing (excluding project financing) to the budget defined in the Technical Memorandum of Understanding (TMU), the programmed levels of foreign financing to the budget are the following (cumulative since September 29, 2000; in millions of hryvnia): 388 (December 2000); 602 (March 2001); 707 (June 2001); 1,523 (September 2001); and 2,279 (December 2001).

6/ Amounts for September 2000 are outstanding stocks.

7/ For the purpose of calculating the adjustor to NIR defined in the TMU, the programmed levels of medium- and long-term cash foreign financing are the following (cumulative since September 29, 2000; in millions of US dollars): 70 (December 2000); 107 (March 2001); 130 (June 2001); 280 (September 2001); and 419 (December 2001).

8/ The nonaccumulation of the external arrears criterion applies on a continuous basis.

9/ The ceilings on medium- and long-term loans (maturity of over one year) are on debt contracted; the ceiling on short-term loans (maturity of up to one year) applies on a continuous basis. The criterion for maturity up to one year does not apply to contracting of loans by the NBU.

10/ The targets refer to total cash collection ratios for payments to the wholesale electricity market cumulatively since end-June 2000 for 2000, and since January 1, 2001 for 2001.

11/ The targets are for total cash collection ratios by Naftogaz on all its gas sales, cumulative from the beginning of each year. Outcomes for December 2000, March 2001, and June 2001 include mutual settlements through the banking system.

12/ Revised projection discussed with the authorities during the June 2001 mission.

**Table 10. Ukraine: Prior Actions for Completion of the Fifth and Sixth Reviews Under the Extended Arrangement and Structural Performance Criteria and Benchmarks for the Period December 2000–December 2001**

|  | Date               | Status   |
|--|--------------------|--|
| <b>A. Prior Actions</b>  |                    |  |
| 1. Achievement of cumulative monthly state unearmarked cash revenue targets for July and August of Hrv 14,247 million and Hrv 16,447 million, respectively.                          |                    |  |
| 2. Submission to the Rada of a budget for 2002 with a deficit of no more than 1.7 percent of GDP.  |                    |  |
| 3. Withdrawal of the banking license for Bank Ukraina.   |                    |  |
| 4. Implementation of trade liberalization measures (para. 17), including the simplification of documentation requirements for the internal and external trade in grains.             |                    |  |
| 5. Full provision of data in accordance with the TMU.  |                    |  |
| <b>B. Structural Performance Criteria and Benchmarks</b>   |                    |  |
| 1. Reduction of the export tax on sunflower seeds to 10 percent.   | December 31, 2000  | Reduced to 17 percent in June 2001.                |
| 2. Provision of legally required information to parliament on privatizations in 2000, and placement of this information on the State Property Fund website.                          | March 31, 2001     | Implemented  |
| 3. Finalization of the terms of reference for the second stage of the Naftogaz audit.  | March 31, 2001     | Implemented  |
| 4. Finalization of a medium-term strategy for Bank Ukraina which would not require recourse to government financing.   | March 31, 2001     | Bank Ukraina's license withdrawn on July 16, 2001. |
| 5. Completion of a review of the Free Economic Zones (FEZs) and Special Investment Regimes (SIRs).   | April 30, 2001     | Implemented  |
| 6. Initiation of bankruptcy proceedings against 5 of the 50 largest tax debtors.   | June 30, 2001      | Implemented as of July 31, 2001.                   |
| 7. Posting on the NBU website of the NBU's externally audited financial statements, with the audit letter and notes, prepared in accordance with International Accounting Standards. | July 31, 2001      | Implemented 1/                                     |
| 8. Completion of the second stage audit of Naftogaz.   | September 30, 2001 |  |
| 9. Implement the single account of the State Treasury of Ukraine.  | December 31, 2001  |  |
| 10. Adoption of the formula-based transfers to local governments in the context of the 2002 budget. 2/   | December 31, 2001  |  |

1/ Financial statements are consistent with IAS with the exception of provisions for government debt.

2/ This measure constitutes a structural performance criterion.

**TABLE 11. UKRAINE: AUTHORITIES' AGENDA FOR STRUCTURAL REFORMS**

| <b>POLICY MEASURES</b>  | <b>Timing</b> | <b>Status</b>   |
|---|---------------|---|
| <b>Fiscal measures</b>  |               |   |
| 1. No netting operations for obligations incurred in 2000 or 2001.  | Continuous    | Article 6 of the 2001 budget law prohibits netting operations. Netting in 2000 limited to cash offsets. |
| 2. Service treasury bill debt held by the NBU in line with the September 2000 agreement.  | Continuous    | Implemented   |
| 3. Publish the list of the 50 enterprises with the largest tax arrears to the budget and the amount of their arrears on the last reporting date.                            | Quarterly     | No publication thus far.  |
| 4. Complete inventory of tax exemptions and privileges by sector and/or enterprise, including the legal basis of exemptions and amounts of foregone revenue by type of tax. | April 2001    | Implemented   |
| 5. Initiate bankruptcy proceedings against 5 of the 50 largest tax debtors.   | July 2001     | Implemented   |
| 6. Adhere to moratorium on establishment of new Free Economic Zones, including spot zones.  | Continuous    |   |
| 7. Replace Kartoteka II with a mechanism that allows STA to access debtors' account after due process, in consultation with Fund staff.                                     | June 2001     | Law abolishing Kartoteka II was enacted in February 2001.   |
| 8. Implement the single account of the State Treasury of Ukraine.   | December 2001 |   |
| 9. Implement the reform of intergovernmental financial relations, which provides for formula-based transfers to local governments in the context of                         | December 2001 |   |

| <b>POLICY MEASURES</b>   | <b>Timing</b> | <b>Status</b>   |
|--|---------------|---|
| the 2002 budget.   |               |   |
| 10. Establish large taxpayers office in Kyiv.  | December 2001 |   |
| 11. Reduce staffing positions of budgetary employees by 25,000 in 2001.  | December 2001 |   |
| 12. Unify fully the excise treatment of imports and domestically-produced goods.   | January 2002  |   |
| 13. Streamline the levies for sanitary and environmental purposes.   | January 2002  |   |
| 14. Enact the Customs Code.  | January 2002  |   |
|  |               | - 57 -  |
| <b>Financial sector reform</b>   |               |   |
| 15. Implement the agreed plan for Bank Ukraina.  | Continuous    | In progress; liquidation procedures have been initiated.                    |
| 16. Improve compliance with the regulatory framework for banking supervision in line with the Core Principles of the Basel Committee on Banking Supervision. | Continuous    | In progress   |
| 17. Ensure that banks created prior to the enactment date of the Law on Banks and Banking Activities bring their activities in compliance with this law.     | Continuous    | In progress   |
| 18. Implement the restructuring program for the Savings Bank agreed with the NBU in 1999 and reduce over time its exposure to the energy sector.             | Continuous    | This program was updated in early 2001 in consultation with the World Bank. |

| <b>POLICY MEASURES</b>   | <b>Timing</b> | <b>Status</b>  |
|--|---------------|--|
| 19. Conduct quarterly audits of the net international reserves of the NBU by reputable international auditors.   | Continuous    | Quarterly audits are being conducted.  |
| 20. Integrate Internal Audit Department into the risk management process of the NBU by ensuring that (i) a representative of the Internal Audit Department is present at the meeting of any committee or during consideration of issues related to risk management or internal control; (ii) a representative of the Internal Audit Department is invited to the meetings of the NBU senior management committees; and (iii) internal auditors are provided with automatic and unrestricted access to any information they may need to perform their duties. | Continuous    | Internal audit is represented in all units involved in risk management; representatives of Internal Audit sit on the NBU Board and other senior management committees. |
| 21. Separate back-office functions of the NBU Foreign Exchange Department from the front office.   | July 2001     | In progress; most back-office functions have been separated.   |
| 22. Risk Management Unit to prepare its first report for the Chairman of the NBU Board on aggregate risk positions and observance of risk parameters related to foreign exchange transactions.   | July 2001     | Implemented  |
| 23. Implement a system of provisioning for doubtful and bad debt, in line with International Accounting Standards.   | July 2001     | In progress  |
| 24. Posting on the NBU website of the NBU's externally audited financial statements for 2000, with the auditor letter and notes, prepared in accordance with International Accounting Standards. The NBU will also publish its comments on these documents.  | July 2001     | The externally-audited financial statements and notes, and the auditor letter, were posted on August 9, 2001.  |
| 25. Prepare re-issuance of licenses to banks in line with the classification of operations provided for by the Law on Banks and Banking Activities.  | December 2001 |  |

| <b>POLICY MEASURES</b>  | <b>Timing</b>  | <b>Status</b>   |
|---|----------------|---|
| 26. Pass law establishing the Deposit Insurance Fund.   | December 2001  |   |
| 27. Create consolidated supervisory agency for the non-banking sector.  | 2002           |   |
|   |                |   |
| <b>Privatization</b>  |                |   |
| 28. Implement privatization program for 2001, in line with the Cabinet of Ministers resolution and the Privatization Program for 2000–02, using open tenders and, as a rule, financial advisors for larger sales. |                | Ongoing   |
| 29. Follow existing regulations regarding sales of assets of indebted enterprises.  | Continuous     | Ongoing   |
| 30. Pass the necessary revisions to the Negative List and Article V of the Law on Privatization of State Property.  | June 2001      | Revisions to the negative list have been approved; discussions ongoing in Parliament regarding Article V.                               |
| 31. Approval by Parliament in the second reading of the Law on the State Property Fund (SPF), which would establish the SPF as the sole agency responsible for managing privatization operations.                 | July 2001      | Law on the SPF approved by parliament in July, but vetoed by the President due to inconsistencies between the law and the constitution. |
| 32. Develop plan, including time frame, to implement recommendations of the Privatization Advisory Group's review of privatization in 2000.   | September 2001 | In progress   |
| 33. Pass law banning asset stripping.   | September 2001 | Implemented   |
| 34. Submit to Parliament a list of enterprises for sale in 2002 that is consistent with the draft 2002 budget.  | November 2001  |   |

| <b>POLICY MEASURES</b>   | <b>Timing</b>  | <b>Status</b>  |
|--|----------------|--|
| <b>Energy sector</b>   |                |  |
| 35. Ensure that communal tariffs are adjusted to full cost recovery levels.  | Continuous     | Largely implemented  |
| 36. Maintain payments discipline in the energy sector, with cash collections to the wholesale electricity market rising from at least 50 percent at end-2000 to 65 percent at end-2001. Cash collections for all gas sold by Naftogaz, as measured on a cumulative basis from the beginning of the year, are to reach at least 40 percent by end-2000, and rise to 65 percent by end-2001. | Continuous     | Targets reached through June 2001.                                   |
| 37. Cut off 50 of the largest 100 non-payers of gas.   | Continuous     | In progress  |
| 38. Maintain current structure of electricity market.  | Continuous     |  |
| 39. Carry out audits of the Distribution Account of the Wholesale Electricity Market and regional distribution accounts by an international accounting firm.   | Monthly        | Monthly audits have begun, starting with the month of December 2000. |
| 40. Finalize the terms of reference for the second stage audit of Naftogaz.  | March 2001     | Implemented  |
| 41. Submit to government a plan for regularization of Naftogaz's external arrears to suppliers.  | March 2001     | A draft plan has been submitted.                                     |
| 42. Complete the second stage audit of Naftogaz.   | September 2001 | In progress  |
| 43. Provide comprehensive data on electricity market debt, including for   | September 2001 |  |

| <b>POLICY MEASURES</b>   | <b>Timing</b>  | <b>Status</b>   |
|--|----------------|---|
| generating companies, and prepare plan for debt restructuring.   |                |   |
| 44. Conclude review of sale of the first six oblenergos.   | September 2001 |   |
|  |                |   |
| <b>Statistics</b>  |                |   |
| 45. The Ministry of Finance to compile government finance statistics in accordance with agreements with the IMF. Establish an inter-agency working group to harmonize responsibilities of the different agencies in this area. | March 2001     | In progress   |
| 46. Prepare statement on NBU's international reserves compiled according to the Special Data Dissemination Standard (SDDS).  | June 2001      | Implemented   |
|  |                |   |
| <b>Other measures</b>  |                |   |
| 47. Reduce the export tax on oil seeds from 23 percent to 10 percent.  | December 2000  | Not implemented; export duty lowered to 17 percent, and give-and-take schemes banned. |

## UKRAINE—TECHNICAL MEMORANDUM OF UNDERSTANDING

### Performance Criteria and Financial Benchmarks

#### Net international reserves of the National Bank of Ukraine (performance criterion)<sup>12</sup>

Net international reserves (NIR) of the NBU are defined as the difference between **usable gross international reserve assets and reserve-related liabilities to nonresidents**.

For the purpose of this program, usable gross international reserve assets comprise all reserve assets of the NBU (Table 1, item 1), to the extent that they are indeed readily available for intervention in the foreign exchange market and held in first-rank international banks. Excluded from usable reserves, *inter alia*, are:

- any assets held at, or which are claims on, domestic institutions (i.e., institutions headquartered domestically, but located either domestically or abroad, or institutions headquartered abroad, but located domestically). Excluded are, *inter alia*, all foreign currency claims of the NBU on domestic banks, and NBU deposits held at the Interbank Foreign Currency Exchange market and domestic banks for trading purposes;
- any precious metals or metal deposits, other than monetary gold, held by the NBU;
- any assets that correspond to deposits of commercial banks held in foreign currency at the NBU and any reserves assets that are: (i) encumbered; or (ii) pledged as collateral (in so far as not already included in foreign liabilities, or excluded from reserve assets); or (iii) frozen;
- any reserve assets that are not readily available for intervention in the foreign exchange market, *inter alia* because of lack of quality or lack of liquidity that limits marketability at the book price.

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<sup>12</sup> Under the Extended Arrangement, Net International Reserves (NIR) of the NBU are defined as the difference between gross usable international reserve assets and liabilities to nonresidents; the bulk of these liabilities is medium-term credit from the IMF. The fact that the NIR position is negative does not mean that the country has negative reserves; it only means that its liabilities to the Fund are larger than its gross usable reserves which are available for foreign exchange intervention. An important indicator of the adequacy of reserves is the ratio of gross usable reserves to imports, which is programmed to increase under the arrangement.

For the purpose of this program, reserve-related liabilities are liabilities with an original maturity of one year or less and comprise:

- all short-term liabilities of the NBU vis-à-vis non-residents with an original maturity of one year or less;
- the stock of Fund credit outstanding;
- the nominal value of all derivative positions<sup>13</sup> of the NBU and government, implying the sale of foreign currency or other reserve assets against domestic currency.

Table 1. Components of Net International Reserves

| Type of Foreign Reserve Asset or Liability <sup>14</sup>                            | NBU Balance Sheet Accounts   |
|---|--|
| <b>1. Gross foreign reserves (<i>In convertible currencies</i>)</b>                 |  |
| Monetary gold in vault  | 1100, 1107   |
| Foreign exchange in cash, including Russian rubles                                  | 1011, 1017   |
| Demand deposits at foreign banks <sup>15</sup>                                      | 1201   |
| Short-term time deposits at foreign banks   | 1211   |
| Long-term deposits at foreign banks   | 1212   |
| SDR holdings and Reserve Position in the Fund                                       | IMF, Treasurer's Department  |
| Securities issued by non-residents  | 1302, 1305, 1307, 1312, 1313, 1315, 1322, 1325, 1327, 1332, 1333, 1335, 1342, 1345, 1347, 1352, 1353, minus 1306, 1326, 1346 |
| <b>2. Short-term liabilities to nonresidents (<i>In convertible currencies</i>)</b> |  |
| Correspondent accounts of nonresident banks   | 3201   |
| Short-term deposits of nonresident banks  | 3206, 3207, 3211   |
| Operations with nonresident customers   | 3230, 3232-5   |
| Use of Fund credit  | IMF, Treasurer's Department  |

<sup>13</sup> This refers to the notional value of the commitments, not the market value.

<sup>14</sup> The definitions used in this technical memorandum will be adjusted to reflect any changes in accounting classifications introduced during the period of the program. The definitions of the foreign accounts here correspond to the system of accounts in existence on August 29, 2001. The authorities will inform the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, and changes in the reporting forms

<sup>15</sup> Excluding the balances in Russian Rubles on the correspondent accounts at three Russian banks which are being liquidated or considered insolvent.

The NIR of the NBU for September and December 2001 will be subject to two automatic adjusters. The first will adjust the NIR floor for the amounts by which medium and long term cash foreign financing<sup>16</sup> deviates from the programmed levels (specified in Table 9 attached to the LOI). Specifically, if the proceeds from foreign financing:

(a) exceed the program limits, the NIR floor will be increased by 100 percent of the additional financing;

(b) fall short of the program limits, the NIR floor will be reduced by 100 percent of the shortfall, but the amount of the adjustment cannot exceed \$100 million.

The second adjuster will automatically increase the NIR floor by 100 percent of the recovery of any maturing foreign currency deposits of the NBU not included in usable international reserves.

For the period from end-September 2000 through the end of the program, the international reserve assets and reserve-related liabilities of the NBU denominated in currencies other than the U.S. dollar, except those held in SDRs, will be converted from other currencies into U.S. dollars at the official NBU fixed cross exchange rates prevailing on September 29, 2000, including the Hryvnia to dollar exchange rate of 5.4397. SDR-denominated assets and liabilities, which will be taken from the records of the IMF Treasurer's Department, will be converted into U.S. dollars at the exchange rate of \$1.29789 per SDR. Official gold holdings will be valued for the period of the program at \$276.0 per ounce, which was the London gold price on September 27, 2000, afternoon session. On September 29, 2000 the NIR as defined above amounted to \$-1,089 million.

*Information source:* Monetary statistics (form 10R) provided monthly by the NBU. For daily monitoring purposes, the NBU will continue to provide the standard daily data sheet on currency operations and weekly reports on NIR and gross foreign assets and liabilities throughout the program period. All derivative transactions, and transactions involving encumbering reserves will be separately reported. The NBU will also provide quarterly balance of payments data in electronic format.

#### **Net domestic assets of the NBU (performance criterion)**

The net domestic assets of the NBU are defined as the difference between the monetary base and the NIR of the NBU, with the NIR as defined above and valued at the program exchange

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<sup>16</sup> Cash foreign financing is defined as disbursements to the budget of cash grants or balance of payments support loans with a maturity of more than a year from multilateral and bilateral official creditors and resources raised in international capital markets by the government or the NBU. This excludes use of IMF resources, or other resources that immediately create a short-term liability on the balance sheet of the NBU.

rate of Hrv 5,4397 per dollar and expressed in hryvnia. On September 29, 2000, the NDA of the NBU amounted to Hrv 20,812 million.

The NDA of the NBU for September and December 2001 will be subject to an automatic adjuster for the amounts by which the cumulative (from September 29, 2000) foreign financing of the budget deviates from the programmed levels (specified in Table 9 attached to the LOI).

If the proceeds from foreign financing:

- (a) exceed the program limits, the NDA ceiling for that month will be reduced by 100 percent of the additional financing;
- (b) fall short of the program limits, the NDA ceiling for that month will be increased by 100 percent of the shortfall in financing, but the amount of the adjustment cannot exceed the hryvnia equivalent of \$100 million valued at the program exchange rate.

The NDA ceiling will also be lowered by 100 percent of the recovery of any maturing foreign currency deposits of the NBU not included under usable international reserves.

Foreign currency amounts will be converted to hryvnia at the program exchange rate of Hrv 5,4397 per dollar. Foreign currency amounts received in currencies other than the U.S. dollar, will be converted into U.S. dollars at the official NBU fixed cross exchange rates prevailing on September 29, 2000.

*Information source:* Monetary statistics (form 10R) provided monthly by the NBU. For daily monitoring purposes, the NBU will continue to provide the standard daily data sheet throughout the program period. All derivative transactions, and transactions encumbering reserves will be separately reported.

#### **Deficit of the consolidated general government (performance criterion)**

The consolidated general government comprises: (i) the consolidated budget, which includes the state budget, and the local budgets; (ii), if not already included in (i), the Chernobyl, Pension, Employment, Social Insurance, State Material Reserve, Leasing, Accident Insurance, Innovation, and State Property funds; and (iii) any other extrabudgetary funds included in the monetary statistics compiled by the NBU.<sup>17</sup>

For the purposes of the program, the deficit of the consolidated government will be measured from below the line as:

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<sup>17</sup> Unless otherwise specified, throughout this Technical Memorandum of Understanding, the word "government" refers to the consolidated general government as defined above.

- total net treasury bill sales as measured by the information kept in the NBU registry of treasury bill sales (net treasury bill sales are defined as the cumulative total funds realized from the sales of treasury bills at the primary auction less the cumulative total redemption of principal on treasury bills); plus
- other net domestic banking system credit to government as measured by the monetary statistics provided by the NBU (this consists of all non-treasury-bill financing in either domestic or foreign currency extended to the government by banks less all government deposits in the banking system); plus
- total receipts from privatization received by the SPF and local governments; plus
- the difference between disbursements and amortization on any bond issued by the government or the NBU to nonresidents for purposes of financing the deficit of the consolidated government; plus
- the difference between disbursements of foreign credits to the consolidated government (including project loans on-lent to public enterprises) and the amortization of foreign credits by the consolidated government (including of on-lent project loans); plus
- the net change in government deposits in nonresident banks, or other nonresident institutions, plus
- net proceeds from any promissory note or other financial instruments issued by the government as defined above.

For the purposes of measuring the deficit of the consolidated government, all flows to/from the budget in foreign currency will be converted into hryvnia at the official exchange rate prevailing at close of business on the date of the transaction. Payments by/to the government against called guarantees are recorded as positive/negative net lending among government expenditures.

The ceiling on the deficit of the consolidated government will be adjusted downward by 100 percent of the amount of the arrears in the payment of scheduled interest on any domestic debt instrument issued by the government.

The ceiling on the deficit of the consolidated budget will be adjusted downward by 100 percent of the shortfall of project financing from bilateral and multilateral agencies from programmed levels; the ceiling will be adjusted upward by 100 percent of the excess of project financing from bilateral and multilateral agencies from programmed levels, but the amount of the adjustment cannot exceed Hrv 500 million. The programmed levels of project loans are specified in Table 9, attached to the LOI.

The ceiling on the deficit of the consolidated budget will be adjusted downward by 100 percent of the amount of guarantees issued by the government or the NBU on domestic credit to nongovernment entities.

For 2001, the ceiling on the deficit of the consolidated budget will be adjusted upward by the amount of privatization receipts in excess of Hrv 3.5 billion up to the amount of Hrv 5.9 billion envisaged in the 2001 budget. The amount of adjustment for September 2001 cannot exceed Hrv 500 million.

The NBU will inform Fund staff if the Treasury does not pay interest or repay principal on T-bills due to the NBU, Deposit Money Banks, or non-bank entities and individuals. In such case, the NBU will provide information on outstanding interest and principal payments.

*Information source:* NBU weekly report on treasury bill sales; monetary statistics provided monthly by the NBU for other net banking system credit to government; monthly budget execution data for privatization receipts; State Commission for Securities and Exchange for net proceeds from bonds issued by local authorities; Ministry of Finance or NBU, as appropriate, for net proceeds from foreign borrowing from the capital markets for purposes of financing the deficit of the consolidated budget; Ministry of Finance for disbursements of foreign credits to the consolidated budget and amortization of foreign credits by the consolidated budget; Ministry of Finance and NBU, as appropriate, for monthly data on credit to nongovernment units that is guaranteed by the government or the NBU; and Ministry of Finance for government deposits in nonresident banks or other institutions. Throughout the period of the program, for daily monitoring purposes, the NBU will continue to provide the standard daily data sheet; the Ministry of Finance will continue to provide twice a month data on amortization of foreign credits; and the Treasury will continue to provide weekly data on the deficit and its components, as defined above.

#### **Non-cash netting operations of the consolidated budget (performance criterion)**

Non-cash netting operations of the consolidated budget comprise all transactions by which government obligations are netted out against government claims without cash payments. The definition applies to all government obligations arising after December 31, 1999.

*Information source:* Monthly Treasury Reports submitted to the IMF by the 25th day of the month following the reporting period.

#### **Non-earmarked central government cash revenue (performance criterion)**

Non-earmarked central government cash revenue comprises all taxes, fees, and charges levied by the central government that are not earmarked by law for specific expenditure programs and collected in cash. Not included in the definition of revenue are any proceeds from loans or other banking system credits, the issuance of securities, or privatization receipts.

*Information source:* Monthly Treasury Reports submitted to the IMF by the 25th day of the month following the reporting period; for monitoring purposes, throughout the period of the program, the Treasury will continue to provide the 10-day report on non-earmarked cash revenue, inclusive of the memo item on netting operations of the central and local governments and between the local governments and the central government.

**Stock of social budgetary arrears on wages, benefits, and pensions (performance criterion)**

Social budgetary social arrears comprise all arrears of the consolidated budget on wages, social benefits, and pensions (including on Chernobyl pensions) owed by the Pension Fund, the central, or local governments. Social arrears are defined as payments one day after they are due and not paid. Wages are defined to comprise all forms of remuneration for work performed, including, but not limited to, payments in cash and in-kind for standard and overtime work. Pension obligations of the Pension Fund comprise retirement pay and all benefit and other obligations of the Pension Fund.

*Information source:* Ministry of Finance.

**External arrears by the government and the NBU (performance criterion)**

External arrears comprise all payment arrears to official and unofficial creditors on debt guaranteed or contracted by the government and the NBU, with the exception of those expected to be rescheduled as part of the Paris Club framework, those to Turkmenistan, and those to private creditors that did not accept the 2000 bond exchange. The criterion for non-accumulation of external arrears applies on a continuous basis.

*Information source:* Ministry of Finance

**Contracting or guaranteeing non-concessional external debt (performance criterion)<sup>18</sup>**

The ceilings on contracting or guaranteeing nonconcessional external debt apply to the contracting or guaranteeing by the government or the NBU of new nonconcessional external debt with an original maturity of more than one year; and within this limit, with an original maturity of more than one year and up to and including three years. Concessional loans are defined as those with a grant element of at least 35 percent of the value of the loan, using currency-specific discount rates based on the commercial interest rates reported by the OECD (CIRRs). Discount rates for assessing the concessionality of loans with a maturity of

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<sup>18</sup> This performance criterion applies not only to debt as defined in point 9 of the *IMF Guidelines on Performance Criteria with Respect to Foreign Debt* (Decision No. 12274-(00/85), August 24, 2000) but also to commitments contracted or guaranteed for which value has not been received.

at least 15 years will be based on the average CIRRs over the last ten years. The assessment of concessionality for loans with maturities of less than 15 years will be based on the average CIRRs of the preceding six-month period.<sup>19</sup> In addition, during the program period, the government shall not contract or guarantee debt of an original maturity of one year or less, other than for normal import financing. The NBU will not issue guarantees for external debt of any maturity. Excluded from the limits is the use of Fund resources; but other balance of payments support—including loans from official creditors and foreign banks, and bond issues—is included within these limits. The amount of debt contracted or guaranteed will be valued at the relevant currencies of denomination and converted into dollars using the NBU's official exchange rates prevailing at the time the debt is contracted. The maturity of debt instruments with put options shall be taken to be the period going from the issuance to the earliest date the option can be exercised.

*Information source:* Ministry of Finance and NBU for amounts and terms of all external debt contracted or guaranteed.

**Monetary base (indicative target)**

The NBU's monetary base (base money) comprises domestic currency outside banks and banks' reserves, including cash in vault of commercial banks,<sup>20</sup> and funds of customers at the NBU.

- a. **Currency outside banks** is defined as:

Currency—banknotes and coins—(NBU accounts 3000 (net)+3001 (net)-3007-3009-(1001:1005)-1007-1009); **minus**

Cash in vault at deposit money banks (DMBs) (DMB accounts 1001:1005 and 1007).

- b. **Banks' reserves** are defined as:

Cash in vault at deposit money banks (DMB accounts 1001:1005, and 1007) **plus**

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<sup>19</sup> Margins added to CIRRs will be 75 basis points for loans with maturity of less than 15 years; 100 basis points for loans with maturity of at least 15 years and less than 20 years; 115 basis points for loans with maturity of at least 20 years and less than 30 years; and 125 basis points for loans with maturity of at least 30 years.

<sup>20</sup> The definitions set out here will be modified to include any other accounts that may be identified or created in the future in connection with domestic currency issue and the deposit money banks' deposits at the NBU.

DMB correspondent account deposits at the NBU in hryvnia (NBU accounts 3200, 3203, and 3206) **plus**

Funds of customers at the NBU (NBU accounts 3230, 3232:3235, 4730:4732, 4735, 4736, and 4739).

On September 29, 2000, base money as defined above amounted to Hrv 14,888 million.

Before changing the reserve requirements for DMBs, the NBU will notify Fund staff.

*Information source:* Monetary statistics provided monthly by the NBU. For daily monitoring purposes, the NBU will continue to provide the standard daily data sheet throughout the period of the program.

## **Other**

### **1. Exchange rates**

The program exchange rate is Hrv 5.4397 per dollar. The program exchange rate between the Hryvnia and the US dollar is an accounting exchange rate used for the sole purpose of converting foreign currency denominated assets and liabilities into Hryvnias. According to IMF standard practice, the program exchange rate is kept fixed over the program period. Therefore, the program exchange rate differs from the actual exchange rate set in the foreign exchange market. Furthermore, setting a program exchange rate for the purpose of computing monetary aggregates does not imply that there is any target exchange rate for policy purposes.

### **2. NBU accounting**

Changes in classification of the accounts in forms 10-R and 20-R will be notified to Fund staff before they are implemented.

All foreign assets and liabilities of the NBU will be included in the NBU balance sheet, valued at the official exchange rate prevailing on the day for which the balance sheet is compiled.

All NBU claims on and liabilities to the IMF will be included in the NBU daily balance sheet at the NBU official exchange rate, and in the NBU monthly balance sheet at the \$/SDR exchange rate of the IMF's Treasury Department at the last day of each month. For the purpose of calculating NIR and NDA under the program, SDR-denominated assets and liabilities, which will be taken from the records of the IMF Treasurer's Department, will be converted into U.S. dollars at the exchange rate of \$1.29789 per SDR.

## **Reporting requirements and monitoring information**

To monitor performance under the arrangement, the NBU will provide to the IMF, no later than the twenty-fifth day of each month, an aggregate balance sheet for the NBU and a consolidated balance sheet for the deposit money banks, in the format envisaged by forms 10R and 20R, respectively. The NBU will communicate in writing to the Fund staff any changes in accounting conventions and valuation principles incorporated into the balance sheet data and will notify the staff before introducing any change to the Charts of Accounts of the NBU and the Commercial Banks, as well as changes in the reporting forms.

Every ten days, the NBU will provide the Fund with the operational monetary survey of the NBU, including any additional information that is needed for the IMF staff to monitor monetary policy and developments in the banking sector.

The Ministry of Finance and the NBU will provide data on credit to nongovernment units that is guaranteed by the government or the NBU on a monthly basis no later than 25 days after the end of the month.

The Treasury will report to the Fund data on daily operational state budget revenue, cash unearmarked state revenue on a 10-day basis, and monthly data on accounts payable for state and local budgets (economic and functional classification). Monthly revenue and expenditure figures of the consolidated, state and local government will be reported no later than 25 days after the end of the month. The monthly Treasury Report will include data on on-budget and off-budget netting operations.

The Ministry of Finance will provide information on the amounts and terms of all external debt contracted or guaranteed by the general government once a month, no more than 25 days after the end of the month. The NBU will report data on private sector debt not guaranteed by the government.

The Ministry of Finance will provide data on the stock of all budgetary arrears on a monthly basis, no more than 25 days after the end of the month: specifically wages, pensions, social benefits, energy, communal services, and all other arrears on goods and services.

The Ministry of Finance will provide monthly operational data on the revenue, expenditures, and arrears, and quarterly balance sheets of the Pension Fund, Insurance Fund, Social Insurance Fund, Employment Fund, Leasing Fund, Accident Insurance Fund, and the State Material Reserve Fund; quarterly data on the number of government employees; monthly data on the total state debt, and planned and actual foreign debt repayments; and monthly reports 1.P0 on actual tax revenue and 1.P6 on tax arrears.

The Ministry of Economy will provide quarterly information on actual levels of communal service tariffs in all regions for major services (heating, water supply, sewage, rent, and public transportation). In addition, the Ministry of Economy, in cooperation with the

National Energy Regulation Commission, will provide the methodology underlying the calculations of full cost recovery, including electricity and gas, as well as their prices.

The State Tax Administration will provide yearly data for 1999 and 2000, and monthly data for 2001 on tax arrears, inclusive of interest and penalties outstanding, in the following format:

|             | Beginning Stock |           |          |           | Netting out | Deferrals | Write-offs | Collections | New Arrears | Ending Stock |
|-------------|-----------------|-----------|----------|-----------|-------------|-----------|------------|-------------|-------------|--------------|
|             | Total           | Principal | Interest | Penalties |             |           |            |             |             |              |
| Tax arrears |                 |           |          |           |             |           |            |             |             |              |

In addition, on a quarterly basis, the STA will provide aggregate data on tax arrears in the above format for the 50 largest tax debtor enterprises, and their cumulative 12-months tax payments.

The STA will provide monthly information on VAT refunds in the following format:

(i) beginning stock of refund requests; (ii) refund requests paid in cash; (iii) netted out against obligations of the taxpayer; (iv) denied requests; (v) new refund requests; (vi) end-of-period stock; and (vii) stock of end-of-period requests older than three months.

For each month, Naftogaz will publish the following information in either "Uriadoviy Kurier" or "Golos Ukrainy":

- Gas sales volumes, in aggregate and by categories, including to: (i) budgetary organizations; (ii) power plants; (iii) communal service enterprises (district heating, etc., but excluding power plants operating on the combined cycle); (iv) households; (v) metallurgy; (vi) chemical industry; (vii) other industrial consumers; and (viii) any other customers not covered by previous categories.
- Gas sales prices with a breakdown by category of consumer, as outlined above.
- Payments for gas by above categories of consumers, including information on share of payment paid in cash.
- Payments arrears, including aggregate arrears for each category of consumers and arrears accumulated since the beginning of the calendar year for each category of consumers.
- List of the 10 largest non-payers in each customer category by month; one list with the largest accumulated stock of receivables at the end of the month, and another list with the largest addition to the stock of arrears during that month (flow).

On a monthly basis, the Ministry of Fuel and Energy, taking into account information provided by Naftogaz and Derzhkomstat, will provide to the Fund staff the following

operational and final information (operational information will be provided before the end of the month following the reporting period):

- Payment by final consumers for electricity for each regional electricity distribution company, with a breakdown into cash (excluding netting operations via monetary means) and any other form of payments.
- Payments to the wholesale market for electricity (State Enterprise “Energomarket”), with a breakdown into total and cash payments, for current consumption, forward payments, and any other form of payment (total cash flow and in percent of the value of electricity sold).
- Cash receipts by electricity generating companies in percent of the value of electricity sold to the wholesale electricity market.
- Data on gas sales and payments in the format indicated above in the section on requirements for “Naftogaz Ukrainy.”
- Payments and prices for imported gas, by country of origin.
- Payments arrears on imported gas, by country of origin, accumulated since the beginning of the calendar year.
- Any use of the gas stand-by facility provided for in the Memorandum of Understandings on transit gas, and which may trigger the use of government resources.

In addition to these reporting requirements, the Ukrainian authorities will provide all other information as specified in the above sections on information requirements.

INTERNATIONAL MONETARY FUND

UKRAINE

**Staff Report for the Fifth and Sixth Reviews  
Under the Extended Arrangement—Supplementary Information**

Prepared by European II Department

Approved by John Odling-Smeel

September 18, 2001

1. This supplement provides additional information on the status of the prior actions required for Board consideration of the fifth and sixth reviews under the EFF, and on recent economic developments. Also attached are the corrected Tables 2 and 9 of EBS/01/152, issued September 4, 2001.

2. **Information provided by the Ukrainian authorities indicates that all prior actions, as specified in Table 10 attached to the Letter of Intent, have been taken.<sup>1</sup>** According to preliminary data, cumulative state unearmarked cash revenue in July and August 2001, amounted to Hrv 14,551 million and Hrv 16,816 million, respectively, exceeding the targets (of Hrv 14,247 million and Hrv 16,447 million, respectively). **The government budget for 2002 that was submitted to parliament on September 14, 2001, envisages a deficit of the general government of 1.7 percent of GDP, in line with the fiscal program (Table 1).** Data on the gas sector have been provided in accordance with the Technical Memorandum of Understanding.

3. The 2002 budget projects total revenue and grants at 30.4 percent of GDP, a decline of 0.7 percentage point of GDP compared to the projected 2001 outcome. The decline in total tax revenue of 0.2 percentage point of GDP is mainly due to conservative projections of payroll, excise, and trade taxes. Nontax revenue will decline by 0.5 percentage point of GDP in view of their low income elasticity. Total government expenditure is budgeted at 32.1 percent of GDP, or 0.7 percentage point of GDP below the projected 2001 level.

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<sup>1</sup> The prior actions on the withdrawal of the banking license for Bank Ukraina and on implementation of trade liberalization measures had already been taken at the time of issuance of the staff report.

Table 1. Ukraine: Consolidated Government Finances Summary, 2000-2002  
(In percent of GDP)

|   | 2000  |       | 2001  |               | 2002                                    |
|---|-------|-------|-------|---------------|---|
|   | Prog. | Prel. | Prog. | Rev.<br>prog. | Budget<br>submitted to<br>Parliament 1/ |
| Total revenue and grants                                      | 34.4  | 34.5  | 31.9  | 31.1          | 30.4                                    |
| <i>Of which:</i> tax revenue                                  | 29.5  | 29.2  | 27.6  | 26.7          | 26.5                                    |
| Total expenditure (cash basis)                                | 35.9  | 35.8  | 34.9  | 32.8          | 32.1                                    |
| <i>Of which:</i> interest payments                            | 3.1   | 3.1   | 3.1   | 2.2           | 2.2                                     |
| Overall cash balance  | -1.5  | -1.3  | -3.0  | -1.7          | -1.7                                    |
| Net accumulation of social<br>payments arrears (reduction: -) | -0.8  | -1.0  | -0.2  | -0.3          | -0.2                                    |
| Overall commitment balance                                    | -0.7  | 0.2   | -2.8  | -1.3          | -1.6                                    |
| Financing   | 1.5   | 1.3   | 3.0   | 1.7           | 1.7                                     |
| <i>Of which:</i> net external                                 | -0.4  | -0.3  | -0.2  | 0.2           | -0.1                                    |
| net domestic  | 0.6   | 0.3   | 0.2   | -0.2          | -0.6                                    |
| privatization receipts  | 1.3   | 1.3   | 3.0   | 1.7           | 2.4                                     |
| Memorandum item:  |       |       |       |               |   |
| Primary balance (cash basis)                                  | 1.5   | 1.8   | 0.1   | 0.6           | 0.5                                     |

Sources: Ukrainian authorities; and Fund staff estimates and projections.

1/ Based on the authorities' revised projection of nominal GDP of Hrv 246,725 million; the breakdown of financing reflects Fund staff projections.

4. Compared with the 2002 fiscal projections presented in EBS/01/152 (Table 2), the budget submitted to parliament contains revenues and expenditures which are both lower by 0.3 percent of GDP. The financing outlook for 2002 remains as presented in EBS/01/152. The draft budget law stipulates that any shortfall in privatization receipts will result in spending cuts.

5. On the structural side, the 2002 budget submitted to parliament includes a number of further improvements, including a new functional classification of expenditure that is more in line with the IMF's government finance statistics (GFS) guidelines and the treatment of privatization receipts as a financing item.

6. **Recent economic developments continue to be very encouraging.** Based on very strong growth in industry, the good harvest, and vigorous export growth, the government has increased the projected rate of real GDP growth from 6.2 percent to 7.3 percent. Inflation, as measured by the CPI, was 3.3 percent during the period December 2000–August 2001, well below the program target for the year as a whole (12.3 percent). Despite some temporary perturbations following the tragic events in the U.S. of September 11, the foreign exchange market in Ukraine has remained stable, with the exchange rate standing at around Hrv 5.4 per

U.S. dollar. On September 14, gross usable reserves amounted to \$2.07 billion, equivalent to almost 5½ weeks of imports.

7. Reflecting higher disbursements of project loans in the first half of 2001 than initially estimated, the budget deficit in March and June has been slightly revised, but remained below the program ceiling (revised Tables 2 and 9, attached).

# NEWS BRIEF



FOR IMMEDIATE RELEASE

News Brief No. 01/92  
FOR IMMEDIATE RELEASE  
September 20, 2001

International Monetary Fund  
700 19th Street, NW  
Washington, D. C. 20431 USA

### **IMF Completes Fifth and Sixth Reviews for Ukraine under Extended Arrangement**

The Executive Board of the International Monetary Fund (IMF) today completed the fifth and sixth reviews under the Extended Fund Facility (EFF) for Ukraine. As a result, Ukraine will be able to draw up to the equivalent of SDR 290.78 million (about US\$ 376.56 million). Including today's disbursement, Ukraine has drawn SDR 1.19 billion (about US\$ 1.59 billion) from the SDR 1.91 billion (about US\$ 2.6 billion) arrangement.<sup>1</sup>

In commenting on the Executive Board's discussion of the review, Anne Krueger, First Deputy Managing Director, made the following statement:

"Economic performance in 2001 has been impressive, with strong growth and declining inflation. Monetary and fiscal policy in the first half of 2001 have been on track and the external position has improved markedly.

"The Executive Board welcomes the authorities' commitment to maintain sound macroeconomic policies. Continued prudent monetary policies in combination with exchange rate flexibility will be essential to maintain low inflation. In order to consolidate recent financial stabilization gains, the budget deficit target for 2002 should not be higher than 1.7 percent of GDP. The recently enacted modern Budget Code and the ongoing

<sup>1</sup> The EFF arrangement was originally approved by the IMF Executive Board on September 4, 1998.

improvements in tax administration will be important to supporting the fiscal targets.

"The Fund looks forward to an acceleration and deepening of structural reforms in Ukraine, as this will be key to maintain favorable growth prospects in the medium term. The authorities should proceed decisively with the restructuring of large banks and ensure their adherence to all prudential norms. In order to improve the environment for private business, it will be important to strengthen transparency and governance in key sectors of the economy, notably the energy sector, as well as in the privatization process. Liberalization of the agriculture sector should also be accelerated," Ms. Krueger said.