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STRUCTURAL POLICY AND PUBLIC FINANCE UNDER INSTITUTIONAL UNCERTAINTY

Abstract. Theoretical and practical problems of structural policy are considered under institutional uncertainty, financial constraints and fiscal consolidation programs. The necessity for development and implementation of a new concept of structural policy is justified in view of the actual state of the public finance, objectives and institutional conditions of the national economy structural transformations. Between the micro level of markets and the macro level of state influence there is "a middle layer", which is especially active, from the structural-institutional point of view. There are those political groups and centers of economic power that are pursuing own goals and have for that informal institutional mechanisms of influence on political decision-making and economic policy. They often focus on presenting their own group interests as the public ones. Thus, market and government failures oppose each other in the field of structural policy. The structural policy in transitive economy under institutional uncertainties should be considered primarily as a systematic policy aimed at the formation of the economic coordination market mechanism. This differs from the neoclassical comprehension of the structural policy as a market failures consequence.

Keywords: structural policy, public finance, institutional uncertainty, structural transformations, fiscal policy, monetary policy, fiscal consolidation, economic activities, sustainability of public finance.

JEL classification: B52, H10, P16, P26.

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СТРУКТУРНА ПОЛІТИКА І ДЕРЖАВНІ ФІНАНСИ В УМОВАХ ІНСТИТУЦІОНАЛЬНОЇ НЕВИЗНАЧЕНОСТІ

Анотація. У статті розглянуто теоретичні та практичні проблеми структурної політики в умовах інституціональної невизначеності, фінансових обмежень і програм фіскальної консолідації. Обґрунтовується необхідність розроблення і реалізації нової концепції структурної політики з урахуванням реального стану державних фінансів, цілей та інституціональних умов структурних трансформацій національної економіки. Між мікрорівнем ринків і макрорівнем державного впливу є "середній шар", який особливо активний зі структурно-інституціональної точки зору. Це певні політичні групи та центри економічної влади, котрі ставлять власні цілі й мають відповідні неформальні інституціональні механізми впливу на прийняття політичних рішень та економічну політику. Вони зосереджуються на представленні власних групових інтересів як суспільних. Таким чином, провали ринку і провали держави протистоять один одному у сфері структурної політики. У транзитивній економіці структурну політику за умов інституціональної невизначеності слід розглядати насамперед як системну, таку, що спрямована на формування ринкового

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механізму економічної координації. Цей підхід відрізняється від неокласичного розуміння структурної політики як наслідку провалів ринку.

Ключові слова: структурна політика, державні фінанси, інституціональна невизначеність, структурні трансформації, фіскальна політика, монетарна політика, фіскальна консолідація, види економічної діяльності, стійкість державних фінансів.

Табл. 1. Літ. 40.

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СТРУКТУРНАЯ ПОЛИТИКА И ГОСУДАРСТВЕННЫЕ ФИНАНСЫ В УСЛОВИЯХ ИНСТИТУЦИОНАЛЬНОЙ НЕОПРЕДЕЛЕННОСТИ

Аннотация. В статье рассмотрены теоретические и практические проблемы структурной политики в условиях институциональной неопределенности, финансовых ограничений и программ фискальной консолидации. Обосновывается необходимость разработки и реализации новой концепции структурной политики с учетом реального состояния государственных финансов, целей и институциональных условий структурных преобразований национальной экономики. Между микроуровнем рынков и макроуровнем государственного воздействия существует “средний слой”, который особенно активен со структурно-институциональной точки зрения. Это определенные политические группы и центры экономической власти, которые преследуют собственные цели и имеют соответствующие неформальные институциональные механизмы влияния на принятие политических решений и экономическую политику. Они сосредотачиваются на представлении собственных групповых интересов как общественных. Таким образом, провалы рынка и провалы государства противостоят друг другу в области структурной политики. В транзитивной экономике структурную политику в условиях институциональной неопределенности следует рассматривать прежде всего как системную, такую, которая направлена на формирование рыночного механизма экономической координации. Этот подход отличается от неоклассического понимания структурной политики как следствия провалов рынка.

Ключевые слова: структурная политика, государственные финансы, институциональная неопределенность, структурные трансформации, фискальная политика, монетарная политика, фискальная консолидация, виды экономической деятельности, устойчивость государственных финансов.

The scholars and economists, policymakers and experts of state agencies, members of academic and public institutions are discussing the necessity to substantiate and implement the “new structural policy” throughout the years of Ukrainian independence. However, nearly a quarter century of debate has not led to any notable conceptual and practical results.

The reasons for such situation are explained by some dogmas of theoretical thinking that have not been overcome yet, and by the desire of policy-makers and government officers to receive from the economic science simple and effective recipes for quick structural transformations or, on the contrary, by the reluctance to consider any recommendations that require the adoption of innovative and responsible policy decisions.

However, there are other important reasons, in our opinion, like permanent institutional instability and uncertainty in Ukrainian economy that in turn creates the conditions for structural state failures and public finance unsustainability.

The studies of the society's and economy's structure are an integral part of the evolution of political economy/economic theory, macroeconomics, theories of economic development and growth, industrial organization and markets, modern institutionalism and evolutionary economics, economic policy theory. There is no need to give a full list of relevant works by famous authors, as a separate publication would be required for it. We only note that investigations of structural changes, dynamics, structural transformations and economic policy by A. Fischer, C. Clark, S. Kuznets, W. Leontief, W. Eucken, J. Tinbergen, W. Rostow, J. Fourastié, W. Lewis, G. Myrdal, J. K. Galbraith, L. Pasinetti, A. Maddison, C. Freeman, G. Dosi, J. Gowdy, D. North, R. Nelson and S. Winter that have become fundamental (regardless of the accepted classification of economic research areas) could not be ignored [1-20].

D. Rodrik observes that “recent economic thinking on policy reforms pays scant attention to structural transformation and industrial development. The implicit view is that once the “economic fundamentals” – macroeconomic stability and well functioning markets – are in place, structural transformation is an automatic process” [21, p. 8].

At the same time the special studies of the theoretical and practical problems of the structural policy are insufficient, especially in the context of their interconnections concerning the public finance. This has certain explanations. Traditionally, scientific research considers macroeconomic policy as a combination of monetary and fiscal policies toolkit. There are some differences in national terminology that is associated with an economic policy. The term “*structural policy*” is more essential for the German tradition, and the term “*industrial policy*” – for the American and Anglo-Saxon ones. EU structural policy in general is treated as a regional policy or policy of alignment, convergence and cohesion [22]. OECD *structural policy indicators* contain a comprehensive set of quantitative indicators that allow a comparison of policy settings across countries. The indicators cover areas of taxation and income support systems and how they affect work incentives, as well as product and labor market regulations, education and training, trade and investment rules and innovation policies [23]. The distributional effects of *structural reforms* have been investigated also [see 24].

OECD Reviews [25; 26], the studies of the European Commission [27-32], the monograph by J. Lin “New Structural Economics” [33], Report of the European Commission “Towards a re-industrialization, driven by knowledge” [34] and others are worth mentioning among recent works. Works by A. Alesina and S. Ardan [35], D. Anderson, B. Hunt, S. Snaddena [36] and others are devoted to the problems of fiscal consolidation.

The problems of uncertainty, including institutional uncertainty, have been studied in the works by F. Knight [37], A. Alchian and H. Demsetz [38; 39], F. Filho and O. Conceição [40] and others.

The aim of this study is to show the theoretical foundation of the conceptual basis of the structural policy in Ukraine, the ways of solving the structural policy formation problems in accordance with the conditions of institutional uncertainty.

A structure is a common concept used in various fields of research. It means a certain community, composed of various parts (elements) linked to each other, with interactions and interdependence (interdependencies) among them. A structure is a sign of certain organization integrity. In this sense, the structure is mostly a static concept. This does not mean that there is no “structural development”, which could be characterized in two ways:

- as a transition from one comparable in statics “structural state” to another;
- as a change in time of the original “structure”, i.e. as structural dynamics, which means its qualitative and quantitative changes.

In economic studies, the concept of structure is used primarily to the branches and proportions in the economy in general, to groups of industries or economic activities, which form a “sector” of the economy, as well as to regions, which correspond to the regional structure of economy. The concept of structure can also be used to the size of companies, types of activity, forms of ownership, management, etc. Accordingly, the structural policy is a purposeful impact of the state on certain “structural conditions” (industries and economic activities, their relatively homogeneous groups or “complexes”) having also specific spatial arrangement and forming “regional economic structures” of the national economy.

Structural policy depends on how an economic system actually operates, specific economic situation in the country, some sectors of the economy and regions, whether there are socio-political and economic shocks.

The main task is to find out whether a modern “structural condition” of the national economy could be improved by the means of structural policy. If it can be done, what kind of structural policy should be carried out to achieve the goals of economic and social welfare?

The reasons for structural changes include market changes, as well as the objectives and economic policies, in particular due to changes in the value system, technologies and production conditions.

It is reflected by the change of economic agents’ preferences that because of the new goods production, satisfaction of latent needs, based on the autonomous development of values, “make” the market price mechanism focus on further new equilibrium states.

This trend is strongly influenced by technical progress, which permanently alters the production functions, and through them leads to a gradual change in physical and human capital and other resources. Taken together, these factors lead to the fact that the “optimal” structure of the economy is never reached, and its actual structure is in a permanent process of change. Reasoning for structural policy should be derived from the fact that a particular economic system could not automatically achieve an optimum economic structure.

In Ukraine, there are no conditions for the “perfect” market mechanism, forming the optimal economic structure due to the constant presence of many

inherited non-market forms. Therefore, the state should use a competition policy to forcibly create a competitive system, which requires a constant displacement of inefficient producers, or those who are unable to adapt to structural changes. It promotes the expansion and improvement of the position of “successful” businesses that give the dynamism to the sectoral structure. In this respect, the competition policy has always been a policy that promotes market-oriented structural change.

Stagnation of some industries or threat to the existence of companies is not a sufficient reason for the structural policy. Rollback, even the collapse of some industries and enterprises is rapid when world market conditions or economic crisis change the world, while the creation of new capacities, corresponding to the new conditions, is much slower. It leads to friction and partly structural unemployment.

Lack of adaptation of the Ukrainian economy to the modern conditions has different reasons: high fixed costs, immobility of businesses and labor, lack of ideas about the future development strategy, etc. The change of economic structure often involves significant social problems that cause an income decline, unemployment growth, and the stagnation of entire economy sectors. They are even more enhanced if they are accompanied by the formation of regional monostructures or “stacked” on top of each other in the same region. It is clear that those who have suffered can hardly be indifferent to mechanisms of structural changes that will lead to improvements only in a long-term period.

Between the micro level of markets and the macro level of state influence there is a middle layer, which is especially active, from the structural and political point of view. We mean those groups of society that are pursuing mutual goals and have for that special mechanisms (collective bargaining) or the capacity to influence economic policy (lobbying). Their purpose is to solve structural and political problems; however, they often focus on presenting their group interests as the interests of society. The combined effect of the above-mentioned factors leads to the fact that the central government focuses on proactive structural policy.

However, the structural policy has also some systemic weaknesses. Theoretically we can prove and show numerous examples that state concepts regarding the future structure of the economy are the cause of subsequent structural and political problems themselves. *Thus, market and government failures oppose each other in the field of structural policy.*

There is no definite answer to the question of how effective the market mechanism is in its actual form, whether it could be corrected by means of structural policy. A possible approach is to compare the relevant market failures with the government ones if there is a specific structural problem and to carry out the “cost-benefit” analysis to take a decision. Unfortunately, the evaluation of costs and benefits is quite difficult.

The matter is complicated by the fact that some of the structural and political issues are not subject to either the market or the state and require group agreements, international agreements and other coordination methods of possible solution. The central problem of structural policy is to set its goals, and not in the sense of improving the overall well-being, but in terms of specific structural and

political activities. The overall objective of structural policy is to increase the efficiency by improving market outcomes, positive impact on the producers and consumers. *In fact, we are talking about how to stimulate the adaptive capacity of the economy and its dynamics.*

Hence, the question arises: can the state evaluate better than suppliers and customers participating in market operations what economic structures will be effective and viable for quite a long period? However, the adaptation processes themselves vary in details and cannot take place completely “by analogy”.

If we are talking about the innovative achievements to help maintain long-term competitiveness of some industries or overcome existing structural weaknesses, then single leverage is not enough; the state should set detailed targets, and structural policy should be implemented accordingly.

Structural policy under the conditions of fiscal consolidation is faced with hard budget constraints that do not allow public spending to be actively used as a direct impact tool affecting structural changes. At the same time, optimization of budgetary expenditures, measures to increase revenues, changes in priorities, mechanisms and volumes of state aid, public investment, social spending can be considered as elements of structural adjustment policies.

Table shows the functional structure of final consumption expenditures of general government in Ukraine and Germany during 2004-2014. During this period, ratio of these expenditures to GDP in Ukraine increased from 16.9 % to 18.6 %. In Germany – from 18.5 % to 19.4 % (2013).

In the structure of final consumption expenditures of general government the share of expenditures related to the development of human capital (health and education), changed from 40 % to 53.2 % (Ukraine) and from 49.9 % to 51.7 % (Germany, 2013). At the same time, the share of social protection expenditures in Ukraine decreased from 12.9 % to 7.8 % and remained almost constant in Germany – 16.1 % and 16.2 % (2013).

The share of expenditures on economic activity in Ukraine declined from 6.0 % to 3.3 %, and in Germany – from 6.9 % to 6.3 % (2013).

Cuts in public spending and a tax burden increase in general have a negative impact on economic dynamics. However, fiscal imbalances, excessive budget deficits and growing public debt worsen the sustainability of public finance, undermining the conditions for economic growth in the medium and long term periods. “Healthy” public finance and “rational” structural policy are the two sides of the same coin. Long-term structural policy can only be based on “healthy” public finance.

The synthesis of ideas of “healthy” and “functional” public finance is relevant to structural policy under conditions of institutional uncertainty.

The ideas that the state can directly provide the “structural adjustment” or “structural modernization” are a dangerous dogma, which in practice leads to excessive government activism, chronically unbalanced budget and a high debt load.

Judging from the mentioned above, the state should at least develop the concept of a *rational structural policy* and implement it in practice if it wants to play a role in shaping the structure of the economy.

Table. Government final consumption expenditure by function at current prices and in percent

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
UKRAINE											
<i>Series 1000: 2008 SNA, hryvnia, Western calendar year; Data in millions and in percent</i>											
General public services	6 336 10.5	10 420 13.0	13 805 13.8	13 476 10.5	17 356 10.3	19 460 10.6	25 398 11.5	23 024 9.6	26 430 9.6	26 041 9.0	26 759 9.2
Defence	4 802 8.0	4 635 5.8	4 808 4.8	6 081 4.8	7 637 4.5	7 088 3.8	8 819 4.0	10 445 4.4	11 517 4.2	11 839 4.1	23 637 8.1
Public order and safety	6 785 11.2	8 751 10.9	10 735 10.8	15 681 12.3	22 002 13.1	22 031 12.0	25 832 11.7	29 134 12.2	34 375 12.4	35 895 12.5	40 686 14.0
Economic affairs	3 616 6.0	4 019 5.0	5 950 6.0	8 121 6.3	9 935 5.9	10 936 5.9	11 612.0 5.3	14 492 6.1	16 458 5.9	15 335 5.4	9 615 3.3
Environment protection	463 0.8	383 0.5	340 0.3	395 0.3	572 0.3	611 0.3	785 0.3	1 237 0.5	1 292 0.5	1 615 0.6	1 128 0.4
Housing and community amenities	1 158 1.9	2 101 2.6	2 466 2.5	3 557 2.8	4 110 2.4	3 253 1.8	3 859 1.8	4 376 1.8	2 664 0.9	2 946 1.0	3 236 1.1
Health	11 561 19.1	15 878 19.8	19 662 19.7	24 977 19.5	32 535 19.4	39 126 21.3	46 221 20.9	49 396 20.7	59 609 21.6	63 642 22.1	61 019 20.9
Recreation, culture and religion	1 627 2.7	2 266 2.8	2 716 2.7	3 537 2.8	4 806 3.0	5 411 2.9	6 740 3.1	7 056 3.0	7 713 2.8	8 199 2.8	8 632 2.9
Education	16 259 26.9	23 873 29.8	29 243 29.3	38 119 29.8	52 862 31.4	60 050 32.6	72 102 32.8	78 154 32.7	93 115 33.7	98 191 34.1	94 012 32.3
Social protection	7 785 12.9	7 830 9.8	9 989 10.1	13 998 10.9	16 362 9.7	16 143 8.8	19 014 8.6	21 377 9.0	23 179 8.4	24 048 8.4	22 578 7.8
Equals: General government final consumption expenditure (GGFCI)	60 392 100.0	80 156 100.0	99 714 100.0	127 942 100.0	168 177 100.0	184 109 100.0	220 382 100.0	238 691 100.0	276 352 100.0	287 751 100.0	291 302 ^a 100.0
Gross Domestic Product (GDP)	357 544	457 325	565 018	751 106	990 819	947 042	1 120 585	1 349 178	1 459 096	1 522 657	1 566 728 ^o
GGFCI/ GDP in percent	16.9	17.5	17.6	17.0	16.9	19.4	19.6	17.7	18.9	18.9	18.6

	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
GERMANY											
<i>Series 1000: 2008 SNA, Euro, Western calendar year; Data in millions and in percent</i>											
General public services	37 867 9.0	36 864 8.7	36 155 8.4	35 741 8.1	38 366 8.4	40 470 8.4	39 762 8.1	43 393 8.6	47 283 9.1	48 439 9.0	...
Defence	23 847 5.7	24 295 5.7	24 270 5.6	25 050 5.8	25 816 5.6	26 467 5.5	26 700 5.4	27 499 5.4	27 189 5.2	28 721.0 5.3	...
Public order and safety	30 246 7.2	30 494 7.2	31 020 7.2	31 142 7.1	32 123 7.1	33 453 7.0	34 088 6.9	34 640 6.8	35 357 6.8	36 272 6.7	...
Economic affairs	28 984 6.9	26 623.0 6.3	27 882 6.5	28 173 6.4	29 494 6.4	30 730 6.3	32 533 6.6	31 646 6.3	34 209 6.6	34 354 6.3	...
Environment protection	5 005 1.2	4 888 1.2	5 065 1.2	4 852 1.1	5 192 1.1	5 632 1.2	5 485 1.1	5 404 1.1	5 437 1.0	5 310 0.9	...
Housing and community amenities	5 893 1.4	5 996 1.4	6 044 1.4	5 898 1.3	6 035 1.3	6 215 1.3	6 084 1.2	6 085 1.2	6 221 1.2	6 318 1.2	...
Health	133 102 31.8	137 262 32.4	141 156 32.8	146 336 33.2	152 286 33.3	161 308 33.5	165 168 33.4	168 326 33.3	172 540 33.1	181 673 33.6	...
Recreation, culture and religion	10 868 2.6	10 883 2.6	11 073 2.6	11 402 2.6	11 997 2.6	12 015 2.5	12 263 2.5	12 990 2.5	14 019 2.7	14 696 2.7	...
Education	75 797 18.1	76 472 18.1	77 135 17.9	78 844 17.9	80 761 17.6	85 368 17.7	88 247 17.9	91 804 18.2	94 412 18.1	97 835 18.1	...
Social protection	67 592 16.1	69 379 16.4	70 775 16.4	72 859 16.5	75 958 16.6	79 780 16.6	83 571 16.9	83 935 16.6	84 623 16.2	87 590 16.2	...
Equals: General government final consumption expenditure (GGFC)	419 201 100.0	423 156 100.0	430 575 100.0	440 297 100.0	458 028 100.0	481 438 100.0	493 901 100.0	505 722 100.0	521 290 100.0	541 208 100.0	562 307 100.0
Gross Domestic Product (GDP)	2 267 580	2 297 820	2 390 200	2 510 110	2 558 020	2 456 660	2 576 220	2 699 100	2 809 480	2 749 900	2 903 790
GGFC/ GDP in percent	18.5	18.4	18.0	17.5	17.9	19.6	19.2	18.7	18.6	19.7	19.4

^a Data for GDP and its components excludes the temporarily occupied territory of the Autonomous Republic of Crimea and Sevastopol.

Data source: United Nations. (2015). National Accounts Statistics: Main Aggregates and Detailed Tables, 2014, II, 591; V, 613. New York: United Nations; Author's calculations.

The structural policy in transitive economy under institutional uncertainties should be considered primarily as a systematic policy aimed at the formation of the economic coordination market mechanism. This differs from the neoclassical comprehension of the structural policy as a market failures consequence.

At the same time, there are three general concepts that are expressed in terms of “restrained state”, “involved state” and “pragmatic state”. In the first case, the state intervenes in exceptional circumstances and the market clearly has an advantage. In the second case, theoretically grounded program of a long-term structural policy that takes into account national priorities for sustainable economic growth factors should be developed. In the third case, the state structural policy is determined by the decisions that take into account the problem and the impact of political forces which act in the interests of certain “economic power” centers.

It should be pointed out that the internal organization of the state conducting structural policy itself is an important component of its own structural policy.

Thus, a high level of centralization can appear in the sectoral and regional aspects and move the structural and political decisions upwards. If the government implements predominantly sectoral structural policy, it may consequently affect regions which win or lose differently depending on the location, the current structure of the economy and other factors. On the contrary, the structural policy with clearly seen regional aspects does not often consider the vertical and horizontal linkages between sectors of the economy, solving sectoral problems only from a particular point of view of the region. The concept of key technologies is also a type of growth strategy. Within the framework of structural policy, the sectors of the economy which in international comparisons have advantages are elected to stimulate their further development. In a broad sense, this policy includes ideas, in accordance with which positive spillovers for other sectors and possibly for the whole economy take place as a result of the new sectors growth.

Structural policy in different versions of its conceptual and practical design is supported by a variety of fiscal and monetary tools in the framework of the systemic economic policy.

The structural transformations of the economy and public finance are the consequences of exogenous, including global and, also, endogenous factors. Internal financial instability and institutional uncertainty in Ukraine stipulated the introduction necessity of mechanisms ensuring public finance sustainability, fiscal risks counteraction, fiscal rules implementation, approaches development concerning the formation of structural policy based on the adaptation of the national state aid system towards the requirements of the Association Agreement between Ukraine and the EU.

In justifying the structural policies, as well as other forms of economic policy, an important role is played not only by the failure of the market and institutional coordination mechanisms, but also by the fact that the state has the right to set goals and forecast expected economic outcomes based on political and value concepts.

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