

# ICPS newsletter

## Regulatory Reform in Ukraine: Successes and Disappointments of the First Year

**Discussion of the fundamentally new draft Conception for the State Regulatory Policy, developed by the government institutions in cooperation with nongovernment organisations, has begun. The sixth issue of the monthly ICPS Policy Studies journal will be published this week, containing the draft Conception and a detailed analysis of current state policy in the field of regulatory reform; possible alternatives or improvements are considered by Andrii Palianytsia, director of ICPS's Regulatory Reform program. The main conclusions of the published work are presented below**

Current criteria for consistent state regulatory reform in Ukraine have two priorities: to revise current regulations and to forestall ineffective drafts of new regulations.

The existing procedure for revising regulatory acts in Ukraine has been quite effective for the first stage of regulatory reform. First of all, an administrative and procedural foundation has been laid to analyse regulatory acts. An established general procedure for all steps from prioritising to monitoring the implementation of adopted decisions has

proven its effectiveness. Second, systematic reviews of complaints and proposals submitted by businesspeople, as well as consultations, have encouraged intensive dialogue between the private sector and the state through the State Committee for Entrepreneurship (SCE).

Nevertheless, the effectiveness of regulatory reform and lack of a more systematic approach have been noted on more than one occasion. It is obvious that this factor has both advantages and serious disadvantages. We are actually faced with a dilemma between the need

### *From the Foreword by Vira Nanivska, Director of the International Centre for Policy Studies*

*During the first year since regulatory reform was launched in Ukraine, the objective has been to reduce the burden of administrative intervention in business. To this end, measures were developed to eliminate existing normative acts and prevent new ones.*

*Although this work was done thoroughly and productively, it was a self-defeating activity for the long term. In reality, deregulation reinforced the old system of state control instead of creating a new market-regulatory system. The possibility of correcting the administrative system within the old framework was a mere illusion.*

*Maintaining an entirely reactive type of regulatory reform in the future is not effective, either. It is necessary to create a fundamentally new, market-oriented system of state regulation, different from that under totalitarianism. The first steps towards this system must entail an analysis of the qualitative difference between administrative control and market regulation by the state; and the determination of the characteristics, structure, and mechanisms of the desired market regulatory system.*

*At the next stage of regulatory reform, a new market-oriented role of the government should be defined with respect to economic activities of the population. Only based on this new role will it be possible to formulate new normative acts and address related problems.*

### **Last Week**

**Alternative method of forming local budgets.** A seminar on "Forming Local Budgets in Ukraine: Will the Year 2000 Be Crucial?" was held as a part of the ICPS's Centre of Policy Excellence (budget policy) project on August 7. Mr. Wayne Thirsk, advisor on fiscal policy at Barents Group, noted in his presentation that local governments in Ukraine, and other FSU countries as well, have limited set of instruments for forming own budget revenues. Conversely, local authorities depend on transfers and shares of national tax revenues such as personal income tax and corporate income tax. Unable to change either the tax rate or the tax base, local governments are seriously limited in forming independent revenues, and lack of independence also narrows maneuverability regarding expenditures. Moreover, the central government determines the amounts of local expenditures based on norms founded on the extant capacities of the state sector. Last but not least, total financing of budget institutions on paper exceeds overall the financial capacity of the state.

Given the present insufficient independence in forming local revenues, norms of local expenditures must reflect the current drops in revenues. One of the methods provides for introducing such responsibility from bottom to top and fixing realistic expenditure rates for each functional category of expenditures, and then summing up to get a total expenditure rate per capita. In developing the 2000 budget, the Ministry of Finance used this very method, in keeping with its practice of using local expenditure data received from the sectoral

administrations in the process of budget development.

The method of expenditure determination from bottom to top has some disadvantages. Firstly, the question of size of local budget shares in the consolidated budget is ignored. If the calculated overall expenditure rate per capita does not correspond to revenue formation capacity, the procedure should be repeated to achieve a better correspondence. Secondly, the entire process can lack transparency because only the Ministry of Finance knows the base used for calculating sectoral expenditures per capita. Third, the procedure practically leaves out the possibility ensuring social services from other sources, particularly the social and cultural services of state-owned enterprises.

Mr. Thirsk proposed an alternative method allowing a more rational solution of this problem. This method provides for determining aggregate expenditures per capita for all local budgets from top to bottom. According to the proposed method, political and theoretical efforts should be aimed at considering the three major elements of local budget formation. Firstly, what should the proportion of local budgets be in the consolidated budget? Secondly, how should aggregate resources of local budgets be allocated between different levels and sublevels of local authorities? And finally, how should expenditures be financed under conditions of limited independence to generate local revenues?

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for flexibility, achievement of prompt results, and effective feedback with businesspeople, on the one hand, and a more systematic long-term approach, on the other. One of the ways to solve this dilemma is to separate out *the systematic regulatory reform*.

This component of regulatory reform is innovative and targeted to provide systematic and irreversible reform. The main function of this component lies in the complex re-regulation of whole sectors of the Ukrainian economy, with the aim of increasing level of compliance by business entities, and effectiveness of state policy. One of the objectives of the government is to develop principles of state regulation for each sector. These principles will act as a foundation for reviewing current legislation as to its appropriateness and effectiveness.

While the revision of existing regulations can be considered a long-term but temporary objective, which has a final goal, *co-ordinating draft regulations* is a continuing government activity aiming to develop effective administrative procedures for filtering out ineffective regulations. Certainly, this should be one of the government's main objectives in a market economy. Therefore, this aspect of

regulatory reform is of the utmost importance since it is closely connected with administrative reform in Ukraine.

Regulatory reform can be successful only if all ministries and agencies are consistent in carrying it out. In terms of reconciling draft regulations, this means that those who develop regulations must provide the rationale, while the SCE must either agree or provide arguments for its rejection. But the current situation is the opposite, with the burden on the SCE to prove why given regulations are not needed.

According to Mr. Andrii Palianytsia, in order to work out a more comprehensive approach to reforming regulatory policy in Ukraine it is necessary, first of all, to clearly define the goal of such policy and the basic prerequisites for achieving this goal. The first prerequisite is active dialogue between the state and market participants. The second prerequisite is the effective government action.

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### *Main aspects of the Conception for the State Regulatory Policy*

*State regulatory policy is the consistent and deliberate activity of government bodies, directed toward optimising state regulation of the economy and the social sector, increasing the feasibility, clarity, and transparency of state regulatory acts as well as decreasing the cost of fulfilling them, both for citizens and entrepreneurs as well as for the state. State regulatory policy is a part of the national policy of Ukraine aimed at providing conditions for sustainable economic growth and improving mechanisms of public administration.*

*State regulatory policy should ensure:*

- the transparency, consistency, and predictability of decisions of executive bodies and local self-government concerning regulatory acts;*
- that new regulatory acts are introduced only after conducting comprehensive analysis of their potential effectiveness in achieving the established goals, and their possible impact on the economic climate in Ukraine;*
- that periodical monitoring is carried out of the effectiveness and consequences of implementing existing regulatory acts and related measures;*
- effective dialogue between executive and local self-government bodies and economic entities;*
- the co-ordination of the activities of all central and local executive and self-government bodies;*
- that executive bodies report on the implementation of state regulatory policy;*
- the liability of public officials for non-execution of laws and infringement of established procedures.*

*Effective state regulation should be based on the principles of necessity, effectiveness, equitability, consistency, transparency, and simplicity with regard to regulatory acts.*

*Gradual improvement of state regulation will allow using limited government resources to decrease regulation costs for citizens and the state, which will increase the competitiveness of products and improve the investment climate in Ukraine. State regulation of the Ukrainian economy will become maximally transparent and predictable.*

*Improved state regulatory procedures will help to decrease the shadow sector of the economy.*