

MEMU Supplement No. 07-2005

Budget Resolution for 2006: Another "consumption budget" is expected

With a three-week delay Parliament adopted the Budget Resolution for the year 2006 on June 21. According to the Budget Code, a budget resolution is supposed to establish the major budgetary guidelines for the coming fiscal year. The Resolution for 2006 envisages that for 2006 the budget to GDP ratio will remain at the current level of 29.6%. It also sets the ceiling for the fiscal deficit at 2% of GDP, and that of the state debt at 22% of GDP. The major budget indicators, envisaged in the Resolution, are based on a forecast of a 9.5% yoy real GDP growth in 2006. This assumption looks rather optimistic taking into account the current economic slowdown and the stalled investment activity, which is not likely to revive until the second half of 2006.

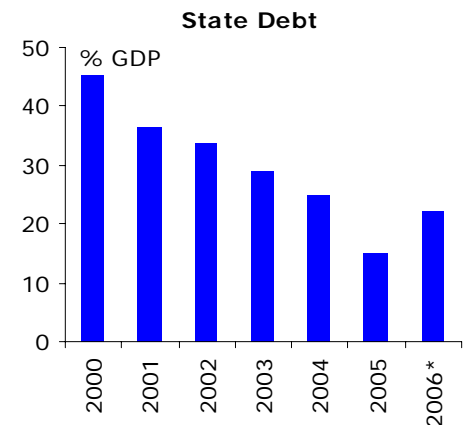
The Resolution foresees a further increase in social expenditures that is likely to entail the same macroeconomic risks as in the current year. In particular, it is envisaged that the minimum wage will further increase to UAH 400 (from UAH 332 scheduled for September 2005) and that the subsistence minimum will rise to UAH 500 (from the current UAH 423). Consequently, the size of the minimum pension, which is linked to the level of the subsistence minimum, will also go up. In addition, it is planned to further differentiate pension payments according to the work record and previously paid pension contributions. All these changes will increase the burden on the Pension Fund, which is likely to run a deficit again, although this is not foreseen in the Resolution. A Pension Fund deficit would have two negative consequences. For the state it will require additional transfers out of the budget. For businesses and households it means that it will be difficult to reduce the high rate of pension contributions (34.3%) paid by employers (32.3%) and employees (2.0%), seen as one of the major reasons for paying wages under the table. Thus, the expenditure side of Budget 2006 is likely to be unrealistic in its social orientation, which reflects the significant political forces on the eve of upcoming parliamentary elections.

Although the Resolution proposes to increase the investment component in the expenditure structure compared to the current year's share, the absolute amount of state investment remains very low compared to the needs of the economy. In addition, the priorities set for public investment are questionable as they include support of specific commercial sectors (e.g. coal mining and agriculture), a dubious move from an economic point of view, which does not promise to improve the efficiency of public spending.

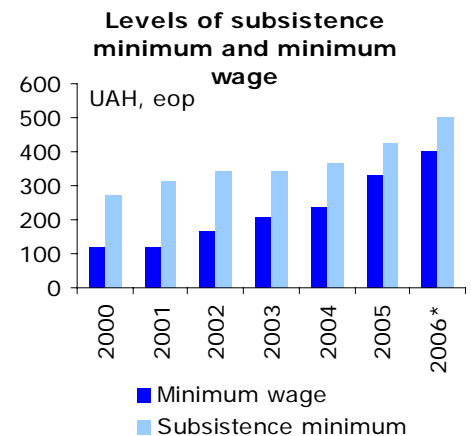
According to the Resolution, the fiscal deficit is to be financed primarily out of privatisation receipts. However, as privatisation is by now a rather exhausted source, it can be expected that the Government will in the end have to increase borrowings at the domestic or international markets.

One distinctive feature of the adopted Resolution is that it sets guidelines of fiscal policy not only for 2006, but also for several years ahead. This can be treated as a positive step towards medium-term budget planning, a common practice of most countries, which provides the economic agents with more certainty about the future fiscal environment. However, the Resolution does not include any time schedules for the execution of the state's fiscal plans. This allows for a high degree of discretion in state decisions, since any of the planned tasks on the long list could be postponed at any time.

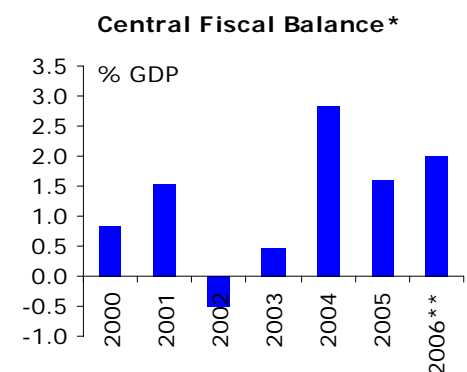
Although the provisions of the Resolution often appeared non-binding during the process of the State Budget preparation and its approval, it can be stated with a high level of certainty that the Budget 2006 will again be a "consumption budget" worsening the prospects for long-term economic growth and fuelling increases in consumer prices in the short-run.



* Ceiling envisaged by the Budget Resolution for 2006
Source: Ministry of Finance



* Levels envisaged by the Budget resolution for 2006
Source: the Ministry of Finance



* Positive number stands for deficit
** Ceiling envisaged by the Budget Resolution for 2006
Source: State Treasury, Law on State Budget for 2005, Budget Resolution for 2006

Authors:
Natalie Leschenko
Oleksandra Betliy
Institute for Economic Research and
Policy Consulting


Quarterly Trends

National accounts **		Q4 02	Q1 03	Q2 03	Q3 03	Q4 03	Q1 04	Q2 04	Q3 04	Q4 04	Q1 05
GDP	UAH bn	63.3	51.5	60.0	75.6	77.1	64.7	79.0	100.5	100.6	-
GDP (real)	% yoy	6.1	8.4	10.0	6.8	12.1	12.7	13.7	14.0	8.5	-
Households consumption (real)	% yoy	11.2	10.2	14.4	11.2	13.6	14.6	16.8	13.1	16.2	-
State consumption (real)	% yoy	2.9	15.0	17.8	19.2	9.0	3.3	1.0	5.0	10.1	-
Gross fixed capital formation (real)	% yoy	5.7	9.0	20.4	24.3	9.0	18.4	6.5	4.6	12.9	-
Exports of goods and services (real)	% yoy	17.0	9.9	9.8	9.8	11.6	18.1	19.9	10.5	8.6	-
Imports of goods and services (real)	% yoy	6.7	13.8	16.2	17.4	17.7	13.8	7.3	6.7	7.8	-
Agriculture, hunting, forestry (real)*	% yoy	1.3	4.0	-13.7	-22.5	6.7	-4.4	0.9	35.7	9.9	-
Manufacturing industry (real)*	% yoy	11.5	12.0	15.4	23.0	20.1	23.9	16.3	12.5	9.4	-
Construction (real)*	% yoy	2.7	18.2	24.8	30.9	16.9	29.9	30.6	16.4	3.9	-
Trade, repair services (real)*	% yoy	3.5	7.2	15.1	22.6	29.6	23.6	35.0	2.7	13.7	-
Transport (real)*	% yoy	11.0	10.0	11.5	15.9	11.7	10.1	8.0	12.3	10.5	-
Balance of payments											
Current account balance	USD bn	1.0	1.1	0.7	0.7	0.4	1.6	2.3	1.7	1.2	1.7
Current account balance	% of GDP	7.9	11.2	7.0	5.0	3.0	13.5	15.5	8.8	6.2	10.8
Trade balance in goods	USD m	225	309	-42	-155	-381	933	1552	774	482	1051
Trade balance in services	USD m	382	387	399	362	409	332	153	377	270	257
Current transfers	USD m	520	500	526	574	584	475	758	720	623	624
Direct investment (FDI)	USD m	300	238	454	390	329	334	614	422	345	231
Portfolio investments	USD m	-520	-825	640	-444	-293	60	-406	781	-511	-114
Gross international reserves	USD bn	4.4	4.6	6.2	6.7	6.9	7.9	9.6	12.1	9.5	13.1
Fiscal indicators											
Consolidated fiscal revenues	% of GDP	28.1	31.6	31.7	30.1	28.6	27.2	26.9	26.3	25.9	32.1
Personal income tax	% of GDP	4.9	5.7	5.7	5.3	5.1	4.4	4.1	3.8	3.8	4.3
Enterprise profits tax	% of GDP	4.3	5.7	5.1	4.8	5.0	3.9	4.0	4.1	6.1	4.8
Value-added tax	% of GDP	6.1	6.2	6.3	5.8	4.8	6.2	5.7	5.1	4.1	8.6
Excise tax	% of GDP	1.9	2.1	2.2	2.1	2.0	2.1	2.1	2.0	1.8	2.0
Consolidated fiscal expenditures	% of GDP	27.3	27.7	29.2	27.9	28.8	25.3	26.5	26.8	35.2	28.3
Current expenditures	% of GDP	na	na	26.3	24.2	24.3	22.4	22.7	21.7	27.2	26.5
Capital expenditures	% of GDP	na	na	3.0	3.7	4.4	2.9	3.8	5.1	8.0	1.8
Consolidated fiscal balance	% of GDP	0.7	3.8	2.5	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7
Privatisation receipts	% of GDP	0.3	0.6	1.0	1.0	0.8	1.5	3.7	3.5	1.0	0.2
Labour market											
Average wage (real)	% yoy	17.7	12.3	19.1	19.9	14.9	19.9	18.6	14.7	15.4	15.0
Household income (real)	% yoy	65.6	-1.2	8.6	10.0	8.7	11.7	16.3	11.3	16.6	24.0
Unemployment rate (ILO methodology)	%	11.1	9.4	8.8	9.2	9.0	9.3	8.3	8.1	8.7	-
Banking system											
Monetary aggregate M0	% yoy cum	35.8	32.4	37.0	30.5	25.3	29.1	25.6	37.1	27.9	28.2
Monetary aggregate M2	% yoy cum	42.2	47.8	54.6	49.9	47.6	45.4	44.8	51.5	32.3	38.9
Household deposits in national currency	% yoy cum	72.5	73.4	74.7	65.0	66.1	69.4	67.3	67.9	26.2	28.3
Household deposits in foreign currency	% yoy cum	59.3	71.2	70.2	70.4	77.5	67.0	61.7	55.2	54.3	51.8
Com. bank credits in national currency	% yoy cum	54.4	63.7	71.2	73.0	61.7	56.8	52.1	44.3	29.4	28.3
Com. bank credits in foreign currency	% yoy cum	40.3	44.1	48.4	57.7	60.9	63.6	56.2	43.5	32.2	33.1
Long-term com. bank credits	% yoy cum	92.5	110.6	156.4	164.0	157.9	141.7	102.7	82.7	57.1	49.5
Long-term com. bank credits	% of total	28.2	31.3	37.4	40.1	45.0	47.4	49.3	50.9	54.2	54.4
Average lending rate on national cur. credits	% p.a.	21.8	18.0	17.2	17.2	17.7	17.2	16.6	17.0	17.6	17.0
Average lending rate on foreign cur. credits	% p.a.	11.3	12.5	12.6	11.7	10.9	12.2	12.1	12.6	12.2	12.1

SOURCES: National Bank of Ukraine, State Committee of Statistics, State Treasury, Ministry of Finance, IER estimates

* change in value added

** preliminary

Notes:
yoy year on year change

p.a. per annum