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Ukrainian Economic Policy As A Part Of European Integration

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ABSTRACT

This research is dedicated to the analysis of the core problems Ukrainian economy faces as well as the potential measures of mitigation

Keywords: Economics, Macroeconomic Policy, Fiscal Policy

INTRODUCTION

At the very outset of Ukraine's independence Ukraine has declared the strategic direction of building economic system based on the European example. However 23 years later Ukraine has more of a "semi-feudal economy of central-astern type".

On March 21st, 2014 the political chapter of Ukraine's association with Europe was signed in Brussels. The economic chapter of the agreement that was signed on June 27th, implies deep economic integration between Ukraine and European Union via the general free-trade zone.

The collaboration between European commission and Ukrainian government regarding the strategy of economic transformation should be summarized in the "road map" of reforms in Ukraine. The "road-map" is to outline the changes that need to be implemented in such important directions as prevalence of democracy and transparency of economic relationship.

CURRENT ISSUES OF THE UKRAINIAN ECONOMY AND POTENTIALS WAYS OF SOLVING THEM

Currently Ukrainian economy is described as being in a critical phase. International rating agency Fitch points out a number of serious risks that persist despite the agreements with the International Monetary Fund. However such agreements increase the likelihood of getting access to external funding. They also mandate an implementation of a range of structural reforms that could mitigate the imbalances and potentially help to get rid of the double digit deficit.

In the rating of the countries with the most corrupt economies Ukraine's rank is 144. Similar indicator of the freedom of doing business puts the country as 112 in the list, and as 164 by transparency of tax payments. In the rating of countries by freedom of speech Ukraine is 131st. Most indicators seem to reflect unfavorable tendencies in the country's economy and social life.

External funding could alleviate some of the structurally entrenched problems along with the problems that appeared as the result of the recent events in the country. In order to get access to this funding Ukrainian government needs to focus on reducing the budget deficit to 2.5% of GDP until 2016 and transferring consumer's gas prices to the sustainable breakeven model. Some of these changes have taken their course: the dates of the first gas price increase are announced and the adjustments to the 2014 budget were made on March 14th.

April 1st, 2014 was the date when the law on "Preventing the financial crisis and creating preconditions for economic growth" was enacted. One of the first steps this law stipulates is the increase of the income tax for wealthy Ukrainians. Those, whose annual income exceeds 500 thousand hryvnas will have to pay taxes at a 17% rate, while those who make more than 1M hryvnas a year will have to deal with the rate of 25%.

Another innovation is the introduction of passive income tax, for income from interest, dividends etc.

The minimum taxable income is set at ten times the minimum wage (currently 12180 UAH a year). Thus the tax rate is 15% for income up to 20,706 UAH, 17% for income up to 40,194 UAH, 20% for income up to 88,388 UAH and 30% for income that exceeds the previous threshold.

Some points of the anti-crisis legislation mention double increase of car excise, which together with the aggressive devaluation of local currency will cut the volume of imported cars by an estimate of 30%. One of the few things that can smoothen out the harsh effect of such increase is the cut of the utilization fee.

Experts forecast decrease in demand for high-end imported drugs. This would be a result of the introduced 7% on top of existing 20% VAT for imported drugs. However the new tax will be applicable only to the privileged retirees, whose monthly pension exceeds 10,000 UAH. Such pensions are usually assigned to the retired members of the parliament, state prosecutors, judges and government officials.

The procedure of purchasing imported goods is going to change in July. Currently this is semi-transparent process of ordering the product on international purchasing platforms through one of too many local vendors and receiving it through one of the regular mailing services. In most cases these goods are not going through custom clearance thus, bypassing taxation altogether. According to the new law the taxable price of goods going through custom clearance will be lowered to $150 from $300.

Four days before the first quarter end the current prime-minister Arseny Yatsenyuk insisted on sequester of the 2014 budget. According to the prime-minister if there changes are not implemented default and GDP decrease of 10% were imminent. If the changes are properly implemented the forecasted decrease of GDP would be 3%.

This is the second time in the Ukrainian history that the budget sequester happened. In 2010 under the pressure of IMF Ukrainian government went for the abrupt of budget income and expenses. Back then the expenses were cut by 17B UAH and income was cut by 13.4B UAH. The government sacrificed funding of an array of industrial and regional programs, Pension fund transfers, subsidies to the agricultural sector. The budget income was cut through lowering expectations for VAT proceeds by 10B UAH. The current sequester puts the largest share of the burden on the social class that in actuality requires the most support: retirees and state employed workers.

Minimum wage freeze for state employees will allow Ukraine to save around 6.8B UAH in budget expenses. On the other hand the effect of plummeting demand due to static income and national currency devaluation cannot be discounted as a serious counter-effect. Lack of internal demand will definitely undermine country's resources for economic recovery.

The rest of the social guarantees provided by the government will most likely decrease since minimum wage is considered a basic social standard. The government has a credit of support from the majority of the nation, which would allow it to implement such politically unpopular measures in the short term. It looks like the next year's budget will have to accommodate larger social guarantees as the sentiment will change towards reconciliation of the success of the new policies.

The state is about to cut around 24 thousand employees out of 249 thousand currently employed. The size of the presidential administration, parliament administration and central institutions of executive branch will be cut to what it was in 2001. Regional councils (organizations responsible for implementation of state policies in each region) will be eliminated and replaced by smaller and more optimally structured executive committees. This would provide another source of budget savings. This would also provide certain autonomy in regional regulation and funding, which has been a subject of discussion during the last several years.

Experts claim that Ukraine will not benefit from the free trade zone with European Union, unless the government defeats the shadow economy. The two main statistical bureaus state that the shadow economy could constitutes around 1-3B UAH in unpaid custom taxes, local taxes and under the table salaries.

Just recently the United States International Trade Commission (USITC) has dropped protective import tariffs on Ukrainian steel that has been in action since 2002. This is the first step of such importance that the United States made in the direction of international trade with Ukraine. Prior to that American market was essentially closed to Ukrainian manufacturers. Such support is especially valuable in light of worsening trade relations with Russia and its political satellites.

IMF reports claim that good indicators of agricultural productivity along with relatively stable internal consumption have mitigated the economic drop in fourth quarter of 2013. However nothing has been done to address inherent internal imbalances in Ukrainian economy. Some of the well-known factors, such as annexation of Crimea as well as social unrest and deterioration of political situation in the country have contributed to the drop in consumption and investment outflow. If the effect of these factors is overcome by the end of 2014 export and internal consumption could return in a zone of moderate growth rather fast. Ukraine has all preconditions for this. At this point IMF refuses to issue an official forecast on Ukrainian economy until political situation clears out. The government reports an expected 3% drop in GDP and inflation at around 12%.

CONCLUSION

The economy of Ukraine is in a rather vulnerable position at this moment in time. The reforms that are currently being negotiated and strategized upon are considered to be some of the most important factors in Ukraine's economic recovery. Defeating corruption and shadow economy are among the goals of utmost importance. Some of the ways of achieving these goals include tax policy, administrative reform and support of small and medium sized business.

AUTHOR INFORMATION

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