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On the draft amendments to the Budget Code focusing on the potential links/impacts on the implementation of the EU-UA Association Agreement

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Draft for discussion

Comments

on the draft amendments to the Budget Code focusing on the potential links/impacts on the implementation of the EU-UA Association Agreement

The context

The comments below were prepared on the bases of a draft received in mid-November in the form of non-official translation. Thus some of the comments are not relevant anymore because the draft itself has been changed or some other comments are based on inaccuracies of the translation.

The purpose

The purpose of this document is to summarize the critical observations-recommendations on the draft amendments to the Budget Code (the "Draft"). The comments reflect the result of the analysis made from the AA implementation. Thus they intend to be comprehensive neither regarding scope nor detail.

General comments

The Draft represents a significant move towards a modernised Public Finance Management system aimed by the PFM strategy. However, with some further improvements could serve better the original objective.

Due to the massive amount of suggested changes and the new underlying logic, the development of a new Budget Code could be considered. If this is not feasible, at least another codification method is suggested to make the suggestions easier to understand.

Specific comments

1. Introduction of the medium term budgeting is a significant step forward. However, as it is drafted, it is not more than a rolling two years outlook/forecast for the years to come after the year the annual budget is drafted for. It seems that deviation from that forecast will be easy and as a result, the aimed impact on strengthened fiscal discipline is doubtful.

The additional missing elements are as follows:

- a) The Draft does not make it clear that the figures (or what figures) of the outlook represent an obligation both for the Government in general or for the individual budget users;
- b) Similarly it is not clear what commitment those figures represent for the budget users for planning and financial commitment purposes;
- c) There are no criteria/rules for legitimising the deviation(s) from the forecasted figures;

- d) The Draft envisages medium-term financial ceilings for the ministries but not for the budget programs. Thus it does not give enough orientation for the policy making for the future and also there is no defined process what to do (and who should take the appropriate action) if the ceiling is about to be broken by new policies/programs within one particular ministry.
2. For making the Draft more effective the following additional rules are suggested for consideration:
- a) At least the ceilings for the next two years should be defined by the Verkhovna Rada (not by the CMU only in the Budget Declaration). Such ceilings should be set not just for the ministries but for the budget programs (or for a gradually increasing number of selected budget programs) too.
 - b) This obligation represented by the approved ceiling should mean that no policy or legislation could be adopted regarding any of the budget programs that would lead to the violation of the limit in the future unless a convincing countermeasure is adopted for compensating the foreseeable violation.
 - c) On the other hand budget, users should be ensured that their programs will be funded in line with the forecast unless specific predefined events occur and should also be authorised to make financial commitments up to a certain percentage of the approved ceilings for enabling the budget programs to move smoothly.
3. The system mentioned above could operate only if there is a reliable process for assessing the fiscal impacts of proposed policies/legislation. Although there are some rules/guidelines in place for calculating the cost of proposals, they need significant improvement.
- a) Besides the cost of implementation, both direct and indirect fiscal impacts should be visible to the decision makers. Depending on the nature of the proposal - and in line with the medium-term budgeting concept – such impacts should be calculated at least for three years but in case of longer-term policies for an even longer-term period.
 - b) Rules are also needed to ensure that the presentation of the fiscal impacts is correctly put in context. They always should be matched against the “baseline” scenario (the deficit path without the proposed change), the medium-term budget (the baseline could be different from the medium term budget due to some already adopted policies) and combine with the impacts of other proposals if relevant.
 - c) Such calculations are not easy to make, and the proposing ministry is typically interested to underestimate the negative and overestimate the positive fiscal impacts. Thus it is necessary to make them centrally, in an institution that has the capacity and also the neutrality. It could be the Ministry Of Finance, a separate office reporting directly to the CMU, or an independent (from the Government) institution. Although the latter would require significant changes in the institutional setup, that could be the most effective instrument for maintaining fiscal discipline. The establishment of a “Fiscal Council” or “Budget Office of the Verkhovna Rada” could make the fiscal decisions more evidence-based and forward-looking. Such a move might have additional benefits: having one of them on board could the fight against populist proposals make more comfortable and increase the room for manoeuvring of the CMU.

4. The Draft suggests to introduce or reinforce some elements of strategic planning. The will is positive, no doubt about it. The problem, however, is that due to the scope of the Budget Code it focuses on the budget process only. It is known that some efforts are going on for introducing some elements of the strategic planning system, the redesigning of the policy-making by Rules of Procedures of the CMU in particular. The restructuring of the pilot ministries has an impact on the planning issues too. The danger is that these steps remain isolated, uncoordinated, sometimes even contradictory. There is no visible “master plan” or concept of the strategic planning system covering both the policy planning and the fiscal planning sides and linking them actively, actually integrating them¹. It is not necessarily suggested that the same of legislation regulates every element, but the different pieces of law should be synchronised adequately in line with one single concept.

A few examples of the elements that need coordinated regulation:

- The hierarchy of planning documents
- The iteration process of medium-term strategic plans of the CMU and the medium-term budget framework
- The integration of the annual policy planning and budget planning
- The development of the medium-term strategic plans of the ministries as a policy planning/institutional development instrument and budget planning instrument
- The linking the policy development to budget programs.

The primary consideration when regulating those issues should be to enable the CMU to think about policies, prioritise and match them against the fiscal constraints as opposed to the present situation when the MoF is forced to make the prioritization based on budgetary criteria mainly.

Impact on the AA implementation

The changes suggested by the Draft could enhance the fiscal discipline but because of the deficiencies (some of the mentioned below) does not support the implementation of the AA to the extent they could otherwise. In case of more developed policy planning and development process linked adequately to the medium term budgeting, the AA implementation could better fit into the CMU priorities and the actual implementation of the adopted regulations could be smoother.

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¹ Such a concept was produced for example by a project funded by Sweden under the title: Government Strategic and Budget Planning in Ukraine: ways of reform, in 2013.