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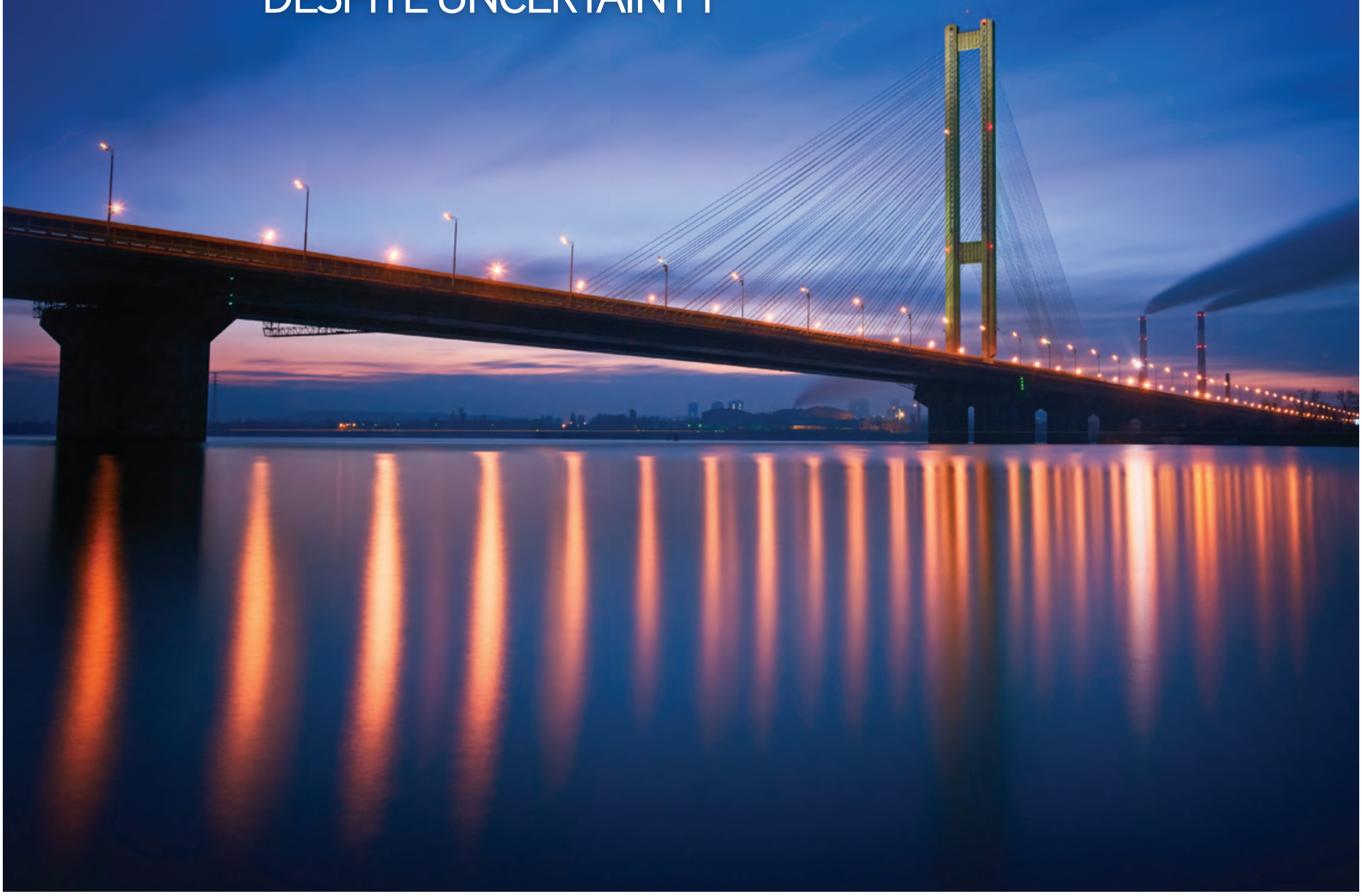
Ukraine strives for stability

REFORMS CONTINUE DESPITE UNCERTAINTY



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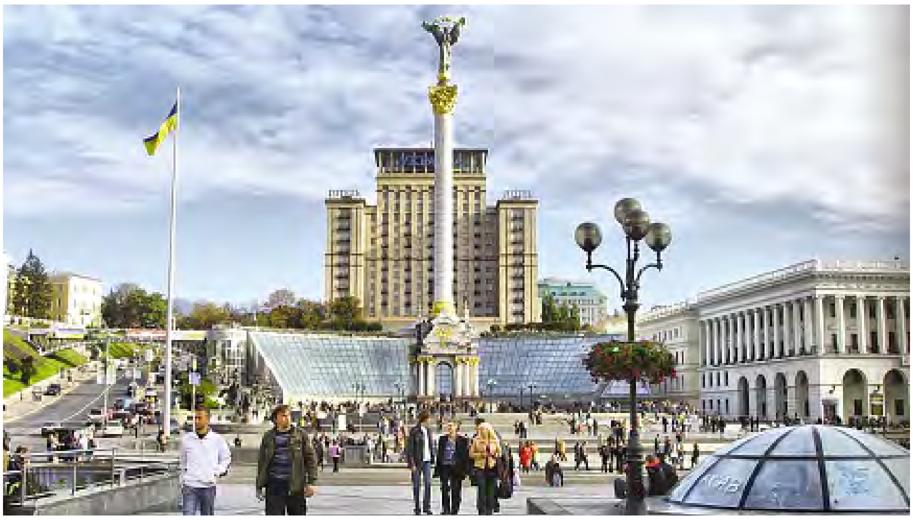

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UKR EXIM BANK

Crunch time for Ukraine

UKRAINE GREETED 2017 WITH CAUTIOUS OPTIMISM, AS ITS GDP TICKED UP AND A BANKING SECTOR SHAKE-UP PROVED SUCCESSFUL. NOW A BLOCKADE OF THE SEPARATIST EAST THREATENS TO STALL ECONOMIC RECOVERY, WHILE POLITICAL COMPLICATIONS COULD SLOW THE REFORMS CRUCIAL TO ATTRACTING INVESTMENT. **STEFANIE LINHARDT** REPORTS

Following years of uncertainty and war with separatist rebels supported by neighbouring Russia, Ukraine's economy looked poised for some degree of recovery in 2017, but renewed tensions in its east could dash expectations.

The vast country, located between the EU and Russia, covers an area of about 603,500 square kilometres and is home to about 42.5 million people. Tensions with separatists, which started in 2014, saw Ukraine's Crimean peninsula being annexed by Russia in March 2014. Meanwhile, separatists in eastern Ukraine's Donetsk and Luhansk regions proclaimed themselves as leaders of people's republics in May 2014, meaning some 13% of Ukraine's landmass is either in disputed territories or in the conflict zone.

The fighting has hurt the Ukrainian economy, which contracted by 6.6% in 2014 and 9.9% in 2015, but was expected to return to a fragile 1.8% growth in 2016, according to data from the central bank, the National Bank of Ukraine (NBU). And while the International Monetary Fund's (IMF's) forecast of a 2.5% increase in GDP in 2017 is welcome, it would still leave GDP at constant prices behind even 2014's Hrv1066bn ($39.4bn), at Hrv1000bn (see graph, page 68).

"What Ukraine has shown in the last three quarters is that it has reached economic stability," says Sevki Acuner, director for Ukraine at the European Bank for Reconstruction and Development (EBRD). "Now it has to capture significant growth – 4% to 6% annually; 1% or 2% growth is not enough if you are looking at how much the economy has contracted in the previous two years."

Blocking progress

And new uncertainty for Ukraine's economic outlook comes from a rail blockade of the main routes between the country's eastern and western territories.

First, western veterans blocked shipments of coal – vital to all parts of the country – from the separatist eastern region to the west, in an attempt to stop the government trading with it. Then, after separatists seized control of coal and steel businesses in the eastern region, president Petro Poroshenko imposed a freeze on rail and road cargo links in March 2017.

These developments could significantly harm Ukraine's recovery, according to the NBU, which believes its 2017 GDP forecast of 2.8% could fall to 1.9% if the blockade continues until the end of the year. Furthermore, if the government does not diversify its coal supplies, the country could face power shortages since it is highly reliant on energy created in its coal power plants – many of which were designed to exclusively consume the rare variety of coal found in the eastern Donbass region.

Economic recovery

The disruption comes just as expectations for the Ukrainian economy had finally turned positive and its GDP had grown by 4.7% in the fourth quarter of 2016. It was an improvement that experts such as Daniel Bilak, a director at investment promotion agency UkraineInvest and chief investment adviser to prime minister Volodymyr Groysman, call "impressive", given the country's difficulties in recent years. "We now have macroeconomic stabilisation, currency stabilisation and positive economic growth that shows reforms are kicking in on the macro level," says Mr Bilak.

The improvements do not stop there. Following the abandonment of the Ukraine hryvnia's peg to the US dollar in early 2014, a flotation of the hryvnia and several devaluations, the currency has stabilised – if at a new level of about Hrv27 to the dollar, compared with the Hrv8-to-the-dollar artificial exchange rate that was in place for about four years.

Besides floating the hryvnia, the NBU also decided to change monetary policy measures to inflation targeting – an often criticised step due to Ukraine's fluctuating inflation history (see consumer price index inflation table, right) – but also this has borne fruit with 2015's 48.7% inflation falling to about 15% in 2016. The medium-term target from 2019 is 5% inflation plus/minus 1 percentage point.

Yet it is not just locals and international financial institutions such as the IMF who are keeping a watchful eye on the country's economic health, but also its creditors – especially since Ukraine's 2015 $18bn debt restructuring and near default.

And with the transfers from the IMF due to end in 2019, credit rating agency Standard & Poor's is asking how robust Ukraine's economy will be at that point, and whether the government will get market funding by 2019 to reduce

Ship to shore: the port of Odessa plays a key role in Ukraine's economy and handles 40 million tonnes of goods per year

the higher scheduled public debt payments for the year. (Payments are due to rise from $2.63bn in 2017 to $3.91bn in 2018 and $7.52bn in 2019, according to data from Dragon Capital.)

Frank Gill, primary credit analyst for Ukraine at S&P, believes "further escalation of the conflict will weigh on Ukraine's growth prospects and, indirectly, on its solvency". He says that at 73% of GDP, general government debt remains "high, and sensitive to exchange rate movements" – given that more than two-thirds of the debt is denominated in foreign currency.

The IMF programme helped Ukraine's foreign currency reserves to reach $15.5bn at the end of 2016 and the NBU aims to reach $21.3bn by the end of 2017 (see interview with NBU governor Valeria Gontareva on page 73). However, at year-end 2016, the reserves only covered about 37% of expected short-term external debt maturing in 2017, according to Mr Gill.

He adds that in the past, the Ukraine economy has been supported by high iron ore prices, which as recently as 2014, made up some 30% of exports – representing about 15% of GDP and signalling the need to diversify the economy.

Reforms delivered...

The need for diversification and the implementation of structural reform in Ukraine is clear. Across the economy, experts agree that NBU reforms to monetary policy, and the clean-up of the banking and financial sector, have so far been the most striking and successful (see banking sector feature on page 70).

"During the past three years, the country has been moving in the right direction," says Ivan Mikloš, former Slovak finance minister and chief economic adviser to Ukraine's prime minister. "For the first time, things are really changing," he adds.

Apart from the banking sector reforms, Mr Mikloš highlights achievements in macrostabilisation, the deregulation of energy tariffs and the reform of state-owned energy firm Naftogaz – which used to cost the government 7% to 8% of GDP and is now turning a profit – as well as anti-corruption measures.

The fight against corruption is a concern not just of the local business community but also of international financial institutions, which highlight a reduction in graft as an important step in attracting FDI (see story on page 76). As part of the country's anti-corruption initiative – launched in May 2014 by the government together with the EBRD, the Organisation for Economic Co-operation and Development and business associations – at the end of 2014, Algirdas Šemeta, former minister of finance in Lithuania and European Commissioner tackling fraud, was appointed to the newly created post of Ukraine's business ombudsman.

"The business ombudsman is now the only anti-corruption institution that is solving the problems of the business community," says the EBRD's Mr Acuner. "In the two years it has been operating, it has received more than 1400 cases, about 1000 have been taken on and 800 or so have been resolved in a satisfactory way." ▶

INFLATION
2013 ONWARDS

DATE	AVERAGE CPI (%)
2013	-0.26
2014	12.10
2015	48.68
2016	15.06
2017 target	8% +/-2 % points
2018 target	6% +/-2 % points
thereafter	5% +/-1 % point

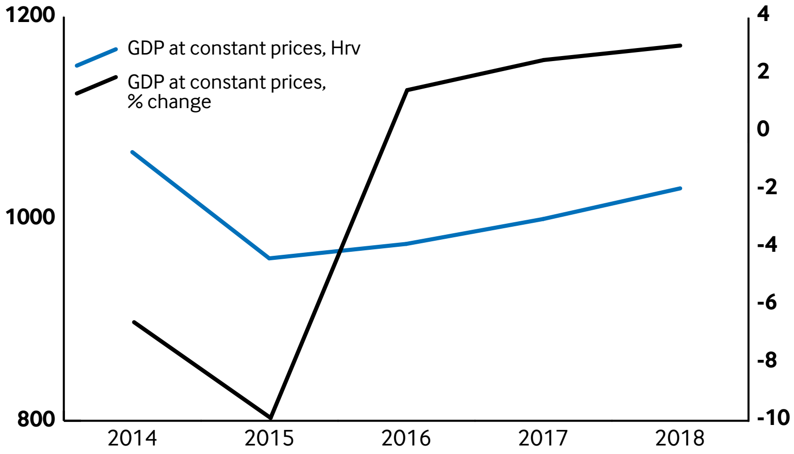
Source: IMF, October 2016, estimates after 2015; National Bank of Ukraine targets

EXCHANGE RATE
2013-17

DATE	HRV/$
31/12/13	7.99
31/12/14	15.77
31/12/15	24.00
31/12/16	27.19
28/03/17	27.15

Source: National Bank of Ukraine

MACRO INDICATORS FOR UKRAINE, 2014-18



Source: IMF, October 2016, estimates after 2015

Businesses have benefited directly from the ombudsman, he adds, noting it has proved a very useful institution for pushing things in “the right direction”, which is one reason why the EBRD will be renewing its funding in Ukraine for the next two years.

...but more are needed

But despite the successes of the business ombudsman, the institution can only recommend, not enforce solutions. So if there is no will from the establishment and enforcement agencies, there might well not be a way to help.

Meanwhile, experts agree that Ukraine needs other reforms. “The most burning issue is the reform of the court system and of the law enforcement agencies,” says Elena Voloshina, acting regional manager for Ukraine and Belarus at the World Bank’s International Finance Corporation (IFC). “The government acknowledges that these are the areas that it needs to focus on but we would like to see faster movement. The challenge is delivering deeper, faster and more profound reforms.”

Though some alterations are being introduced with 2016’s judicial reform package, the implementation is expected to take a few years. According to Mr Mikloš, the reform process is starting with the highest appeals courts, while the implementation of further changes is also occurring from the top to the bottom of the system.

Aside from the judiciary, there still are plenty of issues left to address, however, such as pension and land reform – both prerequisites to the disbursement of Ukraine’s next tranche of IMF funding, expected later in 2017. Equally important are reforms to the healthcare system, as well as intellectual property and creditor rights – the latter being eagerly awaited by the banking sector.

Yet as with Ukraine’s widely publicised collapsed plans to privatise the country’s largest fertiliser company, Odessa Port Plant, in 2016, vested interests can sometimes undermine change. Odessa Port’s privatisation process suffered from a valuation deemed far too high by international financial institutions such as the EBRD and the IFC, while the asset also had some underlying problems, all of which caused the sale to fail.

“It was a big frustration that none of the privatisations occurred in 2016,” says Olexiy Soshenko, a partner at law firm Redcliffe Partners. “This could have fuelled the economy. The government now needs to make some serious changes to its privatisation approach, and present investors with a clean asset to invest in.”

Political difficulties

Ukraine’s political process in itself is complex. Its presidential-parliamentary system of government sees both the president and government hold executive powers, while legislative powers are exercised in the national parliament, Verkhovna Rada. Parliament is fragmented, with 422 seats split between eight different factions as well as 47 unaligned members of parliament. Another 28 seats are currently vacant, largely related to the conflict in the east.

Thanks to a particularity of the constitution (and despite the 28 vacant seats), the governing coalition of Mr Poroshenko’s Solidarity Bloc party and People’s Front, led by Mr Groysman, still requires 226 votes to reach a majority in parliament, leaving it five seats short. To change the requirement from needing 226 votes to pass a bill to a simple majority of non-vacant seats would require a two-thirds majority vote, making it unlikely for such a reform to find enough support.

The government is also facing a potential impeachment challenge in April or May, when the opposition will have the option to give the government a no-confidence vote when it reports on the achievements of the past year in office. Experts expect a lot of criticism but not a no-confidence vote. That would leave the next scheduled elections in March and October 2019, when both the president and parliament will be elected.

“As informal campaigning usually starts a year before an election in Ukraine, this might cause a further delay to meaningful reforms,” says Viktor Luhovyk, research editor at Dragon Capital. “The government will clearly be less willing to go ahead with sensitive issues such as pension reform, which would mean raising the pension age, as this is something the population is vehemently opposed to.”

But for Ukraine, everything hinges on the delivery of thorough reforms, not only for the functioning of society and services but also to attract FDI – as was the case in Slovakia in the late 1990s, according to Mr Mikloš.

“Ukraine has a lot of unused potential,” he says. “It has hard-working labour and strong industrial capacities but it needs a reorientation, and that cannot come without modernisation and investment. But FDI will only come if reform is continuing.” ■

BUILDING UKRAINE'S ECONOMY

The evolution of JSC Ukreximbank began back in 1992, shortly after the success of the December 1, 1991 independence referendum in Ukraine. A 100% state-owned bank, Ukreximbank has been an important pillar of the national economy in independent Ukraine for the past 25 years.

When the first private enterprises were still being set up in the financial sector, Ukreximbank was the only bank in Ukraine that made payments under foreign economic contracts. The bank's trade-related transactions were crucial in order to help open up new markets after established economic ties with fellow former Soviet republics weakened with the collapse of the Soviet Union.

Ukreximbank has historically been one of the prime engines of the economy. The bank's strategy covers industries and business entities that focus on external markets. The corporate client base of more than 47,000 customers embraces all economy sectors and industries. Over the past 25 years, Ukreximbank has nurtured many of the largest Ukrainian enterprises and helped them grow from local companies to global market players.

Today, with a quarter of a century of experience and business connections globally, Ukreximbank remains the country's leading financial institution facilitating foreign trade. As the exclusive financial agent of the government of Ukraine, the bank services loans obtained under state guarantees to support economic development.

BRIDGING BUSINESS WITH IFIS

Ukreximbank pioneered co-operation between Ukrainian banks and international financial institutions (IFIs). The bank remains the number one partner of IFIs in Ukraine. The bank's mutual projects with IFIs address many of the key challenges Ukraine faces such as energy efficiency, industry modernisation, export development, and SME growth.

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT (IBRD)

- Export Development Project is a special investment programme offering credit, technical, and information assistance to Ukrainian exporters. Together with its successor, Second Export Development Project (EDP2), it has significantly increased the participants' export potential and revenue: total exports of EDP2 participants amounted to almost $5bn, with $1 of EDP2 generating almost $3 of export revenues.
- Energy Efficiency Project long-term financing aims to reduce industrial energy intensity, and help to meet general targets to reduce Ukraine's energy dependence.

EUROPEAN BANK FOR RECONSTRUCTION AND DEVELOPMENT (EBRD)

- Trade Facilitation Programme: with a total of $770m trade projects financed since its launch in 2007, this programme supports the foreign trade operations of Ukrainian companies and strengthens the overall trade position of Ukraine.
- Energy Efficiency Programme: with more than 150 investment projects implemented since 2007 in engineering, energy, agriculture, food industry and other sectors covering all regions of Ukraine, this is another potent tool to promote reasonable energy policies among domestic industries.

INTERNATIONAL FINANCIAL CORPORATION (IFC)

- Global Trade Finance Programme: Ukreximbank was the first bank in Ukraine to join this programme, with a guarantee limit raised to $80m since 2009. This has expanded the bank's ability to deliver advanced trade solutions to Ukrainian companies targeting external markets.

EUROPEAN INVESTMENT BANK (EIB)

- The SMEs and Mid-Caps energy and environmental improvement project supports local private sector and socioeconomic infrastructure development and aims to foster climate change mitigation and adaptation.

OPENING UKRAINE TO THE WORLD

In the current economic climate, when even compliance with international standards is no safeguard against risk, Ukreximbank remains one of the main channels for cross-border payments in Ukraine, made through an extensive network of correspondents from 110 countries across the world. Ukreximbank has regularly earned settlement quality recognition awards from key correspondents including JPMorgan Chase Bank (New York), Citibank (New York), Deutsche Bank (Frankfurt am Main) and others.

As a domestic leader in project financing, trade finance, documentary credits and guarantees, Ukreximbank delivers client-oriented solutions to Ukrainian exporters and importers in support of their operations of any kind.

A commitment to best practice and considerable expertise in all trade-related banking products and instruments is further strengthened by the bank's active involvement in the EBRD and IFC trade facilitation programmes and their related advanced training and certification. Ukreximbank is the only bank with Ukrainian capital participating in IFI programmes available in Ukraine as both an issuing and confirming bank. Additionally, the EBRD/ICC e-learning achievements of the bank's trade finance team have earned an Academic Excellence Award.

The trade finance geographic profile of the bank presently covers more than 60 countries. Despite general aversion to Ukrainian risk due to low credit ratings and Russian aggression, Ukreximbank's trade-related instruments are accepted directly by banks in countries representing Ukraine's priority trade partners. Co-operation with IFIs and recognition as a direct borrower and guarantor by more than 35 world-class ECAs enhances the risk mitigation capacity of Ukreximbank for mid- and long-term transactions.

Enlargement of the bank's trade finance geography is only a matter of the market expansion appetite of Ukrainian companies. The bank has great experience in helping Ukrainian businesses to open up new markets. As a rule, Ukrainian companies seeking to enter new or challenging markets come to Ukreximbank to benefit from the bank's quality services, professional connections worldwide, and qualified and experienced experts.

The representative offices that Ukreximbank has opened in London and New York help the bank keep up with advanced market standards and demands. They also facilitate the bank's traditional mission to promote the opportunities enjoyed by Ukrainian companies. This mission is gaining in importance now that Ukraine is seeking a new role in a rapidly changing world.

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UKR EXIM BANK

Ukraine's banks seek a new normal

RECENT YEARS HAVE SEEN A SHAKE-UP OF UKRAINE'S BANKING SECTOR THAT HAS HALVED THE NUMBER OF INSTITUTIONS IN THE COUNTRY AND CULMINATED IN THE NATIONALISATION OF ITS LARGEST LENDER, PRIVATBANK. YET CHALLENGES REMAIN, WITH MORE CASUALTIES LIKELY AS SMALL AND RUSSIAN STATE-OWNED BANKS COME UNDER SCRUTINY. **STEFANIE LINHARDT** REPORTS

Much has changed in Ukraine's banking sector in the past three years, so it is no surprise that the financial sector is seen as the area to have taken on the bulk of the country's reforms. When Valeria Gontareva took office as the central bank governor at the National Bank of Ukraine (NBU) in June 2014, there were some 180 banks serving a population of about 42.5 million.

Within three years this had been reduced to 92 banks, with the largest 40 representing 97% of banking sector assets. The 'clean-up' process culminated in Privatbank, the country's largest lender, being nationalised and recapitalised by the state at the end of 2016.

A new Privatbank

"The biggest reform achievement in Ukraine has been the clean-up of the banking system with the grand finale of the nationalisation of Privatbank," says Sevki Acuner, director for Ukraine at the European Bank for Reconstruction and Development (EBRD). "In the past years, the NBU has done lot of work to restore the financial sector to its proper function."

The nationalisation followed an NBU assessment that Privatbank was not fulfilling the requirements of its recapitalisation plan. However, the bank had provided services to about 20 million Ukrainians, so any move needed to happen quickly and in a determined manner to avoid causing concern.

"Everybody was worried the entire economy might be hit [when Privatbank was nationalised] but the NBU and the finance ministry kept the situation under control," says Olexiy Soshenko, a partner at law firm Redcliffe Partners.

In an effort to recapitalise the largest bank in the country, the finance ministry and NBU injected Hrv116bn ($4.27bn) in Treasury bills – more than 30% of Ukraine's capital base – into the bank. "The main problem of Privatbank was that it had no real assets in the bank" and was providing "loans without any cash flow", says the NBU's Ms Gontareva. Related party lending was also an issue at Privatbank, as well as in some other institutions, she adds, but most of this has now been stopped.

"Had Privatbank not been nationalised, the whole reform result would have been nullified," says Elena Voloshina, acting regional manager for Ukraine and Belarus at the World Bank's International Finance Corporation. "The bank offered a very good service to customers but some of the money accumulated as deposits in the bank was then transferred to owners of the bank through related party lending."

As part of the Privatbank nationalisation, a new management and supervisory board was installed. The next step for the bank is to "concentrate all of its efforts in banking for SMEs and retail", says Ms Gontareva, with the aim of finding new investors within three to four years.

State-bank domination

Finding a strategy for Privatbank is now a top priority, as it is for the country's other state-owned institutions: Oshadbank, Ukreximbank and Ukrgasbank. At 52% of banking sector assets, state-controlled institutions now dominate Ukraine's banking sector and a strategy drawn up in 2015, which did not account for a nationalised Privatbank, now has to be revised.

The Ministry of Finance, as owner of the banks, and NBU, as their regulator, are in the process of agreeing the new high-level business strategies for the banks and their future ownership.

"At this stage, we are still very concerned about the future of state banks. They need improvement in business models and management enhancement," says Ms Gontareva. "Their operational efficiency and credit risk standards are not up to best practice and thus state banks will remain in the focus of our, and government, attention in the foreseeable future."

International financial institutions (IFIs) such as the EBRD are taking an active role in this process. In a memorandum of understanding (MoU) between Ukraine finance minister Oleksander Danyluyk, the EBRD and the chairman of Oshadbank, Andriy Pyshnyy, signed in November 2016, plans for the commercialisation and part-privatisation of Oshadbank have been set out for 2018, with a majority privatisation planned for 2020. The MoU includes plans for a potential equity investment by the EBRD in Oshadbank. The new strategy for all state-owned banks could be announced as early as May.

A cleaner banking sector

The overall clean-up process of Ukraine's banking sector has already seen institutions with unviable business models or non-transparent ownership structures, or those that were not compliant with banking legislation, cease operating. But the NBU is further emphasising the need for banks to reach capital requirements.

"Compliance with the capital requirements requires not only capital injections, but also measures to pledge additional collateral against the previously granted loans, reregistration of loans to real companies with verified cashflows," says Ms Gontareva. She adds that almost all banks have succeeded in fully implementing their recapitalisation plans. "In 2016, capital of Ukrainian banks was increased by Hrv108bn."

New money: Privatbank, Ukraine's largest lender, was nationalised and recapitalised by the state at the end of 2016

Yet in 2017, some of Ukraine's smallest banks, which only account for 3% of banking sector assets, are expected to fail to reach capital requirements set by the NBU. In anticipation of this – and to make the processes for self-declaring insolvency proceedings and mergers easier – in March the parliament approved a new law on simplifying capitalisation and reorganisation procedures for banks proposed by the NBU. Thus, by the end of 2017 the number of Ukrainian banks could again decrease significantly – but this is something that does not particularly worry IFIs such as the EBRD.

"You simply do not need 92 banks in an economy of about $90bn [Ukraine's GDP at current prices]," says the EBRD's Mr Acuner. "You probably need about 35 banks. This can be done in a variety of ways, but you could probably encourage regional champions to create some more significant institutions."

Russian capital

Apart from state-owned institutions and those owned by foreign investors, the Ukrainian banking sector still also comprises some banks that have strong relations with Russia. In conversation with *The Banker* in late February, NBU governor Ms Gontareva suggested banks with Russian state-owned capital should wind down their operations within Ukraine or sell them, as there was "not a very rosy future" for these banks in the country.

Two weeks later, the NBU announced proposals for sanctions against those banks after a recommendation by the country's National Security and Defence Council. This was said to be linked to the banks' acceptance of documents issued by the administrations of the separatist regions in the east as valid means for customers to identify themselves.

This development meant that five Ukrainian banks with Russian state capital – Sberbank, VTB Bank, Prominvestbank, BM Bank and VS Bank – were served with sanctions prohibiting financial transactions involving the transfer of funds to banks' related parties as well as other restrictions imposed on them.

As a result, in late March, Sberbank announced the sale of its operations in Ukraine to a consortium including Norvik Bank in Latvia and a Belarusian private company.

Alfa-Bank moves on

Alfa-Bank's Ukrainian operations, meanwhile, have been spared from these measures. Alfa, privately owned through a majority stake by Russian billionaire Mikhail Fridman, distinguishes itself from the Russian part of the bank through the separate registration of the businesses within the common Luxembourg-registered holding company ABH Holdings.

Alfa-Bank was Ukraine's eighth largest bank by assets as of year-end 2015 and, at the end of 2016, its holding company ABH acquired 99.9% of the fourth largest bank by assets, Ukrsotsbank, from UniCredit. While the two groups are running as separate businesses so far, the aim is to create a joint Ukrainian banking group in the future.

"Alfa-Bank and Ukrsotsbank are now sister banks but in two years we will be one bank in Ukraine," says Oleksiy Blinov, chief economist at Alfa-Bank Ukraine. "The target is to create a universal bank with Alfa's strong retail presence and Ukrsots' expertise in the SME sector."

As of 2015 results, the joint banking group would remain fourth largest in Ukraine with $4bn of assets and the largest non-state-owned ▶

bank, compared with Alfa-Bank's $1.8bn and Ukrsotsbank's $2.3bn of assets at year-end 2015.

The lending challenge

With capitalisation levels at Ukrainian banks improving in line with the NBU strategy, the next important step is to recover lending. But the cost of funding for both banks and customers in the country is high, and mutual trust is low.

The high key rate of 14% is expected to be lowered with decreasing inflation and has already been reduced from 22% at the beginning of 2016 but trust issues on both sides still have to be tackled. For borrowers, the introduction of capital controls following the economic and monetary turbulences of 2014 hit confidence.

Meanwhile, customers with difficulties paying their interest on mortgages in the local currency feel aggrieved after borrowers of foreign exchange FX mortgages that have become non-performing after the 2008 financial crisis have been allowed a moratorium on their debt. For banks, this means non-performing FX mortgages are 'forever NPLs' (non-performing loans) as suggested restructuring plans for these NPLs were never drawn up by parliament.

Another difficulty for banks lies in that "a lot of the companies are operating in the shadow market and cannot provide any real reporting, which means they are not bankable", says Tamara Savoschenko, the chair of the Ukrsotsbank board. This, coupled with the banking sector's legacy NPLs portfolio and difficulties in finding ways to resolve them, is putting pressure on new lending.

"About half of all banking sector loans are non-performing. This, and the high level of bad borrowers, has created the low level of confidence among lenders," says Volodymyr Lavrenchuk, chief executive of Raiffeisen Bank Aval. "Several reforms should be implemented to restore the confidence to boost lending, such as registers of pledged real estate assets, to have a record of which assets were pledged for loans. There needs to be better disclosure of ultimate beneficiaries of companies and better cleaning of legacy NPLs. Change is ongoing but it can't all happen within one year."

HAD PRIVATBANK NOT BEEN NATIONALISED, THE WHOLE REFORM RESULT WOULD HAVE BEEN NULLIFIED

Enforcement difficulties

One of the particularities in working out the banking sector's NPLs is related to the Ukrainian legal and enforcement system. Many thousands of cases have been brought to the courts to resolve NPLs – but with difficulties in enforcing decisions and creditor rights protection lacking international standards, banks mainly rely on their borrowers' willingness to co-operate to work out problem loans.

"We still have a problem with creditor rights protection in Ukraine," says Ms Savoschenko. "There has been a lot of regulation drafted but almost nothing was approved by parliament. This obviously drives the cost of risk higher [when banks are looking at providing new loans]."

"If you cannot get justice in our courts and cannot do proper restructurings or resolutions because of blockages in the justice system, NPL resolution is difficult," says Ms Gontareva. She adds that the NBU has drafted a law on creditor protection but it has not yet made it through parliament. "The main problem is that we have already prepared more than 20 draft laws on the development of the financial sector and only three of them passed the stage of the first reading."

A 'bad bank' for Ukraine?

One potential solution to the Ukrainian banking sector's NPL problem is a 'bad bank' or asset management company to relieve banks of some of their problem loans. The idea is not new but seems to now be backed by more parties, including some IFIs. However, even if plans went ahead, decisions would still have to be made over the best set-up and whether NPLs from all banks or just state-owned institutions should be considered.

Another issue to be determined would be the governance and control of such an institution, says one expert who wished to remain anonymous. He says it could be challenging to achieve a set-up guaranteeing independent and reliable management for the institution, which is why he is sceptical of the idea.

Furthermore, as the bulk of the NPLs are related to extensive credit growth ahead of the financial crisis in 2008 and loans that have turned sour as a consequence of the crisis, others – including Raiffeisen Bank Aval's Mr Lavrenchuk – suggest it is too late for the banking industry to create a bad bank.

In the case of Raiffeisen, no material new NPLs have been recorded since 2010, Mr Lavrenchuk says, which means the quality of those assets that are still on the bank's books as problematic now has significantly changed and any value extraction would be difficult.

A turning point

Hopes are pinned on recent developments such as Ukraine's new law on financial restructuring, which should offer lenders and borrowers a framework on voluntary out-of-court restructurings, aiming at allowing distressed Ukrainian businesses to return to viability through loan rescheduling, partial debt forgiveness and conversions of debt to equity. The law, which was drafted with the help of the EBRD and World Bank, was passed in late 2016.

"Two-thousand and sixteen was a turning point in Ukraine's banking sector; the mood in the market has improved despite continued bank failures," says Alfa-Bank's Mr Blinov. "The market has passed the turning point."

A gradual lifting of restrictions on deposit withdrawals has improved confidence in the banking sector and contributed to a growth in retail and corporate deposits from 64% to 73.4% in 2016. And while credit growth of about 2% in 2016 was sluggish, this is an improvement in the decline in lending previously. With much done and more reforms still to do, Ukraine's banking system looks set for an interesting year. ■

Q&A: VALERIA GONTAREVA

Making the numbers count

VALERIA GONTAREVA, WHO WILL LEAVE HER POST AS THE GOVERNOR OF THE NATIONAL BANK OF UKRAINE IN MAY 2017, **TELLS STEFANIE LINHARDT** HOW FOREIGN EXCHANGE INTERVENTION AND A FLOATING EXCHANGE RATE ARE HELPING THE BANK MEET ITS AMBITIOUS TARGETS

Q The National Bank of Ukraine [NBU] introduced a floating exchange rate and inflation targeting in 2016. How happy are you with the transition?

A The figures speak for themselves. We achieved very fast disinflation. Year-on-year consumer price index inflation dropped from 43.3% in December 2015 to 12.4% at the end of 2016, which means we hit our target for 2016 of 12% plus or minus three percentage points.

This is the result of proactive, forward-looking policy. In order to be able to target inflation, the NBU has conducted numerous reforms of the decision-making process, analytical support, monetary instruments and communication areas.

We were faced with a lot of doubt about whether inflation targeting and a floating exchange rate could really work in Ukraine. But there are no viable alternatives. The flexibility of our exchange rate helps the Ukrainian economy to accommodate shocks. And we have proven that this strategy works.

Q How important are 'other monetary policy instruments' as mentioned in your 2016-2020 guidelines? How frequently do you make use of them?

A Our monetary policy relies on our key policy rate as the main instrument. Currently it is at 14%. Other monetary policy instruments have a supportive role and we try to only use them in exceptional cases.

At this stage, we need to rely on foreign exchange [FX] intervention quite frequently to accumulate international reserves and smooth excessive volatility of the exchange rate. But we assume that the NBU's role on the FX market will diminish in the coming years.

Q Is fiscal policy supporting your inflation targeting approach sufficiently?

A Last year we mostly avoided having to finance fiscal and quasi-fiscal needs by issuing money. Energy sector reforms in particular enabled the NBU to cease supporting Naftogaz. State-owned Oshchadbank and Ukreximbank were capitalised without the monetisation of bonds by the NBU.

An exception was made for PrivatBank after it became state owned. However, this did not have any significant impact on the inflation rate. The funds were used for provisioning and replenishing cash desks and cash points to ensure continuous customer service.

Furthermore, the NBU and Ministry of Finance continue to discuss the re-profiling of the NBU's portfolio of domestic sovereign bonds, worth about Hrv383bn [$14.1bn]. The re-profiling operation would not only help to reduce the burden on the state budget through an extension of maturities and the debt service schedule on domestic sovereign bonds held by the NBU, but would also contribute to efforts by the Ministry of Finance to pursue a prudent fiscal policy consistent with the NBU's inflation target.

The re-profiling would involve the conversion of the NBU-held domestic sovereign bonds into inflation-indexed hryvnia-denominated bonds with longer maturities, which would see the ministry repay the new liabilities to the NBU over a longer period of at least 30 years, but all of this is still currently under discussion.

Q How are you looking to raise your international reserves from $15.5bn at the end of 2016 to your 2017 target of $21.3bn?

A In 2017 our international reserves will increase to $20.8bn thanks to continued active international co-operation. This year, Ukraine is expected to receive four tranches totalling about $5.4bn from the International Monetary Fund. In addition, we expect Ukraine to receive two last tranches of EU macro-financial assistance worth $1.3bn.

Also, we plan to continue replenishing our international reserves by buying foreign currency when there is excessive supply of foreign currency at the interbank FX market. Recently we had to revise down such plans to lessen the impact of the ban on trade with certain areas of Donetsk and Luhansk oblasts on the FX market. ■

This interview was conducted before Ms Gontareva announced she would be leaving her post on May 10

Q&A: OLEKSANDR HRYTSENKO

Ukraine's new optimism

OLEKSANDR HRYTSENKO, CHAIRMAN OF THE BOARD OF UKREXIMBANK JSC, EXPLAINS HOW THE BANK IS SUPPORTING DOMESTIC AND FOREIGN BUSINESSES IN UKRAINE AS THEY MOVE AWAY FROM TRADITIONAL MARKETS

Q How have the geopolitical events of the past few years affected the Ukrainian economy and business community?

A Russia's annexation of Crimea and its subsequent intervention in eastern Ukraine, together with a trade embargo and transit barriers, have had a negative impact on the Ukrainian economy and individual businesses. Many Ukrainian enterprises have been hard hit by the current crisis [due to their] relations with Russia. Some businesses physically lost production facilities (those located on territories beyond the control of Ukrainian authorities), while some exporters lost access to their traditional markets.

The Ukrainian business community has responded resourcefully to this challenge: business leaders are looking for new markets, adapting their products to meet new demands, and entering into new contracts. If you have been selling your products 'just around the corner' for decades, it is extremely difficult to change your entire export strategy within a year, or to immediately begin conducting sales on the other side of the world. However, Ukrainian businesses are doing their best to find new markets, and their efforts are proving quite rewarding.

Q What is the foreign trade situation at present after three years of the current crisis?

A In 2016, the Ukrainian economy was gradually recovering from the severe impact of the Russian intervention while adapting to the new market conditions. However, trade volumes have decreased significantly over the past three years. While trade turnover in 2013 was an impressive $180bn, the total for 2016 was only about $97bn.

The geographical structure of Ukrainian foreign trade is also undergoing drastic changes and experiencing a fundamental shift from the Commonwealth of Independent States to European and Asia markets. The share of trade turnover with Russia has dropped from 27% in 2013 to 14% in 2016, while the share of trade with Europe has increased by 10% since 2013. The share of Asia and other countries is also steadily growing.

The Ukrainian economy benefits from this shift of trade flows, as it has allowed for a reduction in its traditional dependence on the Russian market (which turned out to be as unpredictable as the country itself). It has also allowed Ukrainian companies to diversify both market outlets and product portfolios.

However, due to the extreme economic conditions of the past few years, entry into new markets by Ukrainian enterprises has been more of a revolutionary than an evolutionary process. Ukrainian exports to Russia have dropped more than 80% in recent years, from $17.3bn in 2012 to $3.6bn in 2016. In 2016, Europe and Asia have both become major export destinations for Ukrainian goods, accounting for 37% and 32% of 2016 export volumes, respectively.

The devaluation of the Ukrainian hryvnia since 2014 has contributed significantly to the country's terms of trade. The volumes of export and import goods achieved a balance in 2015, while the 2016 trade deficit was predominantly due to a rise in machinery imports. The growing need for industrial modernisation will create further demand for similar imports.

Key Ukrainian exports include staple products and traditional manufactured exports totalling $25.4bn – about 70% of total exports in 2016. There have also been growing export volumes of some quite new and innovative science-intensive and value-added products, which have been developed and produced, such as IT services and the aircraft and space industries.

Q What can the Ukrainian government do to improve the situation?

A In March 2017, the government presented the strategic trade development roadmap of Ukraine [STDR]. It provides systemic analysis of the obstacles facing Ukraine as it seeks to move towards knowledge- and innovation-based exports for sustainable development and success in global markets. The STDR elaborates three objectives:

- to create an enabling environment that stimulates trade and innovation for diversified exports;
- to develop business and trade support services that improve the competitiveness of enterprises, in particular SMEs; and
- to strengthen the skills and competencies that enterprises, particularly SMEs, require to engage in international trade.

Modernising the Ukrainian business environment and economy is at the core of this roadmap. Several existing and potential sectors are prioritised and identified as being drivers of innovation and high value addition, as well as having the potential to invigorate SME development and stimulate entrepreneurship.

Q What role can the banking sector play in the recovery and in supporting trade?

A The losses incurred by the Ukrainian economy in recent years have been considerable. Nevertheless, we believe it is possible to identify the first signs of a new dawn. Foreign trade, which is very important for the export-oriented and open Ukrainian economy, is recovering gradually. However, as World Economic Forum experts have pointed out, limited access to trade financing is one of the major remaining problems hindering the further development of Ukrainian export businesses.

Thanks to the current challenging economic environment, the financial standing of many Ukrainian companies has deteriorated significantly, placing them in the 'non-bankable' category. Meanwhile, the banks themselves have suffered from worsening loan book quality and a deleveraging of balance sheets, leaving them reluctant to accept new credit risk, especially by providing credit to tier-two companies or SMEs. This situation is now showing signs of change; demand from corporate clients is scaling up and as they recover from the worst of the recent turmoil, the banks themselves are becoming less risk-averse. This positive trend could increase bank lending to the real economy.

We are currently observing a downward trend in interest rates on the local market (our bank is one of the driving forces behind this process). During the past year, the central bank, National Bank of Ukraine, has decreased its rate from 32% to 14%. We hope that our commercial foreign partners will be able to propose more attractive funding conditions.

Last but not least, we see long-term co-operation with international financial institutions [IFIs] under several existing and new projects, which are being developed with the aim of helping Ukrainian businesses to satisfy demand for long-term financing, including for investment.

Financing of foreign trade is a key strength of Ukreximbank, which has historically always been a corporate-oriented bank focused on trade facilitation. The main tasks of the bank are the performance of foreign trade settlements for businesses, the attraction of foreign funds into the economy, and supporting companies looking for new international markets with advisory and financial services.

Ukreximbank provides a range of options to help companies receive financing for their foreign economic activity and mitigate the risks inherent in entering new foreign markets. In order to provide the best service, we seek to utilise our long-standing correspondent relations with foreign state and private banks all over the world, as well as special programmes managed by our multinational partners.

Q Energy efficiency is very important to Ukraine. How is Ukreximbank supporting its development?

A Ukraine's energy industry is a strategically important sector worth individual attention as it could provide huge impetus to the country's economic development while boosting exports. Thanks to the legacy of an inefficient Soviet system where domestic energy rates were of little practical importance, prices for energy resources in Ukraine remained artificially low throughout the post-independence years.

The lack of reforms in the energy sector resulted in Ukraine suffering from levels of energy efficiency that were well below modern standards. For example, at the end of 2013, Poland (with a GDP of $518bn) posted an energy consumption of 65,271 kilotonnes of oil equivalent (ktoe), while Ukraine (with a GDP of $144bn) posted an energy consumption of 70,097 ktoe.

Faced with the absolute necessity of decreasing energy wastage and improving the situation, Ukraine has made some significant progress in reforming the energy sector in the past few years. Nevertheless, further reforms lie ahead in order to make the regulation process transparent and to stimulate market competition. This could allow Ukraine to achieve an ambitious objective: reducing energy intensity by 50% by 2030.

Our bank understands the huge potential of energy reform. In co-operation with IFI partners, we are focusing our efforts on making a positive contribution to the country's balance of payments. A good example of this co-operation is the recently completed energy efficiency $200m credit line with the World Bank. This will result in estimated annual energy benefits exceeding 4.2 million megawatt hours (comparable to the energy demand of a city of about 1 million inhabitants such as Odessa or Dnipro).

The bank has made a strong commitment to sustainable energy development. This includes a dedicated internal energy efficiency policy, and the development of standardised lending products and environmental and social risk management tools. These efforts benefit from the bank's nationwide network and from IFI involvement. We have gained valuable market expertise in project origination, channelling targeted funding, and the pioneering of success stories to scale up energy efficiency countrywide.

Q Given the large challenges, how does Ukreximbank view Ukraine's prospects?

A The past few years have been shaped by the desire of the Ukrainian people to live in a free and democratic country, along with the emergence of a strong entrepreneurial spirit and readiness to build a stable and developed economy. I have highlighted two interesting aspects: trade financing and energy efficiency.

Today, Ukreximbank stands ready to further support Ukrainian and international businesses working in Ukraine by fostering greater financial, technical and advisory co-operation in the energy sector and in the trade finance sphere. The bank is planning to maintain the pace of financing for priority projects. We are now seeing some positive signs of moderate growth in the economy and the revival of core banking sector functions in the country. This gives us a sense of optimism and opens up huge opportunities for partner banks and foreign investors. ■

Oleksandr Hrytsenko, chairman of the board of Ukreximbank JSC

THE BIGGEST REFORM OF THE PAST THREE YEARS IS DECENTRALISATION, WHICH WAS FUNDAMENTAL BECAUSE IT BROKE THE SOVIET VERTICAL OF POWER

Reforms mean business in Ukraine

FOR SO LONG MIRED IN CORRUPTION AND BUREAUCRATIC RED TAPE, IN THE PAST THREE YEARS UKRAINE HAS ENACTED NUMEROUS REFORMS TO IMPROVE THE CLIMATE FOR DOING BUSINESS. NOW, WRITES **NATASHA TURAK**, THE BATTLE IS ON TO CONVINCE INVESTORS THAT THE CONFLICT-AFFECTED COUNTRY IS A SAFE BET

The story is familiar by now: for decades a complicated legacy of corruption, cumbersome bureaucracy and political upheaval has dogged Ukraine's economic ascent. The country possesses a range of diverse and potentially lucrative sectors, yet has staggered behind its regional neighbours due to internal complications and now conflict.

In the past three years, however, the former Soviet state has enacted more reforms than ever before in its history, with the goal of improving transparency, law enforcement and economic growth.

Ukraine has risen in the World Bank's Doing Business ranking from number 152 in 2012 to number 80 today. These are crucial steps, according to many of the stakeholders in the country's business landscape – but as with any country facing such seismic change, there remains more work to be done.

Varied opportunities

Looking at the fundamentals, Ukraine offers enticing investment opportunities across a number of sectors including agriculture, IT, ports and shipping, energy, healthcare and manufacturing. Human talent is abundant and labour costs are low. Yet a survey of corporate executives by international law firm Kinstellar found that 82% of respondents view Ukraine as a difficult place to do business, citing political risk, security risk, corruption and regulatory risk as their top concerns.

Fear of political instability due to the war with Russian-backed separatists in the east of Ukraine deters many investors, and a complex regulatory environment can lead to substantial delays in basic processes such as applications and licensing. Many in the business community, however, cite recent government reforms as reasons for optimism.

"Ukraine has done an incredible amount in a very short period of time – with the police, with judicial reform, with anti-corruption," says Lenna Koszarny, CEO at Horizon Capital. "More has been done in the past two-and-a-half years than in the 20 years preceding. Clearly, when a country hasn't pursued structural reforms for 23 years, there is a lot to do. The process has just started." Her firm is Ukraine's largest private equity fund, and has invested more than $500m in Ukrainian and regional companies to date.

Among Ukraine's reforms are: three anti-corruption bureaus estab-

Human capital: of Ukraine's 45 million inhabitants, 70% hold a secondary education degree, making the country's population one of its greatest assets

lished in 2015 for prevention, investigation and prosecution; an electronic system for asset and income disclosure that has led to the resignations of thousands of public servants; a public e-procurement system meeting World Trade Organization requirements; decentralisation allowing more financial resources to local regions; banking sector and judicial reform; secured macroeconomic stability; a reduction of personal and payroll taxes; and the start in late 2016 of a government effort to repeal hundreds of outdated regulations on taxes, customs, and foreign exchange restrictions.

"The biggest reform of the past three years is decentralisation, which was fundamental because it broke the Soviet vertical of power where all decision making and finance was held at the top," says Daniel Bilak, a director at UkraineInvest, the national investment support agency founded in November 2016.

"We need to make the business environment a safer and more attractive place," he adds. "Difficulties with the rule of law and property rights protection have clearly undermined investor confidence. This is why there is huge judiciary reform under way at the Supreme Court level all the way down to the appellate court. People are starting to feel these reforms, but it doesn't happen overnight."

People power

Arguably Ukraine's best asset is its human talent. Of its 45 million inhabitants, 70% hold a secondary education degree or higher and, according to the World Economic Forum, Ukraine produces 130,000 engineering graduates per year – the most in Europe – and is ranked number one for IT engineering in central and eastern Europe (CEE). The country's IT sector generates about $3bn annually.

Labour costs are also among the lowest in the CEE region; the average monthly salary is $179, according to 2015 figures, significantly below the regional average.

"I've been here 10 years, and what Ukraine has to offer is a solution for Western countries facing a shortage of IT personnel," says Hans Uithol, CEO of Dutch professional services company HYS Enterprise, which runs all its operations from its 150-strong team in Ukraine's port city of Odessa. "It's not about money; it's about the availability of people," he adds.

More than 100 international companies operate software R&D labs in Ukraine including BMW, Volvo, and IBM – Samsung alone employs 1000 Ukrainian engineers for its research projects. IT outsourcing sales have grown twentyfold since 2003, and represent 40% of all Ukraine's exports to the US.

Meeting challenges

All of this has happened despite a lack of dedicated infrastructure supporting tech entrepreneurs, says Bohdan Kupych, vice-president of business development at Kiev-based tech holding company KM Core. "There is no access to capital for entrepreneurs. It's boot strapping, family and friends' money... that's where we work." KM Core has invested about $100m in several tech projects in Ukraine. "We help companies get started to the point where they can attract additional investment," he adds.

"There are some start-ups that ▶

WE CANNOT EMPHASISE ENOUGH THAT NOW IT IS REALLY SAFE TO INVEST HERE, AND YOUR CAPITAL IS SECURE

manage to gather capital, but once they enter the growth stage they're forced to look outside the country," says Yuri Warczynski, co-founder of HYS Enterprise. "That is a disadvantage for Ukraine, but also an opportunity for venture capitalists, for angel investors, for anybody ready to invest in start-up accelerators here in Ukraine." Notably, the founders of WhatsApp and PayPal were both born and raised in Ukraine but found success in the US.

An additional challenge is the impact Ukraine's war has on investor perception, says Oleg Shkuropat, Odessa branch manager at Danish-founded Ciklum, one of Ukraine's leading IT outsourcers with 3000 employees across the country. "The growth of our office here in Odessa has decreased, because of the war in the east and the conflict with Russia," says Mr Shkuropat. "It's hard to convince clients to build out their R&D centres anywhere further from Kiev or the country's west. This office used to grow by 40 to 50 people per year, but in the past three years we're growing by six to seven people per year. Other companies have been less fortunate and closed down."

HYS Enterprise's Mr Uithol believes the biggest efforts "should lie in showing the region is safe", adding: "We cannot emphasise enough that now it is really safe to invest here, and your capital is secure."

Rewarding the risks

Despite the apparent hurdles left by decades of mismanagement, Ukraine's fundamental strengths have provided significant returns for those committed to navigating the country's investment landscape. "Having discussed the current problems, there are in fact a lot of companies here that have made a lot of money," says Mr Bilak.

Many of those successful companies are in agribusiness, one of Ukraine's most lucrative sectors – the country holds 33% of the world's black earth soil, considered the most fertile for agriculture, and its land bank is capable of feeding 500 million people. More than 70% of Ukraine's territory is agricultural land, valued at more than $100bn, and the country is the world's top exporter of sunflower oil and the third largest exporter of corn. The agriculture industry has grown by 14% a year since 2003 and constitutes 38% of all Ukrainian exports.

US-raised Ukrainian John Shmorhun, CEO of AgroGeneration, represents just one of these success stories. Founded a decade ago, the company employs 1400 people across 12 farms in Ukraine and produces 400,000 tonnes of crops per year.

"The reason Ukraine is so important is that we are profitable, in spite of all the hurdles and without subsidies. We were forced to be efficient from the very start," says Mr Shmorhun. "If you want profitable, efficient farming, come to Ukraine."

Growing pains

With additional investment into management, irrigation, logistics and equipment, Ukraine could double or triple its annual grain harvests of 60 million tonnes a year. "Ukraine needs $50bn to $60bn in FDI for its agriculture over the next five to six years," says Mr Shmorhun. "Ukraine doesn't need smart people, labour or soil, it already has that. All we need is the investment."

He says land reform is the biggest issue for agricultural investors – something Mr Bilak says is under discussion, as large companies in the sector face complex land ownership laws and cannot own the land on which they work. "Land reform, pension reform and public administration reform – those are the three big reforms being worked on right now," adds Mr Bilak.

"Investors need to get over the war," says Mr Shmorhun, who states that the conflict occupies 7% of the country, while 93% of it remains perfectly operable. "Things are moving in the right direction. My message to investors is look at the companies and their success rate over the years. Judge for yourself," he adds. "When you can make these types of margins, why not? The war doesn't affect us. Agriculture in Ukraine is revolution-proof. We've proven it."

Room for modernisation

Ukraine is bordered by seven countries, four of them in the EU, and its infrastructure offers connections to key central and western European markets – many of its manufacturing plants are already integrated into European and global supply chains. Thirteen seaports, 170,000 kilometres of roadways, 22,000 kilometres of railways and more than 20 passenger airports support an export-oriented economy, complemented by Ukraine's Deep Comprehensive Free Trade Agreement with the EU, which lifts tariff and non-tariff barriers for Ukrainian exports.

The ports and shipping sector is vital to exporting the country's agricultural produce, yet according to the State Property Fund of Ukraine (SPFU), 70% to 90% of the ports' infrastructure is outdated. FDI is essential to upgrading the ports to boost exports.

This endeavour is complicated, however, by the country's privatisation regime. It has 3500 state-owned enterprises, and so far, ports are not up for privatisation, says Andriy Gaidutskiy, SPFU's deputy chairman. Multinationals such as Cargill and ArcelorMittal therefore develop the ports, investing in projects including grain terminals and logistics, on a concession basis.

TIS Group of Terminals in Yuzhny, 27 kilometres east of Odessa, is Ukraine's busiest maritime hub, operating five maritime terminals for ore, coal, fertilisers, grain and containers. "There is definitely a reason to do business in Ukraine," says TIS CEO Andrey Stavnitser, citing Ukraine's global standing as an agricultural producer.

"Yuzhny is the deepest port in Ukraine, which makes it perfect for large-scale commodity trade. TIS has invested in excess of $500m in maritime and land transport infrastructure, and now Yuzhny is the third largest port in the whole Black Sea," he adds.

"Despite all the bureaucratic challenges, a private business of brick and mortar such as TIS works under international standards and can provide its partners with flexible and reliable services," says Mr Stavnister. The government is forming new concession legislation, and assets from ports to power plants are being prepared for concession or privatisation with the help of international consultants.

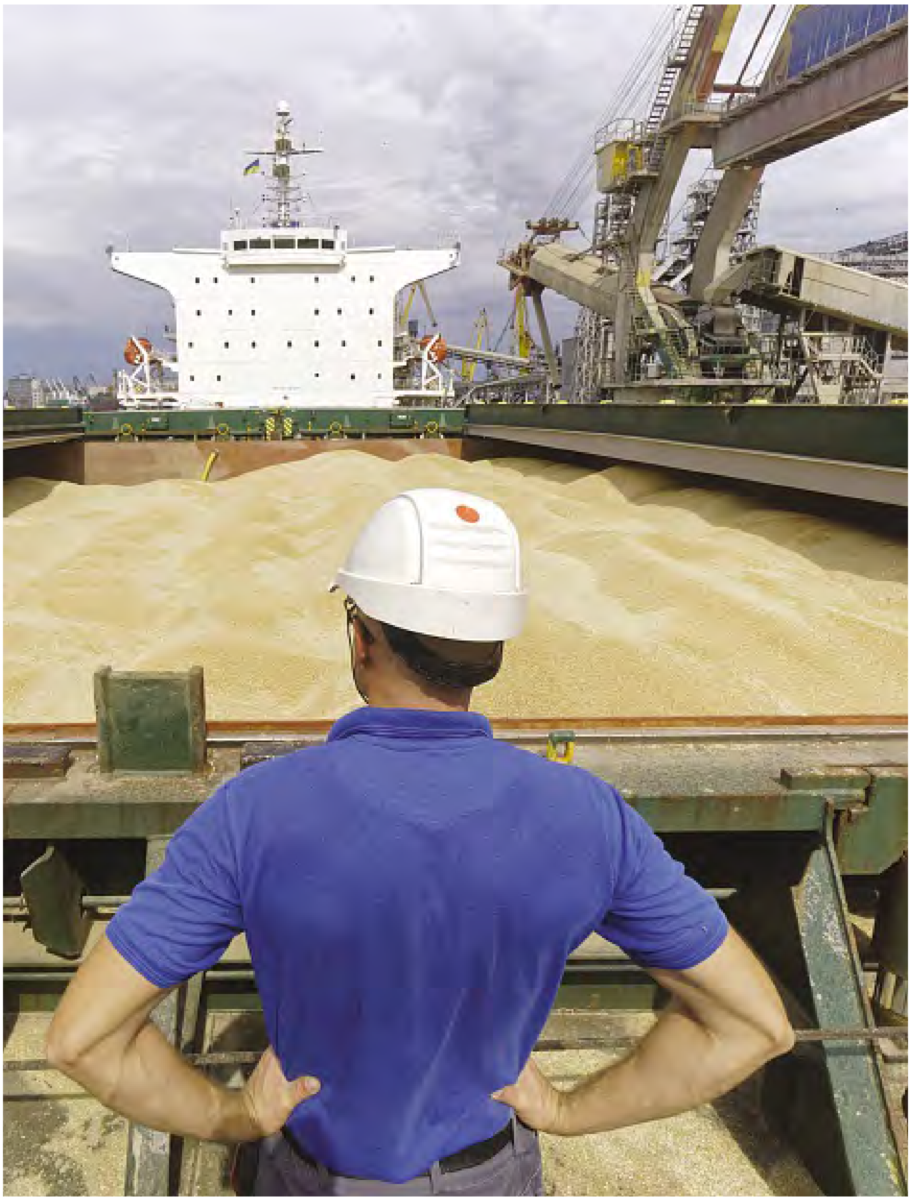
"The process is moving forward – not too fast, but it definitely is. Moreover, existing ports will also be open for large-scale privatisation, which is another reason to consider Ukrainian reforms seriously. I stress that private business is driving all the positive changes – and does this efficiently and promptly, pushing the government for faster and more efficient solutions as needed," adds Mr Stavnister.

Changing mindsets

Numerous other sectors in Ukraine present investment opportunities, among them energy – with everything from oil and gas exploration to coal, where French ArcelorMittal has invested $170m into a coke plant in central Ukraine, to renewables, where Turkish Atlas Global Energy has invested $20m into a wind farm in western Ukraine. Two hydropower plants were privatised in 2016, with more planned for this year.

"The biggest reform we are seeing is a change of mindset, especially in many government officials," says Andy Hunder, president of the American Chamber of Commerce in Kiev, which represents 600 companies. "There is a lot of resistance – we're seeing a clash between old and new. The new people, especially over the past three years, are coming in and they want change. Things are moving, albeit slower than we would like, but we have hit rock bottom and now we are climbing out.

"The voice of business can definitely be heard. A lot still needs to be done, but we are in this together and pushing together."


Grain of truth: agribusiness remains one of Ukraine's most lucrative sectors

So what advice would Mr Hunder give investors in Ukraine? "The most important thing is to have a clear strategy and play by the rules," he says. "If you understand the realities and risks of doing business here, you can really see your success."

Mr Bilak adds: "We're in this transition period between old and new Ukraine that began three years ago. Up until three years ago, people were afraid of the system; now the system is afraid of the people. You have to pull many weeds out before you have a garden and that is the process we're in. You are seeing, and will continue to see, fundamental change." ■

Kiev's heavyweight impact

FORMER BOXING CHAMPION VITALI KLITSCHKO HAS HIS EYES ON A NEW PRIZE. WHILE, AS MAYOR OF KIEV, HIS REFORMS TO BOOST TRANSPARENCY ARE LOCAL, HE HOPES THEY ALSO BOOST THE NATIONAL PERCEPTION OF UKRAINE AS A SAFE PLACE TO INVEST. **COURTNEY FINGAR** REPORTS

Vitali Klitschko has a well-worn yet crowd-pleasing line he likes to use at conferences and business roadshows. The former world heavyweight boxing champion, who is now the mayor of Kiev, declares he personally will be "the bodyguard" of any investments that come into his city.

Enthusiastic applause – and endless requests for selfies with him – tend to follow. Though there are limits to the protection that even a bruiser of a mayor can provide in a national investment environment that is still evolving, reforms at the city level in Kiev give at least a fighting chance of improvement.

"Kiev is at the vanguard of making Ukraine more investor friendly," says Susan Kosinski Fritz, regional mission director to Ukraine, Belarus and Moldova for US agency USAID.

Heavy hitter: Kiev's mayor says his city is "very happy to be in the family of the 'Smart City System' network"

Combating corruption

Mr Klitschko has pursued open-government initiatives as a means of reducing opportunities for corruption. "It is our main goal to change the system, which is big, inflexible, old and corrupt. It's the biggest challenge for us. Through transparency we destroy corruption. To do everything in the open, to make it understandable for everyone, for every citizen, for every investor, it's good for us and it's a great chance for us to present Kiev as a modern city," he tells **fDi**.

"And that is why we are very happy to be in the family of the 'Smart City System' network. We [do this] together with [software company] SAP, which implements the system and that is why we felt the benefits immediately, because we received much more income in our budget. All income, all spending from our budget, is open for the public, journalists – every citizen; there is no space for corruption because corruption works in the shadows."

A law passed in November 2016 set about slashing corruption in the murky area of Kiev's construction permits. This replaces a previously opaque and subjective 'shared participation' payment with a streamlined online process and a flat rate; applicants can now pay either 4% of general construction costs or by the number of square metres times Hrv400 ($15). There is also now an equal tax rate (also 4%) for residential or non-residential property builds.

It is hoped that the improvements to procedures can bring in support from multilateral institutions as well as private investors. "Having addressed the liability issues on the municipal side, we can now bring in the International Finance Corporation, European Bank for Reconstruction and Development [EBRD] and others in infrastructure deals," says Oleg Mistuque, director-general of Kiev's investment agency.

"On some projects that are not lucrative for investors, the city must step in. We're looking at projects where international private investors could step in, along with the EBRD, etc, which would give a good return considering Ukrainian risk."

Mr Klitschko acknowledges there is still a "complicated economic system" in Kiev, just as there is nationally. "Obviously, the conditions are very difficult," he says.

Hearts and minds

Kiev also faces two challenges when it comes to investment promotion: changing the hard realities on the ground and changing investor risk perceptions. There is an acknowledgement that progress must happen at both layers in tandem. With the capital city set to host the popular European song contest Eurovision in May, millions of eyes will be on Kiev – an opportunity Mr Klitschko hopes to use to showcase the city's changing face and boost tourism.

Of course, there is a big difference between deciding to spend a few days in the city to watch a live event, and investing millions of dollars in a long-term project. But the mayor says he will not stop fighting to change investors' minds about the city.

"There are still people scared of investing in Kiev, who think it's too risky. Poland is a good example for Ukraine. We were in a similar position [to Poland] 20 years ago, and now Poland is no different from Germany in terms of infrastructure and many other qualities," says Mr Klitschko. "My job is to show we are serious and trustworthy partners." ■

A European touch

LVIV HAS BOTH CLOSE PROXIMITY TO AND A FONDNESS FOR EUROPE. TOGETHER WITH A WEALTH OF TALENT AND FAVOURABLE LABOUR COSTS, THE CITY IS RAPIDLY BECOMING A POPULAR LOCATION WITHIN THE EU SUPPLY CHAIN, AS **NATASHA TURAK** REPORTS

Named one of *Lonely Planet* travel guides' top 10 undiscovered cities to visit in 2016, Lviv – the largest city in western Ukraine, but only the seventh largest in the country, with a population of 750,000 – is becoming a hub for European businesses looking for high-quality talent and manufacturing on the doorstep of the EU.

Famous for its 19th century architecture, award-winning coffee and handmade chocolate, Lviv has a growing tourism sector and in 2016 welcomed 2.5 million visitors, according to Olha Syvak, chief investment officer at Lviv City Council.

But as a self-proclaimed Western-oriented city – formerly part of Poland and Austria's Hapsburg empire and located just 70 kilometres from the EU – Lviv and western Ukraine are favourably located for manufacturing and integration into the European and global supply chain.

Low energy, low costs

Lars Vestbjerg is CEO of Lviv-based SICA, a Danish footwear manufacturer and president of the Danish Business Association (DBA), which represents the 200 Danish companies operating in Ukraine, 65 of which are in Lviv. He came to Ukraine in 2003 with the aim of outsourcing, taking advantage of the area's proximity to key markets and its low energy and labour costs.

"Of the problems we had when we first came here in 2003, 90% have gone," says Mr Vestbjerg. "The DBA and European Business Association are constantly working through the administration to make life easier for investors.

"Ukraine is good investment country; it's also a good country to live in. Ukrainians are highly educated, and here they are more Western-minded in business and politics," he adds. "We're brainstorming a new FDI strategy," says Ms Syvak. "We say 'Make in Lviv', speaking about IT and manufacturing. We have more than 15,000 employees in the IT sector, designing programs for the US and UK markets."

Lviv IT Cluster is dedicated to uniting the city's 200-plus IT companies through marketing, knowledge-sharing and events such as Lviv IT Arena. It has created a masters degree in technology management with Lviv Business School, whose professors include experts from Princeton and Carnegie Mellon universities in the US.

"We don't want our selling point to be 'low-cost city', but rather 'smart city'," says Ms Syvak, highlighting the 30,000 annual graduates from the city's 12 universities.

Sophia Opatska, founding dean at the Lviv Business School of Ukraine Catholic University (UCU), says: "In Ukraine, our big challenge is changing the mindset from this post-Soviet legacy of a paternalistic society.

"We, as a university, are focused on developing an entrepreneurial and risk-taking attitude." UCU partners with local businesses and firms to develop their programmes, ensuring students are equipped to meet future industry needs."

"Clusters are growing in western Ukraine in manufacturing and the auto industry, feeding assembly plants in Hungary and Slovakia," says Andy Hunder, president of the American Chamber of Commerce in Ukraine. In early 2016, Japanese automotive company Fujikura opened its first local plant, producing electric wiring for Volkswagen and hiring more than 1500 staff, with plans to hire a further 1300.

Up the value chain

"Lviv is leading Ukraine's economic revival, creating well-paying, hi-tech and modernised jobs," says Daniel Bilak, director of Kiev-based UkraineInvest.

Despite Ukraine's political challenges, European companies are flocking to the region. For example, automotive OEMs from Germany (Bader) and France (Nexans) also opened plants in 2016.

Last year, Austrian companies invested $8m into Lviv and Poland spent nearly $16m, according to Lviv Oblast's statistical office. Food production giants Nestlé and Coca-Cola are also thriving in the region. These investments require both manpower and IT talent, moving the region up the value chain.

"When people come here they see a European city; they don't see tanks on the street," says Ms Syvak. "They see a professional local government ready to help. That is why we work to highlight the success stories and show there is good news in Ukraine."

Mr Vestbjerg adds: "We have a good company here and we are operating. There is a war in the east but here you don't feel it at all. There is nothing to be afraid of." ■

Hidden treasure: Lviv was named by *Lonely Planet* as one of the top 10 undiscovered cities to visit in 2016

Sun and silicon

KNOWN PRIMARILY AS A HOLIDAY DESTINATION, ODESSA IS FAST BECOMING A MAGNET FOR TECH START-UPS. BOASTING HIGHLY SKILLED GRADUATES AND AN ENTREPRENEURIAL SPIRIT, THE PORT CITY HAS AN AMBITION TO BECOME UKRAINE'S SAN FRANCISCO. **NATASHA TURAK** REPORTS

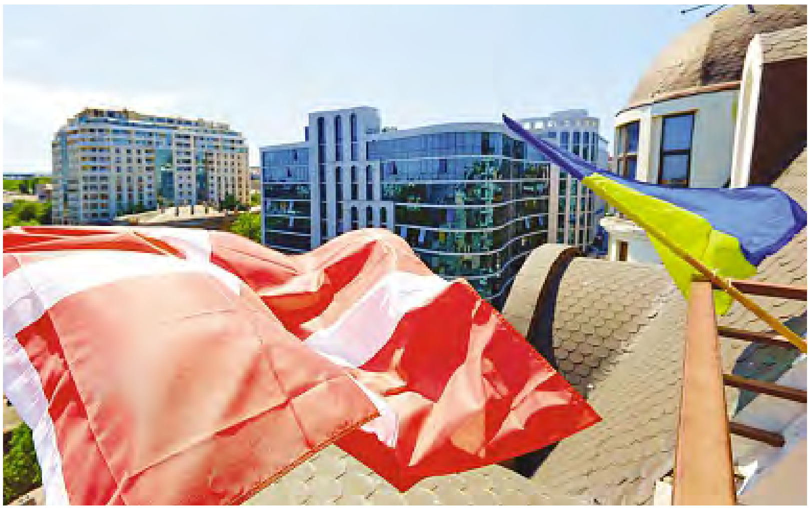


Photo courtesy of Ciklum

More than the sun: Odessa is developing tech spaces to move beyond its status as a holiday resort

A southern port city on Ukraine's Black Sea coast, each year Odessa lures a growing number of travellers with its sun-swept beaches, rich culture and Unesco-preserved architecture. In 2015, the city welcomed 1.2 million tourists, up from 250,000 in 2003 – and in the years since Ukraine's air traffic hit a nationwide low in 2014, Odessa's air traffic increased by 32.5%, compared with a meagre average of 3.8% across most Ukrainian airports.

But there is more to this city than its allure to holiday-makers. Graduating approximately 1000 IT students each year, Odessa has become home to a growing number of technology companies, including R&D outsourcing services for Volvo, BMW, Luxoft and more. In 2015, Forbes ranked Odessa the top city for business-friendliness in Ukraine.

Local success stories

"We see a lot of investment opportunities here, especially with start-ups," says Yuri Warczynski, co-founder of Dutch professional services provider HYS Enterprise. Local success stories include Kwambio, Augmented Pixels and Looksery – the latter of which was purchased by US social media app Snapchat for $150m.

Nearly 200 IT companies occupy the city, many with a staff count of less than half-a-dozen. And Odessa's tech community has started to mobilise, developing private-public initiatives such as Startup Odessa, which works with the city council to improve conditions for entrepreneurs and provide training and mentorship.

HYS Enterprise is part of Odessa IT Cluster, an organisation aimed at promoting the interests of the city's tech community. The organisation encompasses 17 companies and nearly 3000 IT specialists – about 45% of the city's total. Also part of Odessa IT Cluster is Danish-founded Ciklum, one of the top five IT outsourcers in Ukraine with more than 200 international clients, employing 3000 people across the country and 160 in Odessa.

"As an external benchmark, we all want to become Ukraine's Silicon Valley," says Oleg Shkuropat, Ciklum's branch manager. "Of course, this requires capital and knowledge process, but entrepreneurship is in Odessa's DNA. People here have created amazing products and solutions that have become global."

Ukraine's San Francisco

Award-winning mobile app developer Readdle, which designed the first app enabling book and document reading on the iPhone when Apple's App Store was first launched in 2007, was founded in Odessa and employs most of its 107 staff there. Readdle has now seen more than 65 million downloads across its eight productivity-enhancing apps, which include Scanner Pro and PDF Office.

"From a cultural perspective, Odessa is to Ukraine what San Francisco is to the US," says Readdle co-founder Igor Zhadanov. "It is a port city. We have 100 nationalities, and the city's history is very cosmopolitan. This influences how people do businesses: you have a concept of diversity."

Mr Zhadanov cites Israel as an example for Odessa to follow, with its government support for accessing funding, legal advice and international currency going a long way in boosting start-ups. But besides this, he maintains that the best role for government is a small one. "What it takes is not so much financial assets as vision and a long-term perspective. So we need to inspire people and let them do their work. Government participation is not so necessary for that," says Mr Zhadanov.

Retaining the talent

"We have to create the infrastructure that will help bright minds stay in Ukraine," says Victor Bezer, head of supply at Odessa-born video advertising platform VertaMedia, which is headquartered in New York but has operations around the world. Mr Bezer cites inadequate start-up infrastructure and inefficient business regulation as the reasons many Ukrainian entrepreneurs take their ideas elsewhere.

"In Odessa things are moving in the right direction, because we have private universities training engineers and IT companies building networks through events such as the Black Sea Summit," says Mr Bezer, referencing the yearly tech summit in Odessa, which in 2016 brought together more than 1000 participants. "We have a huge community of people trying to improve things, and we see the new generation making that change," he adds. ■


Heavy industry: Zaporizhia's steelworks is still a major employer, and just one of 160 major facilities within the city limits

Eastern Ukraine's many battles

A RUST-BELT SOVIET PAST, A GEOGRAPHY THAT MAKES TRANSPORTING GOODS EXPENSIVE AND THE ONGOING CONFLICT WITH RUSSIA ARE ALL HAMPERING EASTERN UKRAINE'S EFFORTS TO ATTRACT FDI. BUT CITIES SUCH AS DNIPRO AND ZAPORIZHIA ARE COMMITTED TO DISPELLING THE OLD PERCEPTIONS AND ATTRACTING FOREIGN INVESTMENT TO THIS RESOURCE-RICH REGION, AS **YURI BENDER** REPORTS

Since the forced annexation of its Crimean peninsula and the Russian-backed rebel occupation of its eastern fringes in 2014, Ukraine has been going through the most turbulent period of its brief 25-year history as an independent state.

The most challenging environment of all is faced by eastern cities, too far from the EU to make traditional road and rail transport of manufactured goods cost-effective, while near enough to the military front line to deter foreign investment. While western hubs such as Lviv and Ivano-Frankivsk have benefited from low labour costs, highly skilled workers and physical proximity to EU markets, the eastern powerhouses of Soviet days have struggled to keep up.

A low-cost region

"Ukraine is now a low-cost geography, more competitive than China," says Andy Hunder, president of the American Chamber of Commerce in Kiev. "The automobile-related industry stretches from the EU borders, all the way through West Ukraine to Ternopil."

Unfortunately for the east, he adds, the transport of heavy parts from Zaporizhia or Dnipro is now a thing of the past. "It is very difficult to raise capital in the east. Zaporizhia is just 150 kilometres from the front line. Some say it's too risky to invest and that the separatists might return," says Mr Hunder. The region is also hampered by a temporary blockade of cargo to separatist-controlled territories, which affects the whole supply chain of many industrial processes.

But the much-maligned smokestack cities are not taking things lying down. Thanks to civil defence strategies implemented by local governors and workers in early 2014, they managed to fend off the worst excesses of the separatists, who with Russian help, overturned city administrations in Donetsk and Luhansk further to the east.

Investing in the east

Now many cities are redefining their strategies. And there are some Western firms prepared to invest substantial amounts in Ukraine's eastern, resource-rich lands. "US companies are in Afghanistan and Iraq, and compared with Ukraine, those are much worse places to do business," says John Didiuk, director of the Overseas Private Investment Corporation, the US government arm that channels private funds into developing economies, backed by political risk insurance.

"We are able to do much more in Ukraine – our portfolio is currently \$630m. We want to be at the stage where we are at full capacity and have to pull back, but we are not there yet," he adds.

While most of the appetite

among foreign firms is for western Ukraine, US businesses are looking seriously at major eastern cities, says Mr Didiuk. And those cities making the most effort to attract Western partners are reaping the rewards. “It all depends on which regions of Ukraine are more active than others in attracting investment. For instance, Kharkiv did a roadshow in the US and we will bring Zaporizhia with us in future. Political risk insurance is very helpful in these cases,” says Mr Didiuk.

Increasingly, the industrialists and mayors running these cities are also beginning to realise that despite the external pressures and the internal corruption traumatising Ukraine’s economy and society, they also face a massive opportunity. After all, if Donetsk and Luhansk – the engine rooms of Ukraine’s old-fashioned commodities-led industry – are no longer under government control, there is room for some new regional champions, provided local conditions and infrastructure are ready to support their development.

Zaporizhia attraction

The initiatives of some local mayors are clearly resonating with Ukrainian representatives of forward-looking foreign firms. Peter O’Brien, country director at EuroCape New Energy, a Monaco-based international renewable wind and energy group, is very optimistic about the prospects for Dnipro and Zaporizhia. The flat steppe region around the latter is ideal territory for the firm’s wind turbines. EuroCape is currently working with international financial institutions to raise €100m for the first phase of its 167-turbine 500-megawatt facilities.

His plan is to eventually develop the Zaporizhia facility into the largest onshore wind park in Europe, heating and lighting at least 1 million homes in the region. “The steppe offers a higher quality wind resource, with lower turbulence than some other areas in Ukraine,” says Mr O’Brien. But the region’s growth potential and the desire of its political leaders to forge ahead have been just as important.

“Although Dnipro may feel more dynamic and entrepreneurial, Zaporizhia is still at the top end of the range for economic growth,” he says. “The local authorities there have done a lot for the city. They have been busy repaving the roads and the message I get from people is that they are trying to do something positive.”

Many observers were dismayed by organised clans of ‘raiders’ who previously ransacked the regional economy. One man singled out by investors for injecting new hope into the region is Zaporizhia mayor Volodymyr Buriak. The charismatic city boss, previously chief engineer at the city’s sprawling steel works, Zaporizhstal, sees his job as reinforcing basic building blocks.

“We can’t do very much to influence industry, the agrarian sector or military production,” he says, proudly listing many of the 160 industrial plants within the bustling city’s boundaries, including helicopter and aircraft engine maker Motor Sich, car manufacturer ZAT and stainless steel manufacturer Dniprospetsstal. “But when it comes to the workers who keep all this going, we can improve their buildings, invest in the transport they use to travel to work, improve their safety and look after their children in the schools and kindergartens.”

It is his responsibility to the people, 760,000 of them, which is key to Zaporizhia’s future, according to Mr Buriak. “The people of Zaporizhia are our main resource and we want to rebuild this city for them, so that our youngsters don’t have to leave for Europe or the US in search of a better life. We want to create future stability,” he says.

Towards achieving these aims, Mr Buriak is dispensing a Hrv7.6bn ($283m) annual budget, a 25% increase on 2016, predominantly on improving communal buildings, roads and transport facilities. At the end of 2015, for example, there was a shortage of 1600 pre-school places, mainly for factory workers’ children. To begin addressing this deficit, the city has taken over seven facilities from Zaporizhstal. New investments into these will make available 12 extra pre-school groups with places for 260 children.

Mr Buriak hopes such initiatives can change the views of foreigners, and indeed some Ukrainians, who still perceive the urban conurbations of Ukraine’s south-eastern industrial heartlands as a corrupt, Soviet-style rust-belt. “We are working very hard to change that view,” he says. “We need to convince our people, our businesses, our investors that they can trust our authorities once again.”

Building bridges

One key part of what Mr Buriak calls the city’s “unfinished business” is the completion of two major bridges across the vast Dnipro river. As well as the iconic hydroelectric dam, the river is also home to Khortitsya island, the preserved historical home of the Zaporizhian Cossacks, flamboyantly portrayed by Hollywood stars Tony Curtis and Yul Brynner in the 1962 film *Taras Bulba*.

One bridge will connect the city’s left bank to Khortisya and the other will connect the island to the right bank. As transporting goods, people and military hardware across the bridges is considered a matter of national strategic importance, the central government has contributed Hrv200m to the project and regional authorities Hrv40m, in addition to Hrv20m from the city budget. Although building is under way, an extra Hrv740m is needed for this in 2017 alone.

“With the help of investors, we can finish these bridges and allow

IT IS VERY DIFFICULT TO RAISE CAPITAL IN THE EAST. ZAPORIZHIA IS JUST 150 KILOMETRES FROM THE FRONT LINE them to create franchises and collect tolls," says Mr Buriak. A further investment of Hrv180m has been earmarked for construction of a new airport terminal building during 2017, plus Hrv20m to upgrade the runway, with talks under way with foreign investors for further improvements to the facilities.

The mayor is particularly proud of the 10 weekly flights from the city to Istanbul, with Turkey emerging as a key trading partner for the region and negotiations currently progressing with low-cost Turkish operator Pegasus Airlines, in addition to national carrier Turkish Airlines.

Mr Buriak also speaks hopefully about plans for the rebirth of the city's once advanced but now dilapidated river port. The installation of a system of locks along the Dnipro river will allow cheaper transport of goods from factories downstream to Odessa and Kherson on the Black Sea, and eventually along the Danube into the Balkans. "We will become a new transport hub for this region," he says.

The old-style industrial plants, still spewing smoke and dust over the city's population, are also modernising and cleaning up their act. Zaporizhstal has spent $350m over the past four years to update its technology, but still needs to raise $1.5bn to upgrade its metallurgical processing and is looking for external financing to help secure this next tranche.

"The sentiment of Western investors is currently not favourable when it comes to Ukraine," says Rostyslav Shurma, the plant's 33-year old CEO. "But we are financially healthy as a business, with no debt. Investors look at our quality, efficiency and balance sheet and tell us: 'If you were anywhere else apart from Ukraine, we would work with you'."

Challenges to expansion

But there are many challenges to the city's economic expansion programme. Zaporizhia is officially home to 38,200 internally displaced persons, forced to flee their homes in war-torn Donetsk and Luhansk, with true numbers believed to be double this. "There is a big mass of people who have come to us from the temporarily occupied territories," says Mr Buriak. "The state is helping, but we would like this support to be a bit larger. This is a challenge for the whole country. People need somewhere to live and somewhere to work, so they are not depending on state benefits."

Zaporizhia mayor Volodymyr Buriak: "When it comes to the workers who keep all this going, we can invest in the transport they use to travel to work and look after their children in the schools and kindergartens"

There is also a note of caution sounded by some commentators about an 'enemy within' some of the industrialised cities. "There are still seeds of latent, hidden rebellion in eastern cities such as Kharkiv and Zaporizhia," says Vadym Karasyov, one of Ukraine's best known political pundits and a former presidential adviser, close to opposition circles. "[Russian president Vladimir] Putin's partisans are still there and in the right circumstances, he can give them the signal. Just because they are working away in their factories, it does not mean they are loyal to the authorities."

The government in Kiev can still turn things round if it shows signs of reform and progress in the battle against corruption, says Mr Karasyov. But the more the government falters, the more likely it becomes that members of the one-time Russian-leaning disaffected minority will lift their heads.

These elements are also likely to be encouraged by the ongoing redrawing of the global political order. "A lot of people in Ukraine see the victory of [US president Donald] Trump as the victory of Putin. If you add in Brexit and election results in Moldova and Bulgaria, with potential election shocks in France, Germany and Italy, plus the recent Dutch referendum, it gives them plenty of encouragement. A lot depends on the actions of the political class in Kiev," says Mr Karasyov.

Looking for leadership

Investors are worried both about the conflict in the country and Ukraine's political and economic instability in general, says Zaporizhstal's Mr Shurma. "Now that there has been no economic reform in the past year, questions are being asked of the Kiev authorities."

The ultimate ownership of eastern Ukraine's heavy industry by a handful of colourful, politically connected oligarchs may also be a factor that foreign investors are weighing up. Zaporizhstal, for instance, is majority owned by Metinvest, the largest company of the SCM conglomerate, founded by one of Ukraine's leading oligarchs, Rinat Akhmetov, who controversially runs factories and mines on both sides of the conflict lines.

But the mayor quickly dismisses any talk of renewed separatism in this region. "Even if people here speak mainly Russian, Zaporizhia is Ukraine and our people want to see their own city remain in their own country," says Mr Buriak. "I can say, without any doubt, you will never see a DNR [Donetsk National Republic] or LNR [Luhansk National Republic] in Zaporizhia. Maybe foreign investors are being given the wrong information about us." ■

Pokrovsk stirred into action

FOR POKROVSK IN UKRAINE'S DONETSK REGION, LIFE GOES ON DESPITE ITS PROXIMITY TO THE CONFLICT IN THE COUNTRY'S EAST. THE CITY'S PRIORITIES INCLUDE CHANGING ENERGY SUPPLY TO SAVE MONEY, A MOVE ENABLED BY THE GOVERNMENT'S DECENTRALISATION DRIVE. MAYOR RUSLAN TREBUSHKIN TELLS **YURI BENDER** WHY BUDGETARY IMPORTANCE IS SO IMPORTANT TO THE CITY

The Ukrainian city of Pokrovsk in the Donetsk region, home to nearly 65,000 inhabitants, has clearly suffered from the effects of the conflict with Russian-backed separatists, just 60 kilometres to its east. But local industry, consisting predominantly of coal mines and mechanical engineering works, is keen to attract external investment, under the guidance of a local administration that is gradually finding its feet.

City mayor Ruslan Trebushkin is not one for hubristic statements, but understands he has to work within current constraints and tough circumstances. One of his priorities is overseeing the area's transition to biomass fuels, through 15 communal renewable energy projects, gradually replacing expensive gas heating systems.

"Most of Europe pays three times less for electricity and gas than we do in Ukraine, so we are using biomass technology to generate cheaper energy," he says. In this way the city hopes to save $1.8m each year, which can then be earmarked for other investments.

"Today, in Ukraine, the prime minister and president want to encourage such important projects and they want to help cities such as Pokrovsk through decentralisation," says Mr Trebushkin, warming to his theme of greater local budgetary responsibility, permitted by recent Ukrainian legislation. "In many leading European countries, such as Germany and France, there is a similar system, where city councils have the power to spend their own budgets, with greater responsibility for local services," he adds.


Burning issue: Pokrovsk mayor Ruslan Trebushkin is making renewable energy sources his priority

Empowering locals

Mr Trebushkin is keen to give local people greater say in how the annual city budget of Hrv150m ($5.5m) is allocated to schools, kindergartens, roads and roofing of communal buildings "to maximum effect".

He talks openly about the ultimately unsuccessful efforts of "several hundred" local separatists to take over the administration buildings back in 2014 and how the city's hospital treats many wounded soldiers from the nearby frontline.

The Ukrainian Ministry of Information is also improving access to Ukrainian TV channels by upgrading a transmission tower in Pokrovsk, to curb the reliance of many locals on nearby Donetsk-based separatist-run TV stations for their news. (The city was only renamed Pokrovsk in 2016, after its previous Soviet incarnation of Krasnoarmiysk, as part of Ukraine's ongoing 'decommunisation' process.)

Another heated topic is Ukrainian activists' blockade of the roads and railways leading to the territories that are currently occupied by Russian-backed separatist militias. The Ukrainian government also appears to be reluctantly backing a temporary freeze on cargo traffic.

"One side talks about the evils of separatism and corruption and the other about economics," says Mr Trebushkin. "But this is painful for Ukraine. It is our territory and we need to pay the wages of people who work there. It is obviously a blow for the economy. Ukraine is a single, whole organism. You can't cut off a leg or arm and expect it to survive in the same way."

Support from outside

On a more optimistic note, the mayor is starting to see firms from the Netherlands, Denmark, the Czech Republic and Japan becoming involved in small projects of about €25,000 each to back citizenship initiatives and entrepreneurship.

Bigger projects in the pipeline include a shopping centre, housing, a supermarket, several cafes and a trading area for a broader range of outlets, plus a €3m grain elevator with capacity for 25,000 tonnes of grain, which will create up to 70 jobs.

"When I speak to my Polish counterparts, they tell me that our biggest problem is our Soviet legacy," says Mr Trebushkin. "Under the Soviet Union there were too few initiatives actually coming from the people, as the government used to look after everything. This is something we have to change." ■

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