



# MEMU Supplement No. 1-2006

## The Parliament has adopted the State budget for 2006

The Parliament has approved the Law on the state budget 2006 on December 20, 2005. The central fiscal revenues are planned at UAH 125 bn (24% of GDP), while expenditures are foreseen at UAH 137 bn (27% of GDP).

The central fiscal deficit is planned at 2.5% GDP (UAH 12.9 bn), which could be risky for fiscal sustainability and creates grounds for pushing up inflation. Privatisation receipts of 2005 (primarily, funds received from the repeated privatisation tender for metallurgical plant Kryvorizhstal) are the major deficit-financing source in 2006. Besides, in 2006 the government plans to receive UAH 2.1 bn from privatisation receipts and UAH 1.5 bn from borrowings.

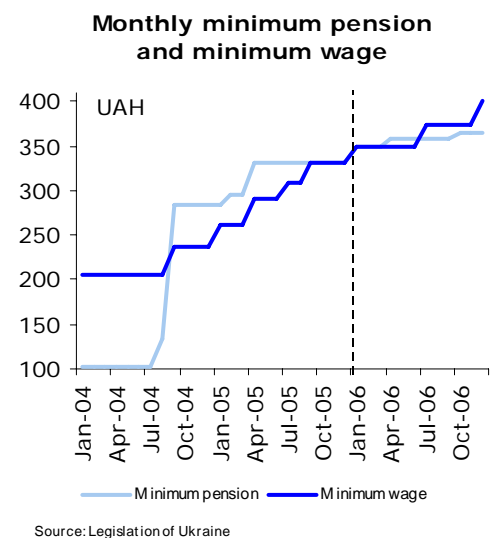
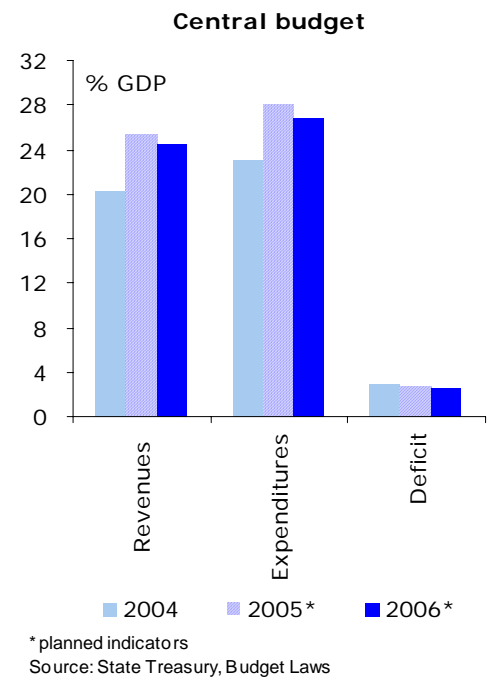
Although fiscal central expenditures in 2006 replicate key features of previous year spending, several important innovations are envisaged. The major *innovation* is a creation of the stabilization fund of UAH 3 bn (0.6% of GDP). However, the absence of the legislation regulating its administration and purposefulness makes the performance of the fund questionable. Also, a reduction of the payroll tax in 2006 is foreseen. The pension insurance contribution paid by employer is reduced by 0.5 percentage points to 31.8%, while unemployment insurance contribution is reduced by 0.3 percentage points to 1.3%. The small drop is rather a declaration of government's intentions than real step towards de-shadowing of wages. Besides, in 2006 the level of pension duty on non-cash currency exchange operations is reduced by 0.2 percentage points to 1.3%.

Social and wage policy of the Government has remained almost untouched, confirming the consumption orientation of the budget. The budget envisages graduate increase in minimum wage and subsistence minimum. The latter implies higher levels of minimum pension, stipends and social assistance payments, which are defined in relation to the subsistence minimum. At the same time, the size of birth grants is fixed at the level of 2005 (UAH 8500) in attempt to partially reduce a burden of social payments.

Due to minimum pension increase and reduction of contributions paid to the Pension Fund, its deficit is planned at UAH 7.3 bn in 2006. The total central fiscal transfer to the Pension Fund amounts to UAH 15.4 bn. Additional transfer at UAH 1.7 bn is foreseen to compensate the losses of the Pension Fund from payment of lower-than-standard pension contribution (6.46%) by payers of fixed agricultural tax. Therefore, the deficit of the Pension Fund as well as the central fiscal transfer remains rather high even though it is lower than in 2005.

There are several drawbacks of the Budget 2006 that hamper fiscal transparency. First, it is an increase in state support of economic activity. Although the Budget Law replaces tax privileges provided to agricultural producers with more transparent direct central fiscal subsidies, violations in budget spending, and sensitivity of the level of state support to lobby groups indicate the restrictive economic justification of such state aid. As before, the Budget Law for 2006 contains amendments to legislation. It envisages rise in rent payment for extraction of natural resources, elimination of loss carry over for 2006, etc. These frequent changes in tax legislation hurts investment climate. Finally, the Budget Law prolongs non-transparent procedure of compensation of Oshchadbank deposits to population that also nets payment arrears to utility enterprises and tax arrears for 2006. This procedure creates grounds for expectations on future write-offs and, thus, has negative impact on payment discipline of both population and utility enterprises.

Summing up, the Budget for 2006 is risky consumption budget. Although it intends to solve some of current problems, no workable mechanisms or serious reforms are included in the Law.



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**Quarterly Trends**

<b>National accounts **</b>		<b>Q3 02</b>	<b>Q2 03</b>	<b>Q3 03</b>	<b>Q4 03</b>	<b>Q1 04</b>	<b>Q2 04</b>	<b>Q3 04</b>	<b>Q4 04</b>	<b>Q1 05</b>	<b>Q2 05</b>
GDP	UAH bn	64.1	60.0	75.6	77.1	64.7	79.0	100.5	100.6	82.5	95.0
GDP (real)	% yoy	4.3	10.0	6.8	12.1	12.7	13.7	14.0	8.5	5.0	3.2
Households consumption (real)	% yoy	8.9	14.4	11.2	13.6	14.6	16.8	13.1	16.2	16.4	14.6
State consumption (real)	% yoy	-18.8	17.8	19.2	9.0	3.3	1.0	5.0	10.1	5.2	2.2
Gross fixed capital formation (real)	% yoy	3.8	20.4	24.3	9.0	18.4	6.5	4.6	12.9	-2.6	-0.9
Exports of goods and services (real)	% yoy	15.3	9.8	9.8	11.6	18.1	19.9	10.5	8.6	0.1	-2.5
Imports of goods and services (real)	% yoy	10.4	16.2	17.4	17.7	13.8	7.3	6.7	7.8	6.6	2.1
Agriculture, hunting, forestry (real)*	% yoy	2.1	-13.7	-22.5	6.7	-4.4	0.9	35.7	9.9	5.9	8.5
Manufacturing industry (real)*	% yoy	8.0	15.4	23.0	20.1	23.9	16.3	12.5	9.4	7.8	3.2
Construction (real)*	% yoy	-1.2	24.8	30.9	16.9	29.9	30.6	16.4	3.9	-5.9	-9.0
Trade, repair services (real)*	% yoy	8.8	15.1	22.6	29.6	23.6	35.0	2.7	13.7	-1.5	-3.2
Transport (real)*	% yoy	7.9	11.5	15.9	11.7	10.1	8.0	12.3	10.5	7.3	6.8
<b>Balance of payments</b>											
Current account balance	USD bn	0.8	0.7	0.7	0.4	1.6	2.3	1.7	1.2	1.7	0.6
Current account balance	% of GDP	6.4	7.0	5.0	3.0	13.5	15.5	8.8	6.2	10.8	3.2
Trade balance in goods	USD m	155	-42	-155	-381	933	1552	774	482	1051	-228
Trade balance in services	USD m	247	399	362	409	332	153	377	270	257	355
Current transfers	USD m	517	526	574	584	475	758	720	623	624	692
Direct investment (FDI)	USD m	156	454	390	329	334	614	422	345	231	355
Portfolio investments	USD m	-592	640	-444	-293	60	-406	781	-511	-114	-86
Gross international reserves	USD bn	4.1	6.2	6.7	6.9	7.9	9.6	12.1	9.5	12.0	13.1
<b>Fiscal indicators</b>											
Consolidated fiscal revenues	% of GDP	28.2	31.7	30.1	28.6	27.2	26.9	26.3	25.9	32.1	35.1
Personal income tax	% of GDP	4.9	5.7	5.3	5.1	4.4	4.1	3.8	3.8	4.3	4.4
Enterprise profits tax	% of GDP	4.1	5.1	4.8	5.0	3.9	4.0	4.1	6.1	4.8	5.9
Value-added tax	% of GDP	6.4	6.3	5.8	4.8	6.2	5.7	5.1	4.1	8.6	9.2
Excise tax	% of GDP	1.9	2.2	2.1	2.0	2.1	2.1	2.0	1.8	2.0	2.0
Consolidated fiscal expenditures	% of GDP	26.4	29.2	27.9	28.8	25.3	26.5	26.8	35.2	28.3	36.4
Current expenditures	% of GDP	na	26.3	24.2	24.3	22.4	22.7	21.7	27.2	26.5	33.6
Capital expenditures	% of GDP	na	3.0	3.7	4.4	2.9	3.8	5.1	8.0	1.8	2.7
Consolidated fiscal balance	% of GDP	1.7	2.5	2.2	-0.2	1.9	0.4	-0.5	-9.3	3.7	1.0
Privatisation receipts	% of GDP	0.3	1.0	1.0	0.8	1.5	3.7	3.5	1.0	0.2	0.6
<b>Labour market</b>											
Average wage (real)	% yoy	21.2	19.1	19.9	14.9	19.9	18.6	14.7	15.4	15.0	19.0
Household income (real)	% yoy	100.8	8.6	10.0	8.7	11.7	16.3	11.3	16.6	24.0	28.0
Unemployment rate (ILO methodology)	%	9.2	8.8	9.2	9.0	9.3	8.3	8.1	8.7	8.7	7.0
<b>Banking system</b>											
Monetary aggregate M0	% yoy cum	46.0	37.0	30.5	25.3	29.1	25.6	37.1	27.9	28.2	39.1
Monetary aggregate M2	% yoy cum	46.5	54.6	49.9	47.6	45.4	44.8	51.5	32.3	38.9	37.4
Household deposits in national currency	% yoy cum	103.6	74.7	65.0	66.1	69.4	67.3	67.9	26.2	28.3	31.6
Household deposits in foreign currency	% yoy cum	55.1	70.2	70.4	77.5	67.0	61.7	55.2	54.3	51.8	45.4
Com. bank credits in national currency	% yoy cum	42.3	71.2	73.0	61.7	56.8	52.1	44.3	29.4	28.3	32.6
Com. bank credits in foreign currency	% yoy cum	37.3	48.4	57.7	60.9	63.6	56.2	43.5	32.2	33.1	36.8
Long-term com. bank credits	% yoy cum	85.8	156.4	164.0	157.9	141.7	102.7	82.7	57.1	49.5	53.0
Long-term com. bank credits	% of total	25.3	37.4	40.1	45.0	47.4	49.3	50.9	54.2	54.4	56.1
Average lending rate on national cur. credits	% p.a.	23.5	17.2	17.2	17.7	17.2	16.6	17.0	17.6	17.0	15.4
Average lending rate on foreign cur. credits	% p.a.	11.9	12.6	11.7	10.9	12.2	12.1	12.6	12.2	12.1	11.0

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