



ASSESSMENT OF EFFICIENCY OF PUBLIC EXPENDITURE AND STEPS TO OPTIMIZATION

Executive summary

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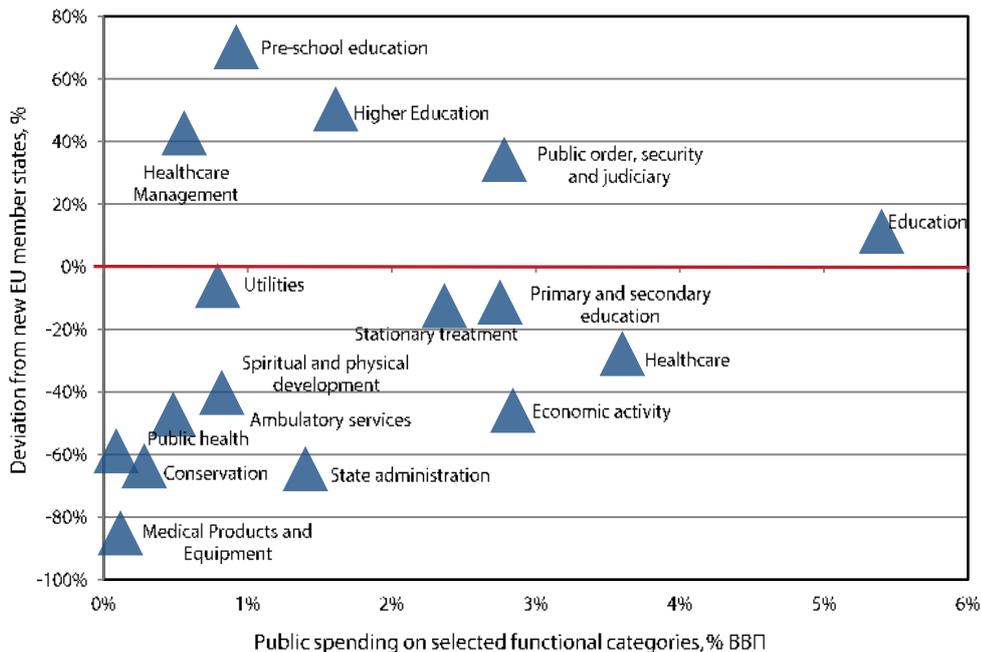
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1 Executive summary

In order to restore economic growth and steer Ukraine on a path of sustainable development in the future, today the government must stabilise the public finances. If Ukraine will implement fiscal consolidation by reviewing and optimising public spending, it can help reduce the budget deficit, lower debt burden and improve the functioning of the public sector and improve the quality of public and social services, which are financed by taxpayers.

Figure 1. The volume of public spending in certain areas in Ukraine and their deviation from spending in new EU member states*



* Categories «Social security and pension insurance», «Defence» and «Debt service» removed because of the relatively high levels of deviation from the corresponding rates in new EU member states

Source: Ministry of Finance, Ukrstat, Eurostat, CES estimations

The effectiveness of state institutions for countries with a relatively large public sector (45-50% of GDP) determines economic productivity in general and can stimulate economic development. For the past 20 years in many countries, public spending grew due to an ageing of the population and as a result increased demand for social services and healthcare. International experience shows that the more clearly defined priorities for public spending and the higher the performance, the better the dynamics of economic growth, the quality of public services and the sustainability of public finances.

After a major review of public expenditure, the structure of expenditures in these countries significantly changed and effectiveness grew. Reformers comprehensively approached the revaluation of state functions in certain sectors and assessed relevant government programs. After the initial reform in some countries, the expenditure review process was repeated and ministries included reviews to the budget calendar. Many countries have introduced fiscal rules on spending both at the legislative level and at the level of political commitment.



The public sector in Ukraine can achieve better results at a lower cost with implementation of structural reforms. In 2015-2016 public spending has been reduced (mostly through inflation), but there are still broad categories of public expenditure where review and optimisation will reduce costs and improve results. The overall level of public spending in Ukraine in recent years was higher than in other countries, although the volume is comparable to some developed countries of the EU. However, some areas of public spending do not get enough funding in comparison with other countries and others receive a substantially larger proportion of resources (see. Figure 1). Relatively high defence spending and debt service due to temporary circumstances and changing priorities mean they should not be seen as a long-term high-cost category that needs immediate review. The greatest potential for increasing efficiency and optimisation are found in areas such as social security, education, healthcare, public order and security.

Review and cost optimisation for social security and pension insurance can reduce annual government spending at least by 1.0% of GDP. The structure of public spending in Ukraine is dominated by spending on social security and pension insurance and this area has high potential for cost reduction following a review of government social programs. In particular, such measures include verification of recipients of social benefits and pensions; increasing the share of social aid, which includes control of wealth status that can save at least 1% of GDP annually. However, the full extent of savings is difficult to assess because the main reduction must occur in the long term by increasing the retirement age.

Cuts in public spending on higher education and optimising the network of secondary schools could save up to 0.4% of GDP. Structural reform of the education sector will ensure compliance with important challenges and increase the return on money spent. Public spending on higher education is 70% higher than the average in CEE.

Large-scale implementation of Prozorro public procurement system will save 0.6% of GDP (under the assumption of savings of 10% by budget administrators). In addition to saving public resources, transparency in public procurement by their scale at the level of 7% of GDP will stimulate competition and raise the efficiency of the economy as a whole, which later will support better dynamics of economic growth.

1.1.1 Optimisation of hospitals, increased independence of medical institutions, and clear definition of the service package guaranteed to all citizens will more optimally reallocate public resources within the health system and save 0.7% of GDP in this area. These funds can be spent on improving the quality of medical services. This will require the implementation of the National Health Reform Strategy for Ukraine 2015-2020 and the Concept of Reforming the Healthcare Industry. Compared to CEE countries, Ukraine spends relatively little on health and gets much worse results for the overall health of the population. Public resources are allocated suboptimally between the levels of healthcare, with almost half of healthcare expenditures being paid by citizens themselves. Due to long-established inefficiency and lack of healthcare spending, the share of people with health problems and reduced working ability is high. The situation is compounded by the general trend of aging. Thus, without reforms in public expenditure in the long-term perspective, the state will need more resources for social aid than now, and this is a risk to the long-term sustainability of public finances.

1.2 Reform of law enforcement will save up to 0.6% of GDP on the condition of quantitative and qualitative parameters of internationally recognised standards. Because of the relatively large number of law enforcement officers, the total cost of the rule of law in Ukraine is on average nearly 2.6% of GDP, while in CEE expenditures in this area are at the level of 2.0% of

GDP. Thus, the efficiency and confidence in law enforcement in Ukraine is low compared with other countries.

Centre for Economic Strategy was founded in May 2015 by Tomas Fiala, CEO of Dragon Capital, Ukraine's leading investment bank, Ivan Miklos, former deputy prime minister and minister of finance of the Slovak Republic, and Svyatoslav Vakarchuk, civic activist, musician. Centre for Economic Strategy contributes to the development of economic growth strategy for Ukraine, conducts independent analysis of the most important policy issues, and builds public support for reforms based on the following principles:

- Economic freedom (liberalization, deregulation, privatization)
- Free and fair competition
- Small but effective state
- Transparency and freedom of information
- Law enforcement and property rights protection
- Sound and sustainable public finance
- Knowledge-based economy

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