

ICPS newsletter

New Ideas Are Sources of Growth

State policy is determined not only by interests but by ideas. As Ukraine's past suggests, ways of thinking can have much more influence than interests. Those ideas that are now being implemented in Ukraine and which almost entirely belong to monetary policies were designed 3-4 years ago. Until new ideas in the sphere of public administration and structural policy start to fill the intellectual environment and become instinctive, no economic changes at the micro level will be noticeable. Alex Sundakov spoke about these preconditions of economic development during the macroeconomic seminar at the International Centre for Policy Studies on 13 April.

Have Any New Ideas Arisen Over the Past Two Years?

The process of developing the idea of financial stability turned out to be very complicated in 1993-1995. Though this very idea was implemented impressively fast when its time had come. After two years of financial stability, economic policy at the macro level is still being discussed in Ukraine. For instance, macroeconomic indicators and methods are discussed when a draft budget is under consideration, as was the case in the past. Policy-makers in most countries spend only 5% of efforts on discussing macroeconomic parameters, while 95% of the time is spent on designing micro-level policies.

Discussion of macro-level policies suggests that macroeconomic methods are still regarded as the most important. The time has probably not come for reforms at the micro level. The only item of such reform widely discussed is public administration. This discussion covers only the concept of government structure. Seldom raised is the question concerning the goal of reform, as well as the correspondence of concrete measures to the overall goal. A year has passed since my previous visit to Ukraine, but I still hear the Soviet-style mix of "solving a concrete task" and "accomplishing a strategic goal". Control

Alex Sundakov, Director of the New Zealand Institute of Economic Research (NZIER), worked in Kyiv for a fortnight as an advisor to the British Know-How Fund. While working for the International Monetary Fund as an economist in Washington D. C. and as a resident representative of the IMF in Ukraine, Mr. Sundakov was directly involved in analysing Ukrainian economic policy. As director of NZIER, he launched Quarterly Predictions — a joint project of the Institute and the International Centre for Policy Studies. During his stay in Kyiv, Mr. Sundakov presented two seminars at the International Centre for Policy Studies. The first seminar was designed for the Centres of Policy Excellence and the second speech was delivered at the ICPS Tuesday macroeconomic seminar. This issue of the ICPS Newsletter gives a brief outline of those presentations.



and measures conducted at the micro level are not connected anyhow with state policy. That is why the strategic goal cannot be accomplished.

The objective of public administrative reform is to improve the decision-making process, and I cannot see this idea around here. The process of making a decision always means not only choosing something, but abandoning something as well. The Ukrainian government pays attention only to the first part of this dilemma: the government makes decisions aimed at "what to do" and does not determine "what should not be done". That is why the reform agenda has no success. A nice example of this stance can be deregulation. This process seems to be all about taking additional measures to verify government decisions. This approach actually adds to the general amount of regulations.

Why No Economic Growth in Ukraine?

Many countries which face the same problems Ukraine does (corruption, interlacing of state and commercial interests, slow privatisation), still experience economic growth. How come Ukraine does not? To my mind, there are three reasons for that:

1. **Corruption in Ukraine does not simply redistribute income, but restrain economic activity.** This "restraining" corruption is a consequence of micro-level policy. If state policy does not provide complete withdrawal of the government from certain types of economic activities, then

it creates more incentives for corruption.

2. **Ukraine cannot overcome the budget chaos.** The government is focusing on keeping general budgetary limits intact. There exists a shared opinion on how these limits should be observed, though almost nobody in the government understands how the limited items of expenditure correspond to state programmes. In 1994, cash control over budgetary expenditure was implemented in order to achieve financial stabilisation. This system envisaged automatic sequestration of state expenses if budget revenues fall short. This system can be helpful in handling a crisis situation for about 6 months. If it becomes a standard, it can lead to a disaster. Disarray in the fiscal sector overruns any growth in the private sector.

3. **The banking system fulfils some functions of state supervisory agencies.** Under the existing payment system, an enterprise working with a bank is under the whole state machine. Banks cannot function as their clients' agents. So the incentive to work with the banking system will be rather small until this system remains a means of discipline enforcement. Should well designed bankruptcy procedures and procedures for providing collateral for loans even be implemented, lending activity by Ukrainian banks will not rise substantially because the banks have to attract deposits. And when drawing down a loan, a bank must be sure that the borrower has full disposal of his money.

Macroeconomic seminar "Two Years Past. Reflections on Achievements and Opportunities", 13 April 1999

Next Week

Designing an Economy-Friendly Fiscal System for Ukraine. The ICPS Macroeconomic Seminar on 27 April will see a presentation by Hennady Balashov, Member of the Supreme Rada. The presentation will be entitled "Pros and Cons of a Single 10% Corporate and Income Tax". Questions proposed for discussion are:

1. What are the main disadvantages of current state tax policy? What are more effective tax policy objectives?
 2. Why 10%?
 3. What will the tax base be?
 4. When will these changes occur (possible time lag)? Evaluation of possible revenues.
- How will state expenditures change? What liabilities will the state take? State role in the economy of Ukraine.

Please note that participation in the ICPS Macroeconomic Seminars held every Tuesday now require special invitation. To receive an invitation you should contact Larisa Romanenko, e-mail: LRomanenko@icps.kiev.ua, tel./fax +38044 4635967

In Two Weeks

Ukrainians Learn the European Integration Experience of the Baltic States. An international conference "Ukraine's European Choice: Baltic Dimension" will be held within the framework of the Ukraine's European Choice project on 3–4 May 1999. The Conference will be co-sponsored by the International Centre for Policy Studies and RAND of the U.S.

The Conference will be devoted to discussing the strategy of the European Union toward Ukraine, problems of co-operation in the Baltic — Black Sea region and possibilities for Ukraine to use the experience of the Baltic states concerning integration into the EU structures.

For further information on the organisation of the Conference, please contact Natalia Lubkovich, e-mail: natalia@icps.kiev.ua, tel. +38044 4635967

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The Role of Governmental Analysts Is to Prepare Decisions the Market Cannot Handle

The state should undertake only those types of activities the market fails to perform effectively. The role a governmental analyst is to provide advice to a policy maker preparing and giving proof for decisions that will facilitate the performance of the state's role in the economy. These were the issues touched by Alex Sundakov in his lecture delivered at the seminar of the Centre for Policy Excellence: Fiscal Policy.

The market has obvious advantages: it provides swift dissemination of information and is a decentralised environment. Though sometimes society can be unsatisfied with market performance, and this is in which lies a job for the government.

Government intervention can prove necessary if the market fails to function due to certain reasons:

- market relations are not possible at all (national security);
- the market functions inefficiently (for instance, building roads can be unprofitable);
- introducing market relations can have negative consequences (donors may be discouraged to give blood for charity if market relations are introduced); and
- the market is possible but market relations are not desirable (running national parks can be quite profitable but the value of the parks can be lost).

Governments in some countries can show substantial interest in certain industries for political reasons. As usual, such industries could function in a market environment. For example, postal services can be well rendered by commercial enterprises.

The government should not directly own enterprises and be engaged in the production of goods and services: in

most cases the state can perform its role without interfering in the marketplace. In order to provide healthcare services to the poor, the government has to purchase services from private hospitals and pass them over to those who cannot afford it. Another objective of the government is to regulate the market in line with the needs of society.

The role of a government analyst is not limited to choosing optimal decisions and solutions for a given problem. In a democratic society, the quality of reasoning is most important. This quality provides information to and assurance of all interested parties, as well as creates an intellectual environment for decision-making.

The best type of governmental analyst is an "advisor" who uses technical information only for the purpose of affording proofs for the best policies. The information created by an "advisor" can be used not only by professionals. "Technicians" consider their task to be only a provision of technical information (figures, reports). "Advocates" try to protect the interests of certain industries or government departments. The latter two types usually lose in a democratic society.

*Seminar "Role of Policy Analyst",
10 April 1999*

Economic Growth with Equity: Which Strategy for Ukraine?

Issue #3 of the ICPS monthly publication Policy Studies came out of press last week. The issue is entitled "Economic Growth with Equity: Which Strategy for Ukraine?" This issue of Policy Studies was prepared in co-operation with World Bank experts.

Putting Ukraine back on the path to prosperity requires policy makers to stop letting economic crises dictate the policy agenda. Short-term problems need to be dealt with in the context of a longer-term strategy focused on improving the living standards of Ukrainian people, including the most vulnerable in society.

What economic strategy should Ukraine follow? This publication identifies and evaluates three different alternatives for Ukraine:

- **The preservation strategy** involves only a slow movement towards a market economy. Under this strategy, Government maintains existing structures of ownership

and control and seeks to preserve the social benefits of the Soviet regime. Long term growth prospects are damaged by the continued support of inefficient production.

- **The protectionist strategy** involves shielding selected domestic industries from competition from external and other domestic producers. If Government is successful at "picking winners", limited protectionism may help develop new industries and deliver economic growth.
- **The competitiveness strategy** implies a much smaller role for Government than the preservation or protectionist strategies. Under this approach, the Government aims to create an environment that encourages competition and gives all producers an equal chance to succeed. This increases the purchasing power of Ukrainian consumers and enhances Ukraine's prospects in export markets.

This report recommends that the Ukrainian Government adopt the competitiveness strategy.