

Ukraine's Consolidated Budget results through June 2011

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Based on Monthly Budget Execution reports of Ukraine's State Treasury

Consolidated budget balance and financing

- Ukraine's consolidated finance in first half of 2011 was in a small deficit, but it remained consistently better balanced than in the same period of last year. By end of the second quarter of 2011, Ukraine's consolidated finance developed a cumulative deficit of UAH 11.1 billion, or around 30% of the annual ceiling. This is considerably smaller than in the same period of 2010, in nominal terms (when the deficit was UAH 25 billion), and reflects a general pattern of consistently better balanced budget throughout the first half of this year, as illustrated in Figure 1. The latest available statistics for consolidated deficit as a % of GDP is for the first quarter of 2011, at which point it was at 0.23% – also a much stronger result than the 2% deficit in Q1 of 2010 (Table 1).

- The budget balance was improved compared to 2010 by considerable growth of revenues, but most taxes are still behind schedule, and their performance is deteriorating. Improved budget balance in 2011 is explained by higher revenues, originating from considerable growth of EPT and VAT, and helping the Government to catch up with the steadily growing spending. As we discuss further, growing VAT was the key

reason for the real revenue growth in Jan-Jun 2011 compared to last year. Another strong factor was a sharp increase in collections of the EPT (37.3% compared to the previous year, in real terms). However, all taxes except EPT are currently performing below period baselines. Moreover, major revenue sources including VAT and import-related taxes (import excises and import duties) have grown at decelerated rates throughout the six months of 2011, with VAT and Import Duties in June being actually smaller than in the same month of 2010.

Table 1. Consolidated Budget Totals through June 2011 (UAH million)

| | Actual budget totals | | Latest period for which GDP data is available and the same period of the previous year | | |
|-----------------------------|--------------------------|--------------|--|---------------|---------------|
| | 2011 Annual budget plan* | Jan-Jun 2011 | Jan-Jun 2010 | 1Q 2011 | 1Q2010 |
| Latest budget totals | | | | | |
| Expenditures | 425,126 | 187,576 | 171,155 | | |
| Revenues | 384,722 | 177,868 | 145,264 | | |
| Deficit (-) / surplus (+) | -37,425 | -11,144 | -24,971 | | |
| Deficit as % of GDP | -2.99% | n/a | n/a | -0.23% | -2.00% |

* Based on the latest Treasury Report and MinEcon GDP forecast

Figure 1. Consolidated budget totals in 2009-2011 (UAH million)

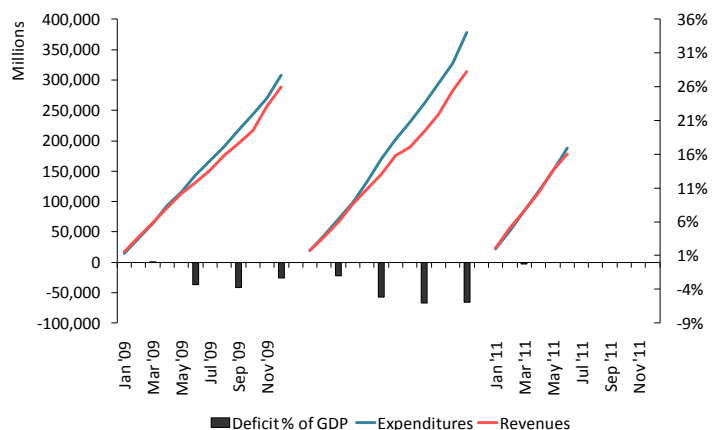
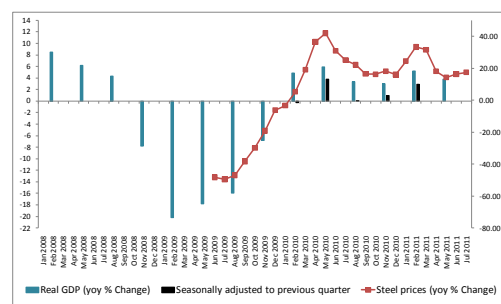


Figure 2. Changes in global steel prices and Ukraine's GDP



- **Decelerating GDP growth in the second quarter of 2011 reinforces concerns over macro-fiscal vulnerabilities related to Ukraine's undiversified export structure.** GDP statistics for Q2 revealed a slight deceleration of real GDP growth (3.8% yoy compared to 5.3% in the Q1). This change mirrors the downward fluctuation in the global steel prices during that period, as well as the country's continued macro-fiscal vulnerability to external shocks, linked to its undiversified export structure (Figure 2).

Consolidated budget receipts

- **Consolidated revenues in January-June 2011 remained significantly higher than last year (by 12.1%) but they were only just above schedule.** Although revenue performance has been highly uneven during 2011, cumulative revenues have consistently remained above last year levels in real terms. By the end of June, cumulative consolidated collections have reached UAH 177.9 billion, which was 12.1% higher in real terms than in the same period of last year (see Table 2). However, although growing compared to previous year, total revenues were only 0.9% above baseline projection for the period (with most taxes behind schedule) and have grown at decelerated rate during the first half of the year.

Table 2. Consolidated Revenues through June 2011 (UAH Million)

| | Nominal actual revenues (Jan-Jun 2011) | Comparisons to plan | | Comparisons to baseline | | Comparisons to same period of 2010 | |
|-----------------------|--|----------------------------|-------------------------------------|------------------------------------|--------------------------------------|--|------------------------|
| | | Annual plan (Jan-Dec 2011) | Actual revenues as % of annual plan | Baseline projection (Jan-Jun 2011) | % Difference of actual over baseline | Nominal actual revenues (Jan-Jun 2010) | % Change in real terms |
| Total Revenues | 177,867.63 | 384,721.64 | 46.23% | 176,325.40 | 0.87% | 145,263.71 | 12.10% |
| VAT | 59,521.07 | 125,523.40 | 47.42% | 63,074.29 | -5.63% | 46,550.06 | 17.08% |
| PIT | 27,830.38 | 59,540.35 | 46.74% | 27,799.58 | 0.11% | 23,097.71 | 10.17% |
| EPT | 25,645.98 | 46,637.84 | 54.99% | 18,826.83 | 36.22% | 17,099.65 | 37.35% |
| Excises | 14,878.62 | 37,364.90 | 39.82% | 16,887.49 | -11.90% | 12,921.08 | 5.33% |
| Land Tax | 5,109.97 | 11,578.63 | 44.13% | 5,396.62 | -5.31% | 4,521.97 | 3.46% |
| Import Duty | 4,512.19 | 10,243.00 | 44.05% | 4,773.96 | -5.48% | 3,403.88 | 21.30% |

Source: Treasury Budget Execution Report.

- **The two major factors behind the growing revenues were the sharp increase in the VAT (assisted by low-base comparison to a drop in VAT in February 2010) and significant expansion of the EPT.** Real growth in cumulative consolidated revenues compared to the same period of the previous year was essentially ensured by strikingly robust performance of the two major taxes: the Value Added Tax (VAT) and the Enterprise Profit Tax (EPT).
 - **Increase in VAT.** Table 3 and Figure 3 illustrate that the bulk of the overall revenue increase in consolidated revenues achieved in the first five months originated from the larger collections of VAT. Cumulative revenues from this tax in January-June 2011 were 17% higher than in the same period of last year, in real terms. Given the size of this tax - which is the biggest revenue source in Ukraine, representing about a third of the consolidated budget, this increase was responsible for 43.3% of the overall revenue growth. However, the impressive comparison of VAT performance to the previous year is explained, to some extent, by a low-base reference point which includes a drop of VAT collections in February of 2010. Respectively, most of the increase in VAT collections in 2011 was registered in February, when monthly collections of this tax were 84% higher than in the same month of the previous year, in real terms (see Table 4 and Figure 4). In all following months, VAT performance was much more modest, and was actually below the 2010 level in the month of June. However, the impact of the striking hike in February is still palpable in the cumulative results for the five months. At the same time, despite the cumulative growth, VAT collections have recently fallen behind schedule, being 5.6% below period benchmark by the end of the Q2 2011 (Table 2).

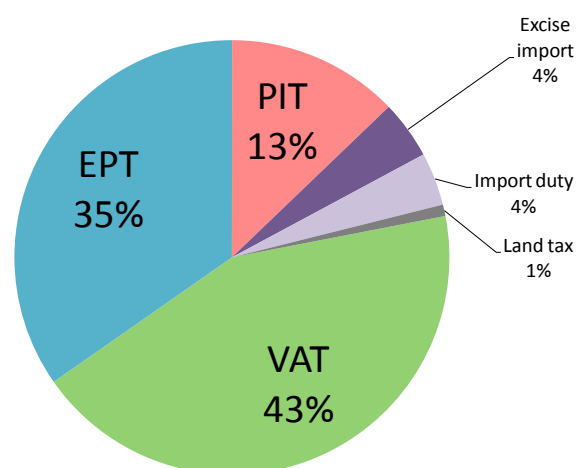
- **Increase in EPT.** EPT is one of the three biggest revenue sources in Ukraine's budget (12% of total consolidated revenues in the 2011 Annual Plan - comparable to PIT at 16% but twice smaller than VAT at 30%). In the first six months of the year, collections of this tax have increased by 37.3% in real terms compared to the same period of 2010, representing the biggest real increase of all other taxes. As shown in Table 3 and Figure 3, this increase was responsible for 34.7% of the overall real growth in consolidated revenues in the first half of 2011. Unlike VAT, EPT collections have been somewhat more consistent throughout the year: the tax has demonstrated two quarterly hikes (albeit each time it was a month earlier than the tax reporting period, as illustrated in Table 4 and Figure 4). As we wrote earlier, the State Tax Administration informed the media that most of the tax increase in January-February (68% of extra revenues) was collected from large enterprises, which include 1,152 entities or 0.13% of the total number of taxpayers in Ukraine¹. With the described real growth, EPT became the tax which demonstrated the best performance in comparison to period baseline projections. In January-June 2011, EPT collections were 36.2% higher than the period projection (see Table 2), while essentially all other taxes were actually behind schedule (the PIT was collected almost precisely as projected).

Table 3. Contribution of individual revenue sources to revenue increase in January-June 2011 compared to same period of last year

| | Real change to same period of 2010 | | % Contribution to overall revenue growth |
|-----------------------------|------------------------------------|---------------|--|
| | (UAH mln) | (%) | |
| Total Revenue Change | 10,641.93 | 12.10% | |
| Revenues Increasing | 11,113.69 | | 100.00% |
| VAT | 4,816.10 | 17.08% | 43.33% |
| EPT | 3,860.30 | 37.35% | 34.73% |
| PIT | 1,422.84 | 10.17% | 12.80% |
| Excise import | 481.33 | 39.07% | 4.33% |
| Import duty | 438.51 | 21.30% | 3.95% |
| Land tax | 94.61 | 3.46% | 0.85% |
| Revenues Decreasing | -471.76 | | 100.00% |
| Other Revenues | -407.30 | -1.79% | 86.34% |
| Excise internal | -64.45 | -0.98% | 13.66% |

Source: Treasury Budget Execution Report; Calculations by FISCO id

Figure 3. Major contributors to real revenue growth in January-June 2011: VAT; EPT; PIT



- **The third biggest contributor to consolidated revenue growth was Personal Income Tax (PIT), which increased at slower rates (and somewhat behind schedule) but still significantly, and more consistently.** As illustrated in Table 2, PIT receipts in January-June 2011 were 11.3% higher than in the same period of last year, and this result has persisted through most of these five months, dropping only in June (Table 4 and Figure 4). At the same time, PIT collections have been just nearly at the level of period baseline projections (above by 0.1% in the cumulative result for January-June 2011), although the annual plan itself for this tax was significantly reduced this year compared to 2010.
- **Import-related taxes are still buoyant and higher than last year but they have steadily decelerated throughout January-June 2011.** The two key import-related taxes – Import Duties and Excise taxes on imported goods - were responsive for a tenth of overall revenue growth in the consolidated budget, being 21.3% and 39.1% higher (respectively) than in the same period of 2010, in real terms. However, performance of these taxes decelerated during the first six months of the year (see Figure 4), with Import Duties actually declining in June. Cumulative collections of Excise taxes on imported goods in the first half of the year were still considerably above schedule (above by 18%)², but Import Duties have by that time actually fell behind schedule (by 5.5%).

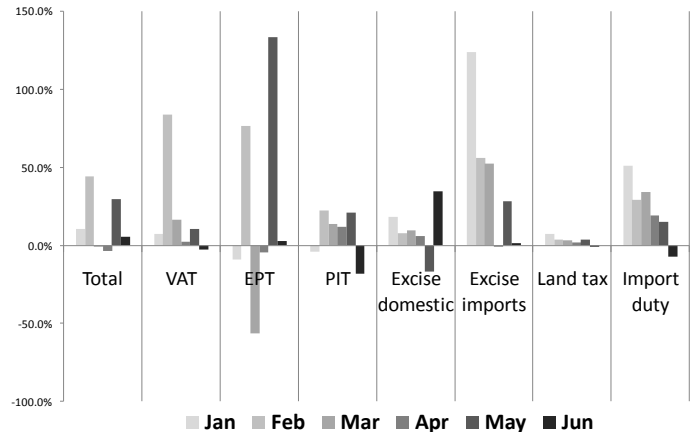
¹ FINANCE.UA, 22.03.2011; <http://fisco-id.com/?module=news&action=view&id=8809>

² Overall performance of combined Excise collections in January-June 2011 (on domestic and imported goods) were 11.9% behind schedule because of the underperforming domestic component (which was behind schedule by 17%).

Table 4. Monthly real revenue growth during Jan-Jun 2011 (over same months of 2010)

| | Monthly % Real Change (2011 to 2010) | | | | | |
|-----------------|--------------------------------------|--------------|--------------|--------------|--------------|-------------|
| | Jan | Feb | Mar | Apr | May | Jun |
| Total | 10.8% | 44.2% | -0.6% | -3.4% | 29.8% | 5.8% |
| VAT | 7.2% | 84.0% | 16.4% | 2.5% | 10.8% | -2.4% |
| EPT | -9.1% | 76.7% | -56.5% | -4.7% | 133.7% | 2.9% |
| PIT | -3.9% | 22.2% | 13.9% | 12.0% | 21.0% | -18.2% |
| Excise domestic | 18.4% | 8.1% | 9.5% | 6.0% | -16.6% | 34.6% |
| Excise imports | 123.9% | 55.9% | 52.7% | -0.6% | 28.3% | 1.5% |
| Land tax | 7.2% | 4.0% | 3.1% | 1.9% | 3.7% | -0.7% |
| Import duty | 51.0% | 29.0% | 34.3% | 19.3% | 15.1% | -7.3% |

Figure 4. Monthly real revenue growth during Jan-Jun 2011 (over same months of 2010)



Consolidated budget spending

- Real consolidated spending grew consistently during January-June 2011.** Cumulative expenditures of Ukraine's consolidated budget in January-June 2011 were 0.2% higher than in the same period of previous year, in real terms (see Table 5). Monthly spending pattern throughout the first months of 2011 has been stable and consistent, with real monthly spending gradually increasing every month (see Figure 5). In June 2011, despite the steady increase in real spending, comparison to the same period of 2010 became continued to be less favourable (dropping from 10.3% in January-April to only 3.3% in January-May and just 0.2% in January-June) because of the hike in social protection expenditures related to a sharp increase in the transfer to the Pension Fund in May-June 2010 (also illustrated in Figure 5).

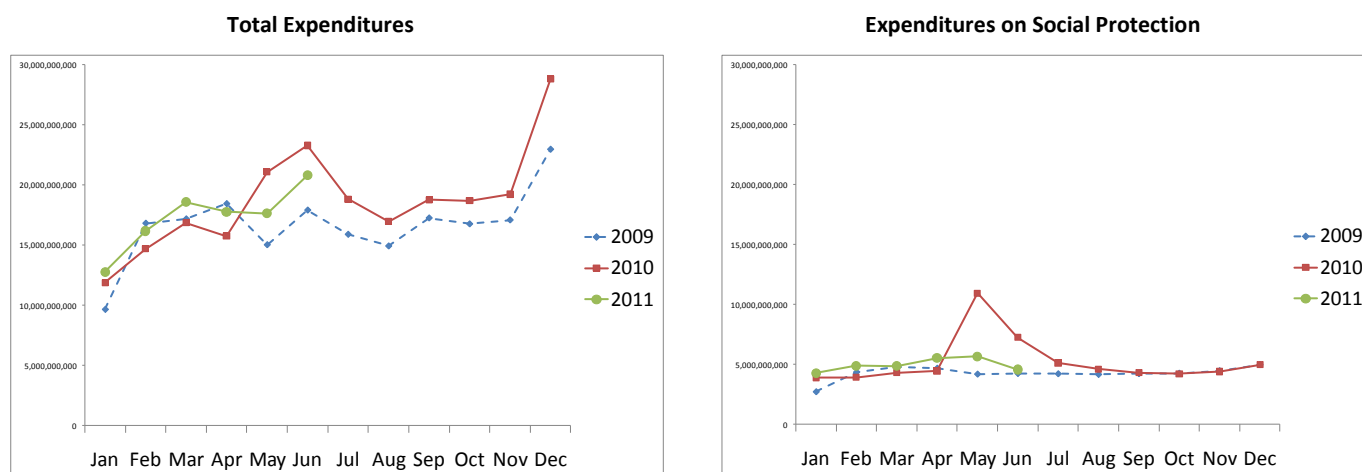
Table 5. Consolidated Expenditures through January-June 2011 (UAH Million)

| | Nominal actual expenditures (Jan-Jun 2011) | Comparisons to plan | | Comparisons to same period of 2010 | |
|-----------------------------------|--|----------------------------|---|--|------------------------|
| | | Annual plan (Jan-Dec 2011) | Actual expenditures as % of annual plan | Nominal actual expenditures (Jan-Jun 2010) | % Change in real terms |
| Total Expenditures | 187,575.98 | 425,125.98 | 44.12% | 171,154.97 | 0.18% |
| Public Administration | 22,197.73 | 54,120.97 | 41.02% | 18,710.66 | 8.34% |
| Defence | 5,365.44 | 14,549.62 | 36.88% | 4,674.45 | 5.04% |
| Civil Order, Security & Judiciary | 13,918.68 | 32,579.58 | 42.72% | 11,786.83 | 7.97% |
| Economic Activities | 19,445.40 | 62,744.02 | 30.99% | 14,678.86 | 21.08% |
| Environment Protection | 1,118.86 | 5,555.42 | 20.14% | 720.72 | 41.57% |
| Housing and Utilities | 2,454.16 | 8,533.28 | 28.76% | 1,623.01 | 37.71% |
| Healthcare | 20,776.45 | 46,412.36 | 44.76% | 18,467.38 | 2.94% |
| Culture and Sports | 4,520.90 | 10,649.68 | 42.45% | 4,623.80 | -10.68% |
| Education | 43,999.10 | 84,471.88 | 52.09% | 38,374.80 | 4.76% |
| Social Protection & Social Care | 53,779.25 | 105,509.18 | 50.97% | 57,494.45 | -14.43% |

Source: Treasury Budget Execution Report

- Social Protection spending decreased in real terms, although the high-base comparison to May and June 2010 exaggerates the magnitude of the decrease, which is in reality much less dramatic.** The high-base comparison to the spending hike in May-June 2010 also explains why social protection spending in January-June 2011 is now 14.4% lower than in respective period of the previous year, although it actually grew consistently every month of the year compared to the previous month, with only small monthly decrease in June (Figure 5). Moreover, in all months of 2011 this programme was funded at the fastest rate among all other functions compared to respective annual targets (51% of the annual allocation spent by end of June, see Table 5). The largest share of social protection spending is support to Pension Fund.

Figure 5. Monthly consolidated real spending in 2009-2011: Total Expenditures and Expenditures on Social Protection



Box: Spending on cash transfers based on “Money Follows the Child” programme

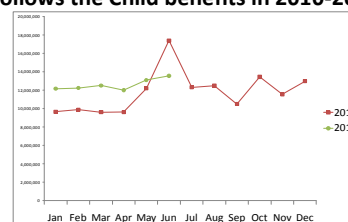
as an example of continuously growing social benefits

An example of a social protection programme which consistently expanded during 2011 is the benefit scheme for family-type orphanages and fostering, named “Money Follows the Child”, which exists in Ukraine since 2006. As illustrated in Table 6 and Figure 6, allocations to this programme in January-June 2011 increased by 10.5% in real terms compared to the same period of the previous year (considerably above the rate of growth in total expenditures and in most other programmes) and have expanded consistently in every month of 2011 compared to previous months (in real terms).

Table 6. Key totals related to "Money Follows the Child" spending in Jan-Jun 2011 (UAH million)

| | Nominal actual expenditures (Jan-Jun 2011) | Comparisons to plan | | Comparisons to same period of 2010 | |
|---|--|----------------------------|---|--|------------------------|
| | | Annual plan (Jan-Dec 2011) | Actual expenditures as % of annual plan | Nominal actual expenditures (Jan-Jun 2010) | % Change in real terms |
| Total Expenditures of the Consolidated Budget | 187,575.98 | 425,125.98 | 44.12% | 171,154.97 | 0.18% |
| Cash transfer based on "Money follows the child" scheme | 136.46 | 283.35 | 48.16% | 112.95 | 10.51% |

Figure 6. Real monthly spending on Money Follows the Child benefits in 2010-2011



- Programmes intensive in capital investment improve compared to very low base of 2010, but are still funded at slowest rates and sometimes below 2009 levels.**

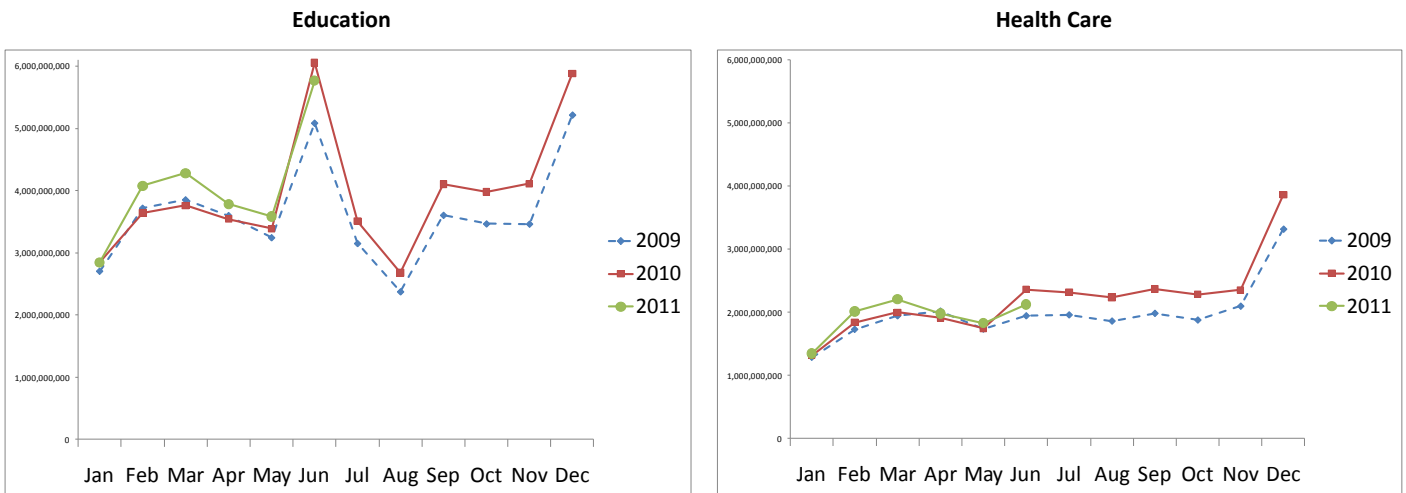
- The biggest real increases in spending throughout January-June 2011 were registered in Environment Protection (up by 41.6%) and Housing&Utilities (up by 37.7%). Real spending on Economic Activities in the first five months of 2011 is also 21.1% above last year's results. However, the growth is registered against the year when these two programmes were among those most underfinanced. As illustrated in Figure 7, for all those programmes, real spending in some months of 2011 was actually lower than in 2009. All these programmes are also funded at slowest rates as percentages of the annual plan (20.1% for Environment Protection, 28.8% for Housing and Utilities, and 31% for Economic Activities), even though the annual plan itself was significantly reduced in 2011 for those particular functions. This, however, could be related to the seasonal pattern of many investment-related programmes.

Figure 7. Monthly consolidated real spending in 2009-2011: Housing & Utilities and Environment Protection

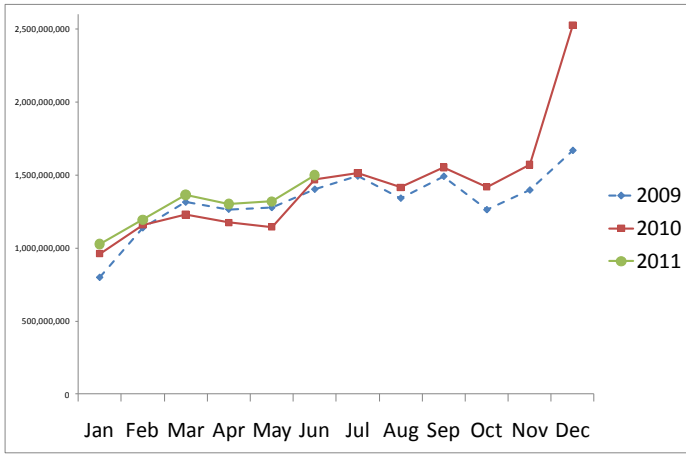


- All wage-intensive programmes repeat their historical patterns, somewhat increasing in real terms compared to last year.** As illustrated in Figure 8, the majority of other expenditure programmes remain within their seasonal patterns, slightly expanding in real terms (Table 5). In particular, total expenditures on Education have been 4.8% higher in January-June 2011 than in the same period of the previous year, in real terms, and total real expenditures on Healthcare were higher by 3%. The real increase in total spending compared to last year in Civil Order, Security and Judiciary was 8%, and in Defence it was 5%.

Figure 8. Monthly consolidated real spending in 2009-2011: Education, Healthcare, Civil Order&Security, and Defense



Civil Order, Security and Judiciary



Defense

