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The executive branch gets used to public policy

The discussions of nine Green Papers that were part of a project called "Setting up 10 Policy Analysis Groups (PAGs) under Ukraine's Executive Bodies" have ended. Having drafted Green Papers on some of the most painful issues in the country's economic and political life, government specialists are slowly mastering the methods of public policy—a proven instrument to support the work of a democratic government and bureaucracy. The debates clearly showed that the practice of setting up PAGs under central executive bodies needs to continue

Increasing the transparency of Government activities and establishing a broad dialog with the public are among the key priorities of the current Administration in Ukraine. Existing procedures, that is, launching public discussions only after a draft regulatory document has been made public contributes little to the dialog between the government and the people as it happens only at the last stage of the decision-making process.

Green and White Papers improve both dialog and policy

These public documents on government policy help significantly improve the level and quality of dialog between a Government and interest groups, and the quality of policy decisions as a whole. They bring in stakeholders at the early stages of a Government decision, when the issue is being identified, the roots of the problem analyzed, options for solving the problem formulated and evaluated, and the best solution discovered. This significantly improves the level of public involvement. It also helps expand the preliminary support base for a particular policy decision and ensures greater success in implementation.

Thinking about the interests of all stakeholders contributes to more effective public policy reform. The current series of discussions confirmed once again that this public policy tool is the only alternative to solving many urgent problems in government policy priorities. Moreover, public debates around a Green Paper dealing with a particular policy and considering the positions of all stakeholders are the only way that Ukraine will be able to develop new, balanced policies that meet EU requirements.

For instance, the discussion of "On strengthening the role of the electricity regulator" produced by the National Energy Regulatory Commission (NERC) revealed that current policy does not match the balance of interests among power consumers, producers and suppliers. The existing decision-making process meant that the interests of consumers were being ignored and the "ad hoc" management of the sector reflected the corporate interests of only one of the sides.

Public policy debates enhance institutional capacity for Twinning

Twinning projects are intended to transfer and effectively apply the expertise of administrative professionals from EU Member States to benefit countries like Ukraine. The preparation and implementation of the first Twinning projects confirmed that one of the main problems in identifying issues, goals and objectives for projects that suit Ukraine's eurointegration strategy is the inadequate capacity of the country's central executive, the project beneficiaries, for strategic planning.

Work on the Green Papers had a clear positive impact on the quality of preparation for Twinning, in the opinion of EU experts. In particular, materials and recommendations of the Green Paper prepared by the NERC and the Ministry of Transport actually became part of the process of preparing terms of reference for Twinning projects. This shows that even the PAGs intermediate results are showing their usefulness.

Policy analysis encourages a clear position on national interests

During political dialog, Ukraine's options to identify and defend its interests are limited for lack of prior policy analysis and, unlike their EU counterparts, Ukrainian negotiators are frequently unprepared. Yet, policy analysis makes it possible to have a clear vision of a particular problem and to develop realistic alternatives for a successful solution. Establishing and keeping a clear position based on national interests is critical in negotiations with the EU. ■

The "Setting up 10 Policy Analysis Groups (PAGs) under Ukraine's Executive Bodies" Project is being implemented by the International Centre for Policy Studies on commission of the Center for the Institutional Development of the Civil Service under the Main Civil Service Administration.

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By the way…

- The "Impact of NGOs on the Formation and Implementation of Party Platforms" Project is putting together its preliminary results. Regional NGOs are analyzing the impact of election platforms, NGOs, and the media on the results of elections in selected cities and regions.
- The second series of workshops of the Conference Board of Canada took place 20–22 June 2006 for the purpose of evaluating potential output.
- The first series of public consultations with stakeholders on the EU–Ukraine free trade agreement started 20 June.

Default is not on the horizon

At the moment, some of the greatest worries around the economic situation in Ukraine concern public finances. A pre-election round of decisions to raise social benefits yet again, growing prices for imported gas with the risk of further increases have all put a strain on the Budget. Yet, weak economic growth offers little grounds to believe that these additional expenditures will be covered fully. Some are even talking about the possibility of a default similar to that in the late 1990s. In an article for Vlast Deneg, ICPS economists Oleksandr Zholud, Oleksiy Blinov and Yevhenia Akhtyrko conclude that a default is improbable within the next few years and outlined the risk factors the Ukrainian government should pay attention to

In the next few years, there is little reason to expect a default. The Budget deficit, which ICPS economists expect will not be more than 2.5% of GDP in 2006, is not high by world standards and is quite acceptable for Ukraine. The margin formed over the years when the country's economy as a whole and exports in particular grew rapidly has strengthened Ukraine's capacity to resist various shocks. Still, if the new Government does not react in time to challenges that the economy is facing, the likelihood of a default will grow.

Risks

The main factor that might lead to a default is a substantial Budget deficit. This tends to lead to rapid rising debt, risks and interest rates. These, in turn, push debt up. The Budget deficit might grow for two reasons: inadequate Budget revenues—taxes, customs duties and so on—and growing expenditures. The risk is even higher when there is a large double deficit, that is, a high Budget deficit coupled with a high balance of payments deficit. This was the situation on the eve of the 1998 financial crisis.

Over the last few years, there occasionally were serous deviations from planned indicators for specific items of Budget revenues. Still, the collection of Budget revenues did not generally deviate wildly from the plan. This means that today the main threats are: (1) developing and approving ungrounded and overstated indicators for the 2007 State Budget; (2) extending tax exemptions to businesses that supported the government in the elections; (3) raising social benefits, which was promised by all political parties that are now in the Rada; (4) refusing to sequester the 2006 State Budget because of an overall deterioration in the economy. Precisely such steps contain the main risks that the government's capacity to fulfill its commitments might decline and they should be watched for. If the social orientation of state policies continues to strengthen, it could lead to serious problems.

Other possible risks are far less important today. For instance, a change in the hryvnia exchange rate, which has been raised again recently, should not lead to problems with servicing the country's foreign debt, provided the central bank has adequate reserves. The current deterioration of the balance of payments is also not critical to Ukraine's position. This process is being accompanied by an influx of foreign capital—both as direct investment and as international borrowings— that, so far, is not speculative. As a rule, speculative money comes to a country when a steep change in the exchange rate is expected.

Diagnosis

At the moment, Ukraine shows no symptoms of a pending default. The country has extended deadlines for repaying both its domestic and foreign loans. Although reduced interest rates have been largely the result of a global trend towards cheaper money that has been observed for several years now, the reduction of risks for investing in Ukraine has been a major achievement of the country.

Growing private sector foreign debt does raise certain concerns. Over the last two years, the total debt of private companies in Ukraine has grown to double the national debt. According to MinFin data, total foreign debt was US $11bn as of early May. Moreover, private sector foreign loans will continue to grow at a rapid pace—US $3–4bn per annum. In the near future, large Ukrainian financial and industrial groups in need of investment capital, primarily into energy-saving technologies, will be borrowing on international markets. However, a large-scale default in the private sector is unlikely, as debts tend to be distributed among many entities and, provided there are no massive shocks, any defaults will only be local in nature.

Recommendations

Just as winter preparations are generally carried out in the summer, the government should pay attention to a number of issues now, in order to minimize the risks later. To prevent a default, first of all, the Budget deficit needs to be kept down. If this is not done, all other mechanisms are likely to only accelerate or postpone a crisis. In response to this kind of advice, Government financial specialists always respond, "That's easier said than done." However, there are a slew of not very onerous principles that can ensure the reliability of public finances, but that, to all appearances, Ukraine has not quite mastered.

Key indicators of a possible default:

- rapid growth in the country's domestic and foreign debts;
- a switch to shorter-term debt papers;
- rapid growth in the yields for domestic T-bills;
- a growing share of Budget spending to service debts and repayments;
- a growing ratio between foreign debt and central bank reserves.

As there are problems with tax receipts, that is, revenues are shrinking in export-oriented sectors due to deteriorating trade conditions and the loss of markets, it is desirable, firstly, to openly sequester the Budget rather of cutting funding for specific items on an ad hoc basis. Secondly, no opaque financing of debts should be allowed, for example, such as NBU loans to the Government as was the case during 1990s, or forcing banks, especially state-owned banks, to purchase domestic T-bills. Thirdly, incentives for the development of a stock market offering a large choice of instruments will not only facilitate debt servicing and a stronger financial sector, but will also help the government increase its debt without too much fear.

Public debt management is critically important. The state must continue to support regular interest payments on the principal in order to prevent a situation where a large chunk of the national debt has to suddenly be paid off in a short period of time. There should also be protection in the law for Budget items that involve servicing the national debt. ■

See Vlast Deneg magazine, №22 (86), 2 June 2006 at http://www.vd.net.ua/journals/articles-1217?arch=1 (in Russian only). For additional information, contact ICPS economist Oleksandr Zholud by phone at (380-44) 272-1050 or via e-mail at ozholud@icps.kiev.ua.

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