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UKRAINE'S BALANCE OF PAYMENTS FINANCIAL ACCOUNT AS AN INDICATOR OF ECONOMIC STABILITY

Abstract. Ensuring financial stability of the state economy in many countries is one of the key central bank's objectives. Given the peculiarities of the Ukrainian economy in 2012-2014, it is extremely urgent to focus attention on the financial account for the crisis prevention. For a long time, the financial account has discharged purely the compensatory function, i.e. covered the deficit of the current account balance and enhanced the international reserves. Still the political instability in 2013-2014, negative investment climate, corruption and deterioration of economic outlook in general have led to increasing the crisis of financial account of the balance. We describe the key issues of financial account and infer that there are several ways of the economic recovery. Firstly, it is necessary to establish trade relations with partners in EU by using the grace period in 2014. Secondly, a policy of pulling the economy out of the «shadow» should be one of the key priorities in new economic programs. Thirdly, we should carry out informed and concerted action in cooperation with other countries in order to stabilize political crisis in the country and restore cooperation with international financial institutions (including IMF). Then it is useful to reduce the current account deficit through using the policy of import substitution and supporting the national enterprises. Finally, support of small and medium enterprises can make a real difference too. In conclusion, we reckon that these issues will help not only save our economy but also develop it in advance.

Keywords: financial account; balance of payments; financial stability; investment.

JEL Classification: E44, F21, F31

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ФІНАНСОВИЙ РАХУНОК ПЛАТІЖНОГО БАЛАНСУ УКРАЇНИ ЯК ІНДИКАТОР СТАБІЛЬНОСТІ ЕКОНОМІКИ

Анотація. Проблема дефіциту фінансового рахунку надзвичайно актуальна для уникнення розвитку кризових явищ, враховуючи особливості розвитку української економіки у 2013–2014 рр. У статті аналізується фінансовий рахунок платіжного балансу як один із основних індикаторів забезпечення стабілізації, покриття дефіциту рахунку поточних операцій. Надано практичні рекомендації для підвищення профіциту фінансового рахунку, зокрема підтримка малого та середнього бізнесу, використання тісного співробітництва з міжнародними організаціями, стабілізація політичної кризи, зменшення дефіциту рахунку поточних операцій через підтримку вітчизняного виробника і зменшення енергозалежності українських підприємств шляхом запровадження енергозберігавальних технологій.

Ключові слова: фінансовий рахунок, платіжний баланс, фінансова стабільність, інвестиції.

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ФИНАНСОВЫЙ СЧЕТ ПЛАТЕЖНОГО БАЛАНСА УКРАИНЫ КАК ИНДИКАТОР СТАБИЛЬНОСТИ ЭКОНОМИКИ

Аннотация. Проблема дефицита финансового счета чрезвычайно актуальна во избежание развития кризисных явлений, учитывая особенности развития украинской экономики в 2013–2014 гг. В статье анализируется финансовый счет платежного баланса как один из основных индикаторов обеспечения стабилизации, покрытия дефицита счета текущих операций. Представлены практические рекомендации для повышения профицита финансового счета, в т. ч. поддержка малого и среднего бизнеса, использование тесного сотрудничества с международными организациями, стабилизация политического кризиса, уменьшение дефицита счета текущих операций через поддержку отечественного производителя и уменьшение энергозависимости украинских предприятий путем внедрения энергосберегающих технологий.

Ключевые слова: финансовый счет, платежный баланс, финансовая стабильность, инвестиции.

Introduction. The current global financial crisis that has not spared Ukraine has become a vivid reminder of the need to improve economic policy at the national and international levels on the providing an effective system for protecting financial stability. Given the high dependence of the national economy from the current international financial and commodity markets it is needless to pay attention not only to the working out the bal-

anced financial and economic policies in Ukraine, but also to protection of the economy from the destabilizing proliferation processes from abroad through various channels. In particular, according to the theory of international transmission trade, financial channels play most important role in the transmission of «infection» from one state to another. In addition, the state has the ability to support the economy in the financial and real

sectors unlike the situation with the common shocks and information channel where the economic laws often do not apply.

Brief Literature Review. Basic conceptual position of balance of payments figures was formed by colleagues of the International Monetary Fund [1]. Matthieu Bussiere (2007) worked out the crisis prevention model on the balance of payments indicators basis [2]. Claudio Borio, and Piti Disyatat (2011) highlighted two conceptual problems, i.e. explaining market interest rates through the saving-investment framework and drawing inferences concerning a country's cross-border financing activity on observations of net capital flows as the background [3]. National experts studied balance of payments and financial stability actively; in particular working papers of O. O. Lynnyk (2011), S. A. Nikolaychuk (2010), A. Y. Shklyar (2010), O. V. Kostyuk (2011), N. V. Zhmurko (2012), P. K. Ylyashenko (2014) and etc. have deserved special attention. However, the synthesis of developments in certain issues, experience and results on the accumulation of financial accounts suggest incompleteness research in this area and the need to actualize consideration the current state of the account and specific ways to improve the financial account surplus, including changes in the foreign trade life in Ukraine.

The purpose of the article is to analyze the components of financial account and work out practical recommendations concerning increasing its surplus for forming positive net liquidity balance and enhancing international reserves.

Results. The financial stability of the state depends on the structure and dynamics of the main articles of the balance of payments in current level of globalization. The capital account and financial account of the balance of payments research is an important issue in the modern economics. Its result is taken into account in working out the decision concerning design and implementation of the basic principles of the monetary policy.

In Ukrainian economy capital and financial account has carried out for a long time purely compensatory function, i.e. covered the deficit of the current account balance (Figure 1). This issue allowed the state to enhance the international reserves and use them mainly to maintain the stability of the hryvnia.

However the global financial crisis of 2008-2009 led to a significant deterioration in investors' mood, which leads to accruing crisis of capital and financial account. Given the negligible volume of capital account balance, in our opinion, it is advisable to focus on the importance of financial account.

Problems of efficiently functioning financial market trends are intensified displayed in balance of payments the corresponding articles on the background of the global financial crisis, lack of a coordinated protection system of foreign investment, low investment climate and political instability, which according to experts, will be protracted [5]. In particular modern economists have noted several main factors of increasing the crisis of financial account balance. They are the following:

1. deterioration of economic outlook, global instability expansion and sharp shortage of liquidity in the major financial markets;
2. confidence decreasing in the domestic banking system, which was partly triggered by administrative measures by the central bank, political instability in the state and the crisis in the banking sector as a whole;
3. scheduled repayment of external liabilities by banks, entities of the general government and other sectors, as well as the complexity of the debt refinancing due to significant liquidity constraints in the global capital markets [6, p. 268];
4. political instability since the IV quarter of 2013 and the high probability of escalating external conflict with the main trading partner;
5. investment climate deterioration in the state that proves by a reputable global ratings (e.g. according to the rating of investment attractiveness of European Business Association since

2011 investment attractiveness worsened and in IV quarter of 2013 it reached the bottom level and stood at 1.81 points out of possible 5) [7];

6. negative forecasts of development of domestic economy by leading rating agencies in the world (e.g. Standard & Poor's, Fitch Ratings and Moody's Investors Services gives the ratings to Ukraine of the level «before-default» with «negative» prospects), that in 2014 were caused by the deterioration of relations with Russia, escalating political crisis, tense and uncertain situation in terms of providing adequate external liquidity, deteriorating macroeconomic indicators, the increase in gas prices.

There was deterioration of the major items of the financial account to a level at which it does not perform an insurance function of chronic current account deficit at the background of above reasons. Thus, there is a significant decrease in the inflow of direct and portfolio investment.

It should be noted that attracting mainly foreign direct investment (often by reinvesting the proceeds, net attraction of foreign credits and loans provided by all sectors of economy) has ensured the inflow of financial resources to Ukraine. One of the priorities of the national economy is attracting investment. The problem of innovation development of economy is still relevant due to the shortage of domestic financial resources. In our opinion, attracting foreign direct investment (FDI) should be a priority for creating a favorable investment climate and for the efficient development of the economy. FDI tend to be durable. Furthermore according to statistics from the National bank of Ukraine investment are concentrated mainly in the financial and real sectors (metallurgy, construction, wholesale trade, real estate). In 2013, foreign FDI inflows decreased by 2 times on the background of a significant aggravation of the political crisis. The escalation of the political crisis, the uncertainty in the financial market in early 2014 will lead to significant outflow of FDI from Ukraine this year. We believe that restoring the inflow of investment should be expected before stabilizing the situation in the state.

According to the official data of National bank of Ukraine, net foreign direct and portfolio investment is positive, but in 2013 shows a significant reduction (Figure 2). However, in our opinion in this case we should make adjustments in data concerning investments from offshore jurisdictions which actually indicates a lower level of real foreign investments in the Ukrainian economy.

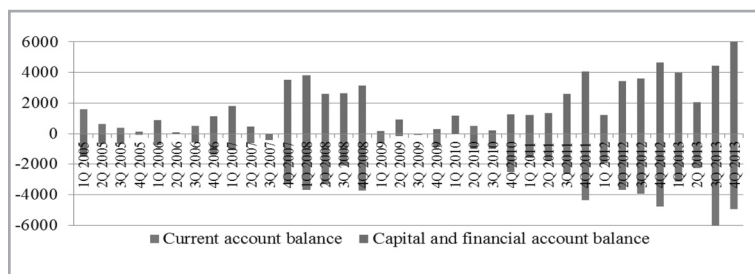


Fig. 1: Balance of payments' key accounts, Ukraine, million USD

Source: Worked out by the authors based at the NBU's data [4]

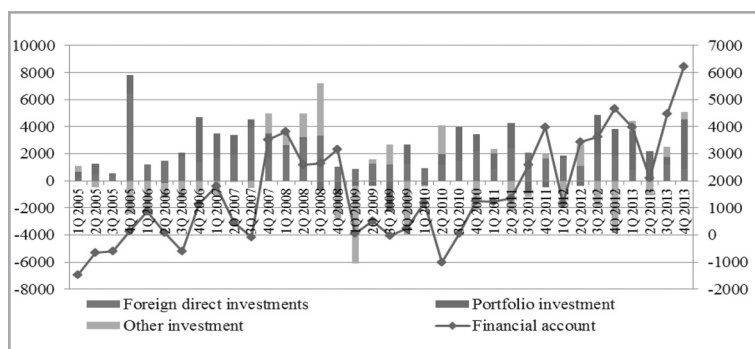


Fig. 2: Financial account and its key components, million USD

Source: Worked out by the authors based at the NBU's data [4]

It is a natural and completely objective fact that inflow and outflow investment (mainly from/to offshore zones) is reduced. Foreign and domestic experts have repeatedly pointed out the main causes of low investment attractiveness of Ukrainian economy. World ratings prove significant problems in Ukraine that hinder the effective conduct business in a state. This leads to the low investment activity on the part of foreign agents. Thus, according to the official data of the World Economic Forum the most problematic factors for business development in Ukraine include political instability, corruption, difficult access to financial resources, excessive tax regulation, bureaucracy business relations with state institutions, inadequate legislation and overall macroeconomic instability [8]. In particular, it was determined that the high level of corruption has the greatest impact on the dynamics of foreign investment in Ukraine [9, p. 176].

In our opinion with regard to investing in bank capital there are some peculiarities in the reasons. We should pay our attention on stringent measures in regulation of the banking business on a global level (Basel III), which leads to the need to accumulate additional capital by foreign parent entities. Therefore, one of the following additional resources is inefficient withdrawal of capital from foreign subsidiary companies (including Ukrainian).

Foreign portfolio investment means a short term using of sources unlike direct investment. Thus it cannot be regarded as one of the key sources of the development of the economy because making a profit will be main target of such investment without any development.

Some experts reckon the actual inflow of capital in the post-Soviet countries (including in Ukraine) is significantly different from the official statistics. The main problem is the high level of shadow economy [10, p. 362]. The outflow of capital also leads to different negative impacts on the economy. In particular, investment resources of the state and business are reduced; balance of payments figures are deteriorated. Then, the process of enhancing the foreign exchange reserves and external debt service is complicated. Finally, monetary supply in the domestic market is decreased, which leads to the problem of assessing the real exchange rate of hryvnia against foreign currencies.

In 2013, net balance transactions with loans and bonds were at USD 7.3 billion. It has been a peak since the crisis. Successful cooperation with different international financial organizations and raising funds through government allocation of government domestic loan bonds are the reasons of such positive trend. Real economy has continued to attract long-term loans. Nevertheless in 2013 they were reduced to USD 1.9 billion compared to 2012. The negative balance was observed only in 2009 and it stood at USD 9.1 billion, which caused by a net repayment of external debt of the banking system and the overall deterioration of the situation in the global financial market. In our opinion, it is needless to conduct a balanced and progressive politics in the transactions of loans and bonds, i.e. evenly distributing payments previously placed bonds and loans received.

Constant accumulation of currency outside banks is the main problem of chronic deficit in item «Other investments». The high devaluation expectations, volatility in the foreign exchange market, a significant level of shadowing of the Ukrainian economy contributes to low confidence in the national currency and the increased demand for foreign currency. In addition, the rapid change in banking legislation reinforced the distrust and circumspect entities. For instance, changing the exchange rate regime in February 2014 (Resolution of National bank of Ukraine No 180 «On Amendments to the Regulation on the establishment of the official exchange rate of the hryvnia to foreign currencies and exchange of precious metals»), the introduction of administrative methods the foreign exchange market (Resolution of the National Bank of Ukraine Board No 49 «On the Measures relating to Banks' Activities and the Conduct of Foreign Exchange Transactions») and etc. [11]. However, given

the low level of international reserves and the requirements of the International Monetary Fund for further cooperation with Ukraine we believe that these measures were necessary.

One of the most important protective factors against deficit of balance of payments and destabilization of the currency market is the formation of reserve assets of the National bank of Ukraine. Since 2011 and until now there has been a significant reduction of international reserves. The main reason behind it is, financing deficit of the consolidated balance of payments and foreign exchange interventions of the NBU in order to keep the hryvnia from devaluation (Figure 3).

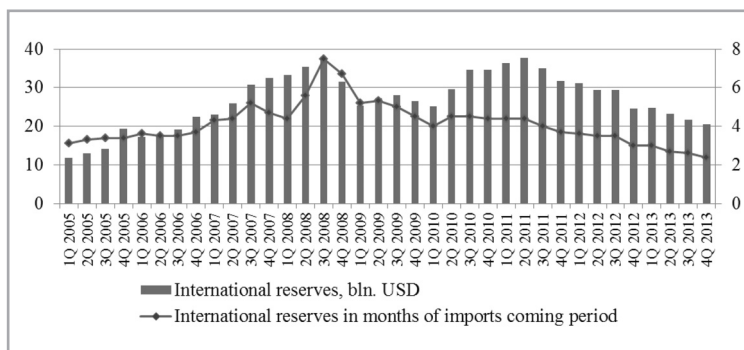


Fig. 3: International reserves of Ukraine

Source: Worked out by the authors based at the NBU's data [4]

However, in early 2014, the scope of official reserves has become critical, as the indicators of adequacy are evidenced. In particular in February 2014, the international reserves stood at USD 15.5 billion, which provides finance imports of goods and services for 1.8 months of next period at the minimum required 3.0 months [12]. Due to critically low level of international reserves, we reckon that central bank policy to limit participation in the foreign exchange market, the introduction of administrative measures for the transition to a flexible exchange rate in the foreign exchange market and precious metals market was appropriate. International experience shows that the optimal structure for the formation of international reserves should move to increase the proportion of securities and gold, as well as currency diversification of official reserves.

At this stage it is appropriate to restore cooperation vigorously with international financial institutions (including the IMF, the World Bank Group) for extension of gross international reserves. Also, it will contribute to escalating financial account surplus, which can not only balance the current account deficit, but also generate some surplus trade balance in order to increase official reserves.

Increase the financial account surplus should be number one in priorities of economic state program. It will lead to lack of balance of payments deficit and even enhance the international reserves. Firstly, it is necessary to carry out concerted and informed action in cooperation with other countries in order to stabilize the political crisis in the country. Secondly, a policy of pulling the economy out of the «shadow» should be provided. It will help to fill up the revenues of the state budget of Ukraine and improve the investment climate in the country [13]. To do this, it is obligatory to create relevant and stricter regulations in the law for tax evasion. First of all it concerns investments that are related to offshore areas.

In addition based on the fact that a significant part of imports are imported informally (i.e. through «gray schemes»), and the scope of Ukrainian exports is systematically underestimated due to the use of transfer pricing, it is good to focus attention on exposing these methods and legally, through amendments to the legislation prevent their further of use. Thus, the balance of payments will be more objective and possibly have a smaller deficit.

Certainly, in order to reduce the burden on the financial account we should operate in parallel with reducing the current account deficit. For example, in public procurement to favor Ukrainian producers, while the introduction of new energy-sa-

ving technologies for domestic enterprises to reduce the tax burden. In the long run this will lead not only to enhancing the domestic production, but also to increase the competitiveness of Ukrainian products and confidently enter on the world market.

Support of small and medium enterprises, which today was protected slightly by the state, is another way to optimize the balance of payments. This allows, firstly, creating jobs, and secondly, satisfying domestic demand for goods and services from national production, realizing in practice the policy of import substitution.

Given the recent trend of Ukrainian development in the international economy and the support of the European Union, we believe that it is necessary to focus attention to establishing trade relations with partners in Europe, using the grace period (May-November 2014) by domestic enterprises for entering to the European market. This will help not only make new useful directions beneficial cooperation, but also to minimize the possible negative consequences of the closure of a significant reduction in the eastern markets.

Conclusions. Therefore, the financial account is always served the function of insurance covering the current account deficit in the balance of payments of Ukraine. However, an unfavorable investment climate, exacerbated foreign situation of Ukraine, a high level of shadow economy and etc. have led to a significant reduction in financial account surplus. In our opinion, commonly agreed and sensible cooperation of the central bank and the government of the state could lead to an improvement of the financial account and then the current account balance. As the matter of fact, those measures should be aimed not only at the short term, but also for long-term advantage of the latest. Thus, part of the financial assistance provided by the international community should not use for current consumption or return existing debt, but for the development of the real and financial sectors. In addition, these measures should be carried out systematically. Although, close cooperation with the IMF is still one of the best outputs of financing the current account deficit nowadays.

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