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How Ukraine Can Survive 2013 Without the IMF

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The global bond market rescued Ukraine from budget revenue shortages during the first half of this year allowing it to meet its foreign debt obligations. The Ukrainian government issued successfully a number of sovereign and domestic bonds that were fully subscribed. While this financial influx helped government cover state budget gaps without an IMF program, Ukraine's luck so far does not guarantee a repeat in the near-term.

Ukrainian authorities will concurrently move along two paths: continue talks with the IMF in hopes of a new stand-by agreement and simultaneously search for alternative financial instruments to meet debt obligations. Among them are domestic investors, Russian banks and Chinese loans. These alternatives may be financially less attractive than IMF loans; however, they are much cheaper politically than the potential public fall out from unpopular reforms.

A new IMF mission is due in Kiev at the end of June. However, doubts remain whether an agreement will be reached because the fund is not ready to change its position on state budget financing of loss-making monopolies. The government is slow to move on important structural reforms in public utilities and breaking up energy and transportation monopolies. The IMF should continue to press for not only quicker government decisions on reform but, more importantly, their implementation prior to a new stand-by agreement for Ukraine.

Building consensus around reforms within the ruling Party of Regions and the government has been a challenge. Oligarchs close to government don't want to sacrifice rents and other favors from the state budget. Instead, they want to prolong them as much as possible. Technically, the central bank has enough financial resources to continue propping up the national currency through emissions well into 2014. Second, government has the ability to last the year without significant changes to state budget expenditures. With time, these problems will exacerbate due to President Viktor Yanukovych's intent to increase social spending and other budget expenditures ahead of the 2015 presidential election.

Ukraine's economy has been shrinking for eleven consecutive months. Not only is the economy stagnating from a lack of foreign direct investment, more onerous, production is declining. Under these circumstances, government talk about increasing budget expenditures based on the flawed assumption of modest economic growth could lead the economy into deeper crisis.

Paradoxically, retail sales continue to grow, meaning that the population is getting its income from non-official sources. To improve the budget situation, Ukraine's parliament desperately needs to pass laws to help increase budget revenues by reducing the shadow economy.

First order of business would be real reductions to the gray economy, as proposed by the Revenues and Duties Ministry. For example, an initiative to introduce a control strip for cash registers is a promising step, which numerous governments before have considered but failed to adopt. It's now time for this initiative to be implemented and applied to all trade channels without exception — from taxi services to open-air markets. Not only will this bring significant revenues to the state budget, more importantly, it could drastically bring retail trade out of the shadow economy.

Another government idea is to reduce the single social tax. This will help legalize incomes only if government can create good will within the corporate sector for cooperating with tax authorities, as well as simplifying tax legislation overall. Current tax norms place entrepreneurs in a difficult position; even if they attempt to follow the law they are unable to do so fully due to loopholes in the regulations and corruption within the tax collecting authorities.

Third, parliament must pass amendments to transfer pricing laws that close loopholes used by Ukrainian companies that shift their profits to offshore entities in tax havens such as Cyprus. Forcing Ukrainian companies that produce raw materials and commodities to pay tax on their profits onshore would help government close the budget gap.

Finally, the budget has an additional safety net known as tax break optimization. For example, tax breaks to the depressed metallurgy and chemical industries, controlled by oligarchs, are absolutely unnecessary. On the other hand, a special tax regime for the agriculture industry is needed to further spur modernization and growth. Government should give limited term tax breaks only for infrastructure projects that facilitate modernization.

The government needs to take unpopular steps to implement a number of fiscal reforms that will negatively impact oligarchs close to it. Government should forget about hopes for an economic miracle, like a sudden increase in global demand for steel and other commodities, which have pulled Ukraine out of past recessions.

The investment community is waiting for government reforms that might boost economic growth in the second half of this year and into 2014. Instead, the government continues to muddle through with half measures that could lead to greater economic crises right before the 2015 presidential election. Soon enough Ukraine might need a bailout from the IMF instead of a stand-by agreement.

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The views expressed in opinion pieces do not necessarily reflect the position of The Moscow Times.