

Promoting Economic Diversity in Ukraine:

The role of the business
enabling environment, skills
policies and export promotion

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Foreword

The global economic crisis – the “Great Recession” – has had a profound impact on the world of work. In Ukraine, the negative effects of the crisis on enterprises and workers emerged in late 2008, but have worsened since. This study has been produced as part of the ILO’s efforts to support the country’s crisis response and its attempts to achieve a sustainable and inclusive economic recovery, in line with the Global Jobs Pact.

The Global Jobs Pact, which was adopted by the International Labour Conference in June 2009, establishes an internationally agreed approach to guide national and international policies aimed at stimulating economic recovery, generating jobs and providing protection for working people and their families. The Global Jobs Pact calls for a decent work response to the crisis in order to strengthen efforts to maintain and create jobs, stimulate the development of sustainable enterprises, develop quality public services and protect both male and female workers, while safeguarding rights and promoting voice and participation.

It provides a framework for the period ahead and a resource of practical policies for the multilateral system, involving governments, workers and employers. The Global Jobs Pact prioritizes employment and building social protection as key elements of international and national action to aid recovery and development. Its principles for global action on jobs are as follows:

- Priority given to employment and building social protection within the framework of international and national action to aid recovery and development.
- Support for vulnerable women and men, including young people at risk, the low-waged, the low-skilled, those working in the informal economy and migrant workers.
- Maintaining employment and facilitating job transitions and access to the labour market for the jobless, for example, through public employment services and skills development.
- Avoiding protectionist solutions, including wage deflation and undermining labour standards.
- Social dialogue, tripartism and collective bargaining.
- Economic, social and environmental sustainability.
- Effective and efficient regulation of market economies to enable sustainable enterprises and employment.
- Heightened policy coherence, including increased development assistance to the least developed countries, as well as to countries with restricted fiscal leeway.

This study is located within this policy framework and is the latest element in the ILO’s response to a request from the Ukrainian Ministry of Labour and Social Policy in December 2008 for the ILO to provide comprehensive policy advice on ways of mitigating the impact of the global economic crisis on Ukraine. This initiative was supported by the social partners. The ILO started practical work in December 2008, and in January 2009 a national conference on mitigating the impact of the crisis was organized in Kyiv with the technical and financial support of the ILO. In February 2009, a study of the economic and social situation of Ukraine was conducted, which was followed by a national tripartite working meeting on 26 May 2009 in Kyiv to discuss the results of this study and the way forward. The participants asked the ILO to conduct additional research and analysis on the following issues:

- Wages, income distribution and the tax system
- Social security and pension reforms
- Economic diversification and skills matching in the metallurgy and tourism sectors

The draft research papers were discussed at a National Tripartite Conference on “Recovering from the Crisis: Implementing the Global Jobs Pact in Ukraine” which was held in Kyiv, 20–21 May 2010.

The report contained in this volume, entitled “Promoting Economic Diversity in Ukraine: The role of the business enabling environment, skills policies and export promotion” builds on ILO in-house expertise on skills, sustainable enterprises, and trade. The preparation of this report was led at ILO headquarters by Marion Jansen, Coordinator of the Trade and Employment Programme, with the support of the ILO National Coordinator in Kyiv, Vasyl Kostyrytsya, and his team. The report is based on analysis and reviews prepared by ILO colleagues Graeme Buckley (Job Creation and Enterprise Development Department), Natalia Popova (DWT/CO–Budapest), Erik von Uexkull (Trade and Employment Programme) and on contributions from the following Ukrainian experts: Ella Libanova, Larysa Lisogor, Olexiy O. Moldovan, Olena Snihova and Yaroslav Zhalilo. Aleksandar Kostadinov and Tuan Nguyen provided data analysis for this report.

This report benefited greatly from discussions with Larysa Kryachko (Deputy Head of the Vocational Education and Training Department of the Ministry of Education and Science), Nellya Nychkalo (National Academy of Pedagogical Sciences), Sergey Prytomanov (Executive Director, Federation of Metallurgists of Ukraine), Valentyna Radkevich (National Academy of Pedagogical Sciences) and Tetyana Tymoshenko (Executive Director of the Ukrainian Federation of Employers in the Sphere of Tourism). Special thanks go to Olga Strietska-Ilina for expert advice and continuous support during the work on this report, to Francesco Panzica for valuable comments and to Irina Golubkova for logistical support to the activities in Kyiv. Special thanks are also given to the participants of the two focus group discussions that took place in Kyiv on March 12 and 13 and to the Ukrainian Ministry of Labour for facilitating the two events.

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Introduction

Ukraine's economy has great potential due to its well educated labour force, large domestic market, access to a variety of resources including some of Europe's best agricultural land, significant coal and some oil and gas reserves, and a strategic location connecting Europe, Russia and Asian markets. Nevertheless, Ukraine ended up among the least successful transition economies during the transition period following the collapse of the Soviet Union. It was only in the year 2000 that growth began to pick up.¹ The first five years of the new millennium saw Ukraine's economy expand by almost 50 per cent and growth continued to be strong afterwards. But growth dropped very sharply during the recent global economic crisis with Ukraine's GDP shrinking by 14 per cent in real terms in 2009 according to the latest IMF data.

This report examines to which extent the concentration of Ukraine's production and export structure has contributed to turning Ukraine into one of the countries hardest hit by the global economic and financial crisis. It then discusses the role increased diversification can play in reducing the country's vulnerability to future shocks and bringing the country back onto a strong and sustainable growth path. It proceeds to analyze obstacles to enhanced diversification and sustainable growth in terms of the business environment, the availability of skills, and the situation of global markets for Ukrainian exports. While an analysis at the aggregate level can give useful guidance as to possible policy directions for enhancing economic diversification, an in-depth analysis of individual sectors is useful – if not necessary – in order to design concrete policy proposals. It is for this reason that two sectors will be analyzed in more detail in this report: the basic metal and metal processing industry and the tourism industry with a particular focus on the hotel sector. Economic diversification can take place within sectors, when new production technologies are explored or new products with higher value added are launched, or it can come through the growth of new sectors. With respect to the metal and base metal sector, there is substantial potential for the former, while the tourism sector, currently relatively small, could become a significant new export sector.

The metal industry is Ukraine's main sector of economic activity, accounting for 7 per cent of GDP and around 40 per cent of overall exports. The latter turned out to be to the country's disadvantage in the recent crisis, because of the sharp drop in global trade experienced by the industry. The recent experience thus provides strong arguments in favor of strengthening economic sectors other than the basic metal and metal processing industry in order to build the future growth path on a more diversified economic structure. Given the country's reserves in relevant raw materials, though, the basic metal and metal processing industry will continue to play an important role for the Ukrainian economy and in this report, avenues will be explored to further strengthen this sector and prepare it to what is likely to be an increasingly competitive environment at the global level.

The tourism industry currently represents less than one percent of the Ukrainian economy but has significant growth potential because of its favorable natural and climatic conditions and large numbers of historical and cultural monuments. The upcoming European Football Championship 2012 that will be co-hosted by Ukraine has the potential to give a significant boost to the country's tourism industry. It will provide the opportunity to promote Ukraine's recreational potential to the outside world. It is for this reason that the tourism industry has been selected as the second sector of analysis for this report.

¹ IFC (2007)

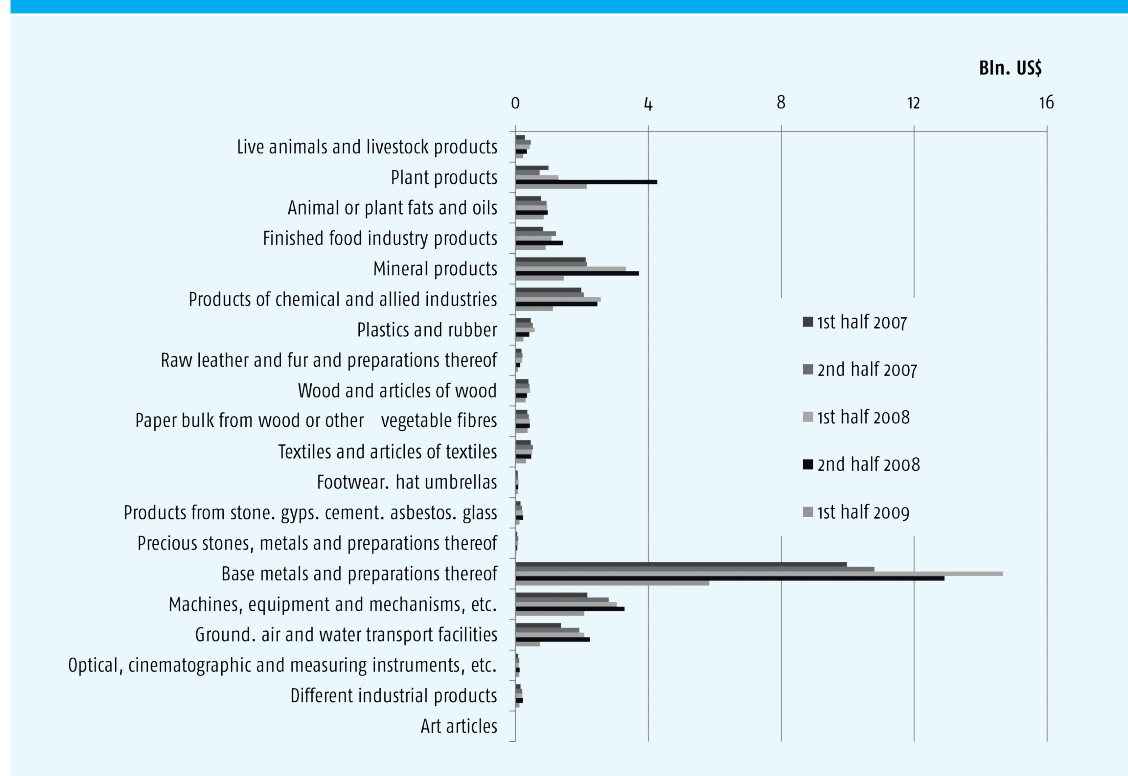
1. The role of trade and export concentration in transmitting the global shock to the Ukrainian economy

The global economic and financial crisis has triggered a contraction in international trade that was unprecedented in the last 60 years. World trade is estimated to have fallen by 30 per cent in the first three quarters of 2009 and the drop was larger in individual countries. In particular, it has been estimated to have reached 53 per cent in Ukraine between January and September 2009 when compared with exports in the same period in 2008. This sharp drop is due to the country's traditional export structure. Metal and metal products, mainly iron and steel, represent over 40 per cent of Ukraine's exports, and almost all exports are in heavy industries. According to balance of payment data, the drop in exports was indeed the main channel through which the global crisis has been transmitted to the Ukrainian economy. The first signs of crisis in Ukraine appeared in the second half of 2008 when net flows of portfolio investment turned negative and FDI inflows also began to decline. Other investments – including foreign currency held by Ukrainians outside the banking system – declined very strongly. But the main external shock reached Ukraine through the real economy in the first half of 2009 when the value of merchandise exports collapsed by 50 per cent and services exports by 37 per cent.

Figure 1 breaks down the export shock by sector of the economy. The strongest impact, both in absolute and relative terms, is for the sector *Base Metals and Preparations Thereof*. In the first half of 2009, exports in this sector were 55 per cent below their value in the second half of 2008 and 42 per cent below its value in the first half of 2007.² A decline of similar relative magnitude took place for *Chemical Products*, while the decline in *Mineral Products* was also very sizeable, but to a large extent a reversal of extreme increases in 2008. The drop in *Machines, Equipment and Mechanisms* was not quite as large, but exports of *Transport Facilities* also declined very strongly.

² The drop in exports of iron and steel was a global phenomenon with world exports dropping by 38, 56 and 55 per cent respectively, in the first three quarters of 2009.

FIGURE 1
UKRAINE: CHANGE IN EXPORTS BY PRODUCT CATEGORY



Source: Ukraine State Statistics Committee

Impact of the Crisis on Employment

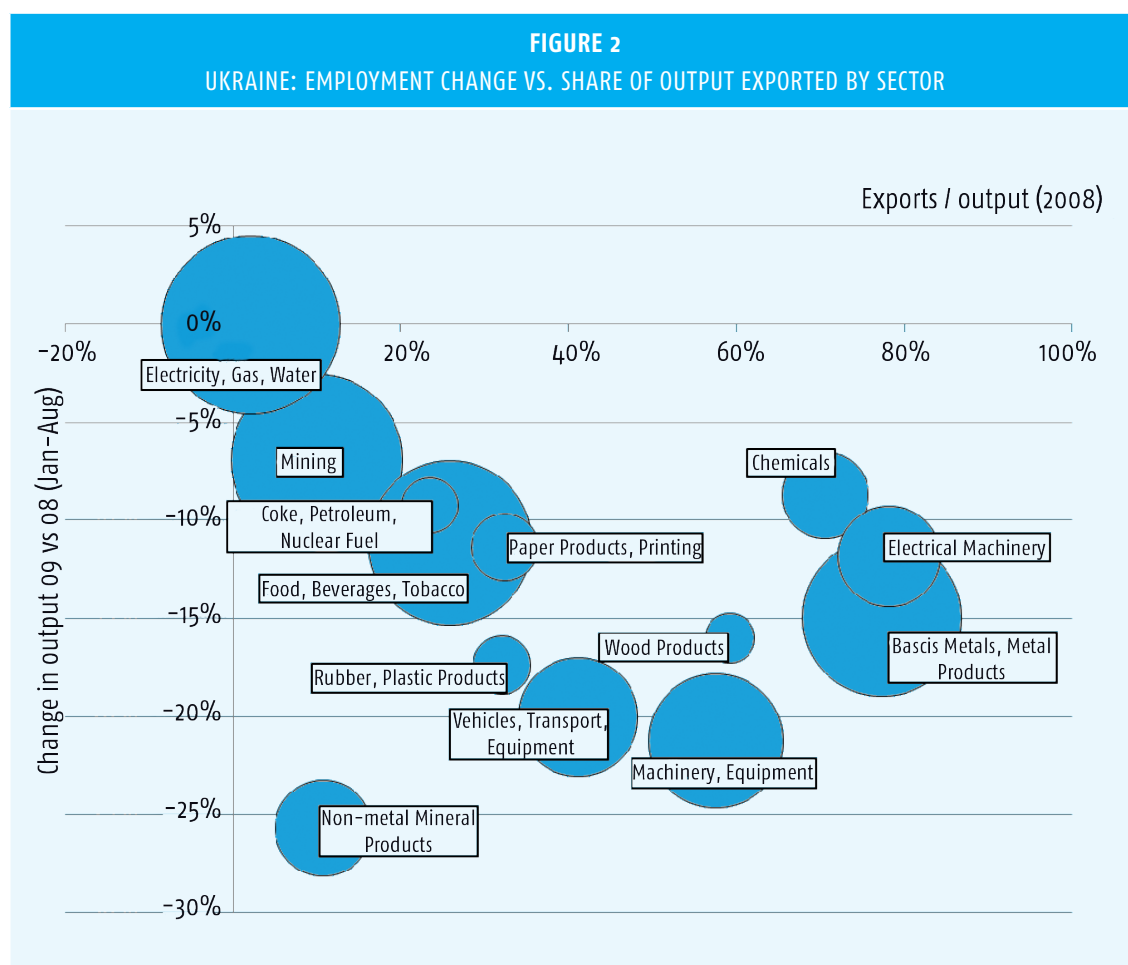
Table 1 presents the available information on the impact of the crisis on Ukraine's labour market. Unfortunately, this data is reported in a slightly different classification system than the sectoral trade data so a one-to-one comparison among sectors is not possible. The largest sectors in terms of employment are *Education and Health and Social Work* with 1.6 and 1.3 mln. employed people respectively. These two sectors – that are characterized by a high share of public employment – do not seem to have been affected by the crisis as total employment increased slightly in 2009, in line with the longer term trend for these sectors. The largest relative changes in terms of employment were registered for *Construction* (–26 per cent), *Non-Metallic Mineral Products* (–26 per cent), *Machinery and Equipment* (–21 per cent), *Other Manufacturing* (–20 per cent), and *Motor Vehicles and Transport Equipment* (–20 per cent). Although some of these sectors already exhibited a negative long term employment growth trend in the five years before the crisis (*Non Metallic Mineral Products* –1 per cent pa, *Machinery and Equipment* –6 per cent pa., *Motor Vehicles* –1 per cent pa), the decline during the crisis is clearly of a much larger magnitude. *Construction* is to a large extent a non-tradable sector, and while some negative secondary effects may have taken place through the trade-channel, it seems more likely that the main impact of the crisis was through financial channels and the turmoil in international housing markets that spurred the crisis.

TABLE 1
UKRAINE: SECTORAL IMPACT OF THE CRISIS ON THE LABOUR MARKET

	Total Employment in 2008 ('000)	Avg. Annual Employment Change 2002-08 (Aug)	Employment Change 2009-08 (Aug)
A, B: Agriculture, Hunting and Forestry; Fishing	794	-15 %	-9 %
C: Mining and Quarrying	480	-3 %	-7 %
15,16: Manufacture of Food Products and Beverage; Manufacture of Tobacco Products	436	-1 %	-11 %
17,18: Manufacture of Textile; Manufacture of Wearing Apparel; Dressing and Dyeing of Fur	89	-11 %	-15 %
19: Tanning and Dressing of Leather; Manufacture of Luggage, Handbags, Saddlery, Harness and Footwear	19	-4 %	-9 %
20: Manufacture of Wood and of Products of Wood and Cork, except furniture; Manufacture of Articles of Straw and Plaiting Materials	40	3 %	-16 %
21, 22: Manufacture of Paper and Paper Product; Publishing, Printing and Reproduction of Recorded Media	72	4 %	-11 %
23: Manufacture of Coke, Refined Petroleum Products and Nuclear Fuel	50	-3 %	-9 %
24: Manufacture of Chemicals and Chemical Products	119	-4 %	-9 %
25: Manufacture of Rubber and Plastics Products	55	7 %	-17 %
26: Manufacture of Other Non-Metallic Mineral Products	149	-1 %	-26 %
27, 28: Manufacture of Basic Metals; Manufacture of Fabricated Metal Products, except Machinery and Equipment	407	-1 %	-15 %
29: Manufacture of Machinery and Equipment NEC	293	-6 %	-21 %
30, 31, 32, 33: Manufacture of Office, Accounting and Computing Machinery, Manufacture of Electrical Machinery and Apparatus NEC; Manufacture of Radio, Television and Communication Equipment and Apparatus, Manufacture of Medical, Precision and Optical Instruments, Watches and Clocks	165	-4 %	-12 %
34,35: Manufacture of Motor Vehicles, Trailers and Semi-Trailers; Manufacture of other Transport Equipment	229	-1 %	-20 %
36: Other Manufacturing	69	2 %	-22 %
E: Electricity, Gas and Water Supply	516	0 %	0 %
F: Construction	497	2 %	-26 %
G: Wholesale and Retail Trade; Repair of Motor Vehicles, Motorcycles and Personal and Household Goods	947	11 %	-13 %
H: Hotels and Restaurants	94	2 %	-6 %
I: Transport, Storage and Communications	974	-1 %	-5 %
J: Financial Intermediation	339	17 %	-19 %
K: Real Estate, Renting and Business Activities;	631	2 %	-3 %
L: Public Administration and Defence; Compulsory Social Security	627	-1 %	1 %
M: Education	1642	1 %	1 %
N: Health and Social Work	1267	0 %	1 %
O: Other Community, Social and Personal Service Activities	389	1 %	8 %

Source: Ukraine State Statistics Committee

Figure 2 plots the change in employment by sector against the share of a sector's output that is exported.³ The size of the bubbles corresponds to total employment in the respective sector. This figure provides an alternative way to illustrate two important phenomena already referred to in the above paragraph: (i) job losses affect virtually all sectors of the economy except for those with high public involvement (*Education, Health and Social Work, Public Administration*), (ii) there appears to be a certain trend for higher employment losses in sectors with higher export shares, but there are important outliers to this trend. In particular, the sector with the highest employment losses, *Non-Metal Mineral Products* (-26 per cent), is among the ones with the lowest export exposure.



Source: Ukraine State Statistics Committee Ukraine

Four explanations can be put forward for the two phenomena:

- (1) As mentioned above, in some sectors (like Construction) employment has been negatively impacted by the crisis through channels other than trade.
- (2) Government interventions during the crisis have affected sectors differently. In particular, a memorandum of mutual understanding between the government and metallurgical companies was signed in 2008. In this memorandum, producers took the obligation to maintain production, employment and wages at an agreed level. In exchange, the government guaranteed to provide the sector with cheap credit resources, to support domestic consumption of metal products, freeze

³ Due to data limitations, only the manufacturing sector is shown and some sub-sectors had to be dropped.

transportation tariffs, reduce tariffs for electricity and to provide VAT refunding within 5 days after presenting the declaration for the last month.

- (3) Reduced activity in exporting sectors also affects suppliers to that sector. This indirect effect of trade is likely to have played an important role in Ukraine. The Metallurgy sector alone consumes 88 per cent of the country's coke production, 25 per cent of fuel-energy mineral mining, 68 per cent of other mineral mining, 15 per cent of non-metallic mineral products, and 15 per cent of electricity, natural gas and water. Beyond that, the metallurgy sector significantly influences the development of infrastructure, in particular, transport, and construction.
- (4) Lower employment, reduced wages or delays in wage pay in exporting sectors affect incomes and thus resulting demands for the products provided by other sectors, through so-called income induced effect.⁴

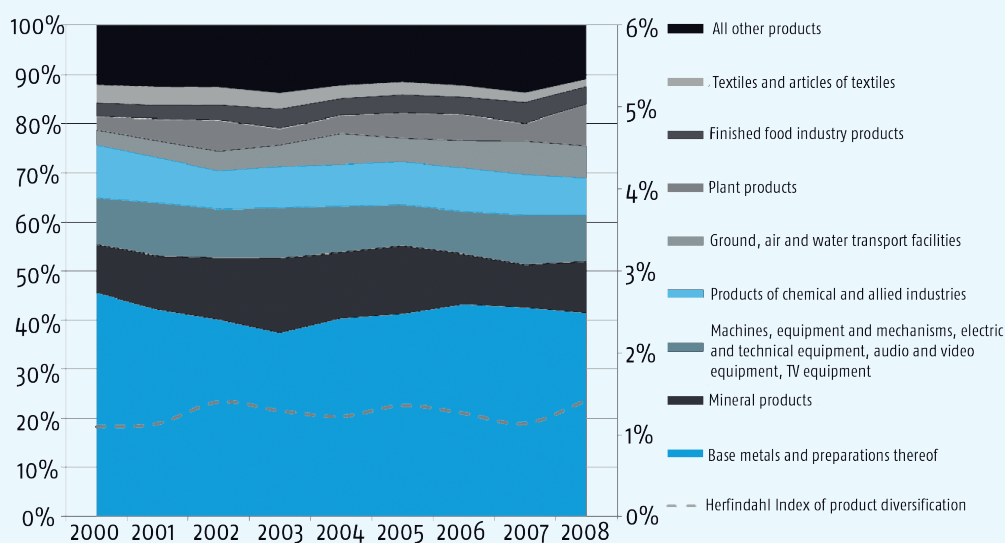
⁴ Kucera et al. (2010) provide evidence for the significance of such income induced effects in the cases of India and South Africa.

2. Ukraine's exports: towards a more diversified export structure?

The fact that export concentration makes countries vulnerable to external shocks is a phenomenon that is not restricted to the most recent crisis episodes. A number of studies have shown that export concentration in terms of products is linked to GDP volatility (e.g. (Jansen, 2004), (Malik & Temple, 2006)). (Bacchetta, Jansen, Lennon, & Piermartini, 2009) also emphasize the importance of geographical diversification of exports to reduce volatility resulting from country-specific shocks. Export concentration has also been argued to have a negative effect on economic growth. For example, (Lederman & Maloney, 2007) apply several econometric tests to confirm that overreliance on just a few products has a negative effect on total exports. (Hesse, 2009) finds a negative impact of export concentration on per capita income. Strong arguments can therefore be made in favor of increased efforts to enhance economic diversification in Ukraine.

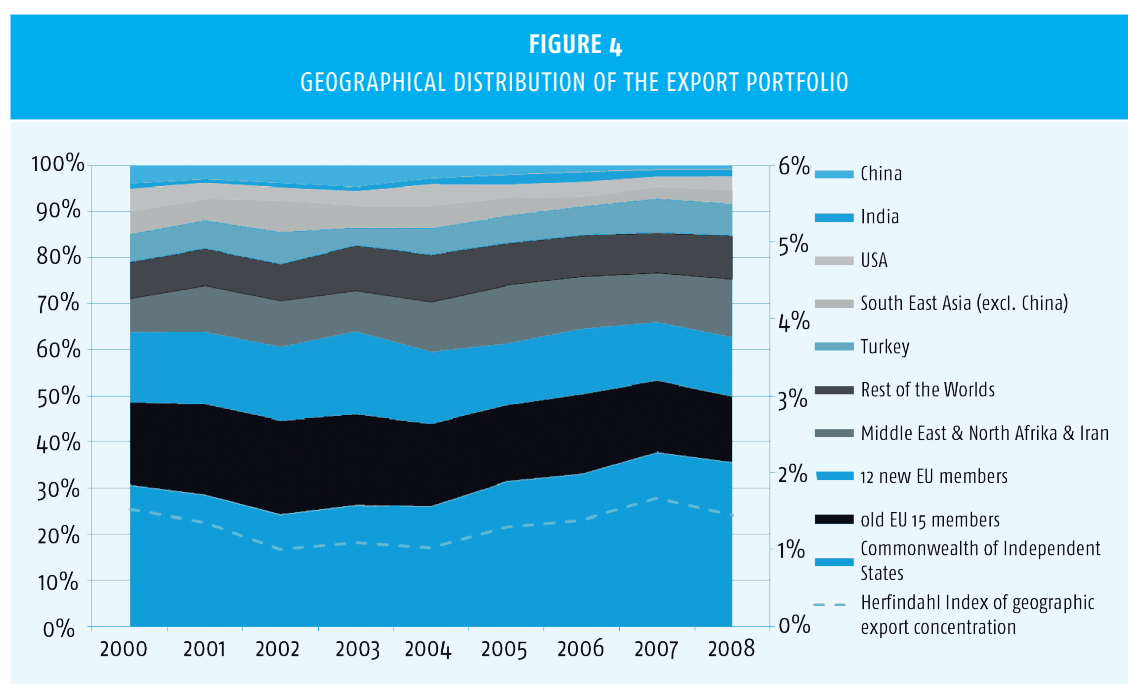
A more in-depth look into the nature of Ukraine's export structure before the crisis, and notably during the period of strong growth preceding the crisis, provides useful insights for policy design. One of the most remarkable observations about the composition of Ukraine's merchandise export portfolio is that it remained almost unchanged in terms of its sectoral composition over the last ten years. Figure 3 illustrates that Ukraine has not established any sizeable new export sectors over the last decade. *Base Metals and Articles Thereof*, mainly iron products, remain by far the most important export sector, accounting for around 40 per cent of total exports. *Mineral Products*, *Machines*, and *Chemical Products* are all around 10 per cent of total exports, so the four largest sectors combined account for about 70 per cent of total merchandise exports. All these sectors typically rely heavily on traditional heavy industry.

FIGURE 3
UKRAINE: COMPOSITION OF EXPORT PORTFOLIO 2000–08



Source: COMTRADE

A look at the geographical distribution of Ukraine's exports reveals that Ukraine exports remarkably little to growth markets like Brazil, China and India. This may have been an additional disadvantage for Ukraine during the crisis as those economies weathered the crisis relatively well. Figure 4 illustrates the percentage distribution of exports by destination as well as a Herfindahl index for geographic diversification much like Figure 3, only that the breakdown for the calculation here is by destination country of exports and not by type of product exported. After declining slightly in the early 2000s, the share of exports going to CIS countries remained fairly stable around 30 per cent for some years and then increased again slightly. Exports to other trading partners grew more or less in line with overall export growth so there were no substantial fluctuations. However, one remarkable observation is the small and declining share of China in Ukraine's exports. This is quite surprising given how strongly China's economy has grown over this period.⁵



Source: COMTRADE

Throughout the last decade, world market conditions have been extremely favourable for Ukraine, with world markets for all of Ukraine's large export sectors achieving high average annual growth rates (*Base Metals and Articles Thereof* +16 per cent, *Mineral Products* +22 per cent, *Machines* +9 per cent, *Chemical Products* +14 per cent). The following analysis shows that Ukraine's impressive export growth between 2000 and 2008 can to a large extent be explained by favourable conditions in world markets, and does not necessarily reflect enhanced competitiveness of Ukrainian companies.

Figure 5 presents a comparative perspective on export growth and the degree to which a country over- or underperformed compared to world market demand for its products. It compares the actual export growth rate to the hypothetical export growth rate if a country's exports had grown in line with the world market for each product exported at the HS6 level.⁶ Actual export growth is broken down into export

⁵ The Herfindahl index for geographical market diversification is calculated at the individual country level and thus takes into account additional information on the distribution of exports within the groups presented here. It remained fairly stable over the years and its small changes were more or less in line with the increase in the share of CIS countries at the regional level, indicating no major changes in the pattern of geographical export diversification at the sub-regional level.

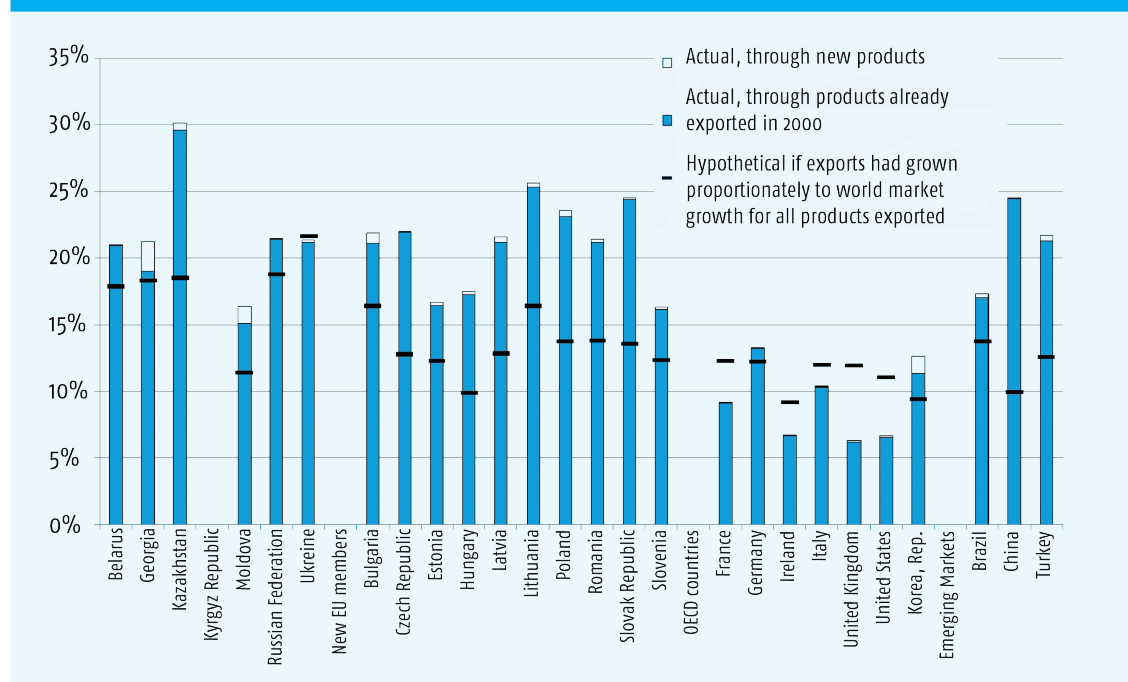
⁶ The hypothetical growth rate is thus the average of the world market growth for all products weighted by their share in a country's export portfolio in 2000.

growth through the expansion of existing products and growth through the introduction of new products because only the former part is comparable to the hypothetical growth rate (in other words, products that are not yet exported in 2000 receive a zero weight in the calculation of the hypothetical growth rate).

Ukraine has the highest hypothetical export growth rate of all countries in the sample – the world market for its export products grew at an average rate of 22 per cent per year. This is very close to the actual export growth rate that Ukraine materialized over this time. Most other CIS countries, with the exception of Moldova, had similarly favourable world market conditions and most of them materialized export growth rates slightly above the hypothetical one, which means that on average, they increased their world market share for the products they export. The Eastern European EU members had significantly less favourable world market conditions, but yet they materialized export growth rates close to or even higher than Ukraine's. Thus, they significantly expanded their world market share for the products they export. The same applies to Brazil, China and Turkey. OECD countries also faced less favourable world market conditions, but except for Germany and Korea performed below their hypothetical export growth rates – in other words, they lost world market share for the products they export.

The message here is that even though Ukraine's exports grew very strongly, it is the only non-OECD country in this sample that did not manage to increase its market share. As for most countries, only a very small fraction of Ukraine's export growth was driven by the introduction of new export products.

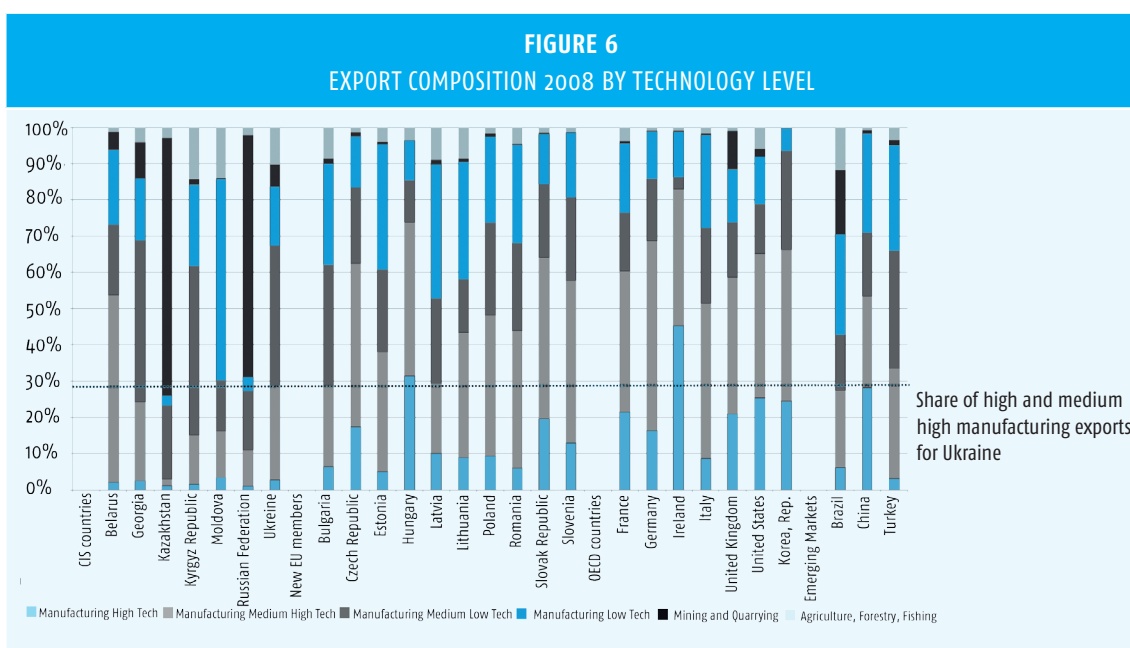
FIGURE 5
UKRAINE: AVERAGE ANNUAL EXPORT GROWTH 2000–08 AND HYPOTHETICAL EXPORT GROWTH AS DRIVEN BY
WORLD MARKETS



Source: COMTRADE

Recent trade literature has argued that what matters for a country's long-term growth is not just the quantity, but also the type of products exported. Hausmann et al. (2007) have argued that independent of fundamentals, such as endowment with natural resources, capital, skilled and unskilled labour, a country's export portfolio can be shaped by "idiosyncratic elements" that leave it producing low-value products and reducing its future growth prospects. Figure 6 presents a classification of the products exported by Ukraine and comparison countries by their technology-intensity. This classification was developed by Eurostat and reflects the research and development intensity of different sectors in the EU. Ukraine has a share of high

and medium high technology manufacturing exports of 29 per cent, higher than that of Russia (11 per cent) and Kazakhstan (3 per cent), but these countries are heavily concentrated in hydrocarbon exports. The high and medium high technology content of Ukrainian exports is comparable to that of Georgia (24 per cent), higher than for Moldova (17 per cent) and Kyrgyz Republic (16 per cent), but much lower than for Belarus (53 per cent). It is lower than for the Eastern European new EU members with the exception of Latvia (29 per cent) and Bulgaria (29 per cent), who have a similar pattern, and much lower than for OECD countries and China (53 per cent). A prerequisite for exporting high technology products is a sufficient supply of adequately skilled labour to carry out research and development and technology intensive production processes that require high skills. Another condition is the presence of an enterprise enabling environment that encourages the economy's transition into medium or high tech activities. Hence the focus in this report on enterprise enabling environment and skills.



Source: Authors' calculation based on data from COMTRADE and Eurostat

3. Strengthening the enabling environment for sustainable enterprises in Ukraine

The above discussion has illustrated that Ukraine could gain from increased product diversification that would make it less vulnerable to external shocks and bring its economy on a more sustainable growth path. Also, there is potential to increasingly penetrate high growth markets and strengthen higher end technology exports, which could contribute positively to sustainable growth.

This chapter intends to give some indication as to the direction in which policy makers may want to think to achieve increased diversification. The focus will be on ways in which the country's business climate can be enhanced in order to stimulate entrepreneurial activities in new product markets. Separate subsections will be dedicated to the role export promotion can play in promoting new products abroad but above all in conquering new geographical markets and to the role of education, training and lifelong learning in enhancing productivity and stimulating innovation.

The importance of the business environment for enterprises' decisions and their performance is regularly underlined in publications like the EBRD/World Bank's Business Environment and Enterprise Performance Surveys (BEEPS), the IFC/World Bank's annual Doing Business reports, the Global Competitiveness Report and the World Competitiveness Yearbook. The ILO approach is derived from the ILC conclusions on the promotion of sustainable enterprises and, in particular, that part of the conclusions concerned with the enabling environment conditions for sustainable enterprises. The ILO approach is close to other methods but adds criteria that affect the social and environmental sustainability of the business operations. A list of the 17 conditions is provided in Box 1. In the following discussions, the focus will be on those conditions that have been identified in the preparation to this report as representing particular bottlenecks for sustainable growth in Ukraine.

BOX 1**DETERMINANTS OF THE ENABLING ENVIRONMENT FOR SUSTAINABLE ENTERPRISES**

Political elements

- Peace and political stability
- Good governance
- Social Dialogue
- Respect for Universal Human Rights and International Labour Standards

Economic Elements

- Sound and stable macroeconomic policy and good management of the economy
- Trade and sustainable economic integration
- Enabling and legal environment
- Rule of Law and secure property rights
- Fair competition
- Information and communication technologies
- Access to financial services
- Physical infrastructure

Social elements

- Entrepreneurial culture
- Education, training and lifelong training
- Social justice and social inclusions
- Adequate social protection

Environmental elements

- Responsible stewardship of the environment

Source: Buckley et al. (2009)

The strength of the enabling environment for sustainable enterprises in the Ukraine

Peace and political stability are basic preconditions to nurture the formation and growth of sustainable enterprises. An opinion survey by the World Economic Forum revealed that the Ukrainian business community perceives the instability of the political situation and government policy to be the major obstacle to business operations (World Economic Forum, 2008). The government could therefore substantially contribute to business performance by enhancing the stability of the political environment in which enterprises operate. Fighting corruption and enhancing government efficiency are also likely to deliver high payoffs, as poor governance in particular in the form of high levels of corruption and weak administrative capacity have been identified as one of the most important constraints to business operations and growth in Ukraine (Table 2 and (European Training Foundation and European Union, 2009))

TABLE 2
GOVERNANCE INDICATORS FOR SELECTED COUNTRIES (2008)

	Control of corruption	Corruption perception index	Government effectiveness
Ukraine	-0.72	2.5	-0.6
Poland	0.38	4.6	0.48
Russia	-0.98	2.1	-0.32
Turkey	0.10	4.6	0.20
Former Soviet Union	-0.86	2.8	-0.60
Eastern Europe and Baltics	0.12		0.28

Source: World Bank: Government Matters Database and Transparency International

Control of corruption and government effectiveness indices range from -2.5 to 2.5. Higher values correspond to better governance. The corruption perception index ranges from zero (highly corrupt) to ten (highly clean).

Ukraine has ratified all the major human rights conventions, as well as all fundamental Conventions covered by the ILO's Declaration on Fundamental Principles and Rights at Work. In particular, Ukraine has ratified the convention on the right to join an independent and freely chosen trade union and the right to bargain collectively. However, the collective bargaining process is often dominated by trade unions and line ministries representing the government as the main employer, and the interests of most smaller scale private employers are often sidelined. Existing employers' organisations in Ukraine tend to represent the interests of large firms and not those of SMEs, which comprises the majority of enterprises in Ukraine (European Training Foundation and European Union, 2009).

The enabling legal and regulatory environment, the security of property rights, the level of competition and access to financial services are conditions that are particularly important when it comes to increasing the diversification of the economy as they are important aspects for starting new business. Credit to private sector as a percentage of GDP increased significantly in the years preceding the crisis and the banking sector significantly increased its level of external borrowing (Economist Intelligence Unit, 2008). But the sustainability of the expansion of the financial sector can be questioned on the basis of the serious difficulties the sector faced during the global crisis.

Regarding the regulatory environment faced by business, the World Bank indices rank Ukraine's policies and regulations low compared to neighbouring countries in respect of their ability to promote private sector development. In Ukraine, the first law on entrepreneurship was adopted in 1991 and since 1996 there has been a sound commitment to business development by policy makers.⁷ But despite some improvement with respect to tax burden, registration and licensing, the overall business environment is still perceived as rather unfavourable. In the World Bank's Doing Business Report, Ukraine has moved from a ranking of 139 in 2007 to 142 in 2010 (out of 183 countries) for ease of doing business and slipped down the rankings in terms of the starting a business category (from a ranking of 109 to 134). Complicated procedures for starting up a new business are factors that negatively affect the business environment, requiring 10 procedures and 27 days in Ukraine (in 2010). The complex nature of business regulation has led to high numbers of businesses operating informally, without registration.

Indeed, the number of formal enterprises remains relatively low. In particular, the number of SMEs never reached the level of the European Union or the average level of advanced transition economies. The World Bank Entrepreneurship Survey confirms this development. For instance, the rate of increase in the number of

⁷ For instance, in 1997 the State Committee for Development of Entrepreneurship was established with the objective of facilitating business creation in Ukraine (Smallbone & Welter, 2009).

newly registered firms and the share of newly registered firms to the total working age population between 2003 and 2007 was low compared with Russia and Turkey but there are a high number of businesses operating unofficially, without registration.

Another aspect that is likely to hamper entry into new business activities, in particular by foreign owned companies, is the fact that Ukraine's system of property rights is considered underdeveloped, in particular with respect to financial aspects and real estate. The global ranking published in the Global Competitiveness Report 2009–2010 (World Economic Forum) places Ukraine 127th out of 133 economies in terms of protection of property rights and 108th in terms of intellectual property rights. Moreover, law enforcement related to intellectual property remains cumbersome and inconsistent.

Fair competition is a precondition for the efficient functioning of markets. Ukraine has a comprehensive competition law which dates back to 1992 and an agency to enforce it – Antimonopoly Committee of Ukraine (AMC). However, in practice domestic and foreign competition is weak in Ukraine. According to the World Economic Forum, this is partly due to a distorted taxation system and an ineffective anti-monopoly policy (World Economic Forum, 2008). The World Bank data show that total business density in Ukraine is low compared to Poland and Russia. According to the Global Competitiveness Report 2009–2010, Ukraine's scores for intensity of local competition, effectiveness of anti-monopoly policies and extent of market dominance are also low compared to the world average (Table 3).

TABLE 3 LEVELS OF COMPETITION IN SELECTED COUNTRIES			
	Total Business Density**	Intensity of Local Competition Index***	Extent of Market Dominance***
Ukraine	16.4	4.4	3.6
Poland	*19.2	5.3	4.1
Russia	32.5	4.4	3.6
Turkey	15.8	5.3	4.0
World (mean)		4.9	3.9

Source: World Bank Group Entrepreneurship Survey (WBGES) and World Economic Forum Executive Opinion Survey (The Global Competitiveness Report).

Total Business Density reflects the number of total registered companies as percentage of the active working age population. The Intensity of Local Competition Index ranges from 1 (limited in most industries and price cutting is rare) to 7 (intense in most industries). The extent of market dominance index also ranges from 1 (dominated by a few business groups) to 7 (spread among many firms).

*2006, **2007, ***2008.

The continuing shift towards knowledge-based economies and the accelerated growth in the technological sphere has led to increased pressures on enterprises to upgrade their production technologies and adopt ICT innovations to enhance their competitiveness. Notwithstanding some improvements in the quality of fixed-line telecoms services, high penetration rates of mobile telephony services and growing internet use, Ukraine's telecommunications infrastructure remains underdeveloped, as a result of slow privatisation progress and insufficient investment. In particular, the percentage of firms accessing different technologies, such as email, is lower in Ukraine than in the rest of the region (World Bank Group, 2009).

Enterprise sustainability critically depends on the quality and quantity of the physical infrastructure. Ukraine's transport system was not particularly good in the Soviet era, and it has worsened since then, as a result of insufficient maintenance and repairs. The road network, consisting of 170,000 km of roads, nearly all of which are paved, remains underdeveloped and has been poorly maintained. The quality of railroads – consisting of 22,000 km of railway track – is comparatively good in Ukraine, but service quality suffers from the monopolistic structure of the market. The air transport infrastructure has been improved in recent years

but remains weak. According to the Economist Intelligence Unit, the country is far from fulfilling its potential as a gateway between Central Europe and transition countries further east.

On criteria related to the condition of 'social justice and social inclusion' Ukraine rates well compared to similar countries. Ukraine experienced high poverty rates as a result of economic decline in the first decade of independence at the beginning of the 1990s. Since 2005, the poverty rate has fallen sharply reflecting economic recovery and the growth in real wages and real income, as well as the government policy to increase social insurance transfers. In line with this, a reduction in inequality in household income occurred. Another noticeable feature of the Ukrainian labour market is the high female labour force participation rate (49.6 per cent in 2005) that compares favourably with many developed countries.

Adequate social protection is key to improving productivity and increasing formalization of enterprise activity. The Constitution of Ukraine defines the rights of citizens to social protection. Ukraine's social expenditure as a percentage of general government expenditure accounted for 52 per cent in 2007.⁸ However, regarding health care, expenditure remains low, at 4 per cent of GDP in 2006, according to the World Health Organisation. This compares unfavourably with other countries.

Sustainable enterprise development goes hand in hand with responsible stewardship of the environment, which in turn needs appropriate regulations and incentives. According to a study by the Economic Commission for Europe, Ukraine faces considerable barriers in developing its industry in a sustainable way. The so-called Ecological Footprint score for Ukraine is relatively good compared to countries like Poland and Russia but remains below the level of middle income countries.

On the macroeconomic side, the global financial crisis has exposed the country's vulnerabilities. As a result of the external shock that hit Ukraine, the country had to make use of a \$16.5 billion loan by the International Monetary Fund. As mentioned above, the main shock occurred through the real economy in the first half of 2009 when exports dropped dramatically. The following section provides more detailed information on Ukraine's trade regime with a particular focus on mechanisms used for export promotion.

Trade and sustainable economic integration: promoting the diversification of exports

In recent years, Ukraine has pursued a strategy of increased integration in global markets. In May 2008, Ukraine acceded to the World Trade Organization (WTO) which has led to various reforms to conform with WTO rules. The country is currently negotiating a free trade agreement with the EU and has already preferential trade agreements with numerous former Soviet Union countries like Kazakhstan and Moldova.

Opinions differ on whether opening up suffices to increase both the extent and the diversification of exports, but it is probably fair to say that the discussion on the role of active export promotion policies has regained prominence in recent years.⁹ Despite the decisive role exports play for a number of Ukrainian industries, the country currently does not have a well-defined and consistent export promotion strategy. Supportive measures tend to be undertaken ad-hoc and informational, methodological and legal support is provided mainly on a non-systematic basis. A system of financial support that is in line with international rules on export insurance and export credit is in planning but currently does not exist. In 2009, the Ministry of the Economy has prepared a draft law "On the state of financial export support", but this law had not been discussed in Parliament yet at the beginning of 2010.

Most export-supportive measures have traditionally taken the form of price corrections through currency devaluations or indirect or direct subsidies. The majority of these measures were provided and distributed in a non-transparent manner and unavailable to exporters from non-traditional export sectors that tend to have weaker lobbying power. This system of support has therefore tended to reinforce existing export structures rather than to enhance diversification.

⁸ According to UNDP, however, Ukraine's social policy has contributed to a culture of dependency and does not help to alleviate poverty through empowerment. About 76 percent of the population in Ukraine lives in a household which benefits from one or more public transfer.

⁹ See, for instance, Newfarmer, Shaw, & Walkenhorst (2009)

Efforts to change and strengthen export promotion policies began in 2007 with the establishment of the Council of Exporters at the Ministry of Economy. The mission of the Council is to support the elaboration of Ukraine's export policy, to increase the economy's export potential, to develop fair competition between exporters, to provide operative co-operation between entrepreneurs and government bodies, and to support the interests of Ukraine and Ukrainian exporters in foreign markets. However, the potential of the Council of Exporters is still underutilized. Until early 2010, only four sessions of the Council had been held: three in 2007 and one in 2008.

Currently, exporters can already obtain information on demand in foreign markets, Ukrainian foreign trade policy, and legislation and terms of trade in partner countries via internet portals set up by the Ministry of Economy as well as some private portals.¹⁰ Since the mid of 2009 the specialized WEB portal www.ukrexport.gov.ua, guided by the Ministry of Economy, provides useful and operative information for exporters. In the beginning of 2010, some branches of the portal were, however, still under construction. Export promotion efforts can also build on an existing network of 60 trade missions in 58 countries and international bodies like EU and UN. 27 of those missions are active in Europe, 15 in Asia and 8 in CIS countries. In the light of the underrepresentation of Ukrainian exports in growing emerging countries, Ukraine may want to consider expanding its network of trade missions into additional Latin American and Asian countries or to strengthen the existing missions in the relevant regions.

Education, training and lifelong learning

Enterprise success, productivity, and competitiveness increasingly depend on human resources. Ukraine inherited a well developed educational system from the Soviet era and the Ukrainian government spends a high share of GDP (6.2 per cent in 2007) on education compared to the EU-27 (5 per cent in 2008).¹¹ Enrolment rates are high compared to other countries at the same stage of development, literacy is almost universal and the share of the population with secondary or higher education is above 90 per cent (European Training Foundation and European Union, 2009). However, in many ways, the educational system in Ukraine does not provide the skills needed by the economy. According to a World Bank Survey, 42 per cent of managers in Ukraine ranked skills of available workers as a major obstacle to their operations. This percentage is high compared to the region. Research by the European Training Foundation on transition from education to work¹² and a World Bank labour demand study¹³ show that more than one-third of university graduates were employed in jobs with low wages and a low qualification level. At the same time, hiring skilled workers was considered very difficult by 90 per cent of the employers interviewed by the World Bank in 2008.¹⁴ The co-existence of the two phenomena indicates the existence of skill mismatches in the Ukrainian labour market.

¹⁰ As the examples of such WEB-resources are worth mentioning: Ministry of Economy, page on foreign trade activity (http://www.me.gov.ua/control/uk/publish/category/main?cat_id=48272), State support of Ukrainian export (<http://www.ukrexport.gov.ua>), Ukraine and WTO (<http://wto.in.ua>), State Service of Export Control (<http://www.dsecu.gov.ua/control/uk/index>), Commercial Chamber of Ukraine (<http://www.ucci.org.ua/home.html>), etc. The sites usually have Russian and English mirror pages.

¹¹ EUROSTAT.

¹² See also: European Training Foundation: Transition from education to work in EU neighboring countries (Luxembourg, Office for official publications of the European Communities, 2008), electronic book [http://213.215.218.67/pubmgmt.nsf/%28getAttachment%29/A45B02F13FE0B90BC125744800444C11/\\$File/NOTE7ELGL2.pdf](http://213.215.218.67/pubmgmt.nsf/%28getAttachment%29/A45B02F13FE0B90BC125744800444C11/$File/NOTE7ELGL2.pdf)

¹³ See also: World Bank, Ukraine Labour Demand Study 2009: http://siteresources.worldbank.org/UKRAINEEXTN/Resources/WB_Book_Report_labor_demand_EN_prew.indd.pdf

¹⁴ Ibid.

In a rapidly changing world, it is increasingly difficult to forecast skill demand and to ensure that skills supplied through the education and training system match demand. In order to ensure high levels of responsiveness, institutional set-ups therefore need to be relatively lean and flexible, and they need to be able to base decisions on up-to-date information. Ukraine's Vocational Education and Training (VET) is still based on a centralised approach (State Ordering System) and allows for limited identification of the real needs of the labour market. Annually, based upon the estimates made by VET schools, regional education authorities prepare regional plans which are sent to the Ministry of Education and Science (MES). The latter prepares a national plan by region, sector and branch that is subsequently forwarded to the Ministry of Economy for final review. The Council of Ministers approves the annual enrolment plan.

In this lengthy planning process the involvement of employers' and workers' organizations is almost completely absent. The needs of leading companies in terms of skills are not reflected. Some attempts have been made to develop methodologies on skills identification mainly in the framework of international projects (including work by the ILO) but these pilot experiences have not been transferred to a systemic level yet. Further, there is weak coordination among educational institutions and employers regarding curricula design, which leads to "educational mismatch" between sector needs and institutional set-up of the educational system.

Currently, VET provides training for more than 1,000 occupations in 35 economic sectors. This is a large number of occupations and there is a need for broadening the content of profiles (by clustering several occupations into one), according to modern practices, which often require individuals to be multi-skilled. At the moment, MES is working on the development of a National Qualification Framework (NQF), linked to the 8 levels of learning outcomes relevant to qualifications of the European Qualification Framework (EQF). It has selected 5 pilot sectors, *inter alia* tourism, and is conducting employers' surveys to design up-to-date occupational profiles. In this type of exercise, it would be desirable to develop a clear methodology for early skills identification, for instance, based on the practices of trend-setting companies. Such approaches would need to become common practice and institutionalised in order for the existing system to be strengthened. Institutionally this could be reached through the creation of "sector skills committees" for all sectors, which guarantee a participatory approach of all leading stakeholders, including social partners.¹⁵

¹⁵ As reference, two examples can be quoted: In Belgium, Industry-based Committees are involved in a dialogue on defining all human resources issues concerning different sectors. At present, there are industry-based committees for goods traffic, the metal and technological industry, textiles & clothing manufacture, health & welfare, building and woodworking, and tourism. The Committees are part of the Flanders Social and Economic Council (Sociaal-Economische Raad van Vlaanderen, or SERV), which is the consultative and advisory body of the Flemish social partners: <http://www.serv.be/webteksten/SERV-folder-ENG.pdf>. In the Netherlands, employers and workers organisations are responsible for guiding key human resources developments. They have special responsibilities relating to the development of the Dutch national qualifications framework, which is based on job profiles drawn up by the social partners and regularly updated by them. http://www2.trainingvillage.gr/etv/publication/download/panorama/5142_en.pdf

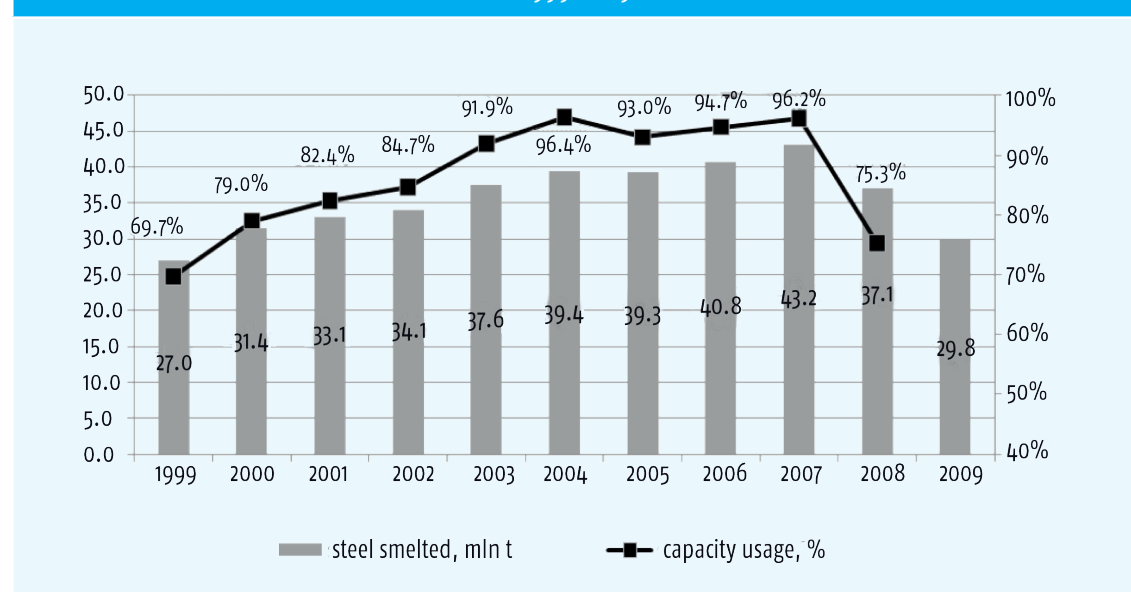
4. Strengthening Ukraine's basic metal and metal processing industry

Background

Ukraine is ranked the 8th largest steel producer of the world, accounting for about 3 per cent of total world ferrous metals output.¹⁶ Ferrous metallurgy is the leading branch of Ukrainian industry and has a strong influence on the total economy. It accounts for 7 per cent¹⁷ of GDP, 10 per cent of total output of commodities and services, 22 per cent of industrial sales, 32 per cent of sales of manufacturing products.

In line with the evolution of exports in the past decade, production in the metallurgy sector expanded between 1999 and 2007 but experienced a sharp drop after the beginning of the global economic crisis in 2008.

FIGURE 7
DYNAMICS OF STEEL SMELTING AND PRODUCTION CAPACITY USAGE BY FERROUS METALLURGY COMPANIES
1999–2009



Source: Authors' calculations based on "Ukrpromzovnishexpertyza", "Ukrmetallurgprom", Foundation for Effective Governance

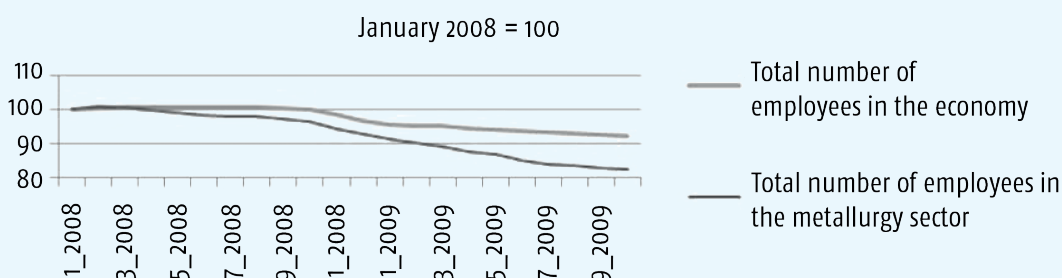
The global economic crisis also had a negative effect on the Ukrainian labour force employed in the metallurgy sector. From the beginning of the recession period, employment in metal and metal processing industry

¹⁶ China is the world's largest producer with a production representing 37.6 per cent of world production. The distance to the next ranked producers is significant: Japan (8.9 per cent), United States (6.9 per cent), Russia (5.2 per cent), India (4.1 per cent), South Korea (4.0 per cent) and Germany (3.4 per cent).

¹⁷ Data of 2007

has declined by about 7.5 per cent in Q3 2009 (see Figure 8). Mainly unskilled labour was dismissed (in particular supporting personnel) and workers with fixed-term contracts. The drop in production was also accompanied by a 75 per cent reduction of vacancies by the end of 2009. Due to the financial difficulties and in order to avoid mass layoffs, wage arrears were frequently used.

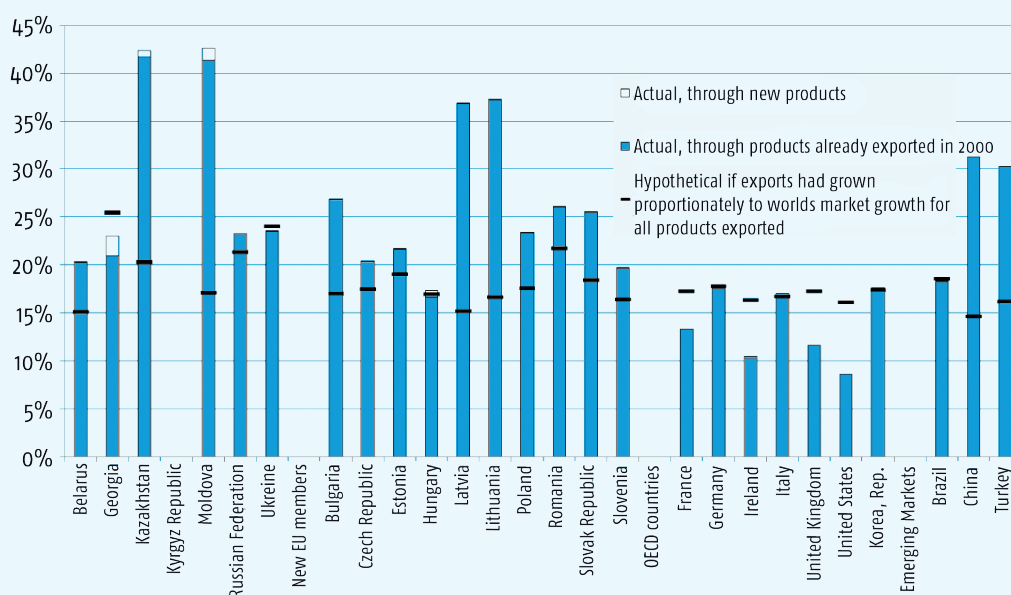
FIGURE 8
EMPLOYMENT DYNAMICS IN THE METALLURGY SECTOR



Source: State Committee of Statistics

Notwithstanding the strong export performance of the sector in the years preceding the crisis, metal exports have not been able to gain market share abroad, thus following the pattern that generally holds for Ukrainian exports and that has been highlighted in section B. Unlike exports of new EU member countries, Ukraine's metal exports have merely grown in line with global demand, notably in the product group "articles of iron and steel" that is relatively high up the value chain (Figure 9). This performance stands in contrast with the performance of China that appears to have focused its export strategy on the higher market end products.

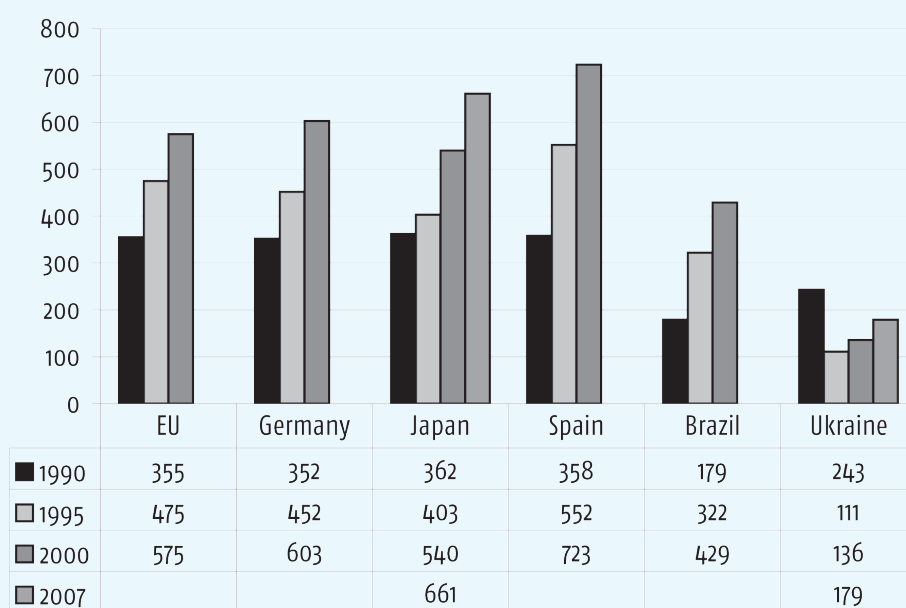
FIGURE 9
WORLD MARKET FOR PRODUCTS IN HS73 ARTICLES OF IRON AND STEEL (5% OF UKRAINE'S EXPORTS IN 2008)



Source: Authors' calculation based on data from COMTRADE

One of the explanations for this moderate performance is likely to lie in the relatively low productivity of the sector as illustrated in the following table. Investment levels have increased significantly in the past decade from 2.3 billion UAH in 2003 to 7 billion in 2006 and 11.2 in 2007. They shrank in 2008, but not dramatically (10.5 billion UAH). Investments resulted in technical improvements, reflected, for instance in a shift away from open-hearth steel production. Yet labour productivity and material and energy efficiency remain low when compared to other countries (Figure 10 and Table 4).

FIGURE 10
LABOUR PRODUCTIVITY IN 1990–2007, TONNES OF STEEL PER PERSON



Source: Authors' calculations

TABLE 4
COMPARATIVE MATERIAL AND ENERGY CONSUMPTION OF METAL PRODUCTION

Resources	Ukraine	Developed countries, average
Coke (kg/t of iron)	520	320
Iron ore (t/t of iron)	1,8	1,5
Natural gas(m3/t of iron)	79	practically not used
Energy (GJ/t of rolled metal)	30	25
Standard coal (t/t of rolled metal)	1,28	0,96

Government support to the metal industry has traditionally to a large extent taken the following forms:

1. Indirect subsidies through low prices for raw materials, energy, gas, transportation services etc.
2. Currency devaluation as export promotion method.
3. Financial and fiscal preferences for the sector.

While these policies may give ad-hoc boosts to the sector, they have important drawbacks:

- They do not set any incentives to increase productivity, to innovate or expand into new product lines. As a result, their effect on competitiveness is artificial, not sustainable and will disappear as soon as the policies are withdrawn.

- The first and third type of policies are potentially in conflict with the WTO Agreement on Subsidies and Countervailing measures and may therefore be challenged by other WTO Members given that Ukraine joined the WTO in 2008.
- Subsidies to raw materials and energy discourage efficient use of resources and thus have a negative long term impact on the industry's competitiveness and environmental footprint.

Measures explicitly targeting innovation are likely to be more successful in achieving a durable improvement in the metallurgy sector's competitiveness. Such measures could take the form of:

- tax credit for the share of the profit directed to productive reinvestment
- tax preferences for imports of energy-saving equipment
- special credit lines for renovation projects

If such measures were not sector specific but targeting all productive sectors, these policies could in addition contribute to increased diversification, in the sense that investments would also be encouraged in industries other than the metallurgy industry.

The government and enterprises active in the metallurgy sector may also want to consider directing more resources into trade diplomacy and the strengthening of expertise in matters of trade law. Iron and steel products have traditionally been among the products most frequently targeted by anti-dumping measures or investigations (World Trade Organization, 2009). This pattern is also reflected in the anti-dumping investigations initiated during the crisis, where the iron and steel sector is the most prominent one. Ukrainian steel exporters have also suffered from this. According to the Global Trade Alert database, Ukrainian metallurgy exports have been the target of nine new antidumping investigations since the onset of the crisis, initiated by Canada, India (two), the European Council, Pakistan and the Russian Federation (four). Strengthened expertise and networks in trade matters would help Ukraine to deal with this type of situations.

Bottlenecks in the enterprise enabling environment

Two further criteria related to the enterprise enabling environment merit explicit mentioning: the competitive environment and infrastructure. Competition issues have come up in two contexts in the ILO work on the metal industry and in the focus group discussion that took place in March 2010. First, the lack of competition in raw material markets within Ukraine maintains input prices for the metal industry artificially high. Production costs for the sector could therefore be lowered through increased competition in input markets. Second, the monopoly in railway services seems to have negative effects on the quality of railway services and notably leads to higher than necessary loss of produce during transport from production site to ports. In many countries crisis related stimulus packages contained strong infrastructure components. This has been the case in industrialized, emerging and developing countries alike. Infrastructure investments, if targeted and administered properly, strengthen the enabling environment faced by enterprises as outlined above. They create employment, and in Ukraine they have the additional advantage that they create internal demand for one of the major industrial sectors, i.e. the metal industry. Infrastructure projects thus seem to be a natural candidate for crisis intervention in the Ukraine, but have not been used by the government during the crisis.

Skills

The sector is dominated by workers with ISCED¹⁸ –3 qualification level. In 2008, the majority of skilled workers (ISCO¹⁹ 7) in metallurgy had upper secondary education (61.6 per cent of total occupations). The same applies to plant and machine operators and assemblers (ISCO 8 level and 59.2 per cent of total occupations). Workers with ISCED–2 level were employed in skilled manual jobs (11.2 per cent) and unqualified jobs (12 per cent). There is a lack of professional management culture in the sector, despite the fact that 71.2 per cent of senior officials hold tertiary education. According to the Federation of Metallurgists of Ukraine, this is due to the existing system of government support that does not create incentives for managers to improve the efficiency of their enterprises. A shift towards policies in support of innovation (as described earlier on) should be accompanied by training offers to managers to accompany this policy shift by emphasizing the importance of a long terms strategy for increased competitiveness.

With regards to skills other than management skills, existing survey evidence provides a picture of a sector characterized by a significant level of skill-mismatch, although lack of reliable data does not allow the exact characterization of that mismatch. Based upon research conducted by the World Bank,²⁰ only 19 per cent of firms in the base metals industry consider inadequate education of workers a serious obstacle. This is far below the average of 42 per cent for all firms in the sample, and the share is similarly low only in the chemicals industry (19 per cent).²¹ However, the share is much higher (51 per cent) for companies in the fabricated metal industry. This is among the highest share for any manufacturing sector, exceeded only by plastics and rubber (56 per cent). The finding suggests that lack of skilled workers may be one of the reasons why Ukraine's metal processing industry remains concentrated on rather low value added products instead of moving into more sophisticated fabricated metal exports. Concerning geographical availability, the lack of skilled labour was a particularly serious problem for enterprises located in the Eastern (48 percent) and Northern (43 percent) regions.

Qualitative research on metallurgic enterprises in the Donetsk and Dnepropetrovsk regions, conducted by the Bureau of Economic and Social Technologies²² in 2008, revealed an imbalance in the supply and demand of engineers. The number of job applications was eight times higher than the number of vacancies but the positions remained open up to 12 months.

The lack of qualified labour is further aggravated by a significant out-flow of skilled workers. According to the results of the Sample Survey²³ on Labour Migration External Labour Migration of the Ukraine's Population, more than 32 percent of skilled worker-migrants in 2007–08 were employed in the metal industry abroad, and their average wage was 766 US dollars compared to the average of 308 US dollars in Ukraine.

The VET system tries to introduce new technologies in the training process, but such efforts are rendered difficult by out-dated laboratories and didactical material, and inadequate educational level of VET staff

¹⁸ ISCED (International Standard Classification of Education) has 7 levels: 0=Pre-primary education; 1=Primary education; 2=Lower secondary; 3=Upper secondary; 4= post secondary non University; 5= University ; 6= PHD, http://www.unesco.org/education/information/nfsunesco/doc/isced_1997.htm;

¹⁹ The International Standard Classification of Occupations (ISCO), <http://www.ilo.org/public/english/bureau/stat/isco/index.htm>;

²⁰ See also: The EBRD-World Bank Business Environment and Enterprise Performance Survey (BEEPS) , 2008, http://siteresources.worldbank.org/INTECAREGTOPANTCOR/Resources/704589-1267561320871/Ukraine_2010.pdf

²¹ The survey covers companies in the manufacturing and services sectors but excludes agriculture and mining.

²² BEST-Bureau for economic and social technologies, <http://www.scm.com.ua/en/publish/category/8459> (accessed 13 April 2010)

²³ State Statistics Committee of Ukraine, Open Ukraine, Ukrainian Centre for Social Reform: Sample Survey on Labour Migration: External Labour Migration of Ukraine's Population, (Ukraine, 2008)

(teachers with university degree amounted to 21 percent of all educators in 2007–08). In addition, the inherent rigidity of the VET system, which prevents the quick adaption of training programs to rapid changes in the demand of enterprises, is another barrier. For that reason, the majority of metallurgical enterprises prefer to hire unqualified jobseekers and train them according to their needs.

An example is offered by “Azovstal Iron and Steel”, ranked among the three largest metallurgical enterprises in Ukraine. In order to prepare appropriately its managers, the enterprise selects a number of four-year students from the Pryazov State Technical University and provides them with additional modules in human resource management and decision making.²⁴

The Ministry of Industrial Policy is one of the leading institutions in the metallurgy sector. Its main competences include: Design and implementation of policies in the sector; promotion of foreign direct investment; elaboration of mechanisms for improved coordination among the main stakeholders, etc. The Ministry has no role in the identification and implementation of education initiatives. In the crisis period, however, the Ministry of Industrial Policy has contributed, together with the Ministry of Labour and Social Policy, to the elaboration of the Decree of the Council of Ministers №25 /14.10.2008 *“About Measures towards Stabilization of the Situation in Mining, Metallurgy and Chemical Plants”*. The decision envisages among other measures the state financing of training courses organized in case of redundancies due to reorganization or temporary suspension of production.

The inter-ministerial collaboration on human resources development issues should be further strengthened. A short- and long-term vision should be developed by policy makers in close collaboration with the social partners, on the content and quality of training necessary in the metallurgy sector to improve international competitiveness. This should take the form of concrete time bound action plans, with indicators of progress and allocation of financial resources.

In order to improve the sector's competitiveness and facilitate the restructuring process, continuous and adult training should be developed. Here, the social partners have an important role to play. They should raise awareness about the need for skills upgrade and involve plant managers in this process. In addition, information campaigns for promotion of training can be organized, at a sector level, with the help of the line Ministry.

With respect to implementation, the design of programs should be done in close collaboration with individual employers. The option is usually workplace-based, tailor-made training in order to meet the specific needs of each enterprise. Taking into consideration the big size of companies in the sector and the financial resources necessary for massive training programs, economies of scale can be achieved through joint sector skills planning. An example could be the selection of one enterprise to pilot in-company industry-based training or a movable team of trainers can be created to serve a number of enterprises from the sector.

²⁴ Novosti [Daily newspaper]: <http://www.pravda.dn.ua/details/40637> (accessed 10 April 2010)

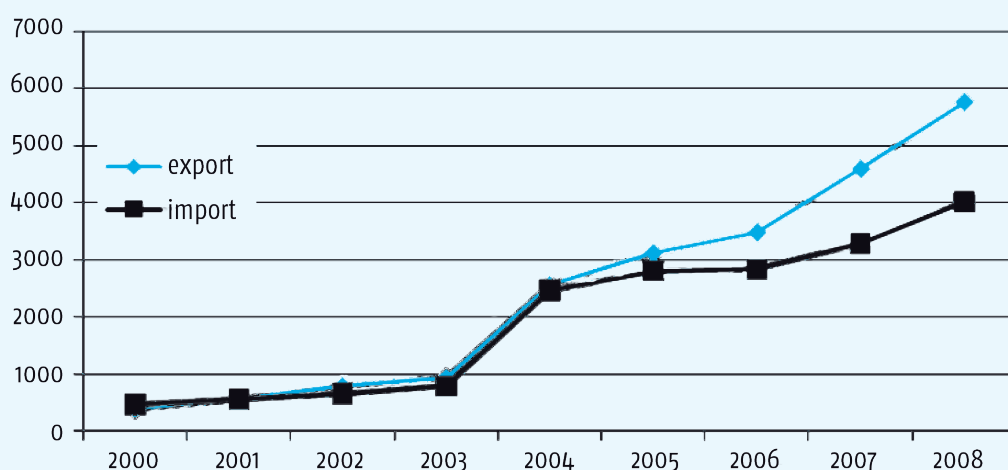
5. Strengthening Ukraine's tourism industry: a focus on the hotel sector

Background

The tourism industry currently accounts for a small fraction of the Ukrainian economy but has significant growth potential because of Ukraine's favorable natural and climatic conditions and large numbers of historical and cultural monuments. The upcoming European Football Championship 2012, that will be co-hosted by Ukraine, has the potential to give a significant boost to the country's tourism industry.

In recent years, the tourism sector has been growing in terms of exports and imports, as reflected in the chart below. Both imports and exports of travel services have risen steadily in terms of value in the period 2000 to 2008, with strong increases in 2003 and in the two years preceding the crisis. The evolution of the number of incoming tourists is similar as it increased from around 7 million persons in 2000 to 25 million in 2008. The number of outgoing tourists instead remained rather stable around 15 million. The number of incoming tourist dropped sharply during the crisis as it did in most tourist destinations, but the global outlook for the tourism industry is rather positive for 2010.

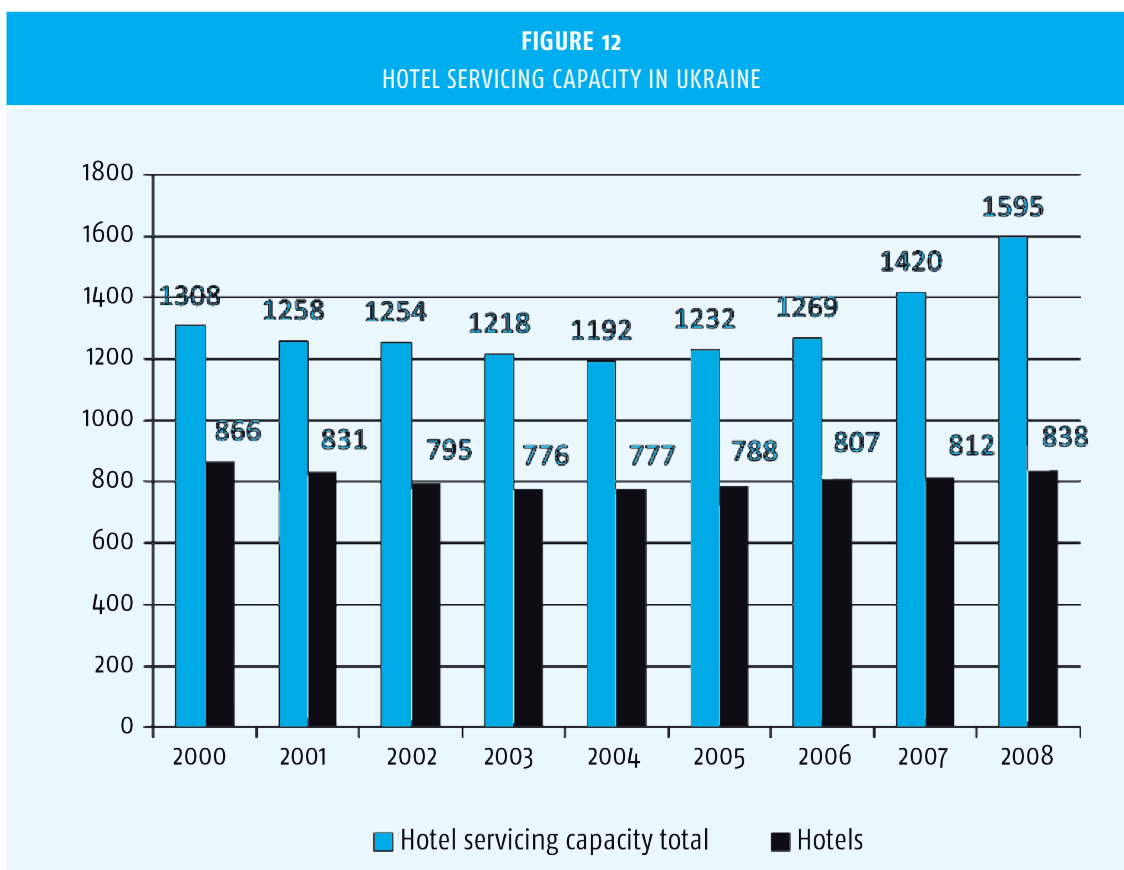
FIGURE 11
IMPORT AND EXPORT OF TRAVEL SERVICES, MLN USD (BOP DATA)



Source: Balance of Payments

Although the tourism industry is growing, it still represents only a small share of the economy compared to other countries. In 2007 tourism accounted for 0.8 percent of GDP. This percentage is over 6 per cent in Spain and around 8 percent in countries like Austria and Croatia.

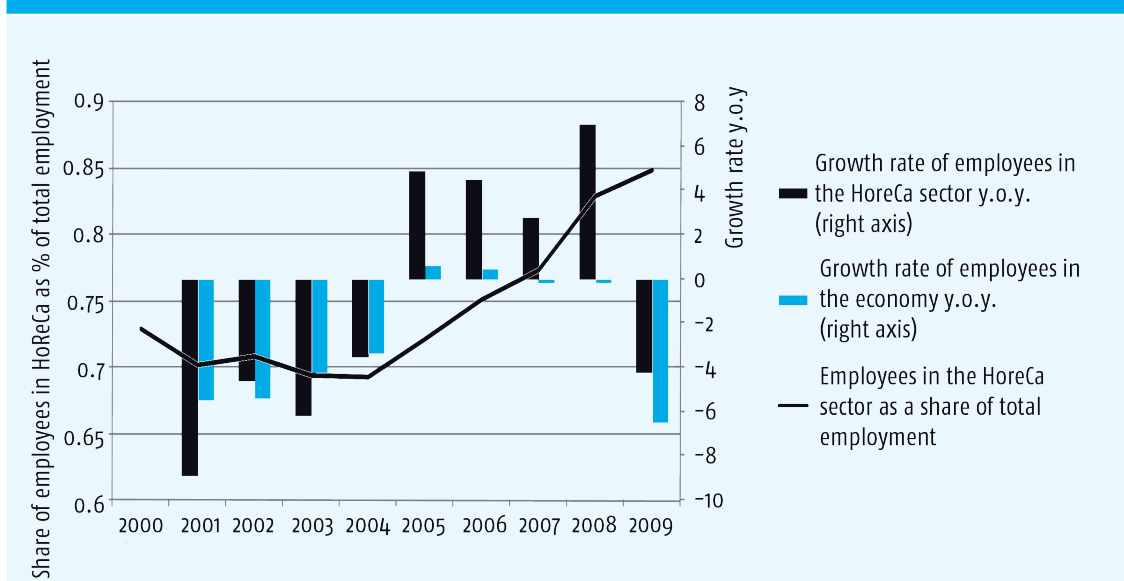
This report mainly focuses on one segment of the tourism industry: the hotel sector. Notwithstanding the constant increase in the number of incoming tourists in the past decade, hotel service capacity decreased between 2000 and 2004. The increase in hotel servicing capacity observed since 2004, has mainly taken place in the non-hotel segment and the number of hotels in 2008 remained below the one in 2000, as illustrated below.



The number of people working in the Hotels, Restaurants and Catering (HoReCa) sector for the period 2002–09 has accounted for less than 1 percent of total employment in Ukraine (see Figure 13), compared to 4 percent of total employment in the EU-25 countries in 2008.²⁵ According to data from the Labour Force Survey (LFS), the number of employed in the hotel sector in 2009 was 36,500, while those employed in the restaurant sector counted 60,500 persons.

²⁵ Eurostat, Labour Force Survey 2008, <http://epp.eurostat.ec.europa.eu/portal/page/portal/eurostat/home/>

FIGURE 13
SHARE OF HORECA IN TOTAL EMPLOYMENT



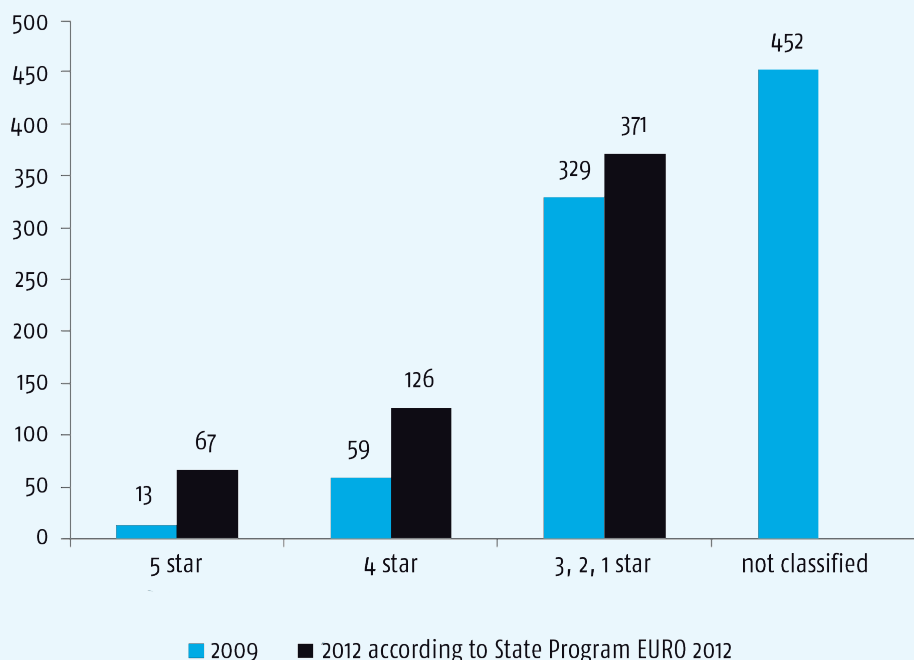
Source: State Committee of Statistics

Fixed capital investment in the hotel sector amounted to 0.5–0.7 per cent of total investment for the period 2002–2007 and is thus somewhat below the sector's weight in the overall economy. In the same period 1.2 per cent of total FDI went into this sector.

The hotel sector consists to a large extent of small enterprises and contained until recently only a relatively small number of top quality hotels. Classification efforts are still going on and in 2009 around half of the existing hotels had not been classified according to a harmonized "star" system. For the EURO2012 hotel capacity needs to be expanded in particular in the high end segment. The State Program 2012 therefore foresees the construction of at least 54 five-star hotels and 67 four star hotels, as depicted below. With only two years to go, EURO preparations, however, appear to be behind schedule, and in early April 2010 the UEFA President gave Ukraine a two month deadline to show significant progress in the preparations. Concerns are highest with respect to the progress in stadium building and in the availability and quality of general infrastructure. But the availability of hotel accommodation has also been pointed out as a concern, as illustrated in the following quote:²⁶ "In Lviv, the stadium is not completed but there are lots of hotels. In Donetsk, there is a fine stadium but for a city that will hold a semi-final there are few hotels."

²⁶ Michel Platini according to BBC News, April 7 2010.

FIGURE 14
NUMBER OF HOTELS BY STAR CLASSIFICATION



Source: Ministry of culture and tourism and State Program EURO2012

Bottlenecks in the enabling environment faced by the hotel sector

The preparations for EURO2012 are likely to suffer from the general bottlenecks to realizing the hotel sector's growth potential that have been identified during the preparations for this report. Problems with the institutional framework, regulatory environment in particular with respect to land allocation and lack of infrastructure have been identified as important obstacles in the hotel sector.

The hotel sector falls under the responsibility of different governmental institutions which slows down administrative processes. The Ministry of Culture and Tourism²⁷ is one of the leading institutions in the tourism sector and its main mandate includes the design of policies in the HoReCa sector. It has an implementing agency called the State Agency for Tourism and Resorts.²⁸ Other ministries with competencies in the field of HoReCa include the Ministry of Education and Science, the Ministry of Economy and the Ministry of Labour and Social Policy. The Ukrainian Federation of Employers in the Tourism Sector,²⁹ founded in 2008, has prepared a *"Concept of Tourism Development in Ukraine (National Tourism Doctrine)"* that includes the suggestion to create "one executive body" that would comprehensively "supervise" all issues linked to the tourism sector development, including preparations for the EURO2012.

In the light of the urgency in which preparations for EURO2012 need to take place, the creation of a body that comprises representatives of all relevant government institutions but also of employers and workers appears to be highly desirable. One of the questions the responsible body should take into account is the question of how to use hotel infrastructure built for EURO2012 after the event. Hotels have in the past tended

²⁷ See also: <http://mincult.kmu.gov.ua/mincult/uk/index>

²⁸ See also: <http://www.tourism.gov.ua/structure.aspx>

²⁹ See also: <http://frtu.org.ua/content/view/29/27/lang.ukrainian/>

to function below capacity level. With an increased number of newly built accommodations, there would be need either for a concerted strategy to increase tourism or business travel to the four EURO cities, or to foresee alternative uses for those accommodations after the event. The clearer the plans for future use are, the more likely it will be that the EURO preparations will be able to attract significant amounts of private investment, either domestic or foreign.

One of the regulatory bottlenecks that was repeatedly emphasised during the preparations for this report, including during the focus group discussions in March, are the complicated procedures for hotel building. The World Bank's Doing Business Report ranks Ukraine 181th out of 182 countries in the ease of obtaining a construction permit. Private sector actors report that the legalization of a land lot requires about 160 approvals, a process that takes two to three years. This is clearly too long to allow for a dynamic hotel sector to flourish. It may also have been one aspect that has slowed down the preparations for EURO2012. The event represents an opportunity to experiment with new approaches regarding land release, approaches that would need to be critically assessed after the event.

With respect to infrastructure, the strengthening of the airport and road infrastructure are the most urgent tasks and the government has signalled commitment to meet the challenge. In the improvement of the infrastructure, issues of road signalling and availability of travel information accessible to foreigners should also be kept in mind.

Skills

The composition of the workforce in the HoReCa sector shows that in the period 2002–08, on average 47 percent of the employed persons held a university degree, which is slightly lower than the national average of 51 percent. More than 35,000 students from 143 educational institutions are involved in vocational education in tourism, of which nearly 2,000 students of vocational schools in Ukraine have a specialization in Hotel and Restaurant service. Regarding continuing training, the number of employed persons who attended training in the HoReCa sector is 5 to 6 times lower compared to other sectors of the economy. There could be different reasons: lack of funding and incentives for employers and employees to invest in training; the structure of the HoReCa sector is dominated by small, family enterprises, with limited resources for training; high number of seasonal jobs.

Turnover in the HoReCa are relatively high due to a variety of factors: small size and limited capacities of the sector to engage more people, relatively low average salary levels and non-attractive working conditions (seasonal work, precarious contracts, high levels of informality, and frequent demands for over-time work without adequate remuneration). Further, skills in tourism are transversal (e.g. language skills, customer orientation, Information and Communication Technologies (ICT) skills) and on demand in other branches of the economy that offer better working conditions, which facilitates mobility.

It is difficult to identify existing discrepancies between skill supply and demand in the hotel sector, as the data needed for such an exercise were not available. Given the important growth potential of the sector, though, and the need for the creation of new enterprises in often new activities, a strengthening of entrepreneurship and management capacity in the sector is likely to lead to strong benefits. In addition, it should be noted that there is an increasing trend in the tourism industry at the EU level towards new, hybrid occupations, which reflect the nature of the new products offered by the market and the increasing role of ICT (Strietska-Illina & Tessaring, 2005).³⁰

There is no specific department at the State Agency or at the Ministry of Tourism and Culture on skills development/human resources in tourism. Further, inter-ministerial collaboration is lacking and the involvement of social partners in the policy design and implementation process is weak. A systemic approach to the human resources development in HoReCa requires, as a first step, the identification of the

³⁰ This point has also been stressed by the Ukrainian Federation of Employers in the Tourism Sector

training needs of the hotel and other tourism sub-sectors. In the short-run, this result can be achieved through focus group discussions and mini-surveys with trend-setting employers. The results will provide key elements on skills identification and diagnosis of the sector's current and future training needs. Based upon these indications, public bodies (Ministry of Education, Ministry of Culture, Ministry of Economy), and representatives of employers' associations and trade unions, will be involved in designing a sector training strategy. It is recommended to establish an advisory body "Tourism Advisory Council" in human resources policy in general and in the elaboration and implementation of such a strategy in particular. The Council would be chaired by the Ministry of Culture and Tourism and would include all relevant public, private and social partners.

With increased development of high-end accommodations in the run-up to EURO2012, a significant number of qualified staff will be required in the short term. This could be achieved by organizing mobile units of expert trainers that serve the locations of relevance for the event. Training courses would be organized locally and the participants will undertake an exam and receive a skill certificate at the end of the course. As it is important to assess the quality of competencies acquired through training, it could be envisaged to liaise with an internationally recognized partner that can help in designing profiles and improving teaching methods, as well as contribute to the quality assessment. Possible partners may be: 1) the International Hotel and Restaurant Association (IHRA); 2) Italian Federalberghi; 3) German Hotel Association (IHA). This system of mobile units could also be used after the event to provide training in locations that are located at large distances from relevant training centres.

Summary and policy conclusion

This report was written in the context of ILO work on crisis mitigation in Ukraine but it was given a forward-looking spirit. It takes a view on reducing the negative impacts of possible external shocks in the future, and on bringing the Ukrainian economy on a more vigorous and above all sustainable growth path after the crisis. This was done by an examination of the business enabling environment and the role of education and skills in Ukraine with a particular focus on economic diversification.

The analysis provided in the first part of the report depicts an economy that has been able to keep track with global developments in the years preceding the crisis, but that has not been able to use those boom years to position itself well for the next decades. In particular the structure of the economy has remained remarkably stable over those years, which implies among other things that the overly high concentration of economic and export activities around the metallurgy sector has been maintained. Ukrainian exports have not managed to significantly penetrate markets in growing emerging economies and are still concentrated in low technology segments notwithstanding the high education level of the Ukrainian labour force.

The availability of natural resources predestines Ukraine to be and remain an important player in the metallurgy sector. This is why this report has discussed ways of strengthening the performance of the sector in order for it to improve its role as a provider of jobs and generator of income within the Ukrainian economy within a global context that is likely to be increasingly competitive in future years. This report has also looked in more detail at the hotel sector that is significantly underdeveloped in Ukraine and has large growth potential.

Policy intervention during the crisis and before has been characterized by interventions in the price mechanisms that affect export prices or production costs. Such interventions, like exchange rate devaluations and subsidies to inputs, have the advantage of having immediate and visible short-run effects on the target groups, but have the disadvantage of being supportive to the status quo in that they help enterprises to remain profitable despite continuing business as usual. Policies in support of change are of a different nature and target investment and innovation rather than output or input. This report has therefore argued in favour of shifting government support away from sectoral subsidies towards tax incentives or subsidies that favour investment. The report has also argued in favour of applying such incentives to all sectors in order to allow also non-traditional exporters to take advantage of them and to embed them in a transparent overall strategy rather than taking ad-hoc measures that often only benefit well-connected companies. The report further recommends to scrutinize and streamline existing regulation affecting enterprise creation in order to make it less burdensome and more conducive to entrepreneurship.

In the general discussion of Ukraine's business enabling environment in this report, it has been pointed out that Ukraine scores badly at the global level when it comes to the intensity of local competition, effectiveness of anti-monopoly policies and the extent of market dominance. The prevalence of large local players also appears to negatively affect the quality of social dialogue in a number of sectors. In addition, the role of market power has been identified as one of the limiting factors for enhanced competitiveness of the metallurgy sector. In particular, the lack of competition in raw material markets within Ukraine and the monopoly in railway services have a negative impact on the competitiveness of Ukrainian companies.

The need for infrastructure improvements has been stressed throughout this document. High quality infrastructure has positive spillovers on all segments of economic activity. In the context of a still relatively weak labour market following the crisis, increased spending on infrastructure is also likely to have benefits because of its potential to create employment. Infrastructure improvements are also necessary to guarantee a successful implementation of the EURO2012.

The metallurgy sector and other export sectors could also benefit from a more pro-active role of government in export promotion and from investments in a stronger trade diplomacy. The expansion and intensification of the network of Ukrainian representations abroad should be considered, in particular with a view on stimulating Ukrainian exports into growing emerging markets like China, India or Brazil.

Dynamic economies that are able to constantly enter new fields of activity and new product or geographical markets tend to be characterized by a strong entrepreneurial spirit. There is scope for strengthening entrepreneurship in Ukraine, and policy makers should consider having this objective in mind in future reforms of the education and training system. In particular it may be desirable to replace traditional concepts of education and training for entrepreneurship – characterized by the availability of separate economic and business education branches – by the concept of entrepreneurship as a key competence. This implies that the entire learning process should be reorganized starting from primary education through university in order to develop a more entrepreneurial society. The Ministry of Education and Science could take the lead in establishing a national strategy for entrepreneurship education. The best practices in Europe can offer a good inspiration for the preparation of the strategy, which may focus on the following key aspects:

- At the level of primary education, the emphasis is on attitudes, skills, creativity and innovation (core entrepreneurship skills);
- At the level of lower and upper secondary education, the emphasis is on more applied knowledge and skills developed through youth enterprises and in association with different service providers;
- At the level of higher education, there is a wide range of entrepreneurship education options, with the specific development of Master and Doctorate programs in entrepreneurship and innovation.

In the existing economic environment, workers will be required to learn and adjust throughout their working life. Therefore, they need not only to learn new skills to meet the growing demands for skills, but also to be equipped to cope with a quickly changing environment. Curricula should include non-technical soft skills, including entrepreneurship, work ethics, and communication, as well as English and other foreign languages. In this light, it should be considered to replace the current State Order System in education by an environment in which educators and employers work together. There is an urgent need that secondary and post-secondary VET is coupled with a solid system of Continuing Vocational Education (CVE).

A number of other innovations in the country's education and training system should be considered in order to equip future generations with the skills demanded. There is no need to spend more money on education as the Ukraine has traditional directed high levels of investment into education. The foundations of the country's education and training systems are therefore rather strong. Yet, the system is characterized by too much centralization and inertia, which renders it ineffective in dealing with a constantly and frequently changing environment. In order to enhance the systems' responsiveness, links between the labour market and VET need to be strengthened, which requires an improved level of coordination between social partners and between the Ministries of Labour and Social Policy, Education, Economy and Industrial Policy. To speed up processes, "sector skills committees" could be established, consisting of the social partners, trainers, practitioners, and the relevant line Ministries. These committees would work on identification of skill needs, the development and upgrading of occupational profiles, which will then be used to develop educational standards and curricula. They could become permanent elements, feeding information into the process of NQF development and also on the most recent sector skills demands. Relying just on ad-hoc employers' surveys to develop and update occupational profiles will not be sufficient for the future.

Also at the more general, strategic level, both sectors discussed in this study could benefit from enhanced inter-ministerial co-ordination and closer collaboration with social partners. In the metallurgy sector consultations among different institutions and different actors have taken place during the crisis and it should be considered to institutionalize such collaboration. The hotel sector is characterized by a total absence of collaboration and co-ordination and decision making has traditionally been slow because the sector falls under the responsibility of multiple government bodies. Therefore, in order to contribute to the strategic development of tourism, it is suggested to establish a Tourism Advisory Council. It will be chaired by the Minister of Culture and Tourism and will include representatives from tourism industry, the relevant government departments and trade unions. The first issues to be addressed are the challenges posed by the global economic downturn and the opportunities provided by the Euro-2012 Football Championship for a sustainable growth of the sector. The Tourism Agency will act as Secretariat of the Council. A possible inspiration for the above Council could be the British Tourism Advisory Council (TAC).³¹

The experience collected in the run-up the EURO2012 can and should be used for continuing efforts to stimulate strategic thinking and creative approaches towards entrepreneurship and skill enhancement with a view on bringing the economy on a strong and sustainable growth path that provides benefits to all.

³¹ http://www.culture.gov.uk/what_we_do/tourism/6328.aspx

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