НАУЧЕН ЖИВОТ

CAN FISCAL POLICY SERVE AS CONTRA-CYCLICAL INSTRUMENT IN TRANSITION ECONOMIES? THE CASE OF UKRAINE[1]

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Discovering which instruments of macroeconomic policy are more efficient for gaining macroeconomic aims, in transition economies in particular, is an issue of great importance.

Over the last century, there have been plenty of debates around the controversial theories and researches validating Keynesian theory and criticizing it. Krugman, Stiglitz, and Sachs proclaimed the entry of modern economics into „a period in which orthodox views are openly questioned, creating an atmosphere characterized by a crisis of confidence" [17]. This stance of questioning makes the science open to the discussion on any possible theories and results.

Recent financial crisis, which started in 2007, laid the end of the stage of prevailing economic liberalism. According to the theory of cycles of development of the world economy, this paradigm is to be substituted by strengthening of regulation activities of the government. However, there are still much problems to be solved and questions to be answered concerning how the government should provide sustainable development of the economy. It is a specific issue in transition economies, where the high level of shadowing and continuous transformation process are inherent to the economies.

According to economic theory, fiscal policy, that is based on the theories of Keynes (1936), Mankiw and Romer (1991), applies the instruments of budget in order to sustain (or stimulate) aggregate demand in the economy on the appropriate level.

Monetary policy is considered to have more rapid impact on the economy because of shorter inside lags. In transition economies, however, it may appear less efficient than fiscal policy, since low level of development of financial market is the cause of longer outside lags in gaining the effects of monetary policy and poor transmission effect. Thus, tax and budgetary system and fiscal policy, having its mechanisms integrated deeper in economic system of transition economies, is the instrument of fiscal regulation that may have more appropriate impact.

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Thus, in Ukraine, economy of which is still on the stage of transition from planned to market, it is more adequate to apply fiscal policy as the mean of equilibrating the economy, decreasing the influence of the cyclical fluctuations and providing sustainable economic development.

With the aim of gaining the main macroeconomic goals such as economic development, full employment, price stability etc., government applies fiscal and monetary policies. Fiscal policy is applied for smoothening of economic fluctuations. Depending on economic conditions and the goal of the government, it accrues different types of fiscal policy. Fiscal policy can be expansionary, contractionary, or neutral (Chart 1).

- Expansionary fiscal policy, or deficit spending, implies increase of government spending or tax cuts in order to push the economy out of recession or high unemployment, incurring a government budget deficit. Counterargument of neoclassical economists to the stimulus effect of expansionary policy is crowding-out effect.
- Contractionary fiscal policy gains to restrict negative effects of overheated economy. It implies decrease of government spending or raise of taxes, manifesting budget surplus [16, pp. 215-224].
- Neutral fiscal policy has a neutral effect on the level of economic activity since it implies a balanced budget, where government spending equals tax revenue.

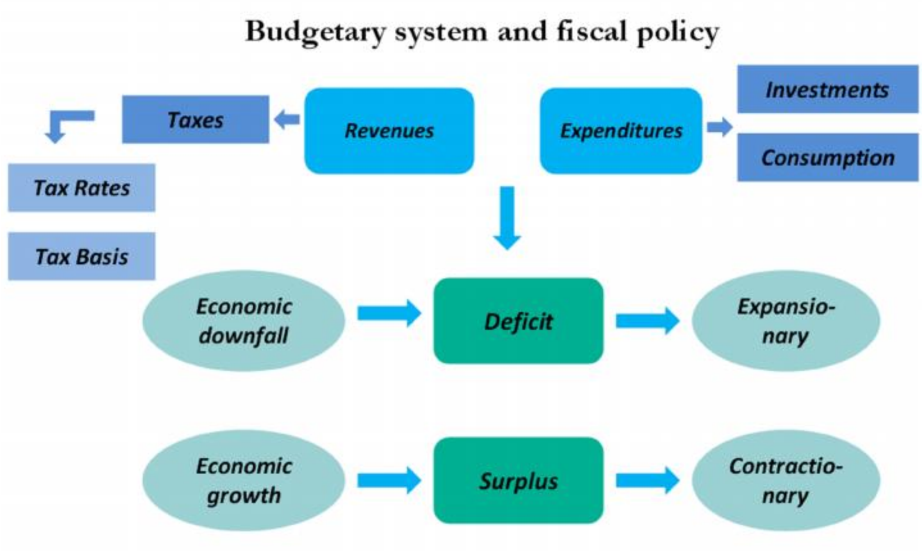


Chart 1. Budgetary system and fiscal policy

Keynesian theory gives more room for debt financing than for increasing taxes. This prevalence exists on the basis of the arguments that debt financing leads to higher aggregate demand, while increase of taxes causes decrease of private consumption.

According to Radionova and Alimpiev (2009), there are 3 directions by which the implications of the research may be divided into Keynesian and non-Keynesian approach to the analysis of interrelations in the economy:

1. Implications the same or opposite to the effects expected according to the Keynesian theory.

From the point of view of expected implications, during last decade some researches got the results on Keynesian and non-Keynesian effects for developing and developed economies based on econometric models applying such methodologies as SEM, ECM, and VAR to the real economic data. Carmignani (2008) for CIS, and Nwachukwu&Egwaikhide (2007) for Nigeria, Baharumshah (2007) for Thailand, Li (2004) for China, Lukianenko (2004) for Ukraine have discovered Keynesian effects. On the other hand, Giavazzi and Pagano (1996) for OECD countries, Carmignani (2008) for OECD out of normal times (and neutral effects in normal times), Baffoe-Bonnie (2004) for Ghana have found non-Keynesian effects. Baldacci (2003) in his studies of the economies of 39 low-income countries has discovered diversed results for different countries depending on macroeconomic conditions and fiscal vulnerability. These results reflect that the instruments of fiscal policy are more integrated and efficient in transition economies than in developed economies and low-income countries. On the other hand, heterogeneity and controversy of these results are the argument for further research.

In the USA both the Keynesian and non-Keynesian effects were found. First Sanders (1995) in his research found non-Keynesian effects. Later on, Darrat and Hammad (1998) and Blanchard and Perotti (2002) found Keynesian effects for the U.S. economy. In the USA during recent decades monetary paradigm was prevailing. Thus, government in its economic policy relied purely on monetary instruments. During recessions FRS accrued the decrease of short-term rates: during recession of 1990 from 9% to 3%, downfall of 2001 – from 6,5% to 1%, and during 2008 – from 5,25% to 0%. The decrease of the rate to 0% was previously applied during Great Depression. In both cases in the times of economic downfall (1929, 2008) it appeared that monetary instruments are incapable to provide economic stability and recovery. Thus, the necessity of applying financial stimulus arose. Also these implications raised additional questions and became a motivation for fostering further research.

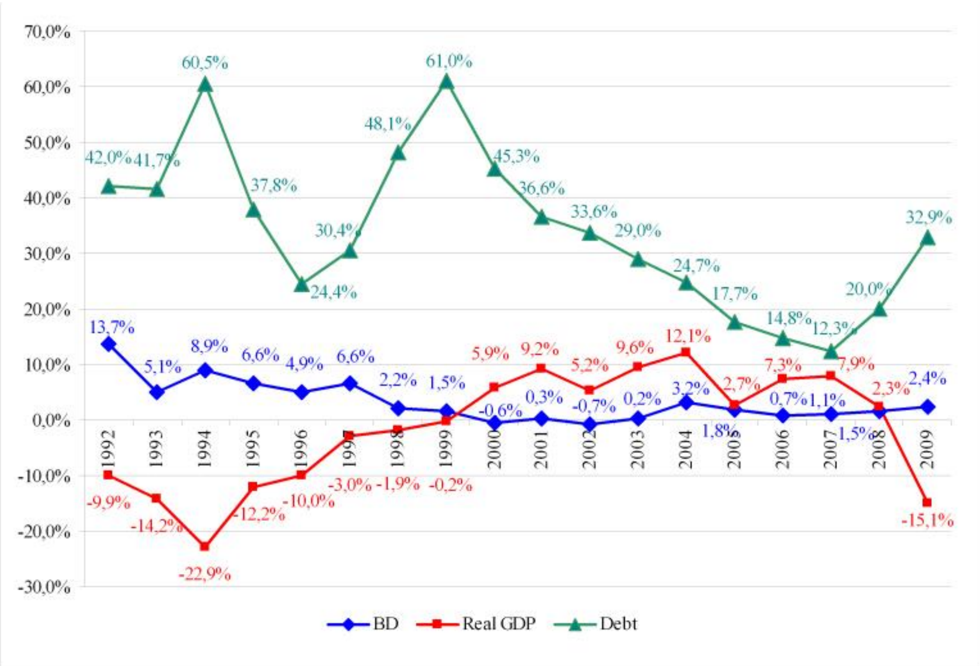
2. Critics of so called ‘fiscal illusion’. It is based on the Ricardo-Barro equivalence theorem, which treats financing of budget expenses by debt instruments equivalently with taxes. It also argues that financing though debt does not increase assets of households. The cause of short-term reaction of economic agents on debt financing is increasing of savings, not private consumption. However, this critics does not prove inefficiency of financial stimulus, since additional government expenditures, financed either by debt or by taxes, may lead to economic growth which may exceed the increase of expenditures.

3. Restrictive rules of fiscal regulation concerning budget deficit and state debt. According to Carlin and Soskice (2006), the main restrictive conditions are Prudent Fiscal Policy Rules (PFPR) such as debt-to-GDP, taxes-to-GDP, budget deficit-to-GDP ratios (including debt service), and the „golden rule” of fiscal policy. The latter

implies that government debt should be accrued during all the economic cycles exclusively for the government investments in structural changes, while current government expenditures should be financed by taxes levied. These policy rules are applied in the Stability and Growth Pact (1997) for EU countries. Marginal proposed ratios of the budget deficit to GDP is 3%, and of state debt to GDP – 60%. These margins were slightly soften in 2005 due to the amendments of the EU countries.

In this paper statistic analysis is applied to the fiscal policy in Ukrainian practice in the context of its macroeconomic conditions over the last 18 years. It explores the dynamics of budget deficit, state debt, and real GDP.

From the comparison of the dynamics of the indicators of budget deficit, state debt, and real GDP growth during 1992-2009, the following results can be achieved (Chart 2).



Data source: *Debt: Ministry of Finance of Ukraine, Real GDP, BD (budget deficit): UkrStat; Debt 1992-1997: Azarov, 2004*

Chart 2. Fiscal policy in Ukraine during 1992-2009

In the first years of independence (1991-1996) there were transformation processes inherent to all the spheres of the economic system of Ukraine. It was the period of forming of the national taxation system and specification of the main taxes in the midst of the high share of the shadow economy. Thus, budget expenditures enormously exceeded revenues (13,7% of GDP in 1992). However, the downward trend of budget deficit decreased to 4,9% of GDP in 1996. This direction of development became possible against the background of the balancing of the tax policy.

In this period there was the highest GDP downfall up to 22,9% in 1994. In this year budget deficit also appeared on the highest rate during 1993-2009 – on the level of 8,9%, as well as state debt was of the highest rate (60,5%) during 1992-1998. This downturn appeared against the high rate of inflation that was caused by money emission in 1992-1996.

At the end of the period in 1996 budget deficit fall to 4,9% of GDP, while GDP decreased its downfall to -10%, and the state debt decreased to 24,4%. Thus, this period of forming of the national economic system was the most challenging, giving high weight to balancing fiscal and debt policy in order to stabilize the economy with high fluctuations of macroeconomic indicators.

During the next period of development of the economy in 1997-1999, an increase of external and internal debt took place, which, in its turn, made a pressure on the expenditure part of the budget. In 1999 the debt reached its maximum value during 1992-2009 on the level of 61% of GDP. The state's insolvency to pay on its debts in the midst of the Asian currency crisis, which reached Europe by this time, caused restructuring of the state debts. At the same time budget deficit went down from 6,6% to 1,5%. Real GDP has also stopped to fall (-0,2% in 1999). Thus, this period can be characterised as the period of unbalanced debt policy against the Asian crisis, which, however, led to low budget deficits and slight upturn of economic conditions.

During the next 4 years (2000-2003) debt policy optimization led to double shrinking of debt to GDP ratio (from 61% in 1999 to 29% in 2003) which also made balancing of the budget possible. The period of 2000-2003 was the period of a balanced budget with the first surplus fixed. In these conditions, real GDP started to raise for the first time during the history of independence. During 2000-2003 it raise by 5,2-9,6% a year.

In 2004-2008 – during the period of prosperity and economic growth, all the economic indicators were balanced. Thus, budget deficit was fixed on the average level of 1,7%, there was a high GDP growth (up to 12,1%), and a low debt-to-GDP ratio – on the level of 12,3-24,7%. The share of GDP redistributed through the budgetary system raise, which is the cause of de-shadowing of the economy. Since during 2004-2008 there were 5 national election campaigns, the expenditures of the budget, and thus, budget deficit contained the component of high political uncertainty. The latter component made its negative impact on the efficiency of fiscal policy, though this period was the most successful from the point of view of economic performance.

Starting from the last quarter of 2008, and during 2009, under the influence of the world economic crisis, economic indicators changed their trends. Thus, during 2009 state debt raise 1,5 times, economic downfall was represented by the GDP fall to -15,1%, and budget deficit – on the level of 2,4%. These trends are evaluated to be rather rapid and sound.

The recent research of the National Bank of Ukraine (April, 2010) constitutes inefficiency of the transmission mechanism through monetary channels. With the aim of gaining sustainable economic development, simultaneously applying fiscal instruments, there is the necessity in the deliberate debt policy. While in 2007 state debt (including guaranteed corporate debt by the state) amounted of 12,3% of GDP, in the midst of worsening of economic conditions in 2009 it raised up to 32,9%. Though according to Stability and Growth Pact, this level is still considered as a safe (less than a margin rate of 60%), its serving makes a significant pressure on the expenditure side of the budgets of Ukraine and makes an obstacle for efficient distribution of resources through the budgetary system.

Because of impossibility of increasing of the state debt at the end of 2009 (because of IMF's refusal in giving the 4th tranche of the stand-by loan), the level of the budget deficit amounted of 2,4%, which does not exceed the safe limit of 3%. This decrease of the budget deficit in comparison to the planned 3,3% and applying expansionary fiscal policy is important for stabilization of economic stance of the country and extrication of the economy out of the recession.

Thus, from the statistic and graphic analyses, the conclusion on sound trends might be drawn. Worsening (or improvement) of economic conditions leads to simultaneous worsening and unbalancing (or otherwise – improvement) of budget deficit, government debt to GDP ratios along with economic downfall (or growth). However, there is still the problem of defining of the cause and effect relations among those indicators.

Thus, applying fiscal policy instruments is important for overcoming of the economic crisis, in Ukraine in particular. Within the directions of the specific attention of the government should be the instruments of the budget deficit and state debt, and their share in GDP, deliberate debt policy, taking into account crowding-out effects while making decisions on allocation of government expenditures, defining the models of behaviour of economic agents on the local market as the reaction to the governmental actions, further investigation of the transmission mechanisms in the budgetary system through the instrument of budgetary expenditures.

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