

Tetiana Iefymenko

FISCAL REFORMS AND SUSTAINABLE DEVELOPMENT IN UKRAINE

This article explores necessary changes in the Ukrainian fiscal system based on the UN Sustainable Development Goals and the post-2015 Development Agenda. A brief overview of the financial sector is provided and its objectives are identified. The author explains the importance of fiscal consolidation, discusses challenges in pursuing fiscal reform, and proposes approaches to respond to them in a way that would ensure transparent and effective procedures of budget formulation and execution. Particular consideration is given to external and internal factors hindering the achievement of fiscal stability and sustainable development goals in Ukraine. In this context, the strengthening of sustainability of general government is essential for the development agenda. Fiscal consolidation is recognized as a driver for institutional reforms. The author concludes by emphasizing that it is vital to continue cooperation with the IMF to enhance the positive effects of fiscal consolidation on economic and social development of Ukraine.

Keywords: sustainable development goals, development agenda, sustainability, fiscal system, fiscal reform, fiscal consolidation, public finance.

JEL classification: H11, H12, O23.

T. I. Єфименко

ФІСКАЛЬНІ РЕФОРМИ ТА СТАЛИЙ РОЗВИТОК В УКРАЇНІ

У статті досліджено необхідні зміни у фінансовій системі України на основі ухвалених ООН Цілей сталого розвитку та Порядку денного в галузі розвитку після 2015 року. Наведено стислий огляд фінансового сектору та визначено його цілі. Обґрунтовано необхідність фінансової консолідації, розкрито виклики під час реалізації фінансової реформи та запропоновано підходи до їх подолання, які забезпечать прозорість і ефективність процедур складання та виконання бюджету. Особливу увагу приділено зовнішнім і внутрішнім чинникам, що перешкоджають досягненню цілей фінансової стабільності та сталого розвитку України. У цьому контексті сприяння сталому розвитку центрального уряду розглянуто як обов'язкову умову виконання порядку денного в галузі розвитку. Рушійною силою інституційних реформ визнано фінансову консолідацію. У висновках наголошено на необхідності продовження співробітництва з МВФ із метою збільшення позитивного впливу фінансової консолідації на економічний і соціальний розвиток України.

Ключові слова: сталий розвиток, цілі сталого розвитку, порядок денний у галузі розвитку, фінансова система, фінансова реформа, фінансова консолідація, державні фінанси.

Лит. 24.

T. I. Єфименко

ФИСКАЛЬНЫЕ РЕФОРМЫ И УСТОЙЧИВОЕ РАЗВИТИЕ В УКРАИНЕ

В статье исследованы необходимые изменения в финансовой системе Украины на основе принятых ООН Целей устойчивого развития и Повестки дня в области развития после 2015 года. Приведен краткий обзор финансового сектора и определены его цели. Обоснована необходимость финансовой консолидации, раскрыты вызовы при реализации фискальной реформы и предложены подходы к их преодолению, которые обеспечат

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прозорість і ефективність процедур складання і виконання бюджету. Особого внимание уделено внешним и внутренним факторам, препятствующим достижению целей фискальной стабильности и устойчивого развития Украины. В этом контексте содействие устойчивому развитию центрального правительства рассматривается как необходимое условие выполнения повестки дня в области развития. Движущей силой институциональных реформ признается фискальная консолидация. В выводах акцентируется внимание на необходимости продолжения сотрудничества с МВФ для увеличения позитивного воздействия фискальной консолидации на экономическое и социальное развитие Украины.

Ключевые слова: устойчивое развитие, цели устойчивого развития, повестка дня в области развития, фискальная система, фискальная реформа, фискальная консолидация, государственные финансы.

The outcome document of the United Nations summit for the adoption of the UN Sustainable Development Goals (2015-2030) indicated the direction of further research in the field of determining the appropriate level of public governance based on global experience. Ukraine, together with the international community, is expected to adopt the post-2015 Development Agenda and a new set of 17 Sustainable Development Goals (SDGs) to replace the expiring UN Millennium Development Goals. Currently, the most authoritative national policy document is the Ukraine-2020 Sustainable Development Strategy, which contains a set of long-term balanced goals and provides details of their further implementation. These goals determine 8 key reform areas:

- Changes in the composition of public authorities and implementation of anti-corruption reform,
- Judicial reform,
- Decentralization and public management reform,
- Business deregulation and development,
- Law enforcement system reform,
- National security and defense system reform,
- Healthcare system reform, and
- Tax reform.

In other words, in terms of the reform theory by Matt Andrews, Arthur T. Denzau, Mary Douglas, Matthew Dull, Douglass C. North, and Victor Polterovych, there is a clear need to change social and economic institutions, and the respective transition period would certainly rely on resource, technological and institutional limitations as well as involve embedded mechanisms that should focus on institutional transformations and counteraction against institutional traps. And there is no doubt that a key role of the fiscal system is to ensure that the above agenda is fulfilled and serves as a main source and an essential part of public reform activities. This is also supported by Christine Lagarde's statement that development efforts must be approached flexibly, where possible, policies must be tailored to the unique circumstances of individual countries, with room to adapt as the world evolves.

Taking into account recent developments in Ukraine, as mentioned in the Memorandum of Economic and Financial Policies between Ukraine and International

Monetary Fund, domestic and external shocks and the escalation of the conflict in the East have taken a significant toll on the Ukrainian economy, affecting confidence and disrupting financial markets. That is why one of critical problems for Ukraine is a simultaneous decrease in the share of state expenditures to GDP, and an increase in real state expenditures due to economic growth.

According to the Memorandum of Economic and Financial Policies between Ukraine and the IMF, Ukraine's main tasks are to restore macroeconomic and financial stability, maintain fiscal and external sustainability, and create the conditions for economic growth in the medium term. Therefore, it is necessary to carry out structural reforms, improve significantly economic governance and business climate in order to restore the confidence of national and international investors, and mobilize domestic financial resources. The 2014 IMF Country Report on Ukraine highlights various economic and financial objectives that Ukraine needs to achieve in order to overcome economic development difficulties and financial risks. In 2014 the IMF downgraded Ukraine's GDP growth to 6.8 % (actual data: -6.8 %) and the current account deficit for 2014 was projected at the level of 2.5 % of GDP (actual data: -4.7 %).

The IMF mission visited Kyiv in 2015 autumn and revised down growth projections for 2015 to -11 % (preliminary data: -9.9 %). Growth is expected to reach 2 % in 2016, supported by recovering consumer and investor confidence, improved export performance, and a gradual easing of credit conditions. Yearly Real GDP growth in the years from 2016 to 2020 is projected to be 2; 3.5; 5.5; 5.2; 5 %, respectively. A decrease in CPI is expected from 45.8 % in 2015 to 5.0 % in 2020.

The Government of Ukraine, jointly with the IMF, has identified the following key policy areas:

- A flexible exchange rate policy and a gradual increase in foreign exchange reserves of the National Bank under conditions of the prudent monetary policy aimed at reducing the inflation rate to less than 10 %;
- The restoration of the banking system sustainability and its ability to lend to the real economy and to sustain economic activity;
- Fiscal consolidation aimed at the recovery of public finance, achievement of an economically acceptable level of public debt and its servicing;
- Deep and ambitious structural reforms, deregulation and improvement of business climate to attract domestic and foreign investment, increase potential growth, and reform government-owned enterprises including the Naftogaz of Ukraine, National Joint Stock Company.

A lower inflation rate, along with stability of the exchange rate (at 24-25 UAH for 1 USD), will facilitate the restoration of positive business climate and predictability for business. Higher price competitiveness will promote the high export rates (5-6 % per year). However, the trade balance and current account balance will remain negative throughout the medium term (-1.8 % and -3.4 % of GDP in 2020),

both caused by high import rates and increased amounts of servicing of external public debt.

Economic recovery will become a basis for the stable fiscal sector income. At the same time, planned public finance consolidation will contribute to the gradual reduction in general government deficit: overall balance will amount to 2.2 % of GDP in 2020. The tax revenues to GDP ratio is expected to increase from 35.8 % in 2016 to 36.3 % in 2020, and expenditures, in contrast, will decrease from 43.4 % to 42 %, respectively. It should be noted that the termination of the direct state financial support for the Naftogaz of Ukraine, National Joint Stock Company is expected starting 2017, which will alleviate the burden on the state budget.

It should be noted that Ukraine has inherited from the Soviet Union the economy which is heavily dependent on public funds and the political decisions of the central Government. In the course of the history of Ukrainian political and economic reforms, industrial and regional policy objectives may have varied significantly but all Ukrainian Governments have continuously supported state-owned enterprises and producers in certain "priority sectors" (e. g. coal mining, steel, chemical, aircraft and ship-building industries, etc.) in order to ensure their survival and viability under conditions of economic instability and growing international competition.

Traditionally, Ukraine's fiscal sector is divided into general government operations, central government operations, and the operations of the Pension Fund of Ukraine and social security funds. Fiscal consolidation should be aimed not only at ensuring the smooth formulation and execution of central and local budgets during the transition to decentralization, but also solving the problems of the general government sector as a whole. Therefore, it is necessary to set objectives covering the entire sector. In our opinion, they should include the following:

- Define terms, conditions and ways to minimize expenditures and/or increase revenues, and balance the revenues and expenditures of the general government, as well as the conditions for the mobilization and application of additional resources (sector deficit funding) in order to promote economic growth;
- Achieve balanced ratios of such general government elements as the central state budget, local budgets, the budgets of targeted state extra-budgetary funds;
- Reduce direct and indirect financial support to public financial and non-financial corporations (by expanding their own resource base) from the state budget and its gradual restriction.

A corner stone in the Ukrainian sustainable development agenda is the Association Agreement between the EU and Ukraine that provides for the strengthening of cooperation in pursuing public financial policy, coordination of fiscal rules, harmonization of the regulatory environment in Ukraine with that of the EU. Cooperation in the field of public finance management is designed to implement

positive experience of fiscal system reform and limit negative external and internal impacts. Relevant challenges include:

- Security and sovereignty threats,
- Deceleration of emerging markets' growth,
- Uncertainty regarding the development of the world's leading economies (EU),
- Corruption and shadow economy,
- Political uncertainty, and
- Inability to ensure that public finance policies follow the IMF Program.

There are different approaches to solve the above problems, but those we consider meaningful in public finance environment are connected with recommendations to introduce fiscal rules in Ukraine aimed at ensuring both short-term and long-term compliance with a balanced state budget, and also to take actions intended to ensure effective and transparent procedures of budget formulation and monitoring of budget execution. It is necessary to provide a budgeting framework based on independent assessments of the macroeconomic development and tax revenues. The decision-making process should be open and transparent, and built on independent assessments of internal and external economic risks.

The latest issues hindering the achievement of fiscal stability and sustainability goals in Ukraine are identified in the course of the Tax Code development process that has to deal with budget deficit based on economic growth projections. Primarily, there is an essential need to comply with the following basic principles of tax policy reform as part of the government's socio-economic strategy, taking into account the balance between the external and internal factors:

- Understandability, versatility, and equality. All institutional units should participate in public spending, depending on their income; investment, trade and economic decisions should be protected against the effects of their probable tax implications;
- Certainty, justice, stability, and convenience. The term, payment mode and the amount of taxes should be clearly set, with a constant decrease in costs of administering both the government and the economic agent; the tax system should be fair, free from any unsubstantiated benefits, progressive to such extent that the amount of tax payments be dependent on the payer's welfare; taxes should be paid at a time suitable to the taxpayer (so that the use of working capital to cover these expenses is minimized) and the payment procedure should be fully understandable;
- Protection of taxpayer rights, sound formation of the tax base. Consistency of various laws should foster investments, economic development, competitiveness, and employment. The revenues of budgets of all levels should be increased by broadening the tax base, i. e. the tax system should include sources of tax revenues with calculation methods that are relatively simple and unambiguous;

- Tax revenues sufficiency and tax policy flexibility. The level of budget revenues should be sufficient to meet the financial needs of the state and taxation should respond adequately to changes in the financial position of institutional units.

Further reforms of tax regulation at the level of microeconomics should create fiscal stability and fiscal consolidation, taking into account the features of market mechanisms. This is especially relevant for direct and indirect taxes that constitute the bulk of tax revenues in Ukraine.

The tax system developments are not the only thing that is to be carefully balanced in terms of fiscal equilibrium before any tactical transformations are to be done. As stated in papers written by former Minister of Finance of Ukraine Olexandr Shlapak, such tasks as improving the strategic planning system of public finance, broadening the scope of results-based method in budget process, increasing the effectiveness of the medium-term budget planning, strategies of the public debt management and support to the fiscal transparency have gained particular importance under present circumstances. Thus, in responding to fiscal challenges, emphasis is placed on restructuring state-owned monopolies, achieving economical levels of regulated tariffs, attracting extra-budgetary funds for infrastructural development, improving the efficiency of spending on social needs, stabilizing the pension system, changing the funding mechanisms for healthcare and education, broadening the tax base and improving tax administration.

In summary, we propose following conclusions:

1. The need to strengthen the sustainability of general government in a transition period is essential for the development agenda; in particular, it could be achieved through the balancing of the fiscal consolidation program.
2. Fiscal consolidation that provides for fiscal reform to enhance the sustainability of public finances is a driver of institutional reforms.
3. In order to enhance the positive effects of fiscal consolidation on economic and social development of Ukraine, it is vital to continue cooperation with the IMF and allocate financial resources in such a manner as to ensure that a key reform potential is realized, institutional traps are avoided and a tool for responding to fiscal challenges is in place.

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