



Victor Maziarchuk

21.04.2014

The state budget of Ukraine: mechanisms for its balancing

Part 5. Proposals for balancing the state budget

In order to ensure the stabilisation of the economic situation in Ukraine and take out a stand-by loan from the International Monetary Fund, the Government of Arseniy Yatsenyuk developed and submitted for approval by the Verkhovna Rada of Ukraine the 'package' of two draft laws: 'On Amendments to the Law of Ukraine On State Budget of Ukraine for 2014' and 'On prevention of financial disaster, and creating the preconditions for economic growth in Ukraine'. On 27 March, 2014, the Verkhovna Rada adopted these laws (they entered into force on 1 April, 2014). The laws provide for the reduction of budget expenditure by **30.5 billion UAH** (2.0 billion euros) by reducing the expenditures related to payment of social benefits to citizens and reducing expenditures for the support of different sectors of the economy of Ukraine.

In order to ensure the continued reform of the Ukrainian economy with effective budget process, the following activities should be carried out:

1. *elimination of the 'abusive tax shelters'*¹ - companies which distort the tax base for the purpose of qualifying for exemption from VAT, income tax, and conversion centres. Implementation of this activity would provide an increase in revenues in the amount of approx. **60 billion UAH** (4 billion euros). In particular, the suggested steps include:

- adequate counteraction of illegal formation and VAT recovery by working with businesses which use 'abusive tax shelters';
- creating the conditions under which conversion of funds would be economically unsound;
- combating illicit trafficking of excisable goods and other goods;
- prevention of incidents of tax evasion using accelerated bankruptcy.

2. adoption by the Verkhovna Rada of Ukraine of the draft law on Amendments to Some Laws of Ukraine regarding the payment of pensions to certain categories of persons - **the elimination of certain types of preferential pensions** provided under separate laws on a preferential basis.

By adoption of the 'stabilization package', which consists of two laws, the Government fulfilled the requirements of the IMF on the cancellation of preferential pensions. However, we consider it necessary to carry out further revision of categories of the population receiving preferential pensions and to cancel them. The implementation of this step would reduce the deficit of the Pension Fund and its coverage with funds from the state budget (87.4 billion UAH, or 5.8 billion euros, allocated from the

¹ 'Abusive tax shelters' - commercial entities, with one or two employees, and with the statutory fund registered in minor amounts. Such firms are created by financial and industrial groups specifically for the implementation of tax minimisation schemes, the legalisation of smuggled or unregistered goods. Through such firms, companies in the real sector of the economy which act as customers, are striving to avoid paying value added tax (minimise liabilities), unjustifiably reclaim VAT from the budget, 'launder' money and convert them into cash. Usually such structures are in operation for one to three months.

state budget to the Pension Fund in the form of subsidies for pensions, allowances and increases in pensions, appointed by various pension plans and coverage of the deficit of the Pension Fund).

3. **Legalisation of salaries** - this can provide additional revenues of roughly 15 billion UAH (1 billion euros).

- revision of rates of contributions to the Pension Fund;
- conducting promotional activity aimed at eliminating the "grey labour market" by raising awareness amongst employers of their obligations to their employees and to the state.
- work of local government representatives in certain sectors of businesses which may pay employees cash-in-hand.

4. The adoption by the Verkhovna Rada of Ukraine of the Law of Ukraine on Amendments to the Tax Code of Ukraine on the introduction of a **tax on inefficient assets** - additional revenues of \$ **3 billion UAH** (1.0 billion euros).

5. Monitoring of compliance with the legislation regarding **transfer pricing**, in particular: the definition of transfer pricing, establishment of mechanisms of tax control over transfer pricing, the determination of the range of operations which are subject to tax control, which will generate **20 billion UAH** (1.2 billion euros).additional revenue

6. **Improving legislation on public tenders**, in terms of ensuring transparency in the tendering processes.² The Implementation of these measures will reduce expenditure through the effective use of funds by roughly **40 billion UAH**, namely by the means of:

- introduction of an electronic system/platform for tendering procurement in the Ministry of Economic Trade and Development ;
- Published data on the website of the State Treasury Service detailing all public procurement with the indication of each public department acting as the buyer and the goods/services purchased if they have a value of over 10,000 hryvnias;
- combating embezzlement of budget funds by avoiding overvaluation of goods and services in tender processes.

7. Adoption by the Verkhovna Rada of Ukraine of the Law on **state support of the coal industry**, providing certain criteria, amounts and conditions of the state support for the coal industry with the phased reduction of subsidies for coal mining enterprises for partial coverage of expenditures related to production costs and increase in budgetary allocations for mine closure and social support for mine workers who lose their jobs due to the closure of mines. This step will provide additional budget **savings** in the amount of approximately **7 billion UAH** (0.46 billion euros).

8. The adoption by the Verkhovna Rada of Ukraine of the Law on the introduction of mandatory commercial metering of heat energy, water and wastewater disposal. This step will provide the tracking of actual consumption of all resources which are consumed and reduce the possibility of distorting the consumption calculations.

9. Introduction of amendments in the law on the formation of the State Register of Capital Expenditures, Investment Projects and Project (Investment) Proposals. It should be provided that the

² On 25 March, 2014, the Verkhovna Rada of Ukraine adopted the Law of Ukraine 'On Amendments to the Law of Ukraine 'On public procurement (regarding the strengthening of procurement transparency concerning the purchase of enterprises), which provides for the extension of this Law on tendering procurement with the use of own funds of public and utility enterprises, and also posting reports on the results of the procurement on the web portal of the authorised body.

exercising of capital expenditure, financing of investment projects/proposals, projects of socio-economic development, national projects or other projects possibly of other names, is performed exclusively after analysis of the feasibility of such costs has been conducted and the project's inclusion in the state register.

10. Reduction of the amount and consolidation of state target programmes. Cancellation of programmes for which funds are not provided for in the state budget and programmes with objectives which do not focus on the innovative development of the economy. A list of such programmes is attached.

For more detailed information, please contact:

Viktor Maziarchuk - viktor.maziarchuk@odfoundation.eu

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