

ICPS newsletter[®]

Modern economic tools make Government more productive

The “Socio-Economic Performance and Potential Analysis Capacity” (SEPPAC) project funded by the Canadian International Development Agency (CIDA) is gradually coming to the application stage. During a series of seminars on 19–23 February 2007, the project’s main government partners—the Ministry of Economy, the Ministry of Finance, the National Bank of Ukraine, and Derzhkomstat, the state statistics committee—joined specialists from the Conference Board of Canada and analysts from the International Centre for Policy Studies to identify and discuss the main assumptions underlying the models that will be used to forecast demographic development and potential GDP in Ukraine up to 2050

Evaluating potential GDP

The project is continuing to increase the analytical capacity of Ukraine’s government officials. During the seminars to evaluate potential GDP, participants discussed changes that have taken place in domestic industry and their impact on a recent rise in productivity. They also looked at assessing and calculating fixed assets and forecasting capital needs, and at the impact of social and organizational capital on economic potential.

Separate attention was paid to calculating and forecasting total factor productivity. As a rule, quantitative or qualitative changes in the volumes of labor and capital cannot fully explain a change in GDP or a difference between the levels of GDP in various countries. This is why this function is attributed to total factor productivity.

Although it does not explain anything on its own, research demonstrates its connection to the development of technologies, the quality of management, strong institutions and protection of ownership rights. Significantly, the gap between living standards in rich and poor countries is largely explained by total factor productivity and not by quantitative or qualitative changes in the available resources, that is, labor and capital.

For example, the more secure property rights are, the greater the return on manufacturing factors. Yet a variable like

secured property rights cannot be directly categorized under resources or productivity, so it has to be treated as a variable in the total factor productivity. Thus, property rights protection is viewed as a variable in total factor productivity. In fact, total factor productivity can account for up to 60% of economic growth.

Applied benchmarking

At the same time as these seminars to evaluate potential output, there was a series of benchmarking¹ workshops that took place directly at the Ministries of Economy and Finance. These workshops were dedicated to identifying data sources, standardization methods, and criteria for deciding whether it makes sense to include specific indicators in this analysis. Participants identified some 55 indicators in seven areas (infrastructure, resources and efficient use of resources, economic development, knowledge economy, environment, quality of life, and institutions).

Among the problems project participants said they faced when collecting data is the fact that the most interesting data either comes from surveys that are not regular or is absent for Ukraine. Specifically, two areas were the most problematic in terms of data retrieval: the environment and institutions. Based on the results of this work, participants will prepare a list of

“ideal” indicators that Ukraine should calculate in the future.

At a joint meeting, partners from the Government discussed criteria for selecting countries and identified countries for comparison. The next step in benchmarking will be data standardization and country ranking. Revised results will be used to write the chapter of the analytical report that is being prepared by the Government.

These partners also agreed on the rest of chapters in this report:

- monetary policy for targeting inflation;
- evaluating factors that influence potential GDP (labor, capital and productivity);
- demographic development in Ukraine;
- long-term fiscal forecast.

Long-term forecasts for effective budget planning

A separate seminar was organized at the request of the Ministry of Finance, dedicated to long-term fiscal forecasting. Project participants familiarized themselves with forecast methodology that is used in Canada.

In the Canadian model, Budget revenues and spending needs are forecast separately for each year, proceeding from forecast data on demography, GDP and inflation. The basis for determining revenues is the tax base and tax rates. The tax base is extrapolated using an econometric model. If such a model does not exist, analysts use an empirical method based on the growth of nominal GDP. The forecast is prepared for all key categories of revenues and specific functions are used to calculate each category of tax revenues.

Thus, for example, to forecast personal income tax receipts, analysts use a function of personal incomes, tax credits, tax deductions, and tax rates. For corporate profit tax, the function includes corporate profits, tax rates and so on.

¹ Benchmarking is a method of comparative analysis of indicators, in this case, those of Ukraine and countries that are at various stages of economic development. It is a valuable instrument for developing socio-economic policy and evaluating its impact.

The basis for forecasting the growth of expenditures is the growth of nominal GDP, population growth and inflation trends, or a combination of these factors. Some categories of expenditures are the function of demand for spending programs and the level of allocations for such programs. For example, pension expenses are determined by the number of individuals of retirement age and the size of pensions. The forecast is prepared for all key categories of expenditures.

To forecast expenditures, analysts use separate assumptions. For example, budget policy parameters that are written into the Budget of the current year are unchanged for the next three years. After that, expenditure growth is forecast as the average value of nominal GDP and the

population plus inflation. The forecast for retirement pensions is based on demographic trends and inflation.

Specific assumptions are made to calculate interbudgetary transfers. For example, the Canada Health Transfer (CHT) will grow at 6% per year past the budget horizon—the actual percentage is based on an evaluation by experts—or the Canada Social Transfer (CST) will grow by a change in indicators of the population plus inflation. For example, Canada's Equalization Program and Territorial Formula Financing (TFF) will grow at 3.5% per year past the budget horizon and so on.

The model for financing healthcare expenditures was examined as an example of how Budget expenditures are calculated.

A special feature of the Canadian model is that expenditures are calculated for each age group of the population and for each gender. Ukraine does not have similar statistics. This is why participants discussed the possibility of adapting the model to the Ukrainian Budget system and available statistical data. ■

The "Socio-Economic Performance and Potential Analysis Capacity" (SEPPAC) project is being implemented by the Conference Board of Canada (CBoC) and the International Centre for Policy Studies with funding from the Canadian International Development Agency (CIDA).

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Voter impact on political parties should be stronger

An All-Ukrainian conference called "A Year after the Elections: Challenges to Civil Society" took place on 23 March 2007, organized by the International Centre for Policy Studies, the Ukraine Citizen Action Network (UCAN) Program, the International Renaissance Foundation, the Ukrainian Center for Independent Political Research, the Democratic Initiatives Foundation, and the Ukrainian Helsinki Human Rights Union. The conference brought together NGOs that had analyzed election platforms and monitored the activities of elected bodies and officials, donor organizations, and the press

The goal of this conference was to evaluate how open Ukraine's representative government is and to develop a strategy of joint action to raise the level of accountability of representative bodies. As a matter of fact, a year after national and local elections that were recognized as the most democratic in the entire history of independent Ukraine, the country is facing the same choice again: authoritarianism or democracy. According to Democratic Initiatives Foundation Director Iryna Bekeshkina, public opinion surveys reveal two opposite trends in Ukrainian society. On one hand, Ukrainians think that democracy is the most suitable form of government for Ukraine. At the same time, they say that democracy is functioning at a low level in Ukraine.

On the other hand, other studies show a strong inclination towards political paternalism—the conviction that a strong leader can do more than laws and democratic procedures. Moreover, this

readiness for the coming of a strong leader is typical of supporters of all political forces, without exception, and across all regions.

Conference participants all expressed a commitment to democratic values and intentions to further advance these for the sake of social development. A resolution adopted at the end of the conference set out the main objective: to increase input into the formation of state and local policies in order to entrench the democratic institutions and procedures of direct, representative democracy, to involve Ukrainian voters in the policy-making process at both the national and local levels, and in establishing public oversight of how these decisions are implemented.

According to ICPS analyst Petro Udovenko, the moderator of a working group called "Strengthening the impact of community organizations on the formation and implementation of party policies," one of

the most important aspects of this work will fall on the shoulders of the third sector. The work of NGOs should be focused on raising the capacity of various population groups to influence political parties and their leaders and representative and executive governing bodies in order to establish a mutually beneficial dialog between governments and civil society organizations on an equal footing. This will make it possible for any community organization to increase its own capacity and to more effectively defend the interests of social groups it represents.

Participants in this conference also discussed how community organizations can successfully influence local governments, relations between community organizations and parties at the local level, and state policy for democratizing the electoral system. ■

ICPS has considerable experience analyzing election platforms and monitoring the activities of elected representatives of government bodies and officials. The last project of this kind implemented by the Centre was the "Impact of NGOs on the Formation and Implementation of Political Platforms" project.

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