

## **Natalie Jaresko Opening Remarks**

### **Chatham House**

### **The Royal Institute for International Affairs**

Tuesday, March 24, 2015, 13:15 – 14:15 PM, Oriental Room

Chatham House, 10 St. James's Square, London SW1Y 4LE

Theme: “Transforming Ukraine’s Economy”

Introduction / Chair: Robert Brinkley, CMG, Chairman, ‘British Emergency Aid to Russia and the Republics’ Trust; British Ambassador to Ukraine (2002-06)

Opening Remarks: 15-20 minutes, delivered from lectern

Q&A session: Seated conversation moderated by Robert Brinkley

## Introduction

Ladies and gentlemen, I would like to thank Chatham House for extending this invitation and thank all of you here today for your ongoing interest in Ukraine.

This is my first trip to London and the UK since I became Minister of Finance of Ukraine last December.

I am honored for the opportunity to speak today in such a renowned international institution and in front of such a respected group of people.

## The War

As you are all well aware, a tragic war driven by Russia and Russian-sponsored terrorists is taking place on Ukrainian territory.

The Kremlin opposes Ukraine's desire to become a fully independent, Western-oriented and prosperous country.

A democratic, pro-European and economically successful Ukraine is perceived as a threat by the Kremlin because it challenges the regime's autocratic model. The idea is antithetical to it.

This seems to be one of the reasons why they have engineered and supported this conflict, first in Crimea and then in Eastern Ukraine, and have launched a massive propaganda campaign against our pro-European Ukrainian government.

Russia's expansionist and revisionist agenda goes well beyond Ukraine, though. Some of Putin's ideologues and political commentators are calling for the Russian army to invade the Baltic States and head on to Warsaw. Russia planes have violated NATO airspace more than 400 times over the last year.

In January and February, Royal Air Force patrols intercepted long range Russian bombers as they flew off the coast of Bournemouth and Cornwall. Recklessly, they had switched off their transponders.

Today, Ukraine is fighting to protect not only its sovereignty and territorial integrity but also the security of the whole of Europe.

Ukrainians are dying for the values of freedom and democracy, values that many take for granted in Europe but that are the bedrock of our Western civilization.

But Ukraine is fighting alone, and bearing a terrible cost.

Be sure of one thing: what the Ukrainian people want more than anything else is peace. We want to live in peace and be a fully sovereign, European nation – firmly in control of our own destiny.

The Ukrainian government has repeatedly demonstrated its readiness and commitment to a peaceful solution to the conflict. We initiate unilateral cease-fires. We repeatedly come to the negotiating table without any precondition. We implement each commitment we make to the agreements.

But Russia and Russian-sponsored terrorists have systematically violated the Minsk I and Minsk II agreements. According to NATO, there are 12,000 regular Russian troops on the Ukrainian territory in the Donbass region, and mercenaries continue to pour across the border.

*[Placeholder for update on Tuesday morning of military escalation/tragedy]*

### The human tragedy of the war

The conflict in the East is a devastating humanitarian tragedy and puts a tremendous strain on our country. Nothing like this has occurred in Europe since World War II.

- More than six thousands of our people – soldiers and civilians - have died to defend Ukraine’s territorial integrity and independence
- More than fifteen thousand people have been wounded.
- Over one million people have been forced to leave their homes due to the war in the east and the illegal annexation of Crimea. These internally displaced persons include some of our most vulnerable citizens – over 60 percent of these are pensioners and 12 percent are children.

- In Crimea, the Tatar population is subject to systematic discrimination, threats, abuse of human rights and selective justice. Ten of thousands of Tatars have had to leave their home – the second forced exile of Tatars from their homeland by the Kremlin.

### The economic cost of the war

The conflict in the East has also had a massive economic impact on the country.

- Ukraine has lost around 20 percent of its economy and its industrial sector output has fallen by nearly 11 percent in 2014 due to the war. In February of this year, the industrial production of the Luhansk region was down by 90% compared to February 2014.
- The infrastructure damage and loss of economic output from the regions under occupation, including Crimea, is massive. More than 10,000 apartment buildings were destroyed in the Donetsk region alone. Numerous industrial plants, airports, roads and energy infrastructure have been destroyed.
- The estimated value of the energy assets stolen by the Russian Federation in Crimea is 300bnUSD.

- Ukraine spends around 5 million dollars a day just to defend its territory from the unprovoked Russian invasion.

### The economic crisis

The war triggered a very serious crisis economic crisis. But let's be honest with ourselves: the current economic crisis did not arise solely from the war. It is also the result of Ukraine's poor previous economic governance.

74 years of communism, 23 years of uncompleted reforms, mismanagement and large scale political corruption by the previous regime have left the country in a miserable economic situation and poorly equipped to cope with a devastating conflict.

- In 2014, Ukraine GDP fell by 6.9 percent with an even sharper contraction in the fourth quarter.
- GDP this year is projected to fall by another 5.5 percent and inflation is expected to be under 30 percent – double the rate last year.
- Ukraine's currency, the hryvnia, depreciated by as much as 70 percent since last year.
- The currency depreciation and official borrowing are expected to push public sector debt to dangerous levels.

- Meanwhile Ukraine's reserves of foreign currency were down to little more than \$5bn before the payment of the first IMF tranche last week.

### Ukraine needs international support

Ukraine cannot stop the expansionist agenda of the largest army on the European continent alone. International support to Ukraine is necessary to protect Europe and prevent an even larger humanitarian and economic crisis at the heart of Europe.

We are very thankful to the United Kingdom for the role it played over the last year in supporting Ukraine and opposing the Kremlin's aggression, maintaining unity within the EU on economic sanctions.

I expressed our gratitude to Chancellor George Osborne yesterday. I also asked the British Government to continue and increase its support in three directions:

- First, Ukraine needs more financial and humanitarian assistance. The 17.5 billion dollars IMF contributions represent less than half of the 40 billion dollars total financial needs for the 2015-2018 period estimated by the IMF. Over the past two years, the UK government has provided 10 million Pounds in bilateral assistance to support governance and economic reform in Ukraine, and recently announced a further 15 million Pounds in emergency assistance for those internally displaced. We hope

that the UK will continue and further increase its bilateral support, in line with other European and Western allies.

- Second, Ukraine needs defensive military equipment and training to protect lives of militaries and civilians, stop the progression of Russian troops and contain the conflict. We are very thankful to the UK for playing a leading role in conducting a military training programme in Ukraine. 35 British military personnel are working in the southern city of Mykolaiv. They are training Ukrainian forces in medicine and defensive tactics and are providing non-lethal equipment.
- Third, sanctions against Russia should be maintained and increased if Russia continues to fail to implement Minsk II. It is critical to stand firm and send clear signals of the price of continuing aggression, and to thwart Russia's attempts to weaken Trans-Atlantic unity between Europe and the United States. Britain plays a key role on both of these fronts.

### Reforms to date

International support can only be effective if the Ukrainian government is also effective and diligent in its efforts to reform the country, fight corruption, improve transparency and accountability, improve the rule of law and create the conditions for the return of economic growth and prosperity.



This is the common objective that unites President Poroshenko, Prime Minister Yatseniuk, the cabinet of ministers and the pro-European constitutional majority in the Parliament.

I am of course coming at this from a conflict of interest, but it is a fact that Ukraine now has the most reformist and professional government since independence.

Cabinet ministers are young, with the exception of the minister of finance - I am the second oldest minister ☹ and could be the mum of several of my colleagues! Most of them speak English and have international experience ; many of them are not career politicians but come from the private sector and represent all walks of life. We all share a resolute determination to change and reform Ukraine. It is a real honor for me to serve among such a professional and capable team even though the challenge ahead of us is daunting.

Since spring 2014 and the departure of President Yanukovich, a lot has already been achieved. Ukraine does not often do a good job of explaining its reform process. Let me tell you a few things that have happened in 2014 before I joined as a minister.

Ukraine organized free and fair democratic presidential and parliamentary elections, resulting in a pro-European reformist majority.

Ukraine signed and ratified the Association Agreement with the European Union. With an educated workforce, significant labor cost advantages and the Deep and Comprehensive Free Trade Agreement with the E.U., Ukraine is well positioned to benefit from closer integration with the European marketplace. There are ample opportunities for British business to invest and play a key role in our economic recovery as we are ideally placed to be a very competitive manufacturing platform for the EU.

Since the revolution, our reform agenda has aimed not only to cope with macroeconomic deterioration but to drive major structural changes and end the old ways of doing business. The Ukrainian government is focused on 5 priority areas:

1. National security and defense
2. Macroeconomic and financial stability
3. Energy independence
4. European integration
5. Good governance

This reform agenda has been adopted as a key part of the IMF program to help stabilize Ukraine's economy and strengthen the financial and banking system. This means:

- tackling corruption at all levels

- increasing the transparency and efficiency of state owned enterprises
- bringing commercial activity out of the shadow economy
- implementing fiscal reform to broaden the tax base, and
- creating the right conditions for businesses and investors

The Ukrainian government has taken critical actions to cut the state deficit in half compared to last year. The combined deficit including the state budget and financing of the national oil & gas company Naftogaz was reduced from 14 percent of GDP last year to a projected 7 percent this year.

We also have begun to reduce the pension deficit with changes to create a fairer system and do away with special privileges for former officials.

Energy sector reform and energy independence are key challenges. Ukraine historically had the most inefficient and corrupt energy sector in Europe.

- We have taken decisive action to restructure the sector, increase energy efficiency and reduce and diversify our gas imports
- We used to depend on Russia for 90 percent of gas imports. Now in the first two months of 2015, thanks to the reverse flow,

in January 2015, two-thirds of our imports came from Europe, and only one-third from Russia.

- We have eliminated a major and systemic source of corruption by getting rid of intermediaries that used to purchase and sell gas from abroad. Billions of dollars had been stolen from the Ukrainian people. This practice has now been put to an end.
- These systemic-level reforms in our energy sector have enabled us to reduce the state financing of state oil and gas company Naftogaz by two-thirds in 2015 compared with 2014. In dollar terms, this means a reduction of state financing from about \$10 billion to \$1.5 billion.

Our top priority is to fight corruption. Having been raised in Chicago and having lived 23 years in Ukraine, I fully understand the paramount importance and the inherent difficulties of tackling endemic corruption.

We are now using a carrot and stick approach to fighting corruption, fraud and abuse.

- We have set up an independent law enforcement agency, the National Anti-Corruption Bureau, with full funding, special powers and a staff of 700 to investigate corruption by government employees, public officials and private legal entities.

- A separate agency is tasked with developing policies aimed at monitoring and preventing corruption through system-wide solutions and incentives.
- We have implemented public procurement reforms with controls, training and transparent tendering processes including a new e-procurement practice to increase accountability and combat fraud and abuse.
- A new electronic VAT system has been introduced to increase transparency and reduce fraud that cost the government upwards of \$1 billion last year.
- We are changing the governance of state owned enterprises with new processes for the competitive recruitment of CEOs. Most of the 3,000 state owned enterprises do not pay any taxes nor dividend to the state. We will now be auditing them and will decide on their future.
- Ukraine has started replacing its entire Soviet era traffic police with a modern, well trained police force now with competitive salaries. This is a change every Ukrainian will feel.

We have adopted important legislation to resolve failing banks quickly and to strengthen law enforcement in situations where related third party transactions and insider deals contributed to bank failures. This will enable the government to pursue and recover assets from bank

owners and bring to justice those involved in fraud or criminal activity. Changes like these are essential to rebuilding public trust and ensuring our citizens' deposits are secure.

We have started reforming our fiscal policies. The goals of our fiscal reform plan are to broaden of the tax base and more fairly share the fiscal burden.

- We are doing this by bringing commercial activity out of the shadow economy with tax breaks. We offered discounts from the very high social payroll tax rate of 41 percent to entice SME businesses back into the formal economy. The goal is to bring the tax rate down to 24 percent for everyone in 2016.
- We are also asking for a greater fiscal contribution from the wealthy with a progressive income tax rate of 20 percent, the equalization of tax on all forms of passive income, and luxury taxes.
- And we are ensuring that everybody pays a fair share by closing fiscal loopholes that were exploited by big businesses to avoid taxation.
- We have also simplified the fiscal system by reducing the number of taxes from 20 down to 11.

## Future reforms

The IMF has already publicly acknowledged Ukraine's first achievements. All of our 2014 IMF reform commitments were met.

I want to stress that these reforms are just the tip of the iceberg. Much more needs to be done and we are just at the starting line.

Two weeks ago, the IMF gave its agreement on a \$17.5 billion four-year Extended Fund Facility, which also unlocks related bilateral and multilateral aid totaling close to \$7.5 billion.

This IMF program was agreed with the Ukrainian government and provides a detailed roadmap for our future reform objectives. I am not sure many of you will read it, so let me summarize briefly the essence of what we want to achieve.

Our goal is first to stabilize our macro-economic situation, and then to create the conditions for a return to growth in 2016. The sooner we can put the funds to work the better. The IMF has already disbursed \$5 billion since last week board meeting and will disburse up to \$10 billion in year one of the four year program to help jump-start the economy.

The program agreed with the IMF is based on five pillars, including

- Monetary and exchange rate policy
  - Strengthening the National Bank of Ukraine

- Bringing inflation down to single digits
- Stabilizing foreign exchange rates
- Banking sector policies
  - Identifying, monitoring and unwinding loans to related parties
  - Strengthening supervision of banking risks
  - Resolving banks that do not comply with their recapitalization plans
  - Strengthening bank capacity to resolve bad loans
- Fiscal policy, including
  - Tax policy reforms, to ensure simplicity and fairness
  - Full economic cost recovery of gas tariff
  - Reductions in the civil service workforce
  - Healthcare reform
  - Education reform
  - Pension reforms
  - Reducing subsidies to SoEs , and eliminating Naftogaz's deficit



- Energy sector policy
  - Increasing tariffs toward market prices, improve collection rates
  - Enhancing Naftogaz’s efficiency and governance
  - Eliminating state subsidies
  - Unbundle Naftogaz in line with the EU Energy Charter Treaty
  - Reviewing our oil & gas royalty approach to make it both fiscally sound and investor-friendly – I know that the current system has raised many concerns among international investors and we are committed to improving it.
- Governance/transparency/business climate
  - Strengthening governance and transparency of government operations
  - Enhancing Ukraine’s anti-money laundering framework
  - Streamlining regulation over economic activity

Delivering on the IMF program objectives will be critical to restore confidence and growth, bring inflation to single digits, keep external deficits manageable, and replenish international reserves.

There is a lot of low hanging fruit to create the right conditions for business and investment – including for small and medium sized businesses. Reducing currency volatility and lowering inflation will enable SMEs to plan, invest and have confidence in the system. Lower interest rates and increased lending from a strengthened banking sector can help businesses expand. Other reforms to cut red tape, deregulate the economy and make tax administration more efficient and service oriented will also lower the burden on small businesses.

We are reorienting our economy in significant ways towards European and global markets and positioning Ukraine to be a reliable partner. We are adopting European Union standards in our governmental institutions and regulations in order to facilitate increased trade and investment. The depreciation of the Hryvnia has impacted imports and put pressure on the state budget, but ultimately, it makes Ukraine's cost position and exports ultra-competitive.

We expect Ukraine's economic prospects will improve in the medium-term. Real GDP growth is expected to rebound to 2 percent in 2016 and rise to 4 percent in the medium term. But these forecasts are also subject to material risks – most prominently the threat of increased violence and the potential shocks to the economy and banking system.

Conclusion:

Ladies and Gentlemen, let me conclude with a few thoughts.

The current military conflict in Eastern Ukraine raises an important question for all of us: If the international community allows a war to continue in the middle of Europe today, what world will we be living in tomorrow?

Ukrainians have chosen a European future. We are fighting for European values and the right to live in a free and prosperous European country that respects human dignity.

This has come at a tremendous cost. Thousands of our compatriots have given their lives and our country keeps one bleeding day after day to defend the values of democracy, independence and freedom.

It is the responsibility of this Ukrainian Government to make our citizens' dreams and vision a reality.

Our task - to reform and defend Ukraine - is immense and unprecedented. The number of obstacles we are facing is equally daunting.

But if Ukraine, as a state, has never been in such a challenging situation since its independence, I can assure you that Ukraine, as a nation, has never been as strong and united as today.

Confidential – Draft – March 24 – 12pm

With the support of the United Kingdom, the European Union and the United States, I hope that

- Peace will prevail over war
- Tolerance will prevail over hatred
- And prosperity will prevail over poverty

Thank you very much