

EXCHANGE RATE PROBLEMS AS AN INDICATOR OF PROBLEMS IN GOVERNING THE NATIONAL ECONOMY

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INTRODUCTION

Building a full foreign exchange market in Ukraine and effectively regulating it are a necessary condition for the formation of an open market economy with all necessary means of stimulating economic entities in the foreign economic sphere. The mechanism of development and effective implementation of full monetary policy play an important role in this process. This covers all the necessary tools of influence on monetary relations and is one of the most important elements in the overall system of measures to maintain macroeconomic and financial stability while promoting economic growth. Over the past 20 years, Ukraine's national currency has depreciated by 17 times against American dollars. This makes radical improving the country's monetary policy of utmost importance.

Monetary policy and monetary security for Ukraine are a young science. The most urgent issues facing the industry have been discussed by O. Baranov'skyy [2004], I. Bin'ko [Shlemko and Bin'ko 1997], V. Heyets [2009], V. Horbulin [Horbulin and Kachyn'skyy 2011], Ya. Zhalilo [2001], I. Krupka [2012], I. Mykhasyuk [2010], H. Pasternak-Taranushenko [2003], V. Shlemko [Shlemko and Bin'ko 1997], O. Trevogo and V. Ilychok [2016] and others.

If Ukraine's economy is to develop further and the country is to integrate into the EU, it is necessary to identify the main imperfections of Ukrainian monetary policy and put forward ways to minimize them.

AIMS AND METHODS

The aim of the article is to analyse the main problems facing Ukrainian monetary policy, characterize their causes and recommend how those causes can be addressed. To accomplish these goals, general scientific methods of analysis and synthesis, grouping

and comparison, logic and dialectics and methods of system analysis were used. The dynamics of real GDP, inflation and employment in Ukraine were analysed while the state of competitiveness in Ukraine and its neighbours were studied through a historical analysis. The statistical data used in the paper come from the National Bank of Ukraine, the State Statistics Committee of Ukraine, The Ministry of Economy of Ukraine and the International Monetary Fund.

RESEARCH MATERIALS

Economic, political and cultural relations between different countries are mediated with cash flows from the payment of goods and services and the import and export of capital, among other factors. This movement of funds in international relations determines the content of exchange relations. The globalization of economic processes, deepening of the division of international labor, the formation of the world market and the integration of national economies into the global economic system has brought about a significant increase in the role of monetary relations. That, in turn, has increased the importance of appropriate state regulation, which in practice is realized through monetary policy.

Monetary policy is a range of economic, organizational and legal actions realized the state realizes in order to implement the strategic tasks it lays out for the development of the national economy. The strategic tasks of monetary policy define it as an organic part of general economic state policy.

These tasks include:

- ensuring sustainable economic growth;
- maintaining stable prices (to ensure low inflation);
- promoting employment;
- providing external economic adjustment (balance of payments adjustment).

The directions and forms of monetary policy are determined by the country's monetary and economic situation, the evolution of the world economy and the alignment of forces in the world.

The first strategic task of monetary policy is to ensure sustainable economic growth. In 1947, professor Ludwig Erhard came to power in a Germany lying in ruins after the bombing by coalition troops at the end of World War II. After two years of reform, Germany fully restored its own economic potential and in 1949 produced a GDP that rivalled that of pre-war 1939.

As Figure 1 shows, in 2016 the volume of Ukraine's real GDP was only 59.7% of its 1990 level. This means that economic growth was hardly sustained during the 1991–2016 years. The country can therefore be said to have failed with regard to the first imperative of monetary policy.

The second strategic task of monetary policy is to maintain prices at a stable level (in other words, to keep inflation low). Figure 2 shows that there was significant inflation in Ukraine during the period 1996–2016 [Statistical Yearbook of Ukraine 2015]. This weakened the hryvna (UAH) purchasing power, which may have driven down the exchange rate.

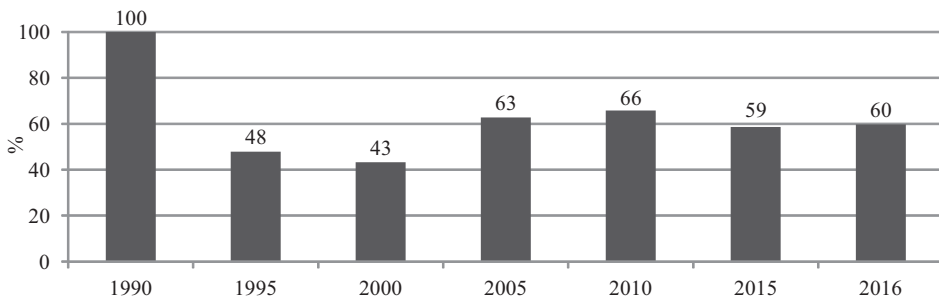


FIG. 1. Dynamics of real GDP of Ukraine to the level of 1990 in the period of 1990–2016

Source: Statistical Yearbook of Ukraine 2015.

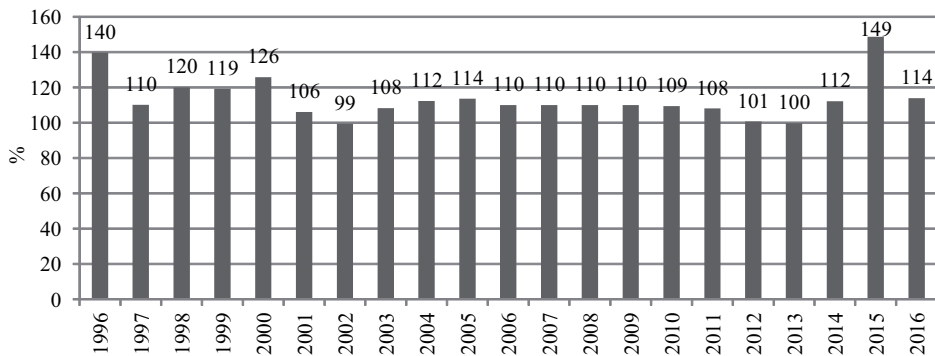


FIG. 2. Inflation (CPI) in Ukraine in 1996–2016

Source: Statistical Yearbook of Ukraine 2015.

Compared with its neighbours to the West (the Czech Republic, Hungary and Poland), Ukraine's inflation processes reveal significant imperfections in government and the National Bank of Ukraine policy. The third strategic task of monetary policy is to promote employment in the national economy (low level of unemployment).

Figure 3 shows that during the years 1990–2016, employment fell significantly – from 25.4 million in 1990 to 16.3 million in 2016, a 35.8% decline. The labor market's reduced capacity forced millions of Ukrainians to seek work outside the country, which made implementing the third strategic goal of monetary policy in Ukraine impossible. The fourth strategic task of monetary policy is to provide external economic adjustment (balance of payments adjustment). Here the most acute problem is the goods account deficit in the country's balance of payments.

Figure 4 shows that, during the years 1996–2016, the total goods account balance in Ukraine's balance of payments was passive. Its deficit climbed to 125.7 billion USD [WWW 1]. This deficit can be financed from state reserves or from a net inflow of foreign

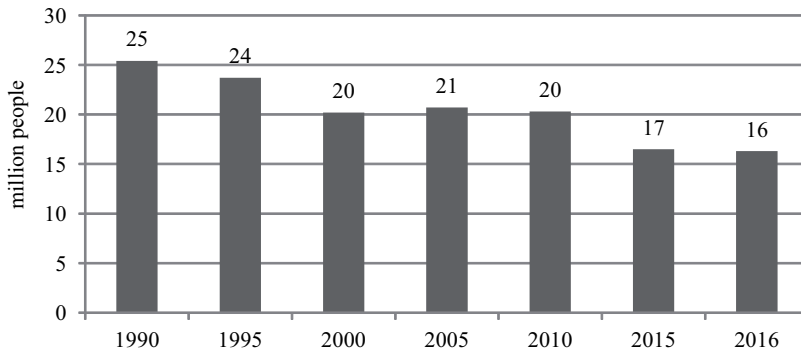


FIG. 3. Employment levels in Ukraine by selected years in the period 1990–2016

Source: Statistical Yearbook of Ukraine 2015.

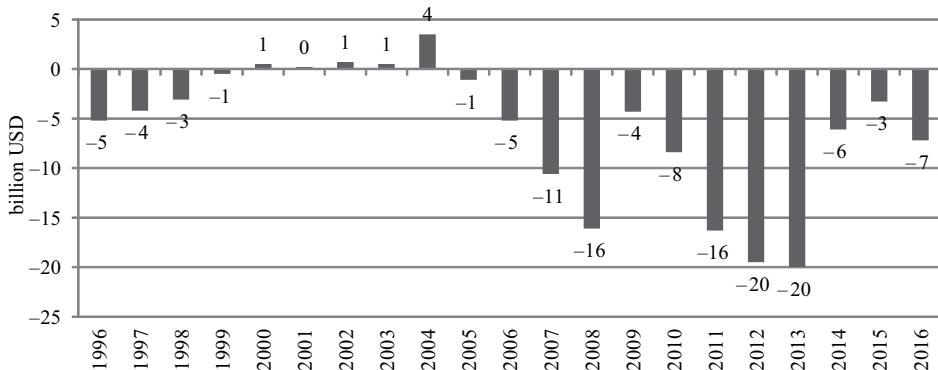


FIG. 4. Trade balance of Ukrainian balance of payments in 1996–2016

Source: WWW 1.

capital. To ensure the latter, the state can take loans from foreigners and sell a number of its assets. In Ukraine, both government and the National Bank of Ukraine policy have been problematic. Ukrainian workers send home about 7.5 billion USD per year [WWW 3]. For the past 20 years, the total amount of foreign currency transfers amounted to about 150 billion. Thanks to these funds, migrant's family members live, buy housing and help their children get a higher education.

A very important factor helping to stabilize both monetary policy and the exchange rate is the net inflow of foreign capital into Ukraine in the form of foreign exchange earnings sent back by workers. It covered the negative goods trade balance between 1996 and 2016.

The extremely high rate of inflation and the substantive goods account deficit in the balance of payments affects Ukraine's exchange rate. This is because there is an inverse relationship between the trade balance and exchange rate. With the deterioration of the

trade balance (as the negative balance increases), the country spends more money abroad than it receives from the sale of its products. For example, in 2012 Ukraine spent 19.5 billion USD more on foreign goods than it sold abroad. In 2013, the negative goods account balance increased to 20 billion USD. Ukraine “failed” 39.5 billion USD due to negative account balance of goods during 2012–2013 [WWW 2]. This created considerable pre-conditions for a potential reduction in the exchange rate of hryvna in the near future. Because demand for foreign currency rose in the currency market as imports were purchased, the supply of the national currency likewise increased. Figure 5 tracks the hryvna exchange rate to American dollar during the years 1996–2016.

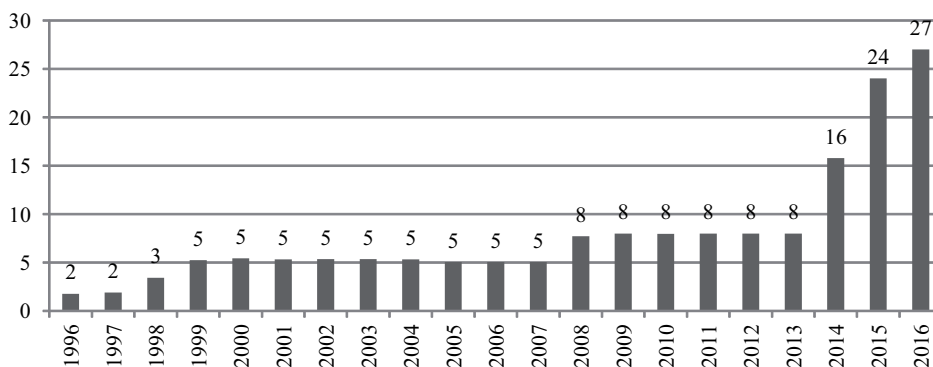


FIG. 5. Exchange rate of hryvna to American dollar during 1996–2016, at the end of the year

Source: WWW 3.

As of 1 September 2016, Ukraine’s current national currency, had been in use for 20 years. During this time, the exchange rate underwent significant changes. On 1 September 1996, a 100 UAH bought 62.89 USD. Twenty years later, on 1 September 2016, a 100 UAH bought 3.70 USD, bringing the depreciation to 17 times for the period [WWW 2].

During this time period, the exchange rate did not correlate annually according to purchasing power of hryvna. For example, during 2005–2007, due to inflation, the purchasing power of the national currency decreased by 35.3% ($113.5 \times 1.1 \times 1.1 = 135.3$). At the same time (according to the monetary strategy of the government and the National Bank of Ukraine), the exchange rate in 2005–2007 remained stable at 5.05 UAH for 1 USD [Statistical Yearbook of Ukraine 2015]. This disparity could not exist for a long time.

During the years 1996–2016 three abrupt decreases in the exchange rate of hryvna occurred. The first took place between August 1998 and December 1999, during the Asian Crisis and the attendant exchange rate drop of hryvna to American dollar (from 1.9 to 5.22). That was a drop of 2.75 times. The second fall came between August 2008 and December 2008, during the world financial crisis (this time from 5.05 to 7.70 UAH for 1 USD, a 52.5% plunge. The third drop occurred between March 2014 and December 2015, during

the Russian Spring and Russia's occupation of Ukrainian territory, the Crimea and Donbas, when the exchange rate of hryvna to American dollar 300%, from 7.99 to 24.00.

During 1996–2016, Ukraine's government failed to appropriately stimulate demand for domestic goods, and likewise to work at import substitution or to decrease the negative goods balance of its balance of payments. It instead focused on increasing the export of Ukrainian goods and services, leaving Ukraine overly dependent on external markets, as Figure 6 shows.

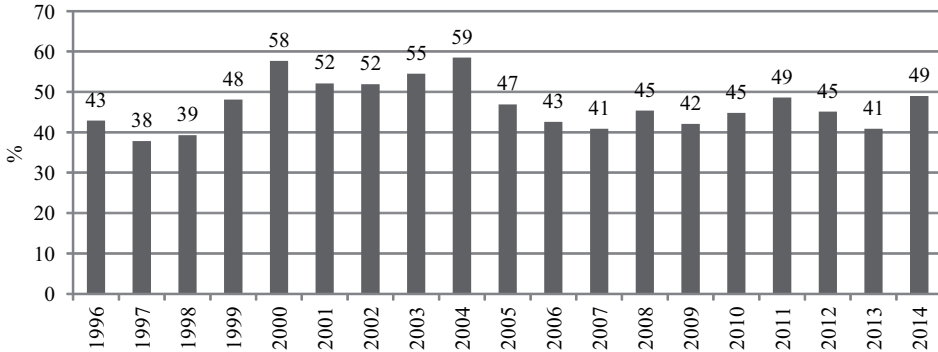


FIG. 6. Ukraine's ratio of exports to GDP in 1996–2014

Source: Statistical Yearbook of Ukraine 2015.

Each of these exchange rate decreases was directly related to a sharp decline in demand for Ukrainian products in foreign markets. This led to a sharp increase in the goods account deficit in the balance of payments. For example, in September 2008 financial crisis swept through the global economy. Demand for Ukrainian base metal exports and products derived from them decreased by 70%. During October – December, all of the country's steel mills stopped working, and the goods account deficit hit 16.1 billion.

In this crisis situation, as well as throughout the 1996–2016 period, in order to increase the price competitiveness of Ukrainian goods in the global market, the Ukrainian government decreased the exchange rate of the hryvnia. In particular, in Autumn 2008 it fell from 5.05 to 7.7 UAH for 1 USD. By contrast, the Czech Republic's national currency decreased by a mere 2%. The significant reduction in the exchange rate in the years 2014–2015 can be attributed to Russia's war against Ukraine and the occupation of Ukrainian territories in Crimea and Donbas. These are the actual limits of the Russian market for Ukrainian goods.

Table 1 shows that in 1996 the Russian market took 38.7% of Ukraine's exports. By 2015, that number had been slashed to only 12.7%. Between 1996 and 2015, the share of Ukraine's exports to the Russian market had fallen by 26.0% percentage points [Statistical Yearbook of Ukraine 2015]. Fortunately, domestic exporters quickly mastered other promising markets. For example, the share of exports from Ukraine to Egypt during the same 20 years increased by 4.8 percentage points, to China by 4.6 percentage points and to Turkey by 4.5 percentage points [Statistical Yearbook of Ukraine 2015].

TABLE 1. Destination of Ukraine's exports by country in 1996 and 2015

Country	Export (bn USD)		Structure (%)		Deviations from structure (%)
	1996	2015	1996	2015	
Belarus	722.5	870.7	5.0	2.3	-2.7
Egypt	96.8	2 079.8	0.7	5.5	+4.8
India	82.3	1 444.1	0.6	3.8	+3.2
Iran, the Islamic Republic	116.5	472.5	0.8	1.2	+0.4
Iraq	0.00	533.6	0.0	1.4	+1.4
Spain	90.2	1 979.8	0.6	5.2	+4.6
Kazakhstan	90.9	712.7	0.6	1.9	+1.3
China	768.1	2 399.1	5.3	6.3	+1.0
Moldova	237.8	524.3	1.7	1.4	-0.3
The Netherlands	99.7	905.7	0.7	2.4	+1.7
Germany	421.9	1 328.7	2.9	3.5	+0.6
Poland	362.7	1 977.3	2.5	5.2	+2.7
Russia	5 577.4	4 827.7	38.7	12.7	-26.0
Romania	157.3	569.9	1.1	1.5	+0.4
Saudi Arabia	28.1	761.6	0.2	2.0	+1.8
Slovakia	230.6	468.8	1.6	1.2	-0.4
Turkey	408.7	2 771.8	2.8	7.3	+4.5
Hungary	371.6	909.7	2.6	2.4	-0.2
France	111.1	497.9	0.8	1.3	+0.5
the Czech Republic	143.0	541.0	1.0	1.4	+0.4
Total exports	14 400.8	38 127.1	100.0	100.0	

Source: Statistical Yearbook of Ukraine 2015.

In 1996, 1 UAH cost 2 PLN while in 2016 1 PLN cost 7 UAH. The hryvna is 14 times cheaper than the Polish over the 20-year period. Another way of putting it would be: the Ukrainian authorities have been 14 times worse in implementing monetary policy than have their Polish counterparts. An active or passive trade balance characterizes the country's competitiveness in the global market. Thanks to the common passive trade balance in Ukraine, the competitiveness of domestic products in the world market is insufficient. To objectively and impartially characterize Ukraine's state of competitiveness, we will use the global competitiveness index – GCI [WWW 4]. This index is the result of global research carried out by the World Economic Forum. And in the modern world system, the competitiveness of the national economy is a determining factor of state economic security.

Table 2 shows that the GCI rate for Ukraine during the years 2012–2017 decreased from 73rd position in 2012–2013 to 85th in 2016–2017, a significantly negative phenomenon. At the same time, Poland improved from 41st to 36th while Russia jumped from 67th all the way to 43rd.

TABLE 2. The position of Ukraine, Poland and Russia in the global competitiveness index

Country	State position				
	2012–2013 (from 144 states)	2013–2014 (from 148 states)	2014–2015 (from 144 states)	2015–2016 (from 140 states)	2016–2017 (from 138 states)
Ukraine	73	84	76	79	85
Poland	41	42	43	41	36
Russia	67	64	53	45	43

Source: WWW 4.

To understand the reasons for these results and the dynamics of Ukraine's GCI position, we will look at this index in greater detail. Global competitiveness index consists of more than 100 variables, grouped into 12 benchmarks ("Institutions", "Infrastructure", "Macroeconomic environment", "Health and primary education", "Higher education and training", "Goods market efficiency", "Labour market efficiency", "The development of the financial market", "Technological readiness", "Market size", "Entrepreneurship compliance according to the modern requirements" and "Innovative capacity"). There are three major groups of sub-indexes: "Basic requirements", "Performance booster" and "Innovation and improvement factors".

TABLE 3. Ukraine's rankings on the global competitiveness index

Indicators	Ukraine's position in the rankings		
	2014–2015	2015–2016	2016–2017
	144 states	140 states	138 states
Common indicator (position)	76	79	85
wastefulness of government spending	138	134	129
quality of roads	139	132	134
inflation, changes in % per year	75	134	136
stability of banks	138	140	138
regulation of stock exchanges	127	135	137

Source: WWW 4.

How should the improvement of Ukraine's position in the global competitiveness index be ensured? For a start, the most problematic components of the index should be analysed. Namely, in the years 2016–2017, from among 138 countries, Ukraine is:

- in last (138th) place on the bank stability ranking;
- in 137th place for the regulation of stock exchanges;
- third from the bottom (136th place) for inflationary changes;
- fourth from the bottom (134th place) in quality of roads;
- tenth from the bottom (129th place) for wasted public funds.

During 1991–2016, fraud and embezzlement of public funds were rampant in the country's financial sector, leading to massive bankruptcies of banks, credit unions, investment funds and others. Such an epidemic of bankruptcies occurred during the global financial crisis in 2009–2010 and again in 2014–2015.

In Ukraine, none of the major financial sector schemers was punished. Even today, the police “consider” these obviously illegal actions to be merely civil relations. This situation would seem to guarantee that these abuses in the financial sector will continue and further stimulate inflation. The current government measures in combating the theft of budget funds have proven wholly ineffective. According to international experts, the state’s position in the ranking of most wasteful spending improved only to 129th in 2016–2017 from 133rd place at the end of 2014–2015.

In the global competitiveness index for 2016–2017, Ukraine had the fifth worst roads. Like few other places in the world, Ukraine feels the lack of funds for road repairs and construction – and the meagre funds that are allocated are used in incredibly inefficiently.

DISCUSSION

Summarizing this information, it can be affirmed that over the past 20 years Ukraine’s government has conducted monetary policy that is in conflict with general accepted international goals. Further, the results of implementing the four strategic objectives of classical monetary policy have been negative, mainly because corrupt officials have enjoyed complete impunity for their crimes, and who have wasted state funds. The result of such impunity is high inflation, a poor transport infrastructure and low overall global competitiveness.

The current situation is complicated by the fact that these problems are systemic, and have been coordinated from abroad to discredit the very idea of the statehood of Ukraine. American Vice President Joe Biden maintains that Russia uses corruption to keep pressure on Ukraine [WWW 5]. The problems will remain unsolved until the state takes two steps. First, it implements real penalties for crimes committed by officials and swindlers and, second, it weakens the “fifth column” (anti-government officials). To do the first, anti-corruption courts must be created and the judiciary reformed in 2017.

On 18 February 2016 the High Qualification Commission recommended the President dismiss from his station the judge from Shevchenko district court in Lviv for betraying his judicial oath. This “judge” appealed an injunction to the Administrative Court and his appeal was granted. With these “judges”, swindlers and the corrupt always agree. A case has been in the Zaliznychnyi District Court of Lviv for three years. At issue is the management of a credit union and their associates who swindled more than 3,000 investors out of more than 23 million USD. None of the criminals was really responsible for the committed crimes, and the majority of them will escape punishment under the Shevchenko law.

In Ukraine there are twice as many lawyers as are needed. Further, we are suspicious of the authenticity of judicial reform for the simple reason that there is no one to replace three thousand compromised judges [Ivanov 2017].

The solution to the second problem is much more complicated, but it is in force to the government today. As the US Ambassador in Ukraine Marie Jovanovych notes, Ukraine has been in a “hybrid” war with Russia for 25 years [WWW 6]. In such wars, spies are among the most effective tools, and it’s no secret that Ukraine’s government employs

a number of Russian Federal Security Service (FSB) agents, who guarantee their collaborators impunity while doing everything in their power to make life in Ukraine grow worse by the year [WWW 7]. The authorities must draw adequate conclusions from the fact of public betrayal by a significant number of internal security services staff in Crimea and Donbas in 2014.

According to the classical tenets of government, when corruption is ubiquitous in a government body, dissolving that body is among the most expeditious ways of getting rid of it. However, because of the war with Russia and the presence of the FSB in Ukraine's ranks, this will prove difficult. To eliminate the bulk of enemy agents in Ukraine in 2017, a new unit parallel to the FSB should be created, comprising a staff that would, over three years, master the skills required for effective action, and ultimately be committed to serving the exclusive interests of the Ukrainian state.

According to information from Ukraine's Ministry of Economic Development and Trade, the shadow economy in Ukraine in 2015 was 40% of the total domestic economy [WWW 8]. With Ukraine's 2015 GDP totalling 1,979.5 billion, the net profit produced by the shadow sector in 2015 would have reached 790 billion ($1,979.5 \text{ billion UAH} \times 0.40 = 790 \text{ billion UAH}$), of which 500 billion, on the strength of the corporate sector, was owned by oligarchs. Moreover, there is a jaw-dropping amount of tax evasion committed with the help of fraudulent offshore companies, which operate "in accordance with applicable law". But the list of offshore zones is approved by the Cabinet of Ministers of Ukraine [WWW 9]. Ukraine's Ministry of Economic Development and Trade has said that the prevailing tax avoidance is caused by "a significant tax burden on the corporate sector against the backdrop of the high cost of credit and the unfavourable external economic conditions in key commodity markets" [WWW 9].

To make matters worse, nothing has been done to address the ineffective fiscal services to reduce the magnitude of the shadow economy. The shadow economy should be reduced through systematic incremental changes being made to the regulatory authorities. There are only a few enterprises leading the shadow economy in Ukraine, and to take this procedure to them would, technically, be no problem. These proposed system-wide changes will create the prospect of a peaceful agreement culminating in the oligarchs giving 10% of their current shadow revenues to the budget. A considerable part of the "tax loss" the oligarchs would endure could legally be compensated by a synergistic effect from the growth of internal demand. In spite of this common sense, some oligarchs will seek to continue to "go the right track", which they have been bequeathed by old man Lenin and similar maniacs. These oligarchs must be properly assessed under current legislation, including the criminal code.

In reducing the corporate sector's participation in the shadow economy, the state in 2017 will additionally collect about 100 billion UAH through income tax and VAT. Of that, the following allocation should be made:

- 25 billion to special financing of the FSB;
- 25 billion UAH to defence;
- the rest (about 50 billion UAH) should be directed to increasing pensions.

The enemy's greatest strategic advantage is its omnipresent agents, but 2017 must be turned into a symbol of its total defeat in Ukraine.

CONCLUSION

Implementing the measures proposed here would decrease the annual outflow of shadow capital from Ukraine by roughly 3.5 billion USD. Budget policy would become more balanced and will approach the level of the budget deficit according to the EU standards. This in turn would minimize inflation and significantly boost economic growth through internal demand factors, ensuring 6% additional GDP growth annually over the next five years. The National Bank of Ukraine reserves would tab annual growth at 1.5–2.5 billion USD. As a result, the national economy would be stable, and the quality of monetary policy of Ukraine annually improve significantly overall, and particularly as the five most sensitive indicators of the index of global competitiveness described above improve [Trevogo and Ilychok 2016].

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Summary. The article focuses on improvements and related issues in the implementation of Ukrainian monetary policy. Over the past 20 years the Ukrainian government has conducted monetary policy that flouts generally accepted international goals. The article also presents an overview of the main economic factors that exert an influence on the exchange rate – inflation and the state of the account surplus of goods payment balance, which is determined by the competitiveness of the economy. The index of global competitiveness is

used as an indicator of the national economy's competitiveness, while the country's current position and dynamics under the global competitiveness index (GCI) are examined. The article details the main factors that have led the country's position to fall, including the fact that the problems are systemic and result from corruption. The impact of the negative factors can be minimized in Ukraine, and monetary policy improved.

Key words: monetary policy, GDP, inflation, employment, balance of payments, competitiveness, national budget, the shadow economy

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