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**Problemy ekonomii,  
polityki ekonomicznej  
i finansów publicznych**



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## Wstęp

*Problemy ekonomii, polityki ekonomicznej i finansów publicznych* wydajemy w serii Prace Naukowe Uniwersytetu Ekonomicznego we Wrocławiu. Niniejsza publikacja, stanowiąca pierwszą z czterech części materiałów konferencyjnych, zawiera 36 opracowań, w tym sześć w języku angielskim. Zostały one poświęcone aktualnym problemom naukowo-badawczym z zakresu teorii ekonomii, realizacji polityki ekonomicznej – w wymiarze mikro- i makroekonomicznym – oraz zagadnieniom związanym ze stanem finansów publicznych w Polsce i na świecie.

Liczne grono autorów prezentuje wyniki swoich dociekań naukowych w postaci teoretycznych i empirycznych analiz związanych z polityką fiskalną na szczeblu centralnym i samorządowym, wykorzystaniem instrumentów polityki podatkowej w odniesieniu do opodatkowania kapitału, pracy i konsumpcji oraz z problemami polityki pieniężnej i rynku kapitałowego w skali krajowej i międzynarodowej. Ponadto zeszyt zawiera opracowania dotyczące nierówności społecznych, polityki regionalnej i lokalnej, rozwoju produkcji rolnej, obszarów wiejskich i przetwórstwa spożywczego, problemów sektora usług turystycznych i transportowych, jak również rozwoju innowacyjności przedsiębiorstw, efektywności wydatków na B+R oraz polityki państwa w obszarze rynku pracy.

Publikacja nasza jest adresowana do środowisk naukowych i studentów wyższych uczelni oraz osób, które w praktyce zajmują się finansami publicznymi, współczesnymi problemami polityki ekonomicznej czy ekonomii. Poszczególne artykuły były recenzowane przez profesorów uniwersytetów, w większości kierowników katedr ekonomii lub polityki ekonomicznej. Za ich rzetelne recenzje chciałbym serdecznie podziękować. Dziękuję również pracownikom Katedry Ekonomii i Polityki Ekonomicznej Uniwersytetu Ekonomicznego we Wrocławiu oraz wszystkim osobom i instytucjom zaangażowanym w powstanie tej publikacji.

Jestem w pełni przekonany, że książka *Problemy ekonomii, polityki ekonomicznej i finansów publicznych* będzie Państwa inspirować do dalszych badań i dociekań naukowych oraz przyczyni się do powstania równie interesujących opracowań w przyszłości.

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**PUBLIC DEBT IN UKRAINE:  
IRRATIONAL MANAGEMENT  
AND RISKS LEADING TO CORRUPTION**

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**DŁUG PUBLICZNY UKRAINY:  
ZARZĄDZANIE IRRACJONALNE  
I ZAGROŻENIA PROWADZĄCE DO KORUPCJI**

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**Summary:** The economic and political crises in Ukraine have forced its government to change its approach to public debt management. In this article the dynamics of public debt in Ukraine and the costs of servicing it have been analyzed. The aim of this article is to suggest new approaches to improve public debt management in Ukraine. The main methods of research are: trend analysis, comparative and empirical analysis. New challenges to public debt management in recent conditions were explored. Areas with an apparent risk of corruption is within government resource allocations were presented. A primary area for corruption risk is in government procurement, especially for the military. Recent reforms have decreased this risk to certain extent, but every year losses from corruption are extremely excessive. Risks of corruption exist in the areas of state enterprise funding and additional capitalization of banks. Public debt management in Ukraine has its own specifics, caused by the current situation in the country. The greatest threat to the efficiency and rationality of public debt management are the risks of corruption and inefficient use of budget funds. On this basis, debt management improvement priorities should be as follows: observance of national interests in the international arena, maintaining, if not improving, the debt security and credit ratings of Ukraine, improving the effectiveness of government investments.

**Keywords:** public debt, public debt management, macroeconomic imbalances, economic crisis, government borrowings.

**Streszczenie:** Kryzysy gospodarcze i polityczne na Ukrainie zmusiły rząd tego kraju do zmiany podejścia do zarządzania długiem publicznym. W tym artykule przeanalizowana została dynamika długu publicznego na Ukrainie oraz koszt jego obsługi. Przedstawione zostały nowe wyzwania dla zarządzania długiem publicznym. W artykule określono również obszary, w których z alokacją zasobów państwowych wiąże się ryzyko korupcji. Głównym obszarem ryzyka korupcji w zamówieniach publicznych są zamówienia dla wojska. Ostatnie reformy zmniejszyły nieznacznie to ryzyko, ale co roku straty związane z korupcją są bardzo wysokie. Zagrożenie korupcją istnieje także w zakresie finansowania przedsiębiorstw państwowych

i dokapitalizowania banków. Zarządzanie długiem publicznym na Ukrainie ma swoją specyfikę, związaną z obecną sytuacją w kraju. Największym zagrożeniem dla efektywności i racjonalności zarządzania długiem publicznym jest ryzyko korupcji i nieefektywnego wykorzystania środków budżetowych. Na tej podstawie określono następujące priorytety poprawy zarządzania długiem publicznym: przestrzeganie narodowych interesów na arenie międzynarodowej, poprawa lub przynajmniej utrzymanie zabezpieczenia kredytowych rankingów Ukrainy, poprawa efektywności inwestycji rządowych.

**Słowa kluczowe:** dług publiczny, zarządzania długiem publicznym, zaburzenia równowagi makroekonomicznej, kryzys gospodarczy, pożyczki rządowe.

## 1. Introduction

The implementation of the European vector of the development of Ukraine has faced many problems and challenges, with greater negative impacts because of the military aggression in the east of the country. In 2014-2015 Ukraine experienced an unprecedented combination of political and financial crises that destroyed its macro financial stability. Macroeconomic imbalances are manifested in all areas of economic life: a drop of government revenue, rising budget deficits and imbalance of payments, growth in the debt burden, growing threats of loss not just financially, but also in the economic security of the country as a whole. Borrowing money with unfavorable terms and their misallocation has led to the deepening of the crisis. Therefore, improvement in the management of public debt is a relevant issue. Effective debt management is able to reduce the level of risk from the debt crisis and promote the economic strength of the country.

## 2. Theoretical background

The economic theory that dominated during the Soviet period proved that national debt is a negative phenomenon. However, the experience of many developed countries has demonstrated that the intelligent use of scarce funding and professional debt management can cause a country becomes a member of the group of world economic leaders. Nonetheless, excessive public debt or an irrational policy of government borrowing could lead to a rise in the cost of debt service, reducing savings and crowding out private investment, which slows down the economic growth of the country in the long run. The issue of debt management is an object of research by many economists. Basic principles of public debt management are present in the writings of J. Keynes [Keynes 1924], O.J. Blanchard and S. Fischer [Blanchard, Fischer 1989], J. Buchanan [Buchanan 1958], M. Friedman [Friedman 1960] and others. However, global challenges at the end of the twentieth century and in the early twenty-first century forced economists to seek new criteria for the optimization of the public debt, and new estimations of its impact on macroeconomic stability and debt security in the context of financial globalization and political challenges.



New approaches to public debt management became necessary after the financial crisis of 2008. The necessity of change in public debt management was shown in articles by H.J. Bloomestein [Bloomestein 2009; 2010]. The impact of public debt and its management after the crisis are explained by J.H. Cochrane [Cochrane 2011]. Default risk and its influence are described in the discussion papers of C. Goodhart and D.P. Tsomocos [Goodhart, Tsomocos 2011]. The group of economists [Baldacci, McHugh, Petrova 2011] suggested improving the process of measuring fiscal vulnerability and fiscal stress. They proposed a set of indicators for measuring fiscal stress which has become useful to the IMF and OECD.

Public debt management in Ukraine has to be changed, not only because of global economic challenges, but also because of internal economic and political problems. Fiscal policy should be adjusted to develop the economy through increased investment and business activity. It means that the use of borrowings to finance current consumption has to be reduced. The aim of this article is to suggest new approaches to improve public debt management in Ukraine.

### 3. Efficiency estimation procedure

The national debt of Ukraine has increased over the past few years (Fig. 1). The growth of public debt was caused by different factors, such as uncertainty over the refinancing of previous debt, the pressure of debt payments on government finance, devaluation, and stagflation.

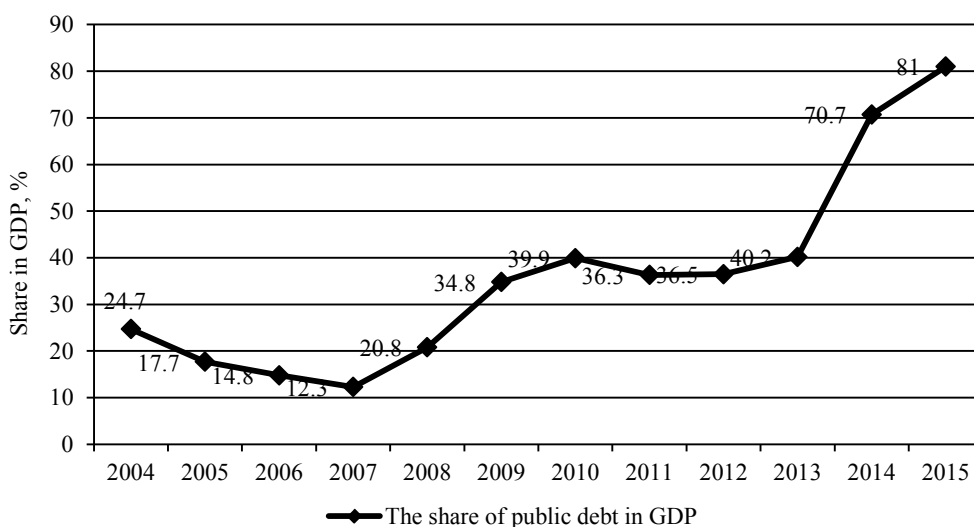


Fig. 1. The share of public debt in GDP in Ukraine in 2004-2015

Source: created by the author based on information from the Ministry of Finance of Ukraine.

The devaluation of the national currency in 2014 caused growth of debt, denominated in foreign currency. In 2013 the guaranteed external debt increased to 51.4% of the amount of total debt; in 2014 it went to 55.6%. These processes increase the risk of dependence on external debt financing. The growth of public debt in 2014 was driven by the following factors:

1. The military conflict in the east of the country, which required increased funding costs for the defense of the country. This reason also became one of the main factors of an increasing risk of corruption.

2. The economic recession, the impact of which was increased through the loss of economic ties with Russia, the annexation of the Crimea, and the loss of part of the Donbass. This is a mixed picture, because on the one hand the Ukrainian government lost taxes from that region but on the other, it reduced its expenditures for subsidies on enterprises in Donbass. The main problem is that the loss of the Donbass region means the loss of access to a significant amount of sources of raw materials, affecting the energy production. This is why Ukraine was forced to import coal from abroad and that procedure was accompanied by excessive corruption.

3. Growth of government social obligations, especially those affected by the military conflict (refugees and soldiers).

4. The need for additional financing for the restructuring and modernization of the economy, driven by the need to redirect exports to other markets, including Western Europe. This causes a need to change production standards, and hence requires additional investment. Effective public management in the case of Ukraine means that debt financing should be allocated in the economy as investments, and furthermore means that the growth of public debt should be accompanied by the growth of government investments, especially when the economy requires the modernization of equipment (Table 1). The dynamics of government investments in Ukraine is shown in Table 2.

**Table 1.** Trends in fixed asset investment in Ukraine in 2010-2014

Indicators	2010	2011	2012	2013	2014
Gross accumulation of fixed capital, % of GDP	18.0	18.3	19.4	17.3	14.0
The degree of depreciation of fixed assets, %	74.9	75.9	76.7	77.3	83.5

Source: calculated by author based on information from the State Statistic Service of Ukraine.

As it can be seen in Table 1, the Ukrainian economy requires a significant amount of investment resources. The government should use the deficit spending to finance those economic sectors which can be “points of growth” for the national economy. Unfortunately, in the last two years, the government reduced its investments in the non-financial sector.

As it can be seen in Table 2, the share of budget investment decreased in the total amount of investment and in government expenditures. In fact, the government is

**Table 2.** Budget investments in Ukraine in 2010-2014, %

Indicators	2010	2011	2012	2013	2014
Share of investments from the state treasury in the all amount of investments	5.8	7.1	5.8	2.4	1.2
Share of investments from the local treasuries in the all amount of investments	3.4	3.4	3.1	2.7	2.7
Share of government investments in the government expenditures	8.1	8.2	8.3	5.8	3.9

Source: calculated by the author based on information of State treasury service of Ukraine, State statistical service of Ukraine.

ignoring the golden rule of funding, which in the long run will cause a shortage of funds for debt service and repayment. A significant part of government expenditures in 2014-2015 was used to finance government procurement of defense products. Unfortunately, the redistribution budget resource in Ukraine is not transparent and well controlled, which is why government purchases are a possible area for an increased risk of corruption.

Government expenditures during public procurement have always been an acute socio-political problem in Ukraine. According to various reports, in 2013, corrupt officials looted 15 to 40% of allocated funds for the purchase of goods and services (more than 280 billion UAH). By the end of 2013, the main risks of corruption in public procurement were:

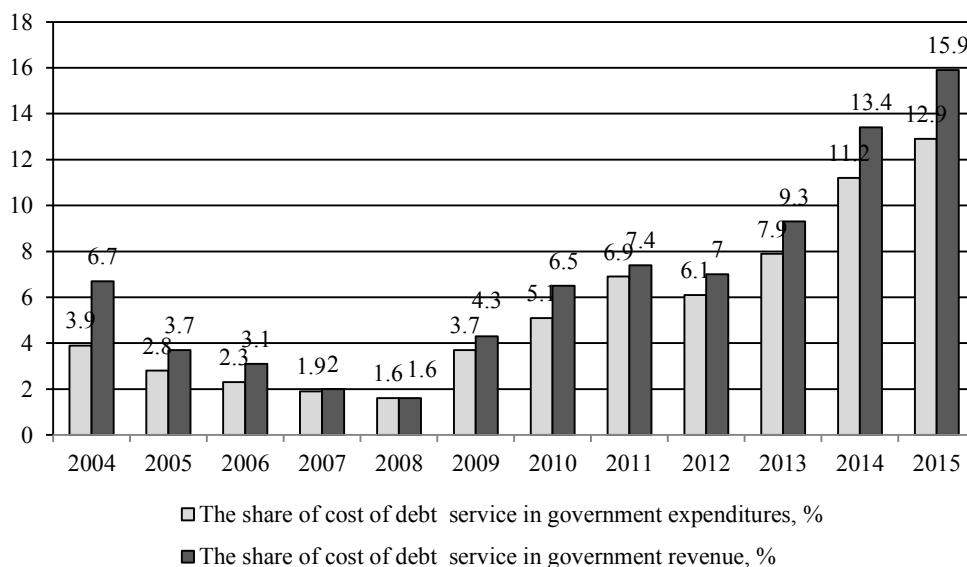
- bids which could be from relatives of members of the committee that organized the tenders,
- dishonest private contractors who, after paying insignificant penalties, continued to compete for tenders,
- fake companies (“company-pads”) which were set up with the intention of defrauding the tender process and used in money laundering or to have bid winners who were ineffectual in performing contractual obligations.

According to experts, by the end of 2013 this risky environment caused about 50% of government procurements to “go into the shadow economy” [Marusov 2014]. Of the 209 billion UAH which was invested by tender contracts, 85 billion was distributed through closed non-competitive procedures to one participant [Звіт міністерства економічного розвитку і торгівлі 2013]. A new edition of the law “About public procurements”, adopted in April 2014, eliminated a number of corruption risks of the previous regulations, but was not able to completely neutralize the negative trends in the economy, affecting the scope of government procurement. However, the share of payments under contracts of private contractors has almost not changed, and remained at a level of 43%, while the annual loss from corruption, according to estimates from the Ministry of Economic Development and Trade, amounted to \$2 billion dollars (US).

Transparency International research about the level of corruption in the defense sphere reveals that Ukraine faces a high risk of corruption in military establishments. Its anti-corruption defense index categorizes countries on a scale from A (very low risk of corruption) to F (critical risk). Ukraine is placed in Group D with a very high risk of corruption. Research has determined the scope of procurement as most risky in the defense sector. Recent amendments to the legislation on public procurement simplified the process of procurement for defense because of the current instability by allowing bidders to use the negotiating process during the anti-terrorist operation, but Transparency International has warned that it increases the risk of corruption. TI recommends regular controls of any privileges to prevent their misuse, because they can negate the positive initiatives such as e-procurement [Міжнародна антикорупційна мережа... 2015]. Thus, in the field of government investments and procurement, the risk of corruption is high and requires further reform aimed at the transparency of information about the using of treasury funds.

5. The need for further budget support of state enterprises and banks, through their additional capitalization. In this case, the first question raised is funding the deficit of NJSK "Naftogaz of Ukraine", which was covered by government borrowings. The government planned to solve this issue by increasing the cost for consumers (285% for gas supply, 67% for the supply of heat). However, a lot of people cannot afford to pay those prices because of growing unemployment and falling real wages. Therefore, the government has decided to provide public subsidies for people to pay for public services. The question then arises of what the point was of raising tariffs if, as a result, a greater share of the population was provided with subsidies from the government. There is nothing wrong in the mechanism of providing government subsidies if it is provided to a small part of the population, those who are not able to provide for themselves due to objective reasons. However, subsidies in 2015 were requested by 5 million households, while the budget for their financing cost more than 20 billion UAH. The rationality of such a decision is not clear, first because of an increase in public spending on the maintenance of such a transfer, and secondly, due to an increase in the risk of corruption in this redistribution of government funds. Instead, there are no questions regarding the effectiveness of the financial management of the NJSK "Naftogaz of Ukraine", in particular in the management of costs. The increase of registered capital of the banks also does not look like a rational step, given that additional capitalization is carried out at the expense of budget funds. The capacity of capitalization schemes leads to suspicions regarding the construction of corrupt schemes for a distribution of funds such as those originally used by the National Bank in the distribution of funds to refinance.

All of these factors have contributed to the fact that the Ukrainian government has often borrowed funds chaotically and on unfavorable terms. Public debt is costly to maintain. Ukraine does not have access to less expensive financial resources from financial markets, so it has to borrow at higher interest rates. This has resulted in rising costs for servicing the public debt in 2013-2014 (Fig. 2).



**Fig. 2.** The cost of public debt service in Ukraine in 2004-2015

Source: created by the author based on information from the Ministry of Finance of Ukraine.

A substantial reduction in the volume of international currency reserves took place in 2014 –7.5 billion USD, and in the first quarter 2015 this indicator decreased to 5.6 billion USD. While the largest share of the public debt is denominated in foreign currency (the share of debt in UAH was only 31.53% in 2015) the growth of the share of debt in the foreign currency means increasing costs to service it. This means the growth in demand for foreign currency from the government and a drop in the currency supply, which has caused a further devaluation of UAH. From this perspective, the growth in government debt can be considered as a negative trend.

However, the growth of the national debt in foreign currency does not always mean slower economic growth and the devaluation of the national currency. As noted by experts from the IMF, the world has had several periods of rapid growth of public debt share in the GDP in many countries. The maximum mean of this indicator was recorded in 1985, 1994 and 2009. While an inverse relationship between the dynamics of GDP and public debt actually occurs very often, not all countries that increased public debt showed the slower growth in GDP. In some countries, the rate of GDP growth was higher than average. From this point of view Ukraine has a chance to survive and even to start further development within its economy, if public debt management was more effective.

## 4. Conclusions

Public debt management in Ukraine has its own specific characteristics caused by the current situation in the country. The greatest threats to the efficiency and rationality of public debt management are the risks of corruption and inefficient use of budget funds. On this basis, debt management improvement priorities should be as follows:

1. Observance of national interests in the international arena. This priority is one of most difficult in terms of accomplishments. Unlike Greece, which used as an argument its possible exit from the euro zone, thereby damaging the European Union, Ukraine has no such a compelling economic argument to improve its situation. However, taking into account the aggression of Russia, Ukraine has gained political leverage, but the use of such instruments should not turn into speculation. Also, the use of political leverage has to be accompanied by real reforms in the country and the true fight against corruption. As additional arguments, Ukraine could use the fact of consistently timely payment of debts. Also, the negotiations with the IMF should demand part use of the tranche for financing economic development within specific programs.

2. Maintaining and improving the debt security and credit ratings of Ukraine. This means that debt restructuring should provide a real reduction of payments on the debt service, and strengthening of the interaction of Ukraine with other international financial institutions and governments. Also openness, transparency, and timeliness of information on the involvement and use of loans have to be ensured. An enhancement of the transparency of public finance can be achieved at the expense of parallel accounting and debt deficits for the cash method and accrual method for the sector of national governance.

3. Providing effectiveness in the use of budgetary investments. This condition requires strong controls not only from the government but also from foreign auditing companies which are characterized by a high level of confidence and good reputation. Also, controls should be provided on independent Ukrainian public organizations. The use of budget funds should take place within the framework of the development programs of the national economy. It means that government investments should be directed to “points of growth”, including the development of infrastructure.

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