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Ukrainian Budget Process Is Inefficient

The Ukrainian-European Policy and Legal Advice Centre (UEPLAC) and the International Centre for Policy Studies together with the Institute of Reform held their second seminar in the framework of the Open Budget project on 18 February. The seminar was devoted to the analysis of budget execution and control in Ukraine. The seminar was co-chaired by Julian Watts, Representative of the EU Delegation in Kyiv and Executive Director of the UEPLAC, and Victor Pynzenyk, Member of the Supreme Rada.

Main presentations were made by Ms Tatyana Vakhnenko, UEPLAC researcher — State Budget Execution and Expenditures Control in Ukraine, and by Andrzej Gonciarz, consultant to the Open Budget project — Budget Expenditures Control: Making It Work.

Absence of Reforms Impedes Proper Budget Execution

Because of the continuous overestimation of economic and fiscal indicators at the budget formulation stage, payment crisis and as a result tax arrears and budget revenues have been overestimated and expenditures have been underfinanced constantly.

Data on execution of the Consolidated Budget prepared by the Main Department of the State Treasury show that the Consolidated Budget was not executed as provided by law any time during 1995-1998, funding of the expenditures constituting 88-96% of approved appropriations. The fiscal situation has been particularly critical at the level of the State (Central) Budget: funding of its spending barely exceeded 80% in 1996-1997 and equalled only 73% in 1998.

For the cash method of budget execution applied in Ukraine, financing expenditures within available financial resources of the State Budget is attributable. This method, although permitting to keep the cash deficit at a given level, is not able to sustain actual spending which develops in line with adopted appropriations.

So the absence of real steps towards comprehensive budgetary reform resulted in the accumulation of budget arrears and the transformation of a substantial part of the budget deficit into a hidden form.

The comparison of actual spending displayed in official reports with approved appropriations does not reflect the problem of non-compliance with the adopted budget in the full extent. This stems from the fact that 18-25% of public expenditures are funded through mutual settlements. Thus in 1996-1998, cash spending of the Consolidated Budget amounted to 72-73% of what had been approved. Despite the legislative prohibition of mutual settlements, a substantial part of public expenditures are "financed" by mutual settlements. However by nature, mutual settlements are not the kind of operations which could fulfil the state's function with financial resources. They are rather a passive adjustment of the government to existing economic imbalances.

Budgetary Legislation Is Violated

Article 95 of the Constitution of Ukraine states that the State Budget Law shall exclusively define state expenditures for public purposes, their amounts and targets.

Article 33 of the Budgetary System Law provides that in the case of insufficient revenues collections, the Supreme Rada or the local soviets shall make the decision on proportional sequestering of budget appropriations for every budget article, except protected articles. If the Supreme Rada does not adopt a decision on cuts in expenditures, the President of Ukraine is empowered to reduce the funding of certain expenditures, having notified the Supreme Rada within two weeks. However the annual State Budget Laws do not abide by this order. For instance, the 1999 Budget specifies the following procedure: should budget revenues fall by more than 10% of the approved amounts, the Cabinet of Ministers has the power to reduce the

Last week

Development Strategy for Local Budget Financing. The macroeconomics seminar held at the International Centre for Policy Studies on 16 February was devoted to the subject running "Local Taxes and Fees — Options and Guidelines for Ukraine". The main speaker was Wayne Thirsk, fiscal economist at Barents Group. Dr. Thirsk stated that as international experience suggested local taxes and fees should meet the following criteria:

1. Local taxes and fees should be paid locally. This means that local taxes and fees should be paid by individuals who live within the specific administrative territory and firms incorporated and doing business in this territory.
2. Local taxes and fees should not cause significant distortion on consumers' or producers' decisions.
3. Local taxes and fees should have low administrative cost.
4. Local taxes and fees should be universal for as many localities as possible. This means that the same set of local taxes and duties must be applicable in different administrative districts of the country.

Wayne Thirsk emphasised that local authorities had to charge full cost for public services they rendered.

During the discussion which followed Dr. Thirsk's presentation, the participants mentioned the necessity of reforming the system of financial relations between the central budget and local budgets — the transfer payments system, setting up local tax agencies and ensuring efficiency of local authorities' expenditures.

This Week

The EBRD reports on the situation in economies in transition. The next Macroeconomics Seminar to be held at the International Centre for Policy Studies on 23 February will be devoted to the discussion of the EBRD's Transition Report 1998. The presentation will be delivered by Julian Exeter, senior economist, Office of the Chief Economist of the EBRD, the Department responsible for producing the Transition Report and Joel Hellman, political counsellor, Office of the Chief Economist of the EBRD, the Department responsible for producing the Transition Report.

Treasury Optimises State Cash Management

Introduction of the treasury system of budget implementation has become an important step toward strengthening control over the flow and appropriate allocation of budget funds.

The State Treasury was established within the Ministry of Finance of Ukraine in accordance with the Presidential Decree on the State Treasury of Ukraine dated 27 April 1995. The State Treasury is to carry out the following tasks: organise and control implementation of the state budget, allocate current state funds, account cash execution of the budget and maintain fiscal reporting, manage state debt, control revenues and allocation of extra-budgetary funds.

The treasury system of budget execution implies accumulation of all budgetary funds on bank accounts opened by the state treasury agencies from which they transfer funds directly to the enterprises that provided services for budgetary units. The mentioned accounts must form a single treasury account system. The single treasury account system allows for monitoring revenue and expenditure flows, provides information on the balance of the single treasury account, and permits allocating available resources for financing the most urgent needs. Therefore, it allows for saving funds and avoiding expensive borrowing. Within the treasury system, budgetary agencies have their registering accounts in the state treasury and their individual current accounts with commercial banks are to be closed.

allotments for distributors of budgetary funds without any changes possible for the protected articles and notify the Budget Committee of the Supreme Rada.

Each year, the State Budget Law specifies the list of protected articles within the economic classification. For instance, the 1998 Budget stipulated the following articles as protected: wages and repayment of wage arrears, social contributions, purchase of foodstuffs and medicines, transfer payments to the population, and grants to local budgets. However some facts prove infringement of the 1998 Budget: wage arrears in the budget sector increased by UAH 243 million in 1998 and spending on medicines were financed by 34% during 9 months of 1998.

Unrealistic budget formulation and absence of clearly defined mechanisms of budget adjustment to changing economic circumstances result in permanent underfunding of the expenditures approved. In addition, lack of efficient control and responsibility enables officials to exceed funding for certain chapters and articles of the State Budget. The Ukrainian budget is conducted within the so-called hands-on management mode. Funds for main distributors of the State Budget are released daily by the decision of the Prime Minister, Minister of Finance, and Head of the Main Department of the State Treasury in accordance with money collected.

The practice of hands-on management of public expenditures leads to the situation where priorities of state policy are decided at the budget implementation stage. Budget execution is to have a purely technical character, consisting of carrying approved allotments to spending units. It is not to involve the re-distribution of funds between government agencies and programmes (in the case of insufficient revenues collection, budgetary allocations are to be reduced by formal budget revision).

Obligations of the Government Must Comply with Available Budgetary Resources

Public resources do not correspond to assumed obligations, therefore the budget is being formulated by violation of legislation from the very start of the budgetary process (according to calculations by the Ministry of Finance, funding of all state programmes stipulated by the legislation requires UAH 80 billion annually). These discrepancies are aggravated more at the budget execution stage.

In order to avoid these problems in the future, we must consider the size and structure of government obligations to the population and the economy should be determined on the basis of the volume of available budgetary resources. These measures will require revision of regulations — some laws which do not comply with the established priorities must be cancelled or amended. Since this process requires a substantial period of time and a lot of efforts at the first stage, it is advisable to work out and adopt the Budget Code which must have priority over other laws.

It is necessary to set up transparent rules for reducing public expenditures, namely to determine the situation with the collection of revenues, which allows sequestering to be carried out by the executive branch and the situation which requires parliamentary revision of the State Budget Law.

Efficient management of public expenditures requires an appropriate institutional framework and strict control over budget execution. Within the state administration, it is necessary to enforce executive discipline and control over adherence to legislative requirements in order to form a capable structure of the state executive power.

What can Ukraine learn from Australian approach to the preparation of the State Budget?

First, a comprehensive reform of the budget process has to be driven by the desire for greater budgetary control. Second, the control function should encompass both (1) accounting control to eliminate corruption and misappropriation of funds and (2) expenditure controls to ensure the integrity of the policy implementations process.

The purpose of the reform is to institutionalise a system of prioritising competing claims against limited amount of resources, This system should include the following elements:

1. *Public Expenditure Review in the middle of a fiscal year as a starting point for the formulation of the next year budget.*
2. *Baseline Budgeting Scheme to ensure improved allocation of public resources. Budget preparation should feature two stages: (i) determination of the baseline budget which corresponds to the minimum level of operating requirements of each ministry or central agency to perform its on-going programmes; and (ii) determination of priority project fund as the difference between the approved overall budget limit and the baseline budget. The priority project fund would represent the amount available for allocation to new programmes and activities and to expansion or upgrading of existing programmes.*
3. *Implement medium term expenditure framework. Because of the one year budgeting framework, there is a tendency for incremental allocation of resources for existing programmes and lack of a strategic prioritisation system to enable restructuring of the budget towards desired areas and more gradual adjustment towards fiscal consolidations.*
4. *Strengthening oversight control by creating an information system for resource management at the Ministry of Finance (in co-operation with the State Treasury).*

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