



# **The impact of the global financial crisis on public service delivery in economies of the former Soviet Union: case of Ukraine**

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# Content

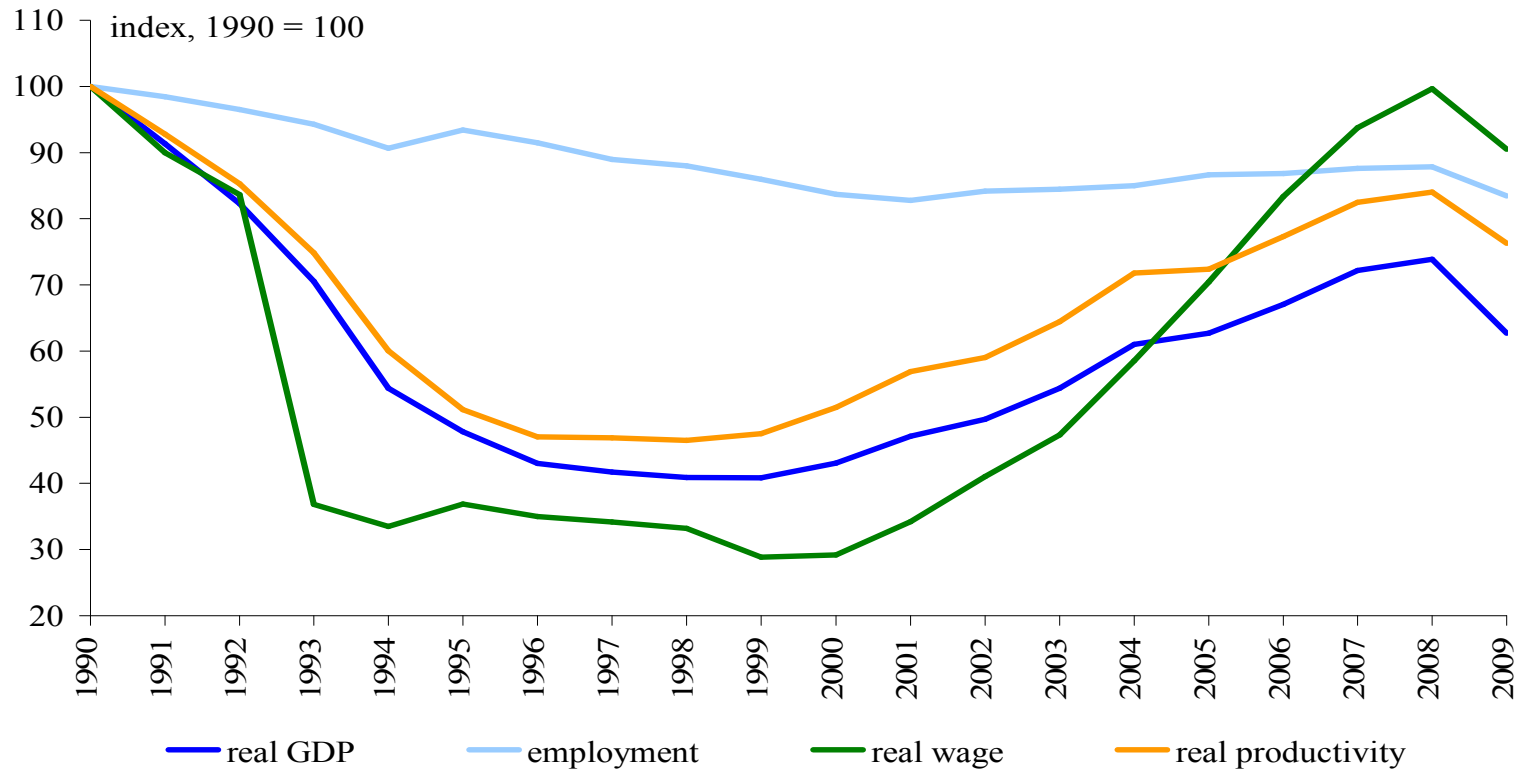


1. Fiscal situation
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# Fiscal situation: Economic growth between 2000 and 2008



## Real GDP, employment, and real wages in Ukraine



Source: Lars Handrich, Oleksandra Betliy: Vor dem Kollaps. Die Sozialsysteme der Ukraine, in: Manfred Sapper, Volker Weichsel (Hg.): Schichtwechsel. Politische Metamorphosen in der Ukraine. Berlin 2010 [OSTEUROPA 2-3/2010]

## **Fiscal situation: Major fiscal policies between 2000 and 2010**



Budget Code (2001) – clearly define budgeting procedure, however:

- centralized budgeting system;
- no medium-term expenditure framework (corrected in 2010 amendment);

Pension system (2003) – PAYG, mandatory fully funded second pillar, and non-state voluntary pension funds (the third pillar);

EPT and PIT tax cuts in 2004:

- EPT cut down to 25% (from 30%);
- PIT was transformed into flat 13% (later 15%) from progressive taxation system;

## **Fiscal situation: Major fiscal policies between 2000 and 2010 (2)**



Privileges to special economic zones were eliminated and different VAT exemptions were abolished (2005);

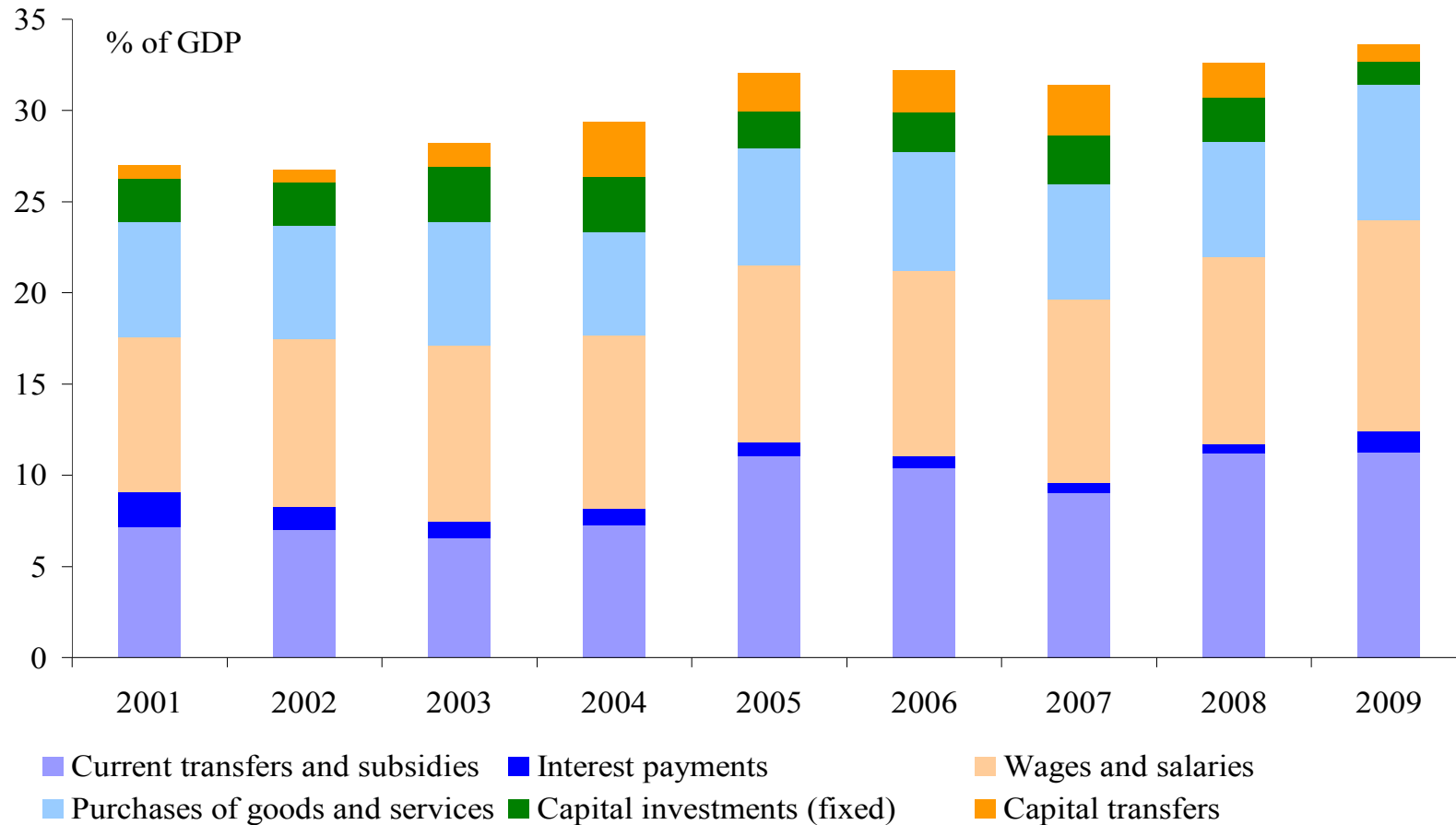
VAT refund problem (worsened after eliminated fees on over-due payments in 2005);

Tax Code 2010 (tightened administrations instead of codifying exercise);

# Fiscal situation: Consumption oriented budgets



## Consolidated fiscal expenditures by economic classification

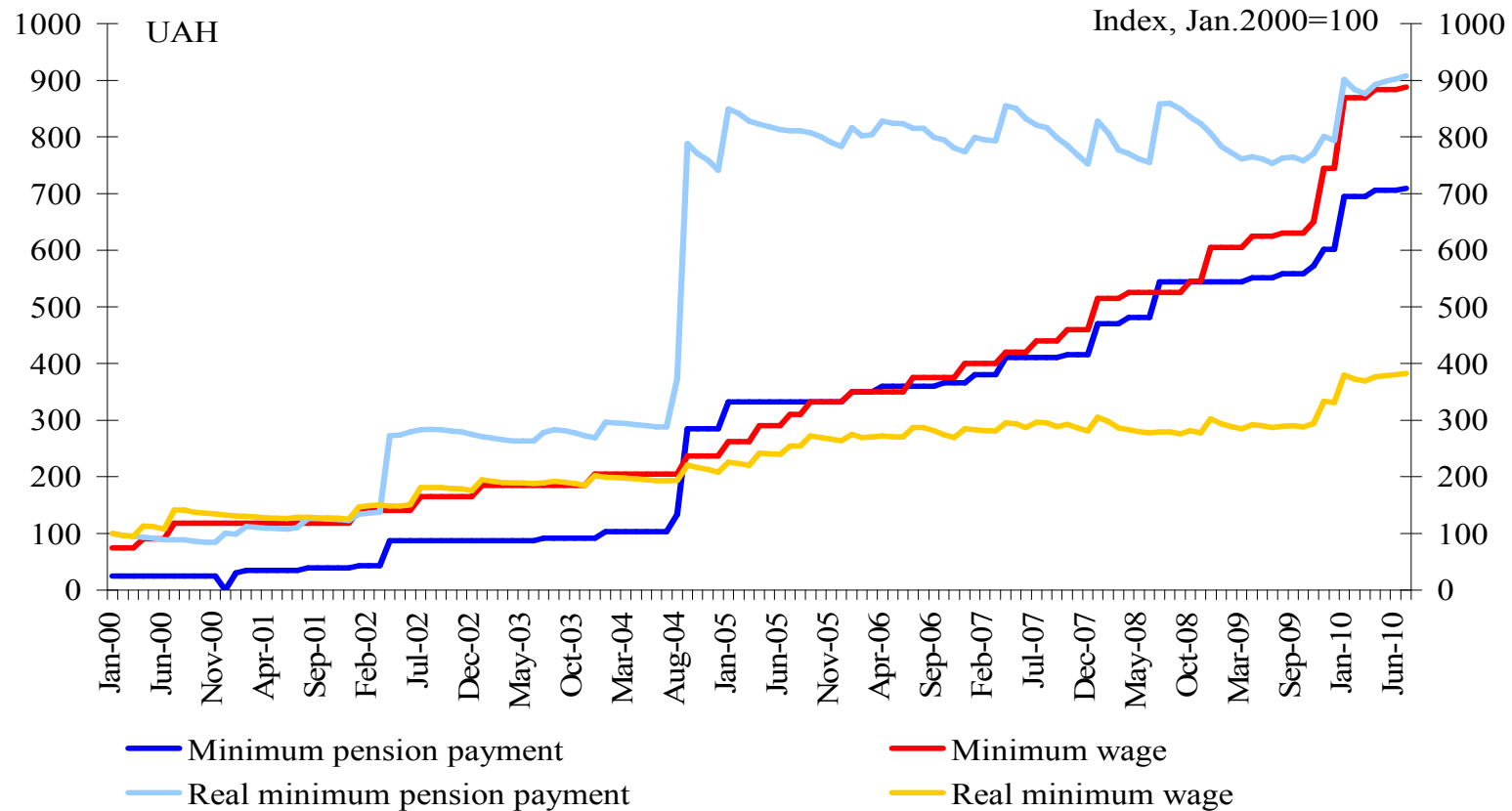


Source: State Treasury Reports

# Fiscal situation: Consumption oriented budgets (2)



## Minimum social standards

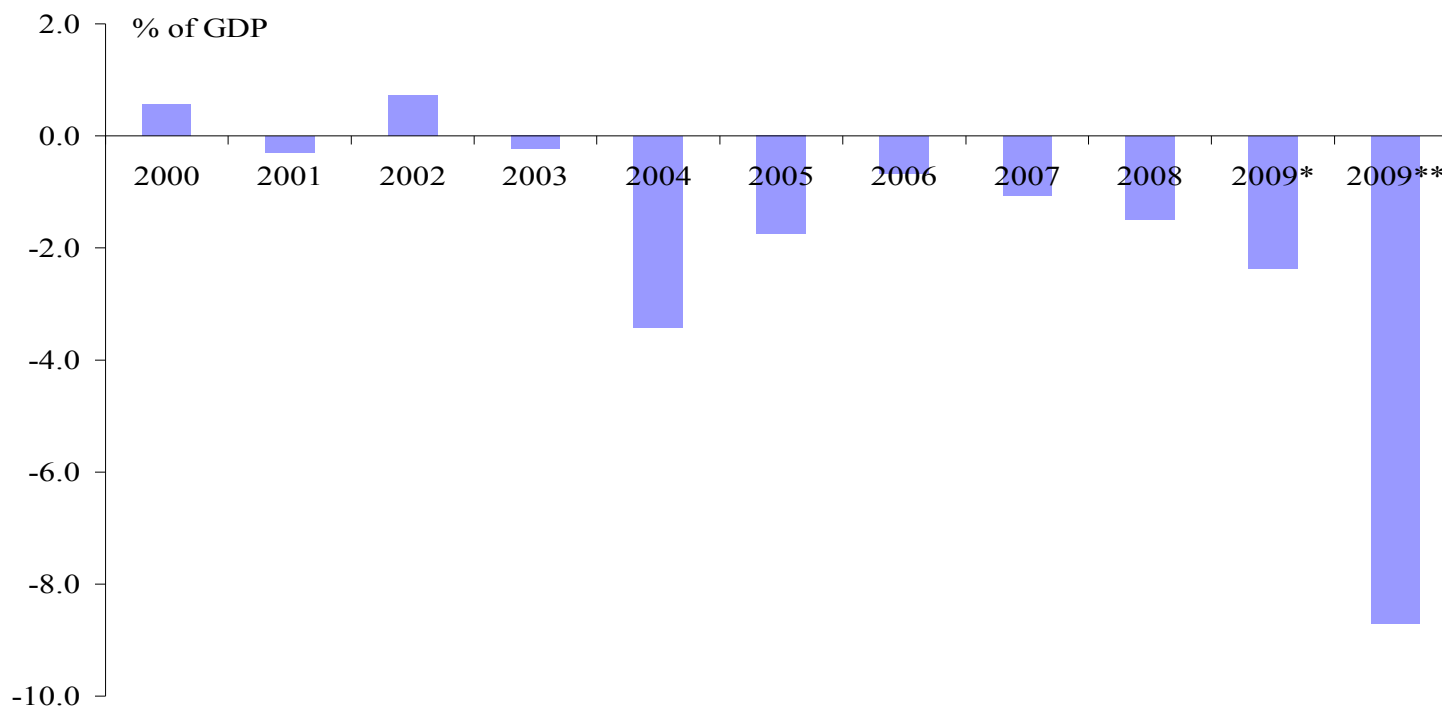


Source: Ukrainian legislation, own calculations

# Fiscal situation: Fiscal deficit



## Consolidated fiscal deficit



Notes:

\* In 2009 the consolidated fiscal deficit was at 2.4% of GDP as reported by the State Treasury. This level does not include banks recapitalization and short-term loans provided to the Pension Fund.

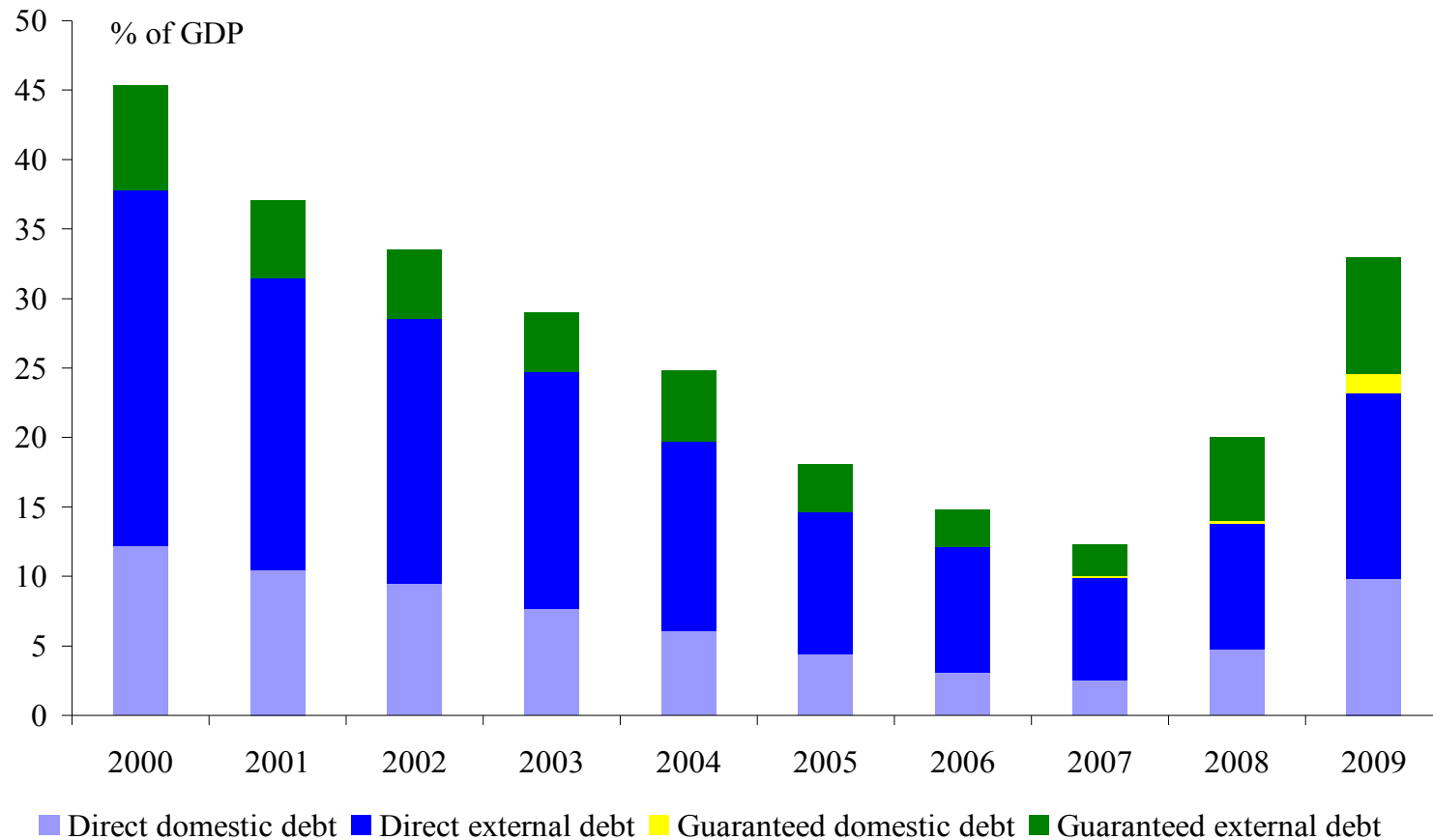
\*\* According to the estimates of the Ministry of Finance, the consolidated fiscal deficit in 2009 was 8.9% of GDP if the loans provided to the Pension Fund are included.

Source: State Treasury Reports



## Fiscal situation: Fiscal deficit (2)

### State debt, end of year



Source: Ministry of Finance

## Fiscal situation: Local budgets



Local fiscal revenues accounted on average for 13.0% of GDP and more than 40% of consolidated fiscal revenues between 2000 and 2008.

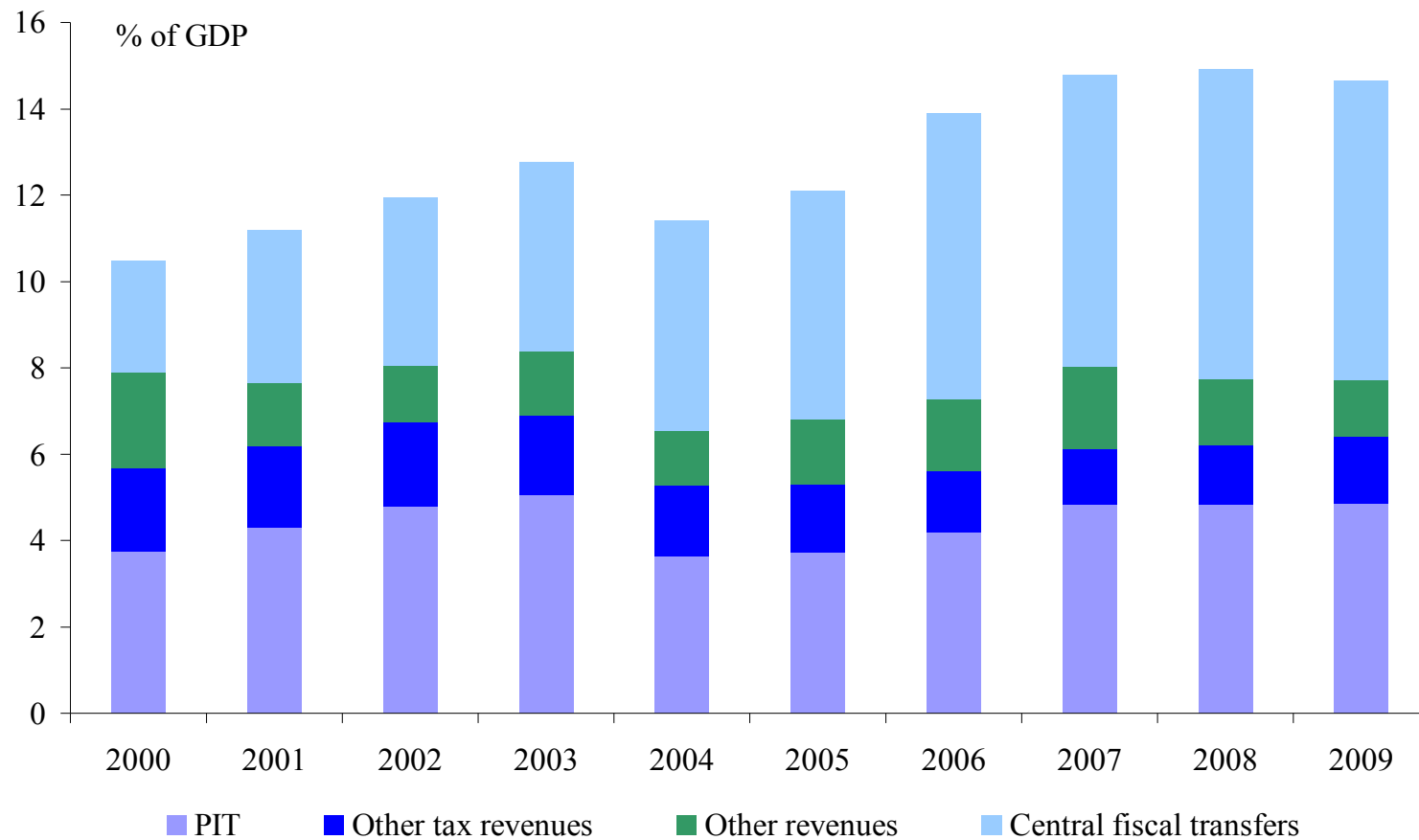
Financing education, health care, culture and social protection account for near 70% of total local fiscal spending.

The major part of local fiscal revenues comes from central fiscal transfers.

Another essential source of financing local budgets are revenues from the personal income tax (PIT)

# Fiscal situation: Local budgets (2)

## Structure of local fiscal revenues

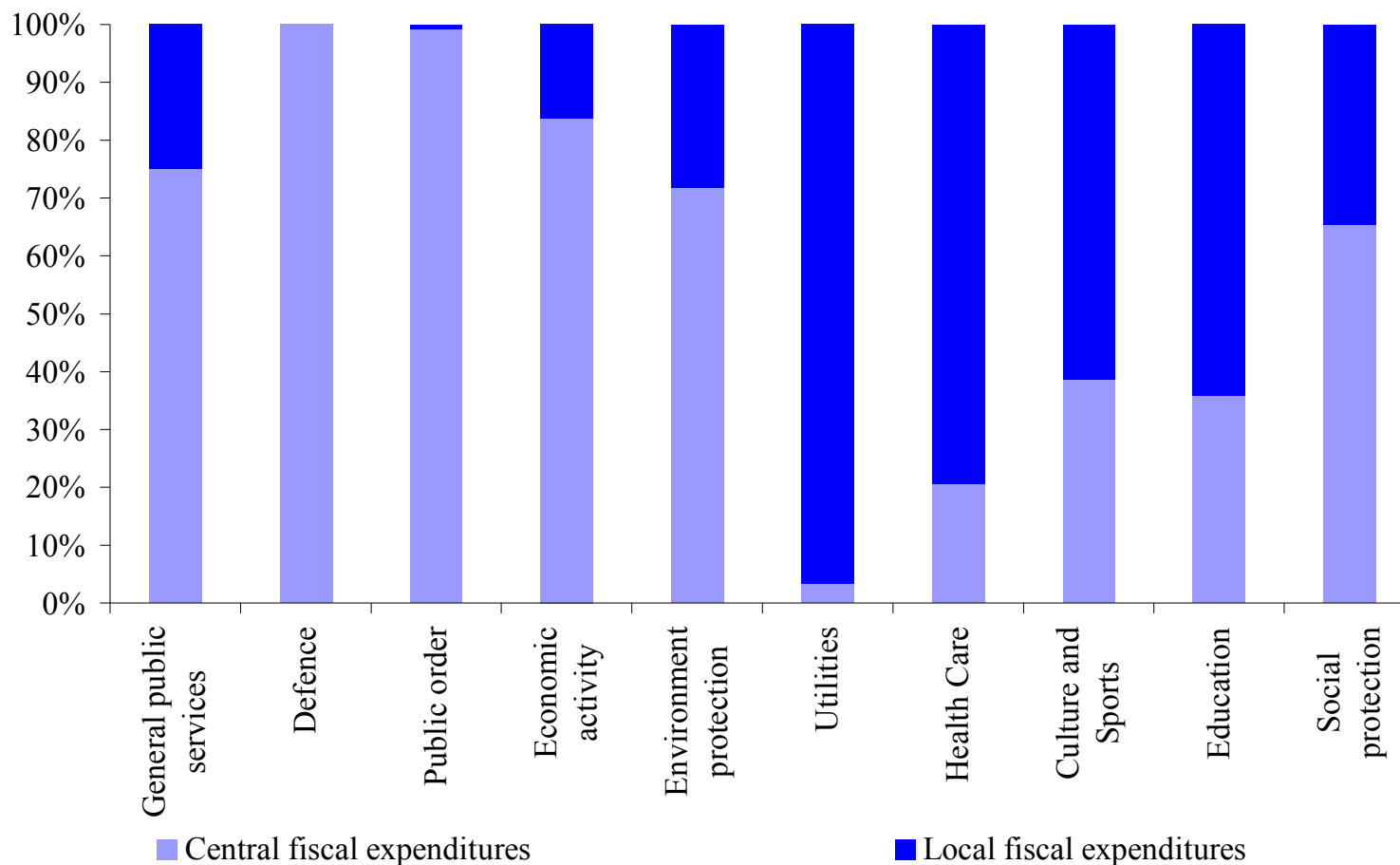


Source: State Treasury Reports

# Fiscal situation: Local budgets (3)



## Fiscal expenditures by source of financing in 2009



Source: State Treasury Reports

# Fiscal performance during the crisis

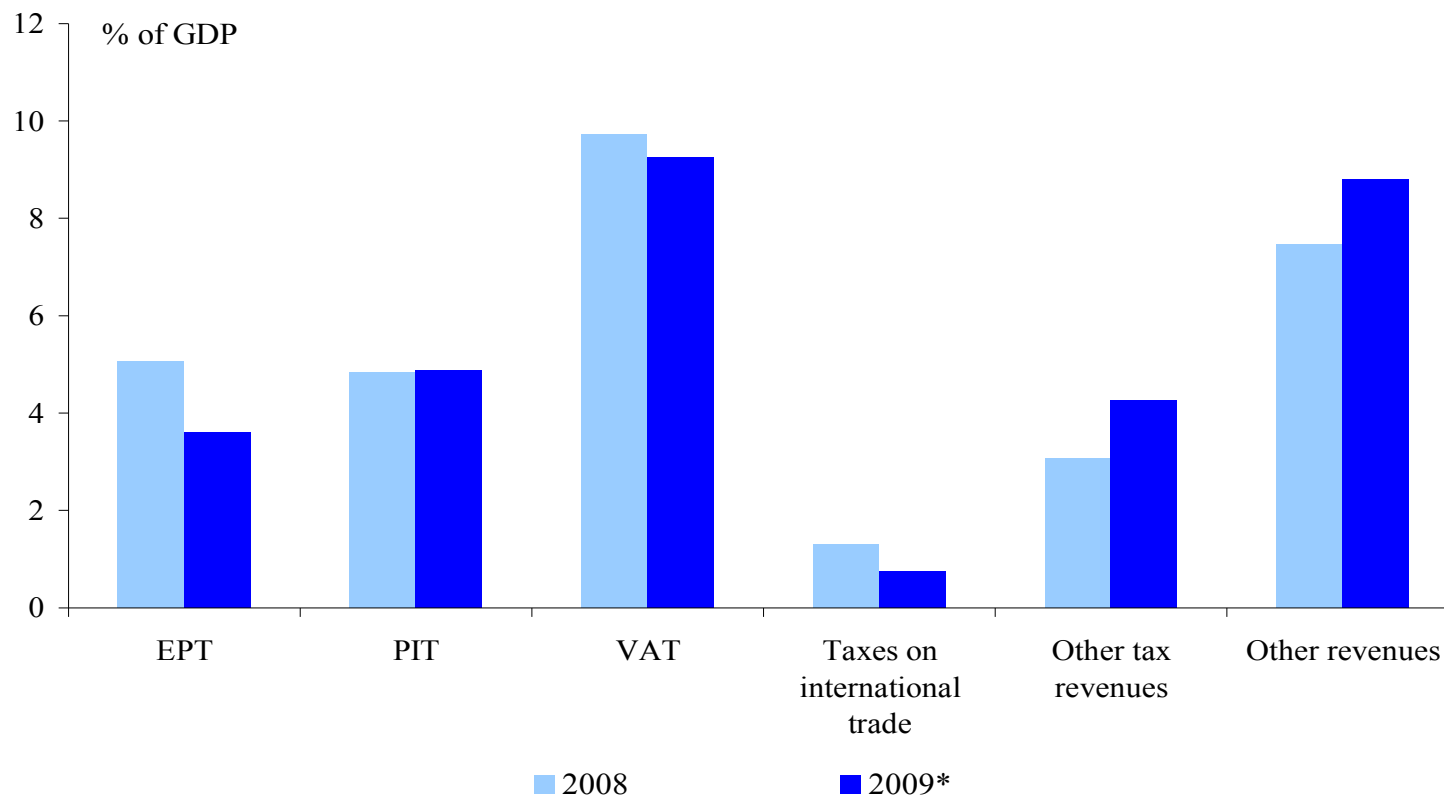


1. Falling tax revenues (despite advance payments and growing VAT refund arrears);
2. Growing non-tax revenues (funding from the Central bank, direct budget support from IMF);
3. Banking system recapitalization;
4. Naftogaz statutory fund increase with T-bills;
5. Drop in capital spending (except Euro 2012 funding);
6. VAT-bonds in 2010;
7. Gas tariffs increase in August 2010;
8. Retirement age increase (only as a plan);
9. Sharp increase in public debt (43.5% GDP, April 2011 vs. 12.3% GDP in 2007)

# Fiscal performance during the crisis (2)



## Consolidated fiscal revenues in 2008 and 2009



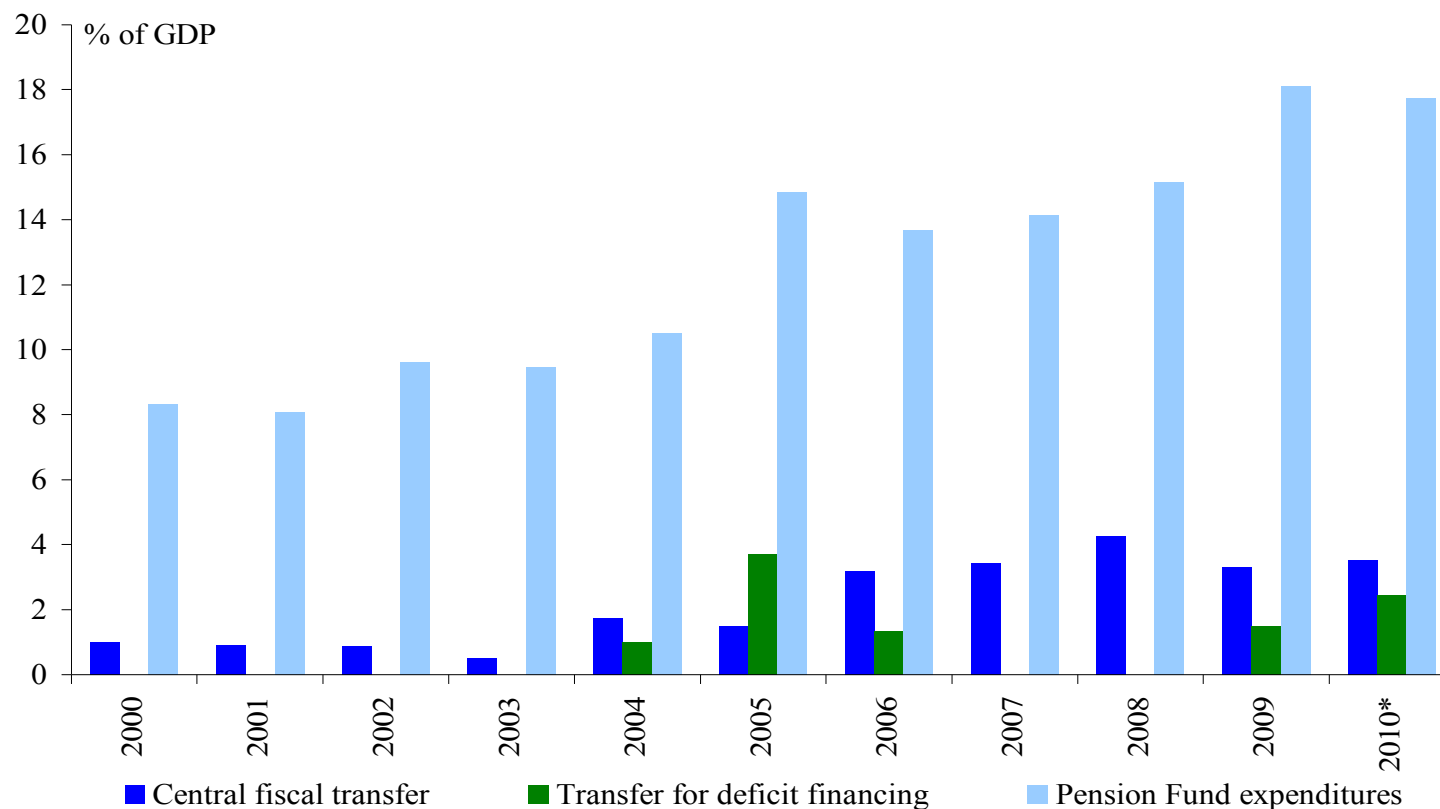
Note: \* - including SDRs as revenues

Source: State Treasury Reports

# Fiscal performance during the crisis (3)



## Central fiscal transfer to the Pension Fund\*\*



Note: \*planned figures

\*\* the figures for 2008 and 2009 do not include loans provided by the State Treasury for covering short-term liquidity gaps of the Pension Fund.

Source: State Treasury Reports

# Education: Key characteristics



1. The state is the main provider of education at all levels; private provision of education services is negligible;
2. Higher education enrollments have been expanding rapidly, with current coverage rates higher than in many new EU member states;
3. The network of educational facilities is extensive; however, the number of the facilities is decreasing;
4. Poor quality of education: in 2007 TIMSS graded Ukrainian students lower than average in the world;



# Education: Policy reforms



Education system is highly centralized financially and administratively, and it has seen limited reform;

The major reformation effort which can be reported is the Budget Code that clarified the education responsibilities of local governments;

Other reforms are quite minor:

- providing “contract” higher education within public universities for students with entry score below the threshold for budget-financed students admission;
- requiring students to purchase textbooks and other educational material that were provided before for free;
- allowing schools to raise and retain funds through rental or sale of unneeded facilities and the provision of paid extracurricular courses;

The most trouble-making system of “normative” – remains unchanged;

# Education: Spending trends and efficiency



1. Public spending has been growing and in 2010 reached 7.2% GDP, which is higher than in other transition countries and OECD countries;
2. General secondary schools (primary and secondary education) – account for over 40% of total expenditures on public education;
3. Higher education absorbs 30% of total government funds;
4. The efficiency of the education spending is low as the budgeting is based on “normatives” (related to numbers of groups);

## Education: Spending trends and efficiency (2)



5. Education outlays are growing at the background of negative demographic trends;
6. Ukrainian education system suffers from overstaffing;
7. Also the rising spending did not translate into quality as recurrent spending constitutes about 95% (with gross wages taking near 50%);
8. Out-of-pocket payments in education are common in Ukraine (partially formalized through “charitable funds”);

## Education: Mid-term outlook



The quality of education is low and it keeps worsening: only two Ukrainian universities were mentioned in the reputable Ranking Web of World Universities (1,283 and 1,440 positions out of 12000);

Domestic education is not attractive for young bright people (due to low salaries) and the situation will remain unchanged as long as the expensive and inefficient system of “norms” is on place;

Enrollments will decline as the school-age population continues to shrink;

# Healthcare: Key characteristics



1. Ukraine has relatively low life-expectancy index – 68 years for both sexes (2008);
2. Mortality rate exceeds birth rate – population decrease by near 250 thnd. people per year;
3. The main cause of mortality are diseases with cardiovascular system;
4. Among infectious diseases, the major problem faced today is the spread of HIV/AIDS and tuberculosis;
5. Number of hospitals and beds remain high (much higher than neighboring European countries);

## Healthcare: Key characteristics (2)



6. The hospital facilities are misused as there is lack of medicines and equipment is outdated;
7. There are both state and privately managed healthcare institutions;
8. Number of medical personnel is increasing, however, the trend is true only for doctors with narrow specialism;
9. Number of nurses and primary care doctors is decreasing;

## Healthcare: Policy reforms



The Constitution of Ukraine declares that “state and community health institutions provide medical services free of charge; the existent network of such institutions may not be reduced.”;

The attempts to reduce list of free services and optimize number of misused hospitals failed due to constitution restriction;

Introduction of mandatory health insurance was also postponed due to constitutional restrictions;

Primary health care system is undergoing a gradual reform: transition towards family-based system;

# Healthcare: Spending trends and efficiency



1. Healthcare spending is also increasing (from 3.5% GDP in 2008 till 4.1% GDP in 2010);
2. In-patient care is the main expenditure category in healthcare system of Ukraine – about 70%;
3. Capital expenditures take small share of outlays and tend to reduce with time (from 13.3% in 2004 to 4.6% in 2009);
4. Wages and salaries constitute the largest share (close to 60%) of public health expenditures;



## Healthcare: Spending trends and efficiency (2)



5. 'Norms'-based budgeting is the main reason of poor public funds use: effectively, money are spent for maintaining existing facilities rather than for financing services provided;
6. According to the World Bank, the government finances close to 60% of total health spending, while the remainder comes from private/out-of-pocket household payments;

## Healthcare: Mid-term outlook



Life expectancy is increasing gradually but this is not due to quality of healthcare;

Birth rate and mortality rates improved somewhat in 2006-2009 but already worsened in 2010;

The fundamentals of Ukrainian healthcare system are likely to stay unchanged which means that the sector will keep stagnating;

# Conclusions



During the past ten years Ukrainian authorities did not complete many structural reforms needed to stimulate future economic development;

The fiscal system remained inefficient and even the economic shock 2008 did not stimulate the authorities for active changes;

Minor policy changes took place in 2010 but the efficiency of the steps is still disputable;

Fiscal policy responded to economic hardship only with increase of deficit and subsequent increase in public debt (43.5% in April 2011);

The mechanisms of public funds allocation remained unchanged: “normatives” budgeting for education and healthcare;