

**ЕКОНОМІКА ТА УПРАВЛІННЯ НАЦІОНАЛЬНИМ ГОСПОДАРСТВОМ**

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**DEPENDENCE OF UKRAINE'S BUDGETARY POLICY ON POLITICAL CYCLES****ЗАЛЕЖНІСТЬ БЮДЖЕТНОЇ ПОЛІТИКИ УКРАЇНИ ВІД ПОЛІТИЧНИХ ЦИКЛІВ**

**Urgency of the research.** It is important to determine the impact of political cycles on budgetary policy in order to improve budget funding of Ukraine, accelerate reforms and stimulate economic development.

**Target setting.** The assessment of Ukraine's budgetary policy dependence on political cycles is important in terms of regulating the budget performance security and financial stability of the state.

**Actual scientific researches and issues analysis.** Political cycles are the subject of research for a number of scientists among them I. Bardin, V. S. Boyko, D. Buchanan, A. Vdovychenko, R. Wagner, N. Dehtyarova, N. M. Lypko, Y. Mironovich, V. Nordhaus, V. Shevchuk.

**Definition of uninvestigated parts of general matters.** Identification of interconnections and interinfluences of political cycles and Ukraine's budget policy as well as effects of such relations remain insufficient.

**The research objective.** The aim of the article is to determine the dependence of Ukraine's budgetary policy on political cycles.

**The statement of basic materials.** The article reveals the presence of the influence of political cycles in Ukraine on budget policy. The deterioration of the Ukraine's budget deficit and state debt indicators is analyzed. Based on econometric models the author proves an artificial increase in expenditures. It was found that the growth of social protection costs is a major factor of political cycles influence on the economy. The author also relates Inflationary processes before and after the elections to adjustments in monetary policy, which in turn requires coordination of fiscal and monetary policies. The author characterizes the challenges for the budget policy of Ukraine.

**Conclusions.** The main challenge to the fiscal policy now is to settle indicators Ukraine's budget security combined with the financial support of the reforms in the economic and political life, despite the military conflict, shadow economy, the political crisis.

**Keywords:** political cycles; budgetary policy; the deficit; national debt; budget expenditures.

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**Urgency of the research.** In the last ten years the problem of spiraling budget deficit ("budget deficit - National debt - fiscal risks - the budget deficit") in the European Union has become a notable threat. This issue becomes even more relevant for Ukraine due to the financial instability, economic crisis, military operations, the necessity of reforms, etc. The spiral depends on fiscal policy, political

**Актуальність теми дослідження.** Для покращення бюджетного забезпечення України, проведення реформ та стимулювання розвитку економіки важливим є визначення впливу політичних циклів на бюджетну політику.

**Постановка проблеми.** Набуває доцільності оцінка залежності бюджетної політики України від політичних циклів для врегулювання показників бюджетної безпеки та стабілізації фінансової стійкості держави.

**Аналіз останніх досліджень і публікацій.** Питання вивчення політичних циклів є предметом дослідження таких науковців: І. І. Бардина, В. С. Бойка, Д. Б'юкенена, Р. Вагнера, А. Вдовиченка, Н. Дехтярьової, Н. М. Липка, Ю. А. Мироновича, В. Нордхауса, В. Шевчука.

**Виділення недосліджених частин загальної проблеми.** Недостатнім залишається виявлення взаємозв'язків та впливів політичних циклів на бюджетну політику України, а також з'ясування їх наслідків.

**Постановка завдання.** Метою статті є визначення залежності бюджетної політики України від політичних циклів.

**Виклад основного матеріалу.** В статті виявлено наявність впливу політичних циклів на бюджетну політику України. Проаналізовано погіршення показників дефіциту Державного бюджету України, державного боргу. На основі економетричних моделей доведено штучне зростання видатків. З'ясовано, що зростання видатків на соціальний захист є основним чинником впливу політичних циклів на економіку. Інфляційні процеси до та після виборів корегуються монетарною політикою. Це вимагає координації бюджетної та монетарної політик. Охарактеризовано сучасні виклики бюджетної політики України.

**Висновки.** Основним викликом бюджетної політики залишається врегулювання показників бюджетної безпеки України в поєднанні з фінансовим забезпеченням реформ в економічному та політичному житті держави, незважаючи на військовий конфлікт, мінімізацію економіки, політичну кризу.

**Ключові слова:** політичні цикли; бюджетна політика; дефіцит; державний борг; видатки бюджету.

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decisions, government's agreements, voting in the Parliament of Ukraine etc. Scientists from different countries proved the existence of a conscious influence of governments and parliaments on the economy of the state before the election to support the ruling elite in the vote, which is also used in Ukraine.

**Target setting.** The assessment of Ukraine's budgetary policy dependence on political cycles is important in terms of regulating the budget performance security and financial stability of the state.

**Actual scientific researches and issues analysis.** Fundamental studies of political cycles were presented in works of Nordhaus V, who determined that the temporary increase in pre-election budget deficit can reduce unemployment, and encourage electoral support. In the interpretation of J. Buchanan and Wagner, provided bounded rationality there is a "fiscal illusion" that allows to enlist the support of myopic voters and thus increase the likelihood of re-powering of elites [4, p. 49].

V. Shevchuk [7] considers political cycles in Ukraine's economy in terms of unemployment rates and GDP, money supply, budget balance, current account balance, purchase and sale of foreign currency and determines the impact on the industry. Thus he proves that the elections in Ukraine are accompanied by deterioration in the budget balance and the increase in money supply.

N. Dehtyarova determined the impact of political cycles in Ukraine on capital inflows. Financing the budget deficit at the expense of issue bonds from internal loan we naturally expect a subsequent increase in interest rates that provided an undervalued exchange rate can be a strong incentive for capital inflows.

V. Boyko [3; 4] distinguishes inflation as the most important factor and the result of political cycles. I. Bardeen [2] identifies correlation with changes in interest rates. Y. Myronovych, N. Lypko reveal the influence of political cycles on foreign trade balance in Ukraine.

**Definition of uninvestigated parts of general matters.** Identification of interconnections and interinfluences of political cycles and Ukraine's budget policy as well as effects of such relations remain insufficient.

**The research objective.** The aim of the article is to determine the dependence of Ukraine's budgetary policy on political cycles. To achieve this goal it is necessary to perform the following tasks: to find out the availability of the influence of political cycles in Ukraine, to identify the impact on budget policy, to describe consequences.

**The statement of basic materials.** Scientists deduced the importance of taking into account the political cycles in fiscal policy of the state and their impact on the budget component. Thus, the political cycle (political-economic cycle, the political business cycle) is defined as a cycle of political activity of government and elected bodies in the period between elections. It affects the price volatility, income, employment and is reflected in changes in GDP, inflation, budget deficit, the money supply, the volume of budget transfers and more.

Before the elections the government consciously increases the State budget's deficit which leads to the jump of inflation after the elections. Therefore, anti-inflation and deficit reduction policies are held after the elections resulting in slowing down the GDP and increase of unemployment. To achieve their goals government uses fiscal and / or monetary instruments for fast changes in the economy, that eventually can stop the reforms and slow down countries output from the crisis. K. Rogoff [10, c. 21-36] emphasizes that if voters are rational enough, fiscal policy has a greater impact on the political cycle than the manipulation with monetary indicators.

Data In figure 1, illustrates the elections' impact on the basic indicators of Ukraine's fiscal policy (inflation and unemployment).

As we can see the inflation has increased after the elections of 2004, 2006, 2007, 2014. The exceptions were 2010 and 2012 years when deterrent and CPI adjustment monetary policies were applied. Regarding the registered unemployment rate, the highest fluctuations were related to the financial crisis more than to the political cycles.

Having applied the estimative modeling of interdependencies among Ukraine's government deficits and indicators such as GDP, CPI, unemployment rate, we confirmed that the variable factors of un-

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employment are actually insignificant.



**Fig. 1. The consumer price index (CPI) and unemployment rate in Ukraine by years 2003-2015 ,% \***

\*Source: drawn by author on the basis of the data from NBU. Hereinafter, Pr - presidential election, Par - elections to Verkhovna Rada of Ukraine (Ukraine's parliament)

In the model above indicators are variables, deficit is dependent, others are resulting. Before the interpretation of results the model was tested for a number of potential problems associated with the time-sensitive data. Thus the gathered series satisfy all prerequisites for a quality model, normal distribution, stationary, autoregression (lack thereof), number of observations (2002 - 2016, quarterly) all of these ensure the representativeness of the sample. Correctness of functional form was tested with RESET - test.

$$y = -0.31 + 0.05X_1 - 130X_2 + 549X_3$$

t                      (2.59)    (1.69)    (0.47)

where y is a deficit,  $X_1$  – GDP,  $X_2$  – CPI,  $X_3$  – unemployment rate

Coefficient of determination adjusted and F - statistics of the model are as follows: 59% to 29,16. This indicates high explanatory strength of the model and its validity (F-statistics). However, t-statistics for the unemployment variation rate is insignificant (less than 1.67). We could assume multicollinearity, but according to VIF-test value of any variable does not exceed the permissible level of 4. Thus, the registered unemployment figures are not significant for the budgetary policy and political cycles in Ukraine.

In our study, the goal was not in proving the existence of political cycles, but in the assessment of their impact on fiscal policy. We consider the growth in expenditures (especially of social orientation) to be the result of the impact. At the same time politics declared the tax burden reduction, simplification of administration so we had to focus our attention on the evaluation of the deficit figures, expenditures growth and Ukraine's debt.

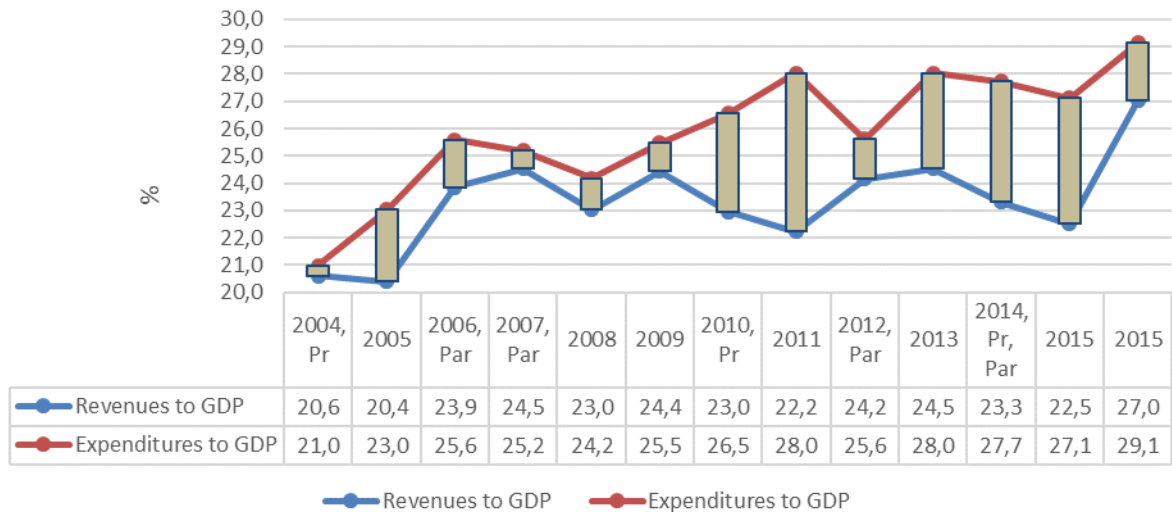
M. Mink and J. de Haan found that the budget deficit for the EU countries in 1999-2004, has been increasing in the years of parliamentary elections. [9] In contrast to European experience political cycles in Ukraine are attached to the presidential elections (Fig. 2).

As we can see, immediately after the presidential elections comes the narrowing of the gap between expenditures and revenues in order to settle monetary growth, inflation and public finances in general.

Despite the financial crisis, the highest gaps were observed during the presidential elections of 2004 and 2010. It should be noted that the solutions for these trends remained the same, even tradi-

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tional in a few quarters after every elections. The implementation of election slogans and repayment of possible political dependencies on oligarchic financial-industrial groups, are inherent rules in Ukraine.

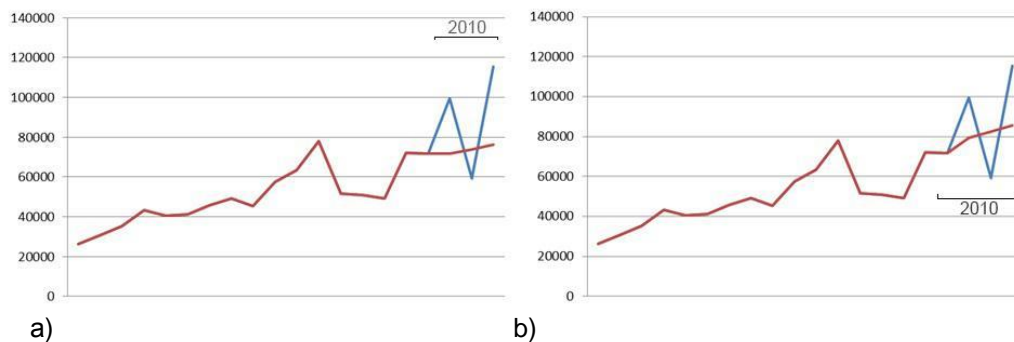


**Fig. 2. Revenues and expenditures of the State Budget of Ukraine's to GDP in 2003-2015,% \***

\* **Source:** drawn by the author on the basis of reports of the State Treasury Service of Ukraine and the State Statistics Committee (GDP) on the implementation of the State Budget of Ukraine

By means of econometric methods, including regression model, we estimated expenditure indicators of the State Budget of Ukraine in 2002-2016, identifying the largest artificial impact on them in 2010. Therefore, having modeled the figures by the method of moving averages, we obtained the following values in mln.: 71577.82, 73960.72, 76343.61 for the last three quarters of 2010, respectively.

At the same time, the actual values were as follows 99414, 59167.9, 115420.3. By applying the trend extrapolation method having smoothed out the latest values we obtained the modeled values: 79307.07, 82373.06 and 85439.05, which also confirm extraneous nature of such interventions.



**Fig. 3. Change of the State Budget of Ukraine expenditures complemented with the data modeled by the methods of moving averages (a) and extrapolation of the trend (b) in 2006-2010, mln. \***

\* **Source:** drawn by author based on the National Bank of Ukraine (NBU) data

It is also necessary to take into account the reasons for the sharp increase in expenditures, particularly in the growth or decline of the economy (for countercyclical policy) and inflation. We decided to include these indicators for our next model basing on years 2002-2016, quarterly data. If the hypothesis of the outside influence (interventions) caused by the election is confirmed, the impact expenditures variable on GDP will be negligible. To test this we need to smooth anomalous values caused by

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by cycles, simulating a "perfect" case where no cycles are observed.

The model:

$$y_t = 29879.35 + 3.17 X_1 + 87 X_2$$

t                    (13.69)    (2.19)

Where "y" - GDP, "x1" - expenditures, "x2" - consumer price index.

As shown in the model (ideal case) expenditures do not pose significant impact and there are no reasons for their increase, thus we state that their growth reflected in actual data is artificial.

It is important to assess the trends of expenditures growth. As reflected in Table 1, most expenditures share belongs to social welfare (we estimate expenditures from the Consolidated Budget of Ukraine, since almost the entire amount is provided from the State Budget and transfers to local budgets). Within the article we'll Evaluate the years of major changes and elections.

Table 1

**Expenditures on social welfare and social standards indexes in Ukraine (2003-2012),%\***

Indexes	Years									
	2003	2004, Pr	2005	2006, Par	2007, Par	2008	2009	2010, Pr	2011	2012, Par
The share of social sector expenditures in the Consolidated Budget of Ukraine	52,37	51,20	60,46	56,56	55,41	57,08	61,95	63,69	60,31	60,71
The share of expenditures on social protection and social welfare in the Consolidated Budget of Ukraine	17,09	18,83	28,19	23,60	21,46	23,95	25,63	27,67	25,29	25,45
The share of expenditures on social protection and social welfare in GDP	4,85	5,60	9,05	7,61	6,73	7,81	8,62	9,66	8,10	8,89
Average minimum wage growth rate per year	103,93	105,51	108,82	103,70	104,66	105,38	106,08	106,70	102,12	103,22
Average minimum pension growth rate per year	103,60	100,00	241,00	102,49	102,97	105,06	100,00	111,01	102,10	102,33

\* **Source:** drawn by the author based on the reports of the State Treasury Service of Ukraine, the State Budget of Ukraine and the Law on the State Budget of Ukraine for the year (social standards)

Since 2004 the share of expenditures for social protection and social security starts growing. In 2005, fulfilling election promises, the government dramatically increases social standards. Thus, starting from 1.01.2005 pension has increased by 6.64 times comparing to December 2004, while the minimum wage increased only by 10.5%. The head of the IMF delegation Albert Meger called the increase in pensions expenditures from 9 to 16% of GDP in just four months (comparing to september 2004) the "world record" [7].

The expenditures growth occurred despite State Budget of Ukraine deficit rising from 429.1 million. UAH in Q2 2004 to 6748.6 mln. at the end of the year. This led to the growing trend of significant deficiency of the State Budget of Ukraine and the Pension Fund. However, despite the crisis, the situation with unreasonable social benefits growth repeated in 2010. The share of social protection and social welfare increased again to 9.66% of GDP (in 2010 - 9.05%). The growth in minimum wages and pensions beset the second place within the study period since 2005.

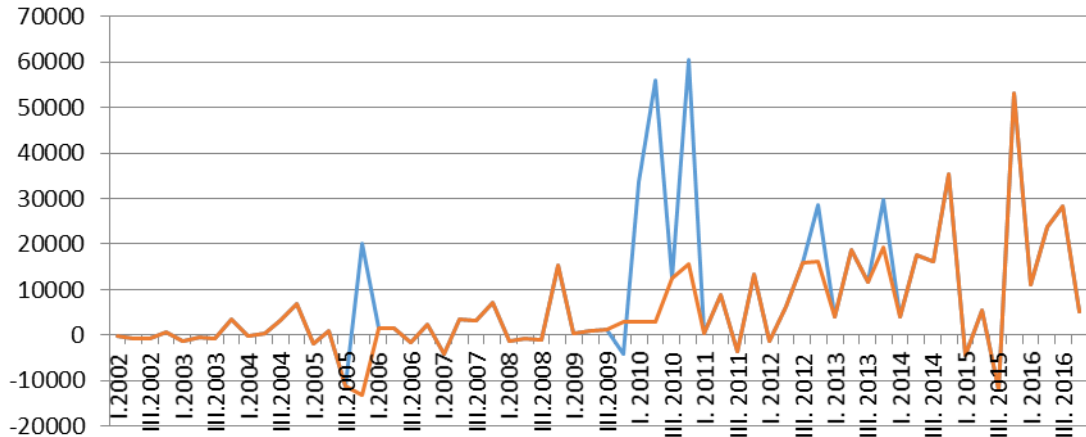
The growth of expenditures for social protection requires increasing funding. Over the studied years all governments determined tax reduction as a trend of tax policy. This is also true for the course of political cycles. Therefore, we assume a hidden financing of the budget, and its deficit by NBU (by means of funds raised from issuing government bonds).

The main drawback of the abovementioned policy for years studied is that expenditures were rising



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faster than GDP. Therefore we decided to analyze fiscal deficit of Ukraine by means of data modeling. According to the rules of modeling extreme values should be flattened, it should be noted that they occur in the periods of elections. Comparing the built model with the official values we get offsets which we assume to be artificial (Fig. 4).



**Fig. 4. Quarterly changes in the State Budget of Ukraine deficit in 2002 - 2016, with data modeled by method of trend extrapolation, mln. \***

\* **Source:** drawn by the author based on the reports of the National Bank of Ukraine

As a result (Tab. 2), Ukraine’s state budget deficit and National debt grow and fiscal indicators exceed regulatory norms of budgetary safety: the deficit in 2010 - 5.8%, in 2014 - 4.6%; National debt in 2014 for the first time in the history of the state has exceeded threshold of 60%.

Table 2

**State budget deficit and National debt of Ukraine comparing to GDP,% \***

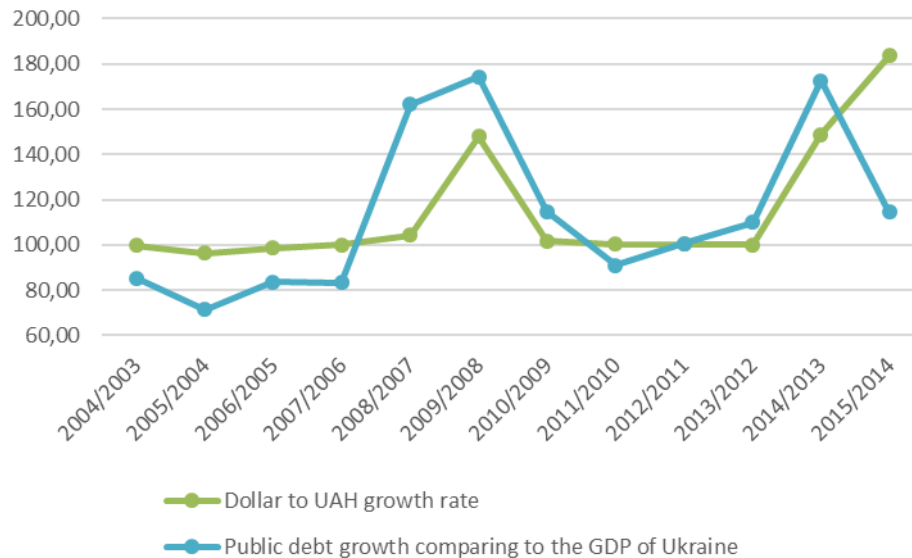
Indexes	Years												
	2003	2004, Pr	2005	2006, Par	2007, PAR	2008	2009	2010, Pr	2011	2012, PAR	2013	2014, Pr, Par	2015
The deficit to GDP at norm of 3%	0,4	2,6	1,7	0,7	1,2	1,0	3,6	5,8	1,4	3,5	4,4	4,6	2,1
National debt to GDP at norm of 60%	29,0	24,7	17,7	14,8	12,3	20,0	34,8	39,9	36,3	36,5	40,2	69,4	79,4

\* **Source:** drawn by the author based on the reports of the State Treasury Service of Ukraine (on the implementation of the State Budget of Ukraine), Ministry of Finance of Ukraine (debt) and the State Statistics Committee (GDP)

However, scientists consider reducing the debt indicator for Ukraine [1], in particular to the level of 30-40%. The growth of public debt led to the growth of macroeconomic risks. This leads to a deterioration of the country’s credit ratings and domestic economy investment potential. Therefore, inevitable prerequisite to settle budgetary security index is a balanced monetary policy. An evidence of this is that the growth of public debt Ukraine is tied not only with fiscal policy but also with the devaluation of the hryvnia in 2008-2009 and 2013-2015, respectively (Fig. 5).



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**Fig. 5. Dollar growth rate and public debt growth comparing to the GDP of Ukraine 2003-2015,% \***

\*Source: drawn by the author based on the reports of the National Bank of Ukraine Ministry of Finance of Ukraine and the State Statistics Committee (GDP)

Over the last ten years, the national currency devalued from 4.5 to 27 UAH for 1 USD. The devaluation of the hryvnia also depended on political cycles. Thus, the devaluation of the UAH after the elections in the 1990s affected the expectations of voters in the 2000th and prompted them to buy dollars before the elections. Therefore before the elections the government held the impression of the Ukraine's economy stability by applying the factors of fixed exchange rate and reduced foreign exchange reserves. Generally before the elections a low interest rate increases the total lending amount, facilitates the financing terms for the growing budget deficit. And the rate's increase after the elections aiming to lower the inflation threatens stagnation of the real sector, reduction of budget revenues and again deficit's growth. This demonstrates the need for coordination in the areas of fiscal and monetary policies.

In addition to using market instruments to inhibit the inflation, the government repeatedly applied the administrative regulation of prices. P.-R. Agenor and K. Asilis proved theoretically that the government might be interested in enhancing price control prior to the election campaign and in a very contrastive manner renounce it after the elections [8, p. 131-142].

The main disadvantage of political cycles is that the alternation of expansive and restrictive changes in fiscal and monetary policy does not allow to carry out adequate political and economic reforms. Such situation was typical for Ukraine, especially during the years of "permanent election".

National development strategies were developed twice since the declaration of Ukraine's independence - by President Yanukovich V. F. (2010) and Poroshenko P. O. These programs presumed systematic changes in all spheres, including the reform of the financial sector in Ukraine. However a separate budget allocation strategy for Ukraine was never elaborated. In February 2017 the government considered "The Strategy of Public Finances management reforming for the years 2017-2020". In 2016 the Ministry of Finance for the first time in the modern history of Ukraine issued budget policy guidelines for 2017 which approved indicators of limiting the deficit of State Budget of Ukraine debt in 2018-2019 years. For the first time debt reduction and restoration of financial stability of Ukraine were legislated as a strategic goal of National finances.

However, the problem of meeting these indexes remains. 20 governments have been in power for the last 25 years and today political scientists actively discuss possible early elections to the Verkhov-

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na Rada of Ukraine in 2018. We should state that frequent change of governments does not allow the continuity of policies, elaboration and enacting development of strategies.

The political cycle of presidential elections in Ukraine comes to its end. Therefore political management of the state is expected in terms of military conflict, financial instability, significant level of shadow economy, deterioration of infrastructure (at the end of 2016 for the first time since the military conflict started we could see a real GDP growth) to liven up economic growth, implement deep reforms in health, education; positively complete the police and defense reforms, activate decentralization and regulate social welfare of various social groups. It should be emphasized that these reforms are not short term, their implementation should take at least three years. Although voters expect results today. Minimum wages have raised by 2 times in 2017 comparing to December 2016. But today more than ever voters await implementation of the proposed reforms and positive outcome of the military conflict.

**Conclusion.** Political cycles are active factor influencing the budget policy of Ukraine. The impact on fiscal policy is implemented by means of inappropriate growth of State Budget expenditures (predominantly for the social protection) without correlation to economic situation. Such actions increase the budget's deficiency and public debt. In contrast to the European experience, political cycles in Ukraine are related to the presidential elections. At present stage Ukraine has developed budgetary policy strategy and proposed a clear definition of key reforms, finally government has introduced medium-term planning. But the main challenge remains within the compliance of the Ukraine's budgetary security indexes with simultaneous ensuring of financial reforms in economic and political life, despite the military conflict, shadow economy and the political crisis.

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