The Effects of Rent-Seeking Behavior on the Efficiency of Fiscal Policy in Ukraine

Nadiia Grazhevska\textsuperscript{a,*}, Angelina Virchenko\textsuperscript{b}, Anna Grazhevska\textsuperscript{a}

\textsuperscript{a}Taras Shevchenko National University of Kyiv, 90A, Vasylkivska str., Kyiv, 03022, Ukraine
\textsuperscript{b}Staff Training Institute of State Employment Service of Ukraine, 17, Novovokzalnaya str., Kyiv, 03038, Ukraine

Abstract

The paper analyses the distinctive features of fiscal regulation of Ukrainian economy as a crucial factor of ensuring national security. The authors reveal the structure of fiscal policy transmission mechanism and highlight the peculiarities of its channels under macroeconomic stabilization. The theoretical and empirical analysis unveils certain obstacles that arise in the Ukrainian economy on the way to establishing macroeconomic efficiency of its fiscal impulses. The most important obstacles of such sort are formation of rentier economy and counterproductive rent-seeking behavior of economic actors. The study of this phenomenon and of their influence on the efficiency of fiscal policy instruments in national economy made it possible to suggest a number of practical recommendations. These recommendations cover bureaucracy reduction, improvement in efficiency and transparency of public administration, provision of clear specification of property rights, implementation of civilized justice system, and enhancement of possibilities for public control of budget spending and use of public property and assets.

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1. Introduction

A crucial feature of the present is an increase in structural interdependence of national economies and integration of their key sectors into co-dependent comprehensive whole, which functions in real time, as claimed by Castells

* Corresponding author. Tel.: 38-066-432-23-12.
E-mail address: greenconf2014@ukr.net
These processes exercise non-equilibrium, indeterminism and pluralism of economic development, which in turn aggravate and differentiate the mechanisms of re-establishment of macroeconomic stability. Under these conditions, the provision of an efficient policy of national security, aimed to guard vital interests of an individual, community and state, becomes especially important.

The provision of national security is particularly crucial for modern post-communist economies, which develop under conditions of high economic instability and experience an accelerated entry into the structures of already existing economic relationships and interdependencies. The current stage of economic development of such economies is characterized by reconsideration of the role of available fiscal instruments of macroeconomic policy and enhancement of their adaptive resilience against internal and external shocks.

The exploration of fiscal policy transmission mechanism and identification of its most effective channels under macroeconomic non-equilibrium is particularly important in order to resolve the economic crisis of Ukrainian economy, caused by systemic deformations accumulated during the transformation period. A fundamental modernization of national economic system along with formation of developed wealth society, integrated into European community, are impossible without profound theoretical comprehension of major obstacles to the macroeconomic effectiveness of fiscal impulses in the Ukrainian economy. One of the key obstacles of such sort is a counterproductive rent-seeking behavior of economic actors related to corruption, implementation of inefficient property rights and decline in production due to wasteful use of resources.

Experts of the World Bank claim that the main problem in the field of business regulation in transformation period in Ukraine was an excessive issuance of permits, regulations and licenses, accompanied by inefficient and corrupt business inspections. According to the report Opportunities and challenges to private sector development in Ukraine (2014), almost half of Ukrainian enterprises were forced to use the so-called "informal ways" of resolving the problems with government agencies (World Bank, 2014). This information was confirmed by the results of Corruption Perceptions Index of Transparency International, according to which Ukraine was ranked 144th out of 176 countries investigated, tied with Bangladesh, Cameroon, Central African Republic, and Syria as one of the most corrupted countries in the world (Transparency international, 2013). The analysts believe that business in Ukraine is highly monopolized, because oligarchic clans often use their connections with government and seek its "selective protection" which destroys a healthy competition and transparency. In Ukraine there have always been different rules of game for entrepreneurs, dependent on their connections with government officials. The officials were not simply involved into financial flows, but initiated them. The most striking evidence of this is the refusal of public enterprises to conduct transparent procurements, which amounted to 350 billion UAH or about $ 45 billion in 2013 (Transparency international, 2014).

Under such circumstances, national security of Ukraine can be enhanced through elimination of rent-seeking nature of the Ukrainian economy, which can be obtained as a consequence of improvement of the fiscal policy transmission mechanism. Such improvement implies formation of an institutional framework that facilitates effective impact of fiscal impulses on the development of the real economy. The effectiveness can be achieved through a clear specification of property rights, freedom of entrepreneurship, decentralized non-personified exchange, transparent work of officials, existence of educated civil society and an independent judiciary.

2. Literature Review

In the modern foreign literature the issues concerning regulations of fiscal policy, provision of national security, as well as the issues concerning efficient functioning of the fiscal policy transmission mechanism were considered in the works of A. Alesina, A. Aslund, V. Bazylevych, E. Baldacci, Ch. Blankart, O. Blanchard, R. Barro, V. Bodrov, J.M. Buchanan, I. Wallerstein, A. Galchynskyi, V. Geyets, M. Castells, G. Mankiw, R. Musgrave, R. Perotti, D. Romer, I. Radionova, S. Slukhai, J. Stiglitz, A. Chukhno et al.

Gavin and Perotti (1997) explored the reasons why the main part of revealed links between fiscal policy and real and monetary sectors that can be found in developed market economies, are disrupted in post-communist economies. Alesina et al. (2008) made an attempt to reveal the logic of why fiscal policy, called to stabilize national economy, and hence to smooth business cycles in low-income countries often turn out to be procyclical. Ilzetzki (2007) explained why such institutional factor as rent-seeking behavior in government sector triggers macroeconomic distortions through procyclical character of fiscal regulations. Radionova and Alimpiiev (2011) discovered that the transition
economies suffer from shock responses to fiscal impulses, which often make government policy partly or completely ineffective. Geyets et al. (2004) highlighted the modern trends in the development of intergovernmental relations and analyzed peculiarities of these trends in transition economies.

The scientists agreed on the fact that one of the main reasons that led to the deep and lengthy transformational recession in Ukraine was an underestimation of importance of an institutional environment. The dominance of rent-seeking in all spheres of public life became one of the major institutional barriers on the way toward modernization of the national economy.

Not surprisingly, the analysis of the mechanisms and effects of rent-seeking behavior is one of the main research topics in the public choice theory along with investigation of tax issues and public expenditures under the provision of public goods. Gordon Tullock (1967), a co-founder of a new political economy, described the phenomenon of rent-seeking behavior of economic agents for the first time. However, the expression rent-seeking was put forward only in 1974 by American economist Anne Krueger. According to Krueger (1974) this term describes behavior of economic agents under institutional transformation, when individual efforts of income maximization generate societal losses rather than benefits.

A significant contribution to the analysis of the prerequisites and consequences of the rent-seeking behavior was further made by Buchanan and Tollison (1980), who interpreted rent-seeking behavior of economic agents, aimed to capture artificial transfers, as a waste of limited resources. The researchers claimed that, despite the fact that these transfers only redistribute resources, the costs of obtaining them contribute to the net societal losses. These losses arise due to the introduction of inefficient property rights and decline in production associated with wasteful use of resources.

A solid analysis of the nature and motives of rent-seeking behavior was provided by Olson (1971), who investigated the rent-seeking behavior in the context of interaction of different interest groups. At the same time, McChesney (1988) justified the concept of rent extraction or extortion, used by politicians and government officials with a purpose to maximize their own benefits. They seek to maximize their own welfare through exercising a pressure on economic actors by threatening them with an implementation of regulations that can worsen their well-being. The negative expectations of economic agents motivate them to make some money transfers to the government in order to give politicians a stimulus not to fulfill their threats.

The rent-seeking is often interpreted as informal institution that facilitates revenue maximization of certain groups of economic agents through elimination or limitation of market competition. Hence, there might be possibilities of formalization of this institution as economic actors seek not only to seize the sources of rentier income, but also want to establish their rules of the game in order to obtain such income through changing the regulatory influence of the state.

Despite the existence of numerous publications on various aspects of formation and development of rentier economy, there is a lack of studies, which analyze the influence of rent-seeking behavior of economic actors on effective implementation of fiscal measures. Moreover, the issues of socioeconomic preconditions and the nature of institutional factors that facilitate rent seeking in post-communist economies also remain unresolved. In addition there must be suggested a theoretical reasoning that would shed a light on the main areas of state regulation of aforementioned processes in order to overcome institutional barriers and to ensure market modernization of the Ukrainian economy.

3. Material and method

Though economic theory explores some of the aspects of macroeconomic instability and proposes certain policy tools for advanced market economies, there exists a lack of theoretical and methodological approaches able to explain the macroeconomic deviations and institutional and behavioral distortions in transition economies. Nevertheless, some of the traditional methods of economic analysis can be adapted and used to study the low-income transition economies, such as e.g. Ukrainian economy.

The paper widely uses comparative method, which helps to reveal the peculiarities of fiscal policy transmission mechanism in transition economies associated with rent-seeking behavior of economic actors. The study demonstrates the contrast between the consequences of the same fiscal impulses in developed economies and in developing transition economies that arises due to the difference in institutional environments.
The causal method has been used in the research while considering the government spending, taxation and debt policy in rentier economy. By using logical method and comparative analysis, the authors made an attempt to reveal the distinctiveness of transmission of the fiscal impulses in transition economies. As a result, the general principles of taxation, expenditures, and management of government debt in Ukrainian economy were formulated.

When applying statistical analysis to reveal special features of Ukrainian economy the authors used a number of time series ranging from 2007 to 2013 such as the volume of the costs of detected offenses and inefficient use of public funds, public spending of state and consolidated budgets, and budget expenditure as a share of GDP. The empirical foundation of the study includes the number of statistical reports of governmental organizations and research institutes. The detailed statistical analysis outlines the key trends of Ukrainian public finances for the period of 2000 – 2013 and highlights some of the specific features of the Ukrainian fiscal policy transmission mechanism. A number of resolutions of the Ukrainian government were analyzed to reveal the distortions in implementation of national fiscal policy. Rating evaluations of the quality of institutional environment around the world, conducted by experts of the World Bank and the World Economic Forum, helped to reveal and analyze the specifics of the Ukrainian economy, characterized by counterproductive rent-seeking behavior of economic actors.

4. Results

During the last decades of the twentieth century (so-called period of “Great Moderation”, that was brought to the attention by Bernanke (2004)) the significance of fiscal policy in macroeconomic stabilization diminished due to the number of reasons. Firstly, its efficiency was considered rather skeptical due to the propositions of the Ricardian Equivalence. Secondly, the monetary policy was able to maintain a stable growth of GDP and low inflation levels, hence there was no reason to use another instrument. In that context, the abandonment of fiscal policy as a cyclical tool may have been the result of development of financial markets that increased the efficiency of monetary policy. Thirdly, in advanced economies the priority was to stabilize and possibly decrease typically high debt levels, whereas in emerging market countries, the low development of the domestic bond market limited the scope for countercyclical policy. Fourthly, the time lags between the periods of design and implementation of fiscal policy, together with the short length of recessions, implied that fiscal measures were likely to come too late. Finally, as Blanchard et al. (2010) claimed, fiscal policy was more likely to be distorted by political constraints than monetary policy. Additionally, implementation of monetary policy was more attractive as its range of tools was limited to the interest-rate policy.

Thus, the monetary policy was preferred to the fiscal policy for some time, but the global financial crisis of 2008 changed the situation fundamentally. The crisis, which began from the housing and financial sectors, has resulted in a significant decline in aggregate demand. This decline was the largest since the times of Great Depression. The aggregate demand dropped due to a reduction in economic welfare, increase in precautionary savings at the expense of lower consumption, existence of uncertain expectations from the side of households and firms and difficulties in obtaining a credit.

According to Blanchard et al. (2010), the fiscal policy has gained popularity in the period of arising threats to economic, social and political security under macroeconomic and global financial instability due to the following key factors. Firstly, as discussed above, the radical change of macroeconomic policy instruments in developed countries. Economic policy instruments that were used from the early 80th ceased to be effective under the global financial crisis (especially in effective aggregate demand supporting). Crisis turmoil gripped the economy around the world in such a way an opportunity to restore balance through a strategy of export-import operations was lost. Moreover, the financial crisis has weakened the traditional monetary transmission mechanism.

Blanchard et al. (2010) argue that a fiscal stimulus should be timely (as there is an urgent need for action), large (because the drop in demand is large), lasting (as the recession will likely last for some time), diversified (as there is uncertainty regarding which measures will be most effective), contingent (to indicate that further action will be taken, if needed), collective (all countries that have the fiscal space should use it given the severity and global nature of the downturn), and sustainable (to avoid debt explosion in the long run and adverse effects in the short run). The challenge is to provide the right balance between these sometimes competing goals—particularly, large and lasting actions versus fiscal sustainability.

Secondly, public debt targeting at a lower level. To implement measures of modern financial regulation not all countries have sufficient "fiscal space". The neglect of state debt was a significant threat to the sustainability of public
finances. Volatile capital flows, large internal and external debt, large risk premium – not only with developing countries and low-income faced with these restrictions, but also some developed countries. Hereby some advanced economies that entered the crisis with high debt levels limited their ability to use fiscal policy. Correspondingly, the countries with emerging market (e.g., Eastern Europe) that ran highly procyclical fiscal policies driven by consumption booms are now forced to cut spending and increase taxes despite unprecedented recessions. By contrast, many other emerging markets entered the crisis with lower levels of debt. This allowed them to use fiscal policy widely without risks for public finances sustainability.

Thirdly, designing better automatic fiscal stabilizers is essential. The global financial crisis tackled the problem of discretionary fiscal measures: they come too late to fight a standard recession. As Baunsgaard and Symansky (2009) and Blanchard et al. (2008) supposed, to boost efficiency of fiscal policy during crisis the improving automatic stabilizers is needed.

It is essential to take into consideration the peculiarities of fiscal policy in post-communist economies: it tends to be procyclical rather than countercyclical that reinforces the business cycle oscillation. For example, the expenditure growth rate of Ukrainian government is comparable with GDP growth rate (see fig. 1) that is the evidence of governmental procyclical trend. Figure 1 demonstrates that during 2011 and 2012 Ukrainian government tried to act countercyclical concerning expenditure response. However with lags in expenditure policy implementation.

![Fig. 1. The growth rates of Ukrainian GDP and Consolidated budget expenditures in 2008 – 2013](image)

Source: State Statistics Service of Ukraine

It is important to note that the effectiveness of government stimulation of economic development and growth is largely determined by the structure of government expenditure and not by its size. The statistic data shows that the expenditure on social protection held the largest share in the structure of the Consolidated Budget of Ukraine during the recent years (see fig. 2). On the one hand it implies social orientation of the budget, but on the other hand an increase in the share of social protection from 22% in 2012 to 29% in 2013 indirectly indicates a decline in living standards and tendency of government representatives to take popular decisions, which block the structural reformation of the national economy.
We should notice that the share of government spending on general public services increased from 11% to 12% in 2013, whereas the expenditure on national defense, public order and national security rose from 7% to 8% in 2013. According to the analysis, this increase occurred at the expense of expenditure on economic affairs that decreased from 13% to 10% in 2013 (see fig. 3).

The attention should also be paid to the most crucial problem of the Ukrainian budget sector. The rapid growth of liabilities, caused by the permanent changes in the budget and tax legislations, complicates the possibilities of control over the fiscal policy and restricts an access to long-term forecasting and planning (the planning horizon in Ukrainian budget is limited to one year).

As the table 1 shows, an increase in the government debt in the last few years was followed by a rapid growth of the costs on its repayment and service. The statistical analysis of the debt policy in 2007 – 2013 illustrates the destabilizing effect of the debt channel of the fiscal policy transmission mechanism in the Ukrainian economy. The
rapid growth of the state debt ratio from 12.3% to 35.9% was accompanied by an increase in the expenses on debt service from 1.63% to 6.56%.

Table 1. Debt service expenditures in 2007-2013.

| Period      | Debt service expenditures, mln UAH | % of Expenditures in the Consolidated Budget of Ukraine |
|-------------|-----------------------------------|------------------------------------------------------|
| 2007        | 3679.0                            | 1.63                                                 |
| 2008        | 4264.8                            | 1.38                                                 |
| 2009        | 9783.8                            | 3.18                                                 |
| 2010        | 16395.4                           | 4.34                                                 |
| 2011        | 23949.0                           | 5.75                                                 |
| 2012        | 24399.8                           | 4.96                                                 |
| 2013        | 33172.1                           | 6.56                                                 |

Source: Accounting Chamber of Ukraine

Since the beginning of the financial crisis in 2008, both the gross public debt and foreign debt started to grow rapidly and reached almost 480 billion UAH at the end of 2013 (see fig. 4).

Another challenge for economic stability in Ukraine arises in a form of a high share of external debt in general government debt (46.5% in 2013). Although there is a steady trend towards its reduction (from 75.0% in 2007 to in 2013), it is accompanied by an increase in government debt so that during the researched period (form 2000 to 2013) an external debt amount grew in five times.

The statistical analysis reveals low efficiency in implementation of fiscal policy instruments in Ukrainian economy during the last decade. As a result, even though fiscal instruments are generally acknowledged to be a powerful means of macroeconomic stabilization, they did not fulfill the expectations due to dysfunctions of fiscal policy transmission mechanism.
In a modern economic literature, fiscal policy transmission mechanism is interpreted as a consistent transmission of fiscal policy impulses to target macroeconomic indicators that define economic stability and economic growth. Its structure can be defined as a set of transmission channels of macroeconomic variables. Each of these channels goes through a number of stages before it reaches the target macroeconomic indicator. Hence, the authors distinguish four main channels and 13 subchannels of fiscal transmission (see fig. 5).

In such a way, fiscal policy transmission mechanism provides an interconnection between public finances and real economy sector. Thus, it is an impulses transmission mechanism from fiscal policy to national economy indicators.

The analysis of fiscal policy transmission mechanism in Ukrainian economy revealed its specificity. Firstly, expectations (mostly pessimistic) of economic actors and sliding level of trust play crucial role in transmission of fiscal impulses: lack of confidence in government as for debt repayment causes the negative effects of fiscal stimulus on output. Ilzetzki et al. (2010) confirm the possibility of such a negative fiscal multiplier.

![Fiscal Policy Transmission Mechanism Diagram](source)

Secondly, the classic subchannel of direct taxation does not provide fiscal impulses in Ukrainian economy properly. As it is known, subchannel of direct taxation implies a labor supply decrease as a response to fall of disposable income after tax rate increase: \( t \uparrow \rightarrow (Y - T) \downarrow \rightarrow LS \downarrow \rightarrow Y \downarrow \). However, in Ukrainian economy as in any transition economy this link is disconnected. The logic is the following. Personal income growth and leisure time are not substitute goods for individuals with extremely low incomes and consequently whose marginal propensity to consume tends to 1. To survive such economic agent will increase labor support to fulfill minimal consumption level. In such circumstances labor supply increase causes real wages fall. Thus, fiscal impulse in the form of direct taxation transmit through such way in Ukrainian economy: \( t \uparrow \rightarrow (Y - T) \downarrow \rightarrow LS \uparrow \rightarrow W \downarrow \). This impulse influence on output is ambiguous: on the one hand, labor supply increase promotes economic growth, on the other hand, diminishing marginal product of labor and ineffective tax revenue use that is essential for such economies reduce this positive impact on output.

Thirdly, analysis of the response of the ten post-socialist countries (Estonia, Lithuania, Latvia, Czech Republic, Slovakia, Slovenia, Poland, Hungary, Bulgaria, Romania) to the global financial crisis of 2008 – 2009, carried out by Aslund (2012), showed that reduction of the government expenditures due to administrative reforms had a positive impact on the economies of this countries in the post-crisis period. Despite an evident theoretical sensitivity of every economic system to an increase in government expenditures which is usually stronger than to a reduction of tax burden, transition economies experience positive effects from cutback of government expenditures as the misuse of state funds diminishes too. Administrative reforms with severe cuts in the state apparatus turned out to be surprisingly politically easy, because the most people wanted fewer bureaucrats and less bureaucracy. According to Aslund (2012)
such change can lead to a collapse of the bureaucracy, and thus to bolster the business environment, favor employment and stimulate economic growth.

Fourthly, as Mauro (1998) claimed, it is crucial to consider ineffective public management as a result of negative externalities in a public sector, low efficiency and minimal productivity of public expenditures and investment. Herewith an inefficiency in public sector can take many forms. The most common form of such an inefficiency is expenditures on salary payments to ghostworkers. The low productivity of public expenditures can take place in the case if they do not reach their goal. Along with bribery and corruption in Ukrainian economy diminish significantly factor productivity and discourage investment activity.

This information was confirmed by the results of Corruption Perceptions Index of Transparency International (2015), according to which Ukraine was ranked 162nd out of 178 countries, tied with Bangladesh, Cameroon, Central African Republic, and Syria as the most corrupt countries in the world. The analysts believe that business in Ukraine is highly monopolized, because oligarchic clans often use their connections with government and seek its “selective protection” which, in turn, destroys healthy competition and transparency.

The experts of “The Heritage Foundation” emphasize that Ukrainian economy has deteriorated in 8 out of 10 indicators. The situation is especially grave concerning guarantee of property rights, investment and public expenditures management.

Notwithstanding the favorable structure of government expenditures to improving of macroeconomic conditions and could attest in favor of effective fiscal impulses have place in Ukrainian economy, functioning of the fiscal policy transmission mechanism is too restricted to provide such an impulses because of such institutional obstacles.

- Ineffective management of government expenditures.
- Negative expectations of economic agents.
- Loss of social capital and lack of trust.
- High macroeconomic risks, including sensitivity to external geo-economic and geopolitical shocks.
- Formation of rent economy and rent-seeking behavior of economic actors.

The analysis proves that key factors of unproductive functioning of expenditure channel in Ukrainian economy are ineffective use of government expenditures and budget loss as a consequence of unfounded management decisions, the absence of developed system of socio-economic forecasting and planning, ineffective use of foreign target loans and special state budget etc. As figure 6 shows, an amount of the volume of budget violations and ineffective use of public funds increased in 6 times during 2002 – 2010. We suppose that the further fall of this indicator is a result of the changes in state political conditions. Nevertheless, according to the report of the Accounting Chamber of Ukraine (2013), an amount of the volume of budget violations and ineffective use of public funds equivalent to 17.9 billion UAH is reached by the end of 2013.

![Amount of the volume of budget violations and ineffective use of public funds in Ukraine in 2002 – 2013, billion hryvnia](Source: Accounting Chamber of Ukraine)
A long period of existence of a command economy along with the effects of path dependence contributed to the formation of the institutional framework in Ukraine that generates formal and informal institutional barriers. These barriers became the main obstacle on the way of formation of civilized market relations. Many features of the previous economic development (e.g. state paternalism, passivity, violation of legal norms) significantly influenced the formation of rent-seeking behavior of business entities in Ukraine. Unfortunately, such behavior of the key economic actors cannot be changed in a short time due to the effects of institutional inertia.

According to the recent researches, “institutional inadequacy” of the Ukrainian state is related to the lack of a long-term strategy for socio-economic transformation, making decisions under pressure from the groups of influence, forcing particular formal transformations excluding existing informal constraints and institutional complementary.

Institutional barriers related to a counterproductive rent-seeking behavior of economic agents bring about a number of negative consequences for the economy of Ukraine. The main effects caused by rent-seeking can be summarized as follows: (1) rent-seeking behavior of economic agents impairs the market structure, prevents the development of competition and ultimately increases the prices of goods and services; (2) under conditions of high corruption and suppression of market competition companies tend to spend significant amounts of money to overcome administrative barriers and to protect their property rights; (3) high administrative barriers increase business risks which in turn leads to higher interest rates on loans and hence to higher costs of long-term investment projects and shorter planning horizons; (4) threat of rent extraction leads to transformation of capital into less socially valuable, but more mobile and less risky forms which results in inefficient allocation of resources and formation of shadow economy; (5) rent extraction causes significant transaction costs of legitimization of entrepreneurship such as registration, licensing, certification and standardization costs. As a consequence resources are driven away from manufacturing and are used unproductively for bribery and lobbying.

Thus, on the way of reforming the Ukrainian economy must give priority to overcoming such institutional barriers that facilitate existence of counterproductive rent-seeking behavior of economic actors.

It is generally known that behavioral models of principal economic actors cannot change in a short run period by the reason of institutional inertia. There was a number of genetic features of previous economic development period that affected rent-seeking behavior forming under transformation period of Ukrainian economy such as: state paternalism, passivity, the habit of legal norms violation, etc.

The Ukrainian economic reforms of the 1990s of the 20th century were characterized by an incremental institutional change and a desire to release the national economy from a government intervention as quickly as possible. As a consequence a rent-seeking or speculative state was formed with a typical dispersion of power between oligarchic clans. The major desire of such clans is not an economic prosperity of the whole nation, but redistribution of available resources through the state budget and acquisition of certain privileges.

The first large rents received in the post-Soviet economies originated from arbitrage as a difference between free market prices and state-controlled prices or arose from the presence of multiple exchange rates. Some methods of rental enrichment have disappeared eventually, especially those that were caused by inflation. But successful rent-seekers bribed numerous politicians and were able to find new sources of rental incomes. Hellman (1998) mentions that in such an environment self-defense of the speculative rent-seeking economic agents became an acute problem of post-communist restructuring.

Aslund (2003) claims that the main tragedy of post-communist economic transformation was the intense struggle between the liberal reformers who sought democracy along with market economy and businessmen or officials that were practicing rent-seeking in a crucial transition period. The market economy has generated its own paradigm and new types of businessmen that support its existence in contrast to the speculative economy that only multiplied the profits of rent-seekers that have invested their money in politics.

Administrative barriers are beneficial to those officials who carry out the functions of licensing or market regulation and in most cases are rent receivers themselves. Such rent-seeking behavior of officials has different implications for big, small and medium business. Under the conditions of rental economy big business focuses on lobbying for government support in the form of tax breaks, subsidies, guarantees or soft loans. The powerful influence of interest groups under circumstances of limited budgetary resources contributed to threatening imbalances in the distribution of budget support in Ukraine. For example, Ukrainian government spends more than a billion euros to support the coal industry, but invests only one million euros in micro crediting of small and medium businesses. Furthermore, the budgetary subsidies of coal industry recently increased in more than 2.5 times. At the same time, according to
Ukrainian Strategy for Energy 2030. a market price of subsidized coal is about $38.4 per ton which is significantly lower than its prime costs of $96 and 96% of the mines in Ukraine were not rehabilitated for over 20 years.

According to a study carried out by experts of the World Bank, licensing in Ukraine requires a lot of time and money. The value of companies' direct cost to comply with the requirements for permits, inspections and technical regulations in 2010 was about $900 million, that is equal to the value of 195 000 full-time employed workers. Herewith Ukrainian companies constantly complain about the burden of a permit system, inspections and technical regulations. The report of Security Service of Ukraine presents that the share of companies that annually are inspected in Ukraine is much higher than it is in other post-communist countries (68% in Ukraine in 2011, compared with 31% in Georgia in 2005 and 20% in Uzbekistan in 2007).

As reported by World Economic Forum in 2014-2015 Ukraine ranked number 76 in the Global Competitiveness Ranking of 144 countries. It is noteworthy that Global competitiveness of the Ukrainian economy was adversely influenced by different kinds of institutional barriers such as excessive bureaucratization of the national economy, low public trust in politicians, poor performance of law enforcement agencies and courts, violation of property rights and intellectual property rights, significant amounts of corruption and bribery, etc. (see figure 7).

Fig. 7. Ratings of Ukraine according to different indicators of Global Competitiveness Index of 2014-2015
Source: World Economic Forum

Institutional barriers, related to a counterproductive rent-seeking behavior of economic agents, bring about a number of negative consequences for the economy of Ukraine. The main effects caused by rent-seeking can be summarized as follows:
- rent-seeking behavior of economic agents impairs the market structure, prevents development of competition and ultimately increases the prices of goods and services;
- under conditions of high corruption and suppression of market competition companies tend to spend significant amounts of money to overcome administrative barriers and to protect their property rights;
- high administrative barriers increase business risks, which in turn leads to higher interest rates on loans, and hence to higher costs of long-term investment projects and shorter planning horizons;
- threat of rent extraction leads to transformation of capital into less socially valuable, but more mobile and less risky forms, which results in inefficient allocation of resources and formation of shadow economy;
- rent extraction leads to emergence of significant transaction costs, associated with legitimization of entrepreneurship (e.g. registration, licensing, certification and standardization costs). As a consequence, the scarce resources are driven away from manufacturing and are used unproductively for bribery and lobbying.

These circumstances, in turn, undermine the effectiveness of the fiscal policy transmission mechanism in the Ukrainian economy through:
a heavy dependence of debt and tax channels of fiscal transmission on negative expectations of economic actors, which reduces stimulating effect of financial interventions;

- low productivity of public spending and investments, as a result of rent-seeking behavior, adversely influences economic growth and employment;

- increase in government expenditures (especially under floating exchange rate) can cause economic downturn and rising unemployment;

- ineffectiveness of the system of transfer payments to households under institutional obstacles brakes the direct link between public spending and GDP;

- indirect influence of government spending on output (through the market of goods and services) is not effective because of the existing counterproductive rent-seeking behavior of economic actors.

5. Conclusions

The destructive institutional environment was constructed in Ukraine during the period of post-communist transformations. As a consequence, the national economy got into so-called “institutional trap” in which the rejection of informal interactions hindered its normal functioning, whereas the formation of rent-seeking behavior undermined its long-term growth. The extent and intensity of rent-seeking behavior in the Ukrainian economy is associated with the two following factors: (1) its genetic heritage in a form of informal institutions, stable behavioral stereotypes and economic culture of a former command economy; (2) institutional imbalance typical for transitional economy, which is characterized by contradictory interactions of socioeconomic routines and innovations in the society with asymmetric information.

The counterproductive rent-seeking behavior of economic agents is a substantial institutional barrier that hinders the effective functioning of fiscal policy transmission mechanism in Ukrainian economy. As we mentioned previously (2014), the information asymmetry of the budget process and the incomplete disclosure of the public finances bring about negative expectations of economic agents and impair the dynamics of real macroeconomic indicators.

Under these circumstances the effectiveness of the fiscal policy transmission mechanism in the national economy can be enhanced through determined actions of the Ukrainian government aimed at:

- elimination of the excessive bureaucracy of the national economy while increasing transparency, accountability and law-abidingness of government agencies;

- distinct separation of government agencies responsible for public administration and those responsible for public services in order to prevent a merger of political and business interests;

- clear specification of property rights, reduction of the personification level of contractual relations and enforcement of the same rules of the game for all market participants regardless of their place of registration or sphere of activity;

- introduction of an effective system of control over activities of officials that will unavoidably punish the corruptive actions;

- formation of an independent judiciary and establishment of a civilized and effective system of justice;

- appointment of professionals to administrative positions with regard to their competence, business and moral qualities and regardless to their political affiliation;

- drastic increase in opportunities for public control over government spending, management of public funds, property, resources and assets.

As a consequence, the Action Program of the Cabinet of Ministers of Ukraine for 2015 reflects a rigorous intention of Ukrainian society to move towards profound economic reformation. The economic reforms of Ukrainian government will be devoted to the reduction of the number of contact points between business and state; adjustment of the structure and functions of the regulatory bodies to the standards of European Union; reduction in the number of regulatory bodies from 56 to 28, and contraction of their functions from 1032 to 680; adoption of a new law on licensing of business types; budget decentralization and shrinkage of a public sector by 10%; competitive hiring of a new government personnel; implementation of e-government; establishment of the National Agency for prevention of corruption and the National Anti-Corruption Bureau as a law enforcement agency; control over lifestyle of government officials; implementation of electronic declaration of officials’ income and expenditures, etc. Hence, the conclusion can be made that identification and implementation of specific instruments that can be used to overcome
destructive rent-seeking behavior of economic actors must be a key priority of economic research and practice in Ukraine.

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