

# ICPS newsletter

## Ukraine develops strategy for reducing shadow economy

*For a large part of the population, the "shadow economy" has become a means of survival. Actually, it has helped to avoid social shocks related to Ukraine's economic crisis. However, long ago the conclusion was drawn that the negative results of the shadow economy outweigh the positive ones. In particular, among the negative results of the shadow economy are its failure to fulfil public obligations due to the loss of budget revenues, low impact and inappropriateness of administrative decisions, and moral degradation of society. The Ministry of Economy of Ukraine is finalising its work on the State Program for Reducing the Shadow Economy. The draft of this program was the subject of a public discussion which took place at the International Centre for Policy Studies*

Overall, participants expressed their satisfaction with the very fact that such a programme is being developed. In particular, they noted that finally economic incentives are preferred over administrative sanctions as methods for reducing the shadow economy. At the same time, the leading point of the seminar discussion was about the need to have a systemic approach to the problem of the shadow economy and to make this program the priority for all branches of government.

The taxation system and corrupt public servants at all levels were cited by participants as the major causes of the shadow economy in Ukraine. Yaroslav Zhalilo (National Institute for Strategic Studies) noted that as long as the state executes its fiscal functions by increasing the tax burden, businesses will stay in the "shadow" to avoid this burden.

Oleksandr Suhoniako, head of the Ukrainian Banks Association, addressed the moral aspects of the programme for reducing the shadow economy. Today, Ukrainian society has no guidelines for defining what is good and what is bad. For this reason, the decision

### **Draft Programme for Reducing the Shadow Economy: Goals and means**

*The draft of the State Programme for Reducing Shadow Economy of Ukraine has been developed in accordance with the Cabinet of Ministers programme titled "Reforms for Prosperity". Covering the period from 2000 through 2002, it includes the plan of government actions for reducing the "shadow economy" and creating an economic environment favourable for starting and developing effective legal business activity.*

*The project intends to bring about a substantial increase in the size of the official economy in Ukraine by creating favourable conditions for the transition of economic activities from the illegal sector to the legal one. This transition should help to achieve better fulfilment of budget obligations, increase population incomes, and strengthen democratic institutions.*

*The programme gives the following definition of a shadow economy: "economic activity which, in accordance with the System of National Accounts, involves the creation of added value which entirely or partially is not embraced by official statistics and not included to the taxation base".*

*Among the major types of shadow economy the document mentions the following:*

- evasion of taxes, levies, and other obligatory payments;
- illegal economic activities;
- financial violations in the budget, banking, and external sectors and in the realm of privatisation.

*The Programme defines the following ways for reducing the shadow economy:*

- decreasing the tax burden, decriminalisation of small tax evasion;
- cancellation of tax incentives;
- changing the structure of the tax system: shifting the tax burden from production to consumption and overall simplification of the taxation system;
- simplification of the system for registering business entities and the reporting system;
- limiting the power of regulating bodies for reducing their interference in business activity;
- ensuring the transparency in activities of executive authorities, prevention of public finance abuse;
- development of the banking sector, financial markets, and market environment institutions;
- increasing sanctions for breaking the law;
- ensuring continuous research conducted by research and public institutions on problems of the shadow economy.

*The expected results of this programme include:*

- average annual reduction of the shadow economy by 2% in 2000–2002;
- increase of gross domestic product by 10–15% in 2002 in comparison with 1999;
- increase in income of the population: real income of the population in 2000–2002 will increase annually by 4–5% on average, while incomes from business and property will increase at a high rate;
- increase in investments: the share of gross investments in GDP in 2002 will increase to 22%;
- improving the structure of money supply by reducing currency in circulation;
- legalising employment in the shadow sector of the economy.

## Last Week's Events

**Building European democracy through education.** Last week, the International Centre for Policy Studies received an official message from the European Commission regarding origination of the grant for the project "Model European Democracy (MED): An Education Game". ICPS has been chosen to be an immediate contractor of the European Union's executive body.

Under this project, ICPS will cooperate with the Ministry of Education and Science of Ukraine and RAND/Europe and will involve experts from the European Council, the European Court of Human Rights, embassies of European Union countries, and UN missions. Pechersk International School, the Kyiv Business Lyceum, the Lyceum for International Relations, and 9 pedagogical universities will be the partners in implementation of this programme. The duration of the project is one year.

The major goals of the project include:

- build the capacity of teachers to pass on fundamentals of European democracy in the educational process;
- disseminate knowledge about the structure and activities of European institutions.

Under this programme, 61 freshmen of pedagogical universities and institutions from 9 oblasts of Ukraine will be trained. Interns will be introduced to the activities of Western European institutions, their role, functions and methods for influencing the development of society. Training events will be organised as a game imitating the work of the European Parliament Council, the European Court of Human Rights, and the Historical Commission. The learning programme involves classes, educational games, round tables, observations, writing assignments (team projects), etc.

The project includes the publication of materials (manuals, textbooks) which will be developed by experts for students as well as reports and research done by international consultants.

*For additional information please contact Milena Kornil (tel.: 462-4937/38, e-mail: mkornil@icps.kiev.ua)*

to stay in the "shadow" is not considered immoral. In the speaker's opinion, the state itself is immoral, because it does not keep up with its public obligations. And in an immoral state there is no place for honest business. The programme for reducing the shadow economy, therefore, must include provisions for increasing the responsibility of the government for its actions.

Discussion participants emphasised that in Ukraine, corruption is not only a characteristic of the individual anymore, it has reached the institutional scale. Here the question was raised: can the programme be successful if it supposed to be executed by the same powers which until now have been implementing policy and adopting laws that

resulted in the booming shadow economy? In other words, the government should be transformed by its own efforts and by the strength of new legislation it will adopt. Such actions demand enormous effort. To solve this problem, extraordinary techniques should be applied. The very fact of evolving the State Programme for Reducing the Shadow Economy launches the struggle of the government against itself. ■

*Public discussion of the draft State Programme for Reducing the Shadow Economy by the Ministry of Economy of Ukraine, organised by the Ministry of Economy of Ukraine and the International Centre for Policy Studies, took place on September 20, 2000.*

## Summary of Discussion in Groups

### Question #1. What are the goals of the programme?

- Take the economy out of the shadow
- Increase trust in the government
- Improve macroeconomic indicators and increase budget revenues
- Create conditions for working legally
- Increase the standard of living
- Create a favourable investment climate
- Win the trust of foreign investors
- Accumulate national capital

### Question #2. To what extent does the programme correspond to general economic strategy currently followed by the government?

- Both the strategy and the programme are declarative
- The programme should be a part of the economic development programme
- The programme must become a priority for public agencies

### Question #3. What kind of actions should be taken?

- Shift the emphasis from administrative measures to economic ones
- Improve legislation on the economic, budget, and credit systems
- Legalise shadow capital
- Increase the efficiency of financial control systems
- Block channels for budget resources misuse
- Analyse international experience
- Increase the responsibility of controlling bodies for the results of audits
- Differentiate profit taxation
- Create a methodological base for estimating the size of the shadow economy, develop a methodological document regarding the inclusion of the shadow economy in the System of National Accounts

### Question #4. What should the President, government, Verkhovna Rada, mass media, and the public do for programme implementation?

- Establish responsibility at all levels of executive government
- Complete administrative reform
- Fundamental changes in the taxation system
- Ensure the stability of tax legislation
- Regulate the process of legal document development in agencies
- Introduce obligatory expertise of legislation impact
- Hold public discussions of programme results
- Publicise trials of corrupt offenders
- Appoint public servant responsible for programme implementation
- Increase the effectiveness of public property management

### Question #5. Are there capacities and resources to implement these actions?

- There is no political will to ensure the responsibility for programme implementation
- There are resources but there are no effective tools or commitment
- Additional financial resources are necessary for increasing the qualification of controlling bodies' representatives and for ensuring appropriate information and methodology.

ICPS Newsletter is a weekly publication of the International Centre for Policy Studies delivered by electronic mail. To be included in the distribution list mail to: [marketing@icps.kiev.ua](mailto:marketing@icps.kiev.ua). ICPS Newsletter is published by the ICPS Publications Group. ICPS Publications director Hlib Vyshlinsky ([hlib@icps.kiev.ua](mailto:hlib@icps.kiev.ua)) ICPS Newsletter editor Yevhenia Yehorova ([ee@icps.kiev.ua](mailto:ee@icps.kiev.ua)) English text editor D. (Ksenia) Ovcharenko. Articles may be reprinted with ICPS consent.

The International Centre for Policy Studies is an independent non-profit research organisation with the objective of improving the Ukrainian policy development process. This is achieved by increasing the know-how of key government officials for policy choices, formulation, and debate, and the awareness of the public-at-large of the benefits of policy. Address: 8/5 Voloska Street, Kyiv 04070, Ukraine Phone (380-44) 462-4937/38/58 Fax (380-44) 463-5970 Web-site: <http://www.icps.kiev.ua>