

# Industrial Development in the Ukraine

Even in the fourth year after the dissolution of the Soviet Union, Ukrainian industry still failed to show signs of recovery and growth. Industrial output in 1995 fell by 11.5%, investment – according to official figures – by as much as 48.9%. There has been a 24% fall in industrial employment since 1990. Despite the strong expansion of the service sector – many of whose activities are not recorded in the statistics – hidden unemployment is expected to have increased further. The Ukrainian government reacted to the dissolution of socialist industrial structures primarily in the form of administrative intervention, which sought to block structural change, while failing to halt it in the medium term. Even now the policy approach relies largely on government-backed vertical branch development programmes. A large number of enterprises are to be restructured by interministerial committees. The creation of industrial-financial groups decreed by the government aims primarily to bring the new Ukrainian-Russian corporate groups under public control. Structural policy is inadequately oriented towards market economic principles. There is thus the real danger that resource allocation will continue to be performed largely by the state.

## Industrial development from 1990 to 1995

### Industrial output by branch

Even after the drastic contraction of output in the years 1990 to 1994, a turnaround was not achieved in 1995: industrial output contracted by 11.5%. The overall output loss since 1990 amounts to 48%. As in earlier years, the branches most badly affected in 1995 were engineering (-24.8%), building materials (-29.1%) and light industry (-24.8%) (cf. table 1). Basic-good industries, by contrast, performed relatively well. Electricity output, for example, fell by just 5.4%, that of the iron and steel industry by 6.6%. The smallest decline – 2.4% – was experienced by non-ferrous metallurgy.

In 1990 engineering, the branch that has suffered the most spectacular decline in output, accounted for 30.7% of industrial production; by 1995 this relative share had fallen to 15% (cf. table 2). No end to this contraction is as yet in sight. One of the central reasons for the decline in the relative importance of engineering – besides the loss of sales opportunities from the former Soviet Union – is the dramatic decline in military production. Arma-

ments, building machines, motors, aircraft and ship-building were accorded priority under socialism. So far only a very few engineering firms have successfully "converted", i.e. have gained access to civil sales markets. The relative share of industrial output produced by light industry has also fallen sharply. Despite favourable conditions prevailing in the Ukraine in this area – low wages, a skilled workforce, proximity to west European markets, well-equipped machine park – light industry's share of industrial output fell from 10.8% in 1990 to just 2.7% in 1995.

An increase in relative importance was again achieved by the basic goods industries in 1995. Over the period 1990 to 1995 the iron and steel industry managed to double its output share (from 11.9% to 21.9%); the fossil fuel and electricity generating industries expanded in relative terms to an even greater extent. This has served to further increase the "bias" towards basic goods in the Ukrainian industrial sector. This is problematic not only with regard to the already very high energy intensity of the sector: there is the real danger that the relative expansion of energy-intensive industries is due solely to the subsidisation of energy. Thus the competitive advantage of energy intensive industries would be lost if energy prices were adjusted to market conditions. This is serving to postpone structural change.

### Investment

With respect to industrial investment, too, the decline continued in 1995. Following an interruption in the contraction of investment in 1994 – one probably due partly to statistical factors – investment fell, according to official figures, in 1995 alone by 48.9% (cf. table 3). Thus the overall decline in investment since 1990 amounts to around 70%. This trend poses a threat to the medium- and long-term prospects for economic growth. In addition to private investment, public capital spending has also contracted dramatically in many areas, particularly construction and infrastructure.

The distribution of industrial investment across the various branches is again characterised by the increase in relative importance enjoyed by heavy industry (electricity, coal, metallurgy); conversely investment in engineering has lost ground in relative terms (cf. table 4). Also symptomatic is the sharp decline in the relative importance of investment in the building materials, glass and ceramics industry, from 5.1% (1990) to 2.0% (1995). This reflects the sharp fall in construction activity. Given the 13% decline in coal output and the clearly chronic lack of mining investment, the significant rise in the share of industrial investment realised in coal min-

Table 1

## Gross Output by Industry, 1991 to 1995

Change on previous year in %

	1991	1992	1993	1994	1995
Whole industry	-4.8	-6.4	-8.0	-27.3	-11.5
of which:					
Electricity industry	-4.0	-6.4	-5.9	-12.5	-5.4
Fuel industry	-11.2	-14.5	-22.5	-17.2	-10.5
Iron and steel	-11.7	-9.7	-23.8	-28.8	-6.6
Non-ferrous metallurgy	.	.	.	.	-2.4
Chemicals and petrochemicals	-6.8	-12.7	-25.2	-25.5	-10.2
Engineering and metal-working	+4.2	-3.6	+6.1	-38.3	-24.8
Wood, cellulose and paper	+2.3	+1.3	-2.8	-32.8	-21.1
Building materials	+1.5	-3.7	-15.0	-37.0	-29.1
Light industry	-2.6	+5.4	-13.3	-46.8	-34.8
Food industry	-12.8	-14.5	-12.3	-18.4	-13.8

Sources: Statistichnyj Scorinik Ukrainy za 1994 rik. Kiev 1995, p. 128; Statistichnyj bjuleten' za 1995 roku. Kiev 1996, p. 5; Ekonomichnyj i social'nyj rozvitok Ukrainy v 1995 roci. Kiev 1996, table 78.

ing (from 13.5% in 1994 to 22.7% in 1995) seems highly implausible. Rather, it seems likely that, as occurred in previous years, the investment funds provided by the government were used to pay wages.<sup>1</sup>

## Employment

There is still no statistical recognition of the de facto existence of unemployment. Official statistics put the unemployment rate at the end of 1995, for example, at just 0.6%.<sup>2</sup> The International Labour Organisation, on

<sup>1</sup> Cf. *World Bank*, Ukraine – Coal Industry Restructuring Sector Report, Washington D.C., 1996.

<sup>2</sup> Cf. *Ukrainian Economic Trends*, January 1996.

Table 2

## Structure of Gross Output by Branch

% shares<sup>1)</sup>

	1985	1990	1991	1992	1993	1994	1995
Electricity industry	3.2	3.2	3.6	6.4	9.4	11.5	11.4
Fuel industry	7.2	5.7	3.8	14.3	8.5	11.2	13.2
Iron and steel	12.6	11.0	9.9	22.7	16.8	19.9	21.9
Non-ferrous metallurgy	.	.	.	.	.	.	1.6
Chemicals and petrochemicals	6.1	6.0	5.9	6.7	6.0	6.9	7.5
Engineering and metal-working	28.4	30.7	26.4	18.6	19.8	17.0	16.0
Wood, cellulose and paper	2.8	2.9	2.9	2.2	2.6	2.4	2.2
Building materials	3.6	3.4	3.7	3.6	4.7	4.0	3.9
Glass and ceramics industry	0.5	0.5	0.6	0.5	0.5	0.6	.
Light industry	11.6	10.8	12.3	6.7	6.1	4.4	2.7
Food industry	18.7	18.6	24.4	13.6	19.7	17.1	15.0
Total	100	100	100	100	100	100	100

1) At current prices.

Sources: Statistichnyj Scorinik Ukrainy za 1994 rik. Kiev 1995, p. 130; Statistichnyj bjuleten' za 1995 roku. Kiev 1996, p. 9

Table 3

## Investment by Industry, 1990 to 1995

in million karbovanec; 1991 prices

	1990	1991	1992	1993	1994	1995
Whole industry	18 450	15 159	11 149	9 681	9 876	5 048
change on previous year in %	.	-17.8	-26.5	-13.2	+2.0	-48.9
of which:						
Electricity industry	1 540	1 012	700	1 072	666	824
change on previous year in %	.	-34.3	-30.8	+53.1	-37.9	+23.7
Coal industry <sup>1)</sup>	2 601	2 963	2 968	1 511	1 330	1 143
change on previous year in %	.	+13.9	+0.2	-49.1	-12.0	-14.1
Oil and gas industry	1 521	979	442	1 282	1 382	583
change on previous year in %	.	-35.7	-54.9	+190.0	+7.8	-57.8
Non-ferrous metallurgy	1 824	1 723	1 544	1 332	1 263	956
change on previous year in %	.	-5.5	-10.4	-13.7	-5.2	-24.3
Chemicals and petrochemicals <sup>2)</sup>	1 160	965	710	727	1 519	348
change on previous year in %	.	-16.8	-26.4	+2.4	+108.9	-77.1
Engineering and metal-working	5 405	3 340	1 828	895	686	279
change on previous year in %	.	-38.2	-45.3	-51.0	-23.3	-59.3
Wood, cellulose, paper and printing industry	420	364	147	88	76	56
change on previous year in %	.	-13.3	-59.6	-40.1	-13.6	-26.3
Building materials, glass and ceramics industry	944	1 033	573	316	235	101
change on previous year in %	.	+9.4	-44.5	-44.8	-25.6	-57
Light industry	879	561	510	424	430	68
change on previous year in %	.	-36.2	-9.1	-16.9	+1.4	-84.2
Food industry <sup>3)</sup>	1 924	2 094	1 599	1 600	2 226	613
change on previous year in %	.	+8.8	-23.6	+0.1	+39.1	-72.5

1) Incl. peat. — 2) Incl. pharmaceuticals. — 3) Incl. mills and animal foodstuffs.

Sources: Narodne gospodarstvo Ukrainy u 1993 roci. Kiev 1994, p. 119; Statistichnyj Scoricnik Ukrainy 1994. Kiev 1995, p. 253; Ekonomichnyj i social' nyj rozvytok Ukrainy v 1995 roci. Kiev 1996, tables 13 and 17.

the other hand, estimates the actual extent of underemployment at between 20 and 25%.<sup>3</sup>

The volume of industrial employment has, though, fallen from 7.1 million (1990) to 5.4 million (1995) (cf. table 5). Besides the still major importance of engineering in employment terms, the striking feature is the employment growth in the electricity, oil and gas industry and the iron and steel industries. Since 1990, employment in the electricity industry has almost doubled. Yet the employment trends also show that industrial firms still face only limited pressure for adjustment: although industrial output has fallen by 47% since 1990, employment contracted by just 24%. Consequently, increasing labour market flows are to be expected in the coming years; this implies the need for a labour market policy.

## Privatisation

Overall, privatisation made slow progress in 1995, although some success was achieved in the so-called "small privatisation". Non-state-owned enterprises increased as a proportion of the total from 45.8% (1994) to 56.3% (1995), passing the 50%-line for the first time (cf. table 6). The relative number of private firms was lowest in the electricity industry (21.7%) and the oil and gas industry (6.8%), which in the Ukraine are considered to be "strategic sectors". Privatisation in light industry, the food industry and iron and steel, on the other hand, proceeded at a brisker pace.

The progress that has been made at a formal level in privatising firms should not, however, obscure the fact that privatisation cannot be expected to lead to significant efficiency gains. In many cases the privatised firms remain dependent on the previous owner, the state, for instance through supply or sales linkages. Moreover, it is rare for 100% of a firm's shares to be transferred to private ownership; often the state retains up to 49%.

<sup>3</sup> Cf. Standing, Guy, Labour Market Dynamics in Ukrainian Industry, in: *ILO-CEET Papers*, Budapest 1994; Standing, Guy, For a Realistic Apprehension of Unemployment in Eastern Europe, in: *Employment Observatory East Germany*, no. 16-17/1995.

Table 4  
Structure of Investment by Branch

% shares

	1990	1991	1992	1993	1994	1995
Whole industry	100	100	100	100	100	100
Electricity industry	8.3	6.7	6.3	11.1	6.7	16.3
Coal industry <sup>1)</sup>	14.1	19.5	26.6	15.6	13.5	22.7
Oil and gas industry	8.2	6.5	4.0	13.2	14.0	11.6
Non-ferrous metallurgy	9.9	11.4	13.8	13.8	12.8	18.9
Chemicals and petrochemicals <sup>2)</sup>	6.3	6.4	6.4	7.5	15.4	6.9
Machinery equipment	29.3	22.0	16.4	9.2	7.0	5.5
Wood, cellulose and paper	2.3	2.4	1.3	0.9	0.9	1.1
Building materials, glass and ceramic industry	5.1	6.8	5.1	3.3	2.4	2.0
Light industry	4.8	3.7	4.6	4.4	4.4	1.4
Food industry <sup>3)</sup>	10.4	13.8	14.3	16.5	22.5	12.2

1) Incl. peat. — 2) Incl. pharmaceuticals. — 3) Incl. mills and animal foodstuffs.

Sources: Narodne gospodarstvo Ukrainy u 1993 roci. Kiev 1994, p. 119; Statistyczny Scoricnik Ukrainy 1994. Kiev 1995, p. 253; Ekonomichnyj i social' nyj rozvitok Ukrainy v 1995 roci. Kiev 1996, tables 13 and 17.

Finally, there is still no market for securities and the country's bankruptcy law is not being applied, so that neither privately owned nor publicly owned enterprises are subject to a hard budget constraint.

### State control retained

Ukrainian industry continues to suffer from a substantial degree of state control, which restricts entrepreneurial freedom and thus blocks structural change at the micro level. The lack of an overall economic policy framework offers considerable scope to former industry ministries and regional authorities to exert their influence on restructuring. Moreover, since the start of 1996 there have been signs at governmental level of renewed "planning activity", an activity manifesting itself in concrete industry policy measures. Thus, while from a macroeconomic perspective the reform process as a whole is making progress, there is the danger that at the micro level state planning will be maintained.

### Vertical industrial policy and state planning

The "government industry policy concept" announced in February 1996 subjected so-called "strategic" industries to state planning and supervision. These include the automobile industry, shipbuilding, aircraft construction, machine-tools, microelectronics, telecom-

munications, light industry and the food industry.<sup>4</sup> Five-year plans are currently being drawn up for these branches, for which the branch ministries are making resources available for investment.<sup>5</sup>

Other vertical industry policy programmes have been defined for each branch of the energy sector.<sup>6</sup> Contrary to earlier projects, the gas and oil branches are to be brought together into large state holding companies. The state committee for oil and gas – with a status equal to that of a ministry – would thus continue to be responsible for planning and the allocation of investment funds. Competition would be restricted on both the producer and consumer side. The government programme for the restructuring of the coal industry contains particularly serious risks. In view of the fact that, at most, one third of the Ukrainian coal mines can operate profitably, the planned increase in mining output from 70 million t to 115 million t would appear to make little sense.<sup>7</sup> The limited resources available would be better devoted to facilitating the market adjustment of potentially compet-

<sup>4</sup> Cf. Decree by the ministerial cabinet of the Ukraine no. 272/1996.

<sup>5</sup> The ambivalence of Ukrainian economic policy is clearly shown in the preamble to the industry policy programme, where it is stated that: "State industrial policy is the activity of the government oriented towards the maintenance, support and development of domestic producers in all branches relating to the vital interests of the country, in particular its economic independence and the social and cultural standard of life of the population."

<sup>6</sup> World Bank op. cit.; International Energy Agency, Energy Policies of Ukraine, Paris, 1996.

<sup>7</sup> Cf. World Bank, op. cit.

Table 5

## Employment by Industry, 1985 and 1990 to 1995

in thousands

	1985	1990	1991	1992	1993	1994	1995
Whole industry	7 534	7 100	6 913	6 515	6 012	5 477	5 398
of which:							
Electricity	125	137	154	166	171	180	231
Fuel industry	691	656	666	688	688	649	695
Coal mining	657	626	634	655	656	615	652
Iron and steel	503	447	435	452	440	421	481
Non-ferrous metallurgy	48	44	52	53	50	42	43
Chemicals and petrochemicals (incl. pharmaceuticals)	390	351	360	350	326	295	293
Chemicals	276	256	251	245	230	212	.
Petrochemicals	54	51	50	51	47	41	.
Engineering and metal-working	3215	3058	2960	2671	2427	2127	1885
Machine tools	105	95	94	88	80	72	.
Machinery	272	270	260	224	192	167	.
Automobiles	114	107	107	111	110	100	97
Tractors and agricultural machines	242	225	210	195	180	158	144
Repairs to machines and plant	501	453	439	335	313	278	.
Wood, cellulose and paper	320	297	289	272	253	234	208
Wood processing	232	215	208	195	181	162	137
Building materials	447	395	388	381	348	313	245
Glass and ceramics	92	76	82	83	77	71	71
Light industry	842	756	709	615	481	414	380
Textiles	274	242	227	217	195	168	159
Clothing	400	366	338	261	168	143	126
Leather, fur and shoes	163	142	139	131	114	99	92
Food industry	693	683	653	637	625	605	591
Mills and animal foodstuffs	65	67	66	61	58	54	36
Printing	42	39	37	34	32	30	29

Sources: Statistichnyj Scoricnik Ukrainy za 1994 rik. Kiev 1995, p. 50 f; Statistichnyj bjuletjen' pro chid ekonomichnoj reformy v Ukrainy za 1995 rik. Kiev 1996, p. 78.

itive pits. Conversely, this means that uneconomic pits should not continue to receive public support to the extent foreseen in the government programme.

### Planned corporate restructuring

An additional problem of structural change is that the government is attempting to extend government planning to restructuring at the level of the individual firm. In 1995 two pilot restructuring programmes were initiated by the government in which an interministerial planning committee is responsible for the various steps of deconcentration, privatisation and strategic reorientation. The firms in question are the former military-industrial combine "Kiev Radio Works" and the "Titanium Combine" in Saporoschje.

On completion of these pilot restructuring schemes – which were considered to have been successful – the engineering ministry announced its intention to identify a further 60 firms to be restructured along the same

planned lines.<sup>8</sup> In addition to the branch ministry and the firms' management, the economic ministry, the state property fund and the anti-monopoly committee are participating in the restructuring schemes. This raises the danger that entrepreneurial initiatives will be delayed by laborious and bureaucratic decision-making processes. Moreover, branch ministries tend not to be aware of the need to deconcentrate large combines as rapidly as possible.

Nor does the government refrain from planning activity when it comes to involving foreign investors. In May 1996 a commission was set up within the industry ministry responsible for the participation of foreign investors in certain enterprises, in particular large, state-owned firms: the automobile factory in Saporoschje, the steel works in Dneproderschinsk, the electronics factory in Lvov, and the alumina works in Nikopol). Parallel to this, an "investment advisory council" was set up

<sup>8</sup> Cf. Speech by the Engineering Minister to parliament, 17 June 1996.

Table 6

## Ownership Structures by Industry

% share of all firms

	Non-state-owned firms		of which:			State-owned firms		of which:		Owned by international organisations and foreign nationals	
			Leased firms	Joint-stock firms	Employee-owned firms			Central government-owned	Local authority-owned		
	1994	1995	1995	1995	1995	1994	1995	1995	1995	1994	1995
Whole industry	45.8	56.3	11.1	29.8	5.7	54.0	43.5	36.5	6.9	0.2	0.2
Electricity industry	18.3	21.7	12.0	8.7	0.5	81.6	78.3	76.7	1.6	–	–
Fuel industry	2.4	6.8	1.5	5.2	–	97.6	93.2	91.7	1.5	–	–
Iron and steel	38.7	52.3	9.4	37.6	4.7	61.3	47.7	47.0	0.7	–	–
Non-ferrous metallurgy	34.4	46.7	20.0	23.3	3.3	65.6	53.3	53.3	–	–	–
Chemicals and petrochemicals	53.4	65.0	10.3	47.2	4.7	46.6	35.0	32.7	2.3	–	–
Engineering and metal-working	38.3	56.8	8.6	40.6	3.1	61.3	42.8	41.4	1.4	0.4	0.4
Wood, cellulose and paper	44.9	56.1	6.9	33.3	9.7	55.1	43.9	41.3	2.6	–	–
Building materials	48.1	64.2	12.7	34.5	9.6	51.2	35.2	30.2	5.0	0.6	0.7
Light industry	68.0	77.3	10.9	41.8	18.6	31.9	22.7	18.3	4.4	–	–
Food industry	61.8	67.5	14.7	25.5	3.7	38.0	32.3	27.2	5.1	0.2	0.2
Mills and animal foodstuffs	28.8	29.5	24.5	2.9	1.7	71.2	70.5	–	–	–	–
Printing	9.4	13.1	5.5	4.4	2.0	90.6	86.9	25.6	61.3	–	–

Sources: Statistichnyj byulleten' pro chid ekonomichnoj reformy v Ukrainy za 1995 rik. Kiev 1996, p. 41; Ekonomichnyj i social' nyj rozvitok Ukrainy v 1995 roci. Kiev 1996, Table 54.

within the cabinet of ministers; it, too, is to be responsible for attracting foreign investors. In addition, in the wake of the government reshuffle in July 1996, a "National Agency for Reconstruction and Development" was founded, whose tasks also include facilitating the access of foreign investors to Ukrainian firms.<sup>9</sup>

### Plans for industrial-financial groups

The creation of industrial-financial groups constitutes one of the new planning instruments. These are corporate conglomerations determined by the government in which industrial firms are joined together with banks and ministries. Whereas in Russia the initiative for the formation of corporate groupings tends to come from the banks, in the Ukraine the prime motive behind the formation of such groups is one of industrial policy. The Ukrainian industry-financial law (5 May 1996) provides for significant reductions in customs duties for "transnational" (i.e. primarily Russian-Ukrainian) industrial-financial groups. Ukrainian industry considers that such groups provide an opportunity to reactivate defunct networks with Russian companies and to exert political pressure on branch ministries.

<sup>9</sup> Cf. Intelnews, 6 July 1996 and Presidential Decree, no. 493/96, 2 July 1996.

On the initiative of the Council of Ministers, 32 proposals for the formation of industrial-financial groups have been put forward, most of them in the base industries.<sup>10</sup> In most cases Ukrainian firms contribute to such groups by supplying raw materials and semi-finished intermediary goods, while Russian firms are responsible for producing the final products.

### Outlook

The Ukraine is currently in a critical phase of the economic reform process. The key to sustained economic growth now lies in accelerating structural change at the micro level. To this end the deconcentration of companies must be facilitated, the appropriate framework of corporate legislation enacted and enforced, anti-trust policies intensified, and new businesses provided as large a scope as possible to develop. Thus the Ukraine is currently at a major economic policy crossroads. In view of the on-going domestic political and economic conflicts, it is difficult to foresee at present which path it will take.

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<sup>10</sup> Cf. Interfax Ukraine, 7 May 1996; Window on Ukraine, 21 November 1995, 19 April 1996.