Center of Public Finance and Governance at Kyiv School of Economics

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Fiscal Digest – 2023

Executive Summary

- In 2023, Ukraine's state **budget deficit** reached $36.5 bn (or 20.6% of GDP), broadly in line with original plans and 3.1 percentage points higher than in 2022 ($28.3 bn). Assistance from foreign partners was critical with grants of $11.6 bn representing 16% of total budget revenues. In addition, Ukraine received $30.9 bn in loans for budget financing in 2023. Net domestic bond issuance contributed $5.4 bn.
- **Revenues** (excluding grants) increased sharply compared to the previous year – by $20.2 bn or 49.1% y-o-y. Tax revenues rose by 12.1% on the back of the economy's adjustment to the war, changes to the tax code, and effects from inflation. Non-tax revenues increased by more than 150% due to transfers from the NBU ($2.0 bn).
- **Expenditures** soared by 31.3% y-o-y to $109.8 bn, with military spending accounting for $57.4 bn alone. Additional expenses for security reached $14.0 bn. At the same time, expenditures decreased in the sector of Health care by 14% to $4.9 bn, in the Education sector by 8.6% to $1.7 bn and in the Social protection sector by 2.6% to $12.8 bn. Ukraine's budget benefitted from the postponement of debt service on its commercial and part of public external debt, with interest payments reaching $8.1 bn in 2023.
- Total **state debt** (including guarantees) reached $145.3 at the end of 2023 – an increase of $33.9 bn or 30.4% vs. the previous year. At 85% of GDP, this is a sharp increase vs. 2021 when it was 49%. The structure of debt shifted significantly, with new external debt amounting to $31.2 bn and new domestic debt to $3.8 bn. As of end-2023, debt in foreign exchange accounted for 73% of the total.
- The **2024 deficit** is expected to reach $38.6 bn as revenues are projected to decline to $43.5 bn (-40% vs. 2023) and expenditures to drop to $81.3 bn (-26%). Two key risks to the outlook are (i) higher military spending due to an escalation of the security situation; and (ii) revenue and financing shortfalls due to less assistance from international partners (currently planned to reach $37.0 bn).

Key Figures on the Ukrainian budget, $bn

Indicators	2022	2023	2024E
Total revenues	**55.3**	**73.1**	**43.5**
Grants	14.4	11.6	N/A
Non-tax and other revenues	11.7	28.6	4.8
Tax revenues	29.4	32.9	38.7
Total Expenditures	**83.6**	**109.8**	**81.3**
Defence	35.3	57.4	29.1
Deficit	**(28.3)**	**(36.5)**	**(38.6)**
Deficit (net of grants)	(42.7)	(48.1)	(38.7)
General Gov't Balance* ($ bn)	**(26.1)**	**(36.3)**	**(27.2)**
General Gov't Balance* (% GDP)	(16.1)	(20.4)	(14.6)
State Debt ($bn)	**101.6**	**136.6**	**177.2**
State Debt (% GDP)****	70.9	80.3	97.6

Notes: *without grants; **without grants and reinvested earnings; ***including grants and IMF financing; ****primarily calculated in national currency (UAH).

Source: Ministry of Finance of Ukraine, KSE

Budget Revenues

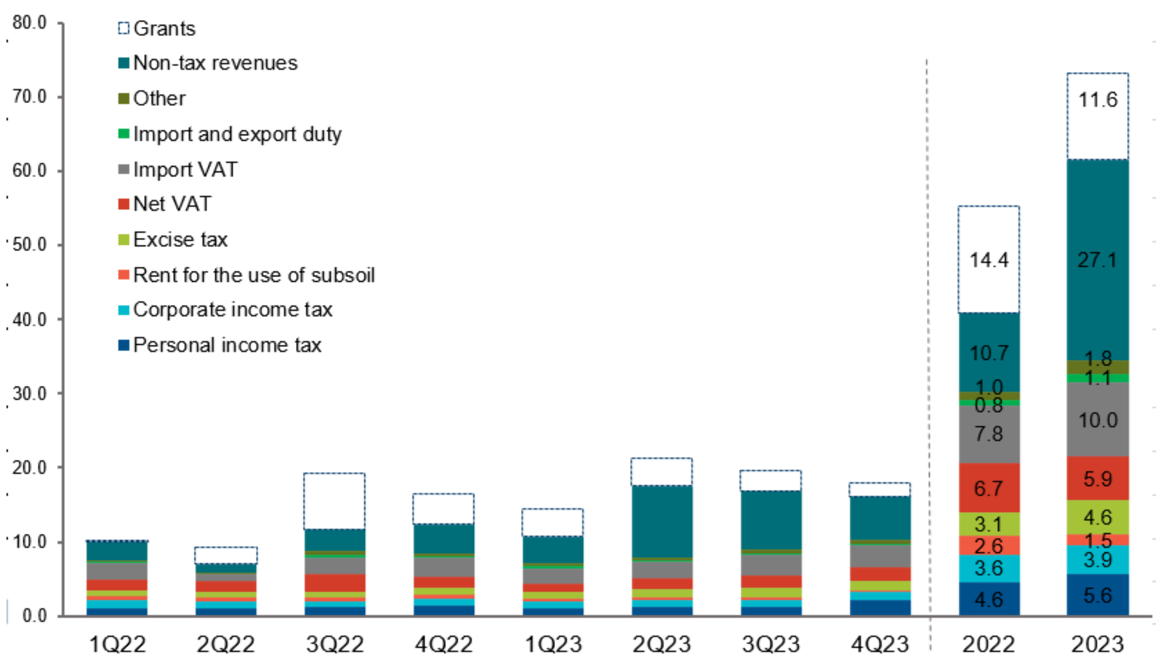
In 2023, budget[1] received **$61.4 bn in revenues** (excluding grants of $11.6 bn), an increase of **$20.2 bn** or **49.1%** vs. 2022. While grants remained a crucial source, their amount **decreased** by **19.4%** in 2023. Notably, improved revenue collection more than made up for this: **total revenues including grants for the first three quarters** of 2023 exceeded the **value of the full 2022 year**.

Tax revenues saw a notable uptick in 2023, rising by 12.1% y-o-y, accompanied by a significant shift in their composition. This transformation was fueled by several factors, including considerable financial support to military personnel, discontinuation of numerous import tax incentives, and the amplifying effects of inflation. Notably, the share of import VAT surged from 26.6% to 30.4% of total tax revenues in 2023 vs. 2022, while excise taxes rose from 10.8% to 13.9%, and personal income tax from 15.6% to 17.2%. Additionally, import and export duties rose from 2.7% to 3.3%. Corporate income taxes registered an increase of 8.7% y-o-y, driven by exceptional profits generated by banks and some state-owned enterprises during the fiscal year.

The year 2023 saw a rise in revenues from indirect taxes, including VAT, excise taxes, and import and export duties, owing to the discontinuation of certain tax incentives and a surge in consumption. However, there was a decline in customs administered revenues, attributed to the blockade of Ukrainian freight transport by Polish carriers and an unexpectedly robust exchange rate of 36.6 UAH/USD (2023 average, compared to the planned figure of 42.2 UAH/USD).

Non-tax revenues surged from $10.7 bn in 2022 to $27.1 bn in 2023, primarily driven by charitable contributions. Furthermore, the National Bank of Ukraine transferred $2 bn to the state budget in 2023, a significant increase from the $0.6 bn transferred in the previous year. Social security contributions to the Pension Fund and other social insurance funds amounted to $13.1 bn in 2023, marking a 12.4% rise from 2022.

Figure1. Structure of budget revenues in 2022-2023, $ bn



Source: Ministry of Finance of Ukraine

[1] *Here and after term "budget" is used for the central (state) level budget*

Budget Expenditures

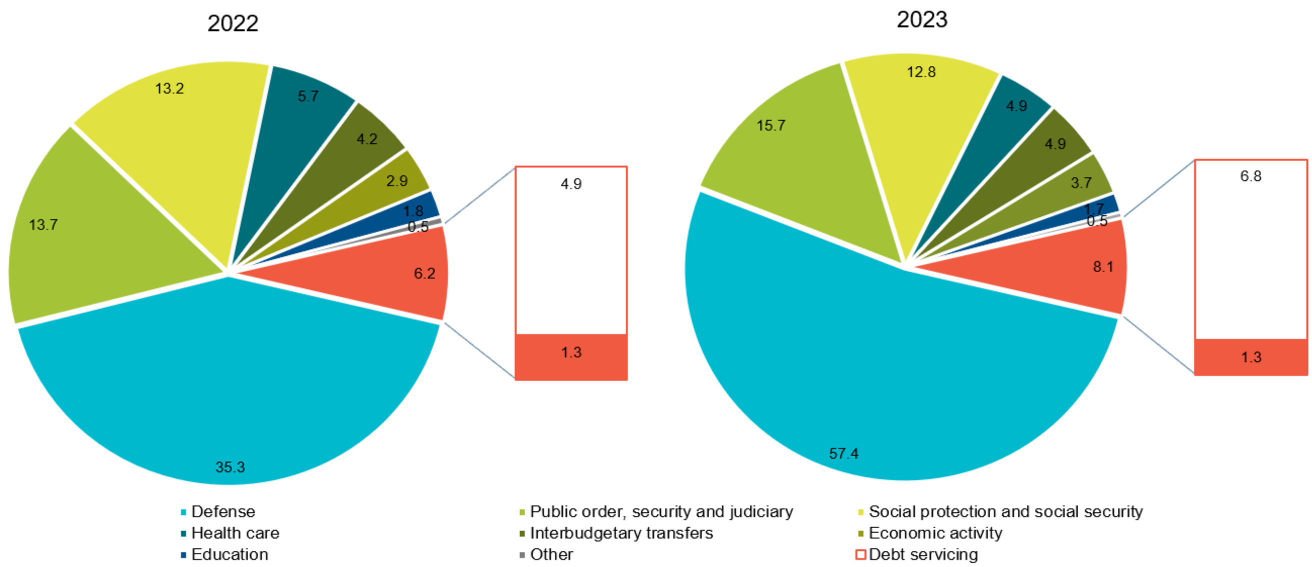
In 2023, budget expenditures soared to over $109.8 bn, a substantial increase of 31.3% compared to 2022. The primary areas of expenditure were war-related expenses, social spending, and debt service.

War-related budget expenditures are estimated to be 65% of total expenditures, while 35% was directed towards socio-economic development (compared to approximately 57% or $48 bn, and 43% or $36 bn in 2022, respectively).

Spending by the Ministry of Defense amounted to $57.4 bn (+62.3% y-o-y), 52.3% of all expenditures. Additionally, war-related spending within the security sector is estimated at roughly $14 bn (+17% y-o-y). The main drivers of this dynamic were a significant increase in financial support for military personnel, modernization and procurement of military equipment, and other expenses to maintain the combat readiness of the Armed Forces of Ukraine.

Social expenditures of $12.8 bn (-2.6% y-o-y) were largely made up of pension payments, social protection of persons in difficult life circumstances (including internally displaced persons), support to low-income families, and social protection of children, families, and persons with disabilities.

Figure 2. Structure of budget expenditures in 2022-2023, $bn



Source: Ministry of Finance of Ukraine, Openbudget

Social Box

Due to constant rocket attacks and flooding caused by the explosion of the Kakhovka Hydroelectric Station, the number of internal displaced persons (IDPs) in need of assistance from the government has increased. Since February 24, 2022, the registered IDP count has risen by 3.4 mn people, reaching a total of 4.9 mn (12% of the population of Ukraine before the full-scale invasion). Among them, 48% (2.5 mn people) received housing assistance for IDPs in 2023 (+608.2 thousand people y-o-y). As a consequence, expenditures on social assistance payments increased by 13.7% y-o-y, reaching $4.8 bn.

Along with that, **budget expenditures on social protection and social security have significantly increased* compared to before the full-scale invasion due to the growing number of individuals in need.** Expenditures on social protection and social security accounted for $12.8 bn in 2023 (11.7% of the budget expenditures), $13.2 bn in 2022 (14%), and $12.4 bn in 2021 (18.4%).

** Despite the notable increase in expenditures on social protection and social security in Ukrainian hryvnia terms from 2021 to 2023, the substantial depreciation of the Ukrainian hryvnia against the US dollar during this period results in these expenditures being lower when expressed in US dollars.*

Expenditures on social assistance payments by the Ministry of Social Policy in 2021-2023, $bn

Social assistance payments	2021	2022	2023
General social assistance payments	4.3	4.8	4.8
Housing assistance payments for IDPs	0.1	1.7	2.0

Source: Ministry of Social Policy of Ukraine

There is further uncertainty regarding the funding needs for social security expenditures due to the prolonged duration of the war and unknown number and speed of the return of Ukrainian refugees and their requirements for social assistance:

- As of the end of 2023, the number of forced migrants from Ukraine worldwide is 6.4 mn people, which is nearly 16% of the population of Ukraine before the start of the full-scale invasion (estimates by the UNHCR).
- The total number of people who have returned to their permanent place of residence in Ukraine among internally displaced persons and refugees is 4.6 mn people (estimates by the IOM).

The increasing complexity in supporting the solidarity pension system arises from a significant portion of expenditures on pension payments from the budget, coupled with the nearly equal number of the working population (1.7 mn people) and pensioners (1.5 mn people). The transfer to the Pension Fund for pension payments and covering of funding shortfalls is the most significant allocation of funds from the budget in the field of social protection. In 2023, it amounted to $7.5 bn (+$1.7 bn y-o-y), constituting 35% of the Pension Fund's budget or 59% of the expenditures of the Ministry of Social Policy.

There is a risk of insufficient funds to cover social protection expenditures due to a decrease in contributions from international partners. During times of war, funding for priority social and humanitarian expenses is sustained through grants provided by the US, EU member states, and other countries and allies of Ukraine (except for expenditures on social insurance funded through contributions from the Single Social Contribution).

Budget financing

The budget deficit reached $36.5 bn in 2023 (with $11.6 bn in grants counted as revenues), amid large war-related expenditures (approximately 65% of budget expenditures) and a limited ability to increase tax collection. The deficit was marginally higher than planned in the initially enacted Law on State Budget for 2023 ($35.5 bn). Importantly, it would approach $48.1 bn without support through foreign grants. On average, expenditures exceeded revenues by $4.0 bn per month (excluding grants).

Budget funding sources (revenues and gross financing) in 2023, $bn

Sources	2022	2023	Change (%. y-o-y)
Internal budget sources	**62.1**	**76.9**	**23.8**
Domestic government bonds*	20.9	15.5	(25.8)
Own budget revenues (without grants)	41.2	61.4	49.0
Share of internal budget resources (%)	66.5	64.4	-
External budget sources	**31.3**	**42.5**	**35.8**
External loans	16.9	30.9	82.8
Grants	14.4	11.6	(19.4)
Share of external budget resources (%)	33.5	35.6	-

Note: *In 2022, $12.6 bn out of this amount is attributed to the emission of the NBU

Source: Ministry of Finance of Ukraine. KSE calculations

In both 2022 and 2023, Ukraine relied significantly on external financial assistance. In 2022, funds received from foreign partners made up 33.5% of all state budget sources (revenues and gross financing). This dependency increased further to 35.6% in 2023. Consequently, if external financial support were to decrease, the government would need to consider measures such as cutting expenditures or issuing currency to cover the deficit. This could compromise financial stability and lead to macroeconomic imbalances, including devaluation of the national currency, increased inflation, and reduced citizens' welfare.

The deficit was primarily financed through loans from external sources, which gross fund inflow amounted to $30.9 bn (+82.8% y-o-y, $16.8 bn in 2022). Amortization of external debt was modest ($1.8 bn), as commercial and some official debt payments were postponed until 2024, resulting in $29.1 bn of net inflows.

Funds from international partners, according to the terms of their provision, can only be spent on non-defense expenditures, which include healthcare, education, support for state governance, and other social and humanitarian expenses. Meanwhile, defense funding is exclusively sourced from domestic revenue streams, including tax and non-tax revenues, and proceeds from the issuance of government bonds.

Sources and amounts of external loans to Ukraine in 2023

Foreign loans received in 2023	$bn
Programs of macro-financial assistance from the EU for 2023	19.5
IBRD Loans	4.6
IMF funds under the four-year Extended Fund Facility program	4.5
Loans from the Government of Canada	1.8
IDA loans within the framework of the project "Supporting public expenditures to ensure sustainable public administration in Ukraine"	0.4

Source: Ministry of Finance of Ukraine

Through 2023, the Ministry of Finance raised a gross amount of $15.5 bn via domestic government bonds and redeemed $10.1 bn, resulting in a net inflow of $5.4 bn into the state budget (outflow of $4.2 bn in 2022). This corresponds to a system-wide rollover rate of 150% in all currencies (67% in 2022). Due to the slight hryvnia devaluation at the end of the year (by 4%), domestic debt has increased by only $3.8 bn compared to end-2022.

The primary holders of domestic government bonds are the NBU ($18.2 bn, 44% of the total) and commercial banks in Ukraine ($17.3 bn, 42%) as of the end of 2023. The remainder is held by legal entities ($3.7 bn, 9%), individuals ($1.4 bn, 3%), non-residents ($1.1 bn, 3%), and municipalities ($53 mn, 0.1%).

Figure 3. Budget Balance, $bn

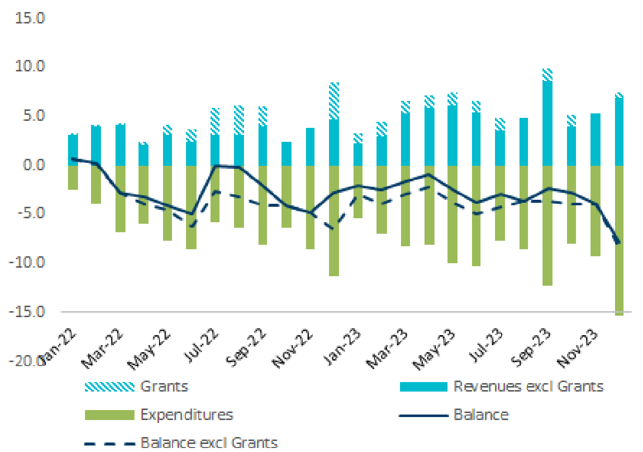
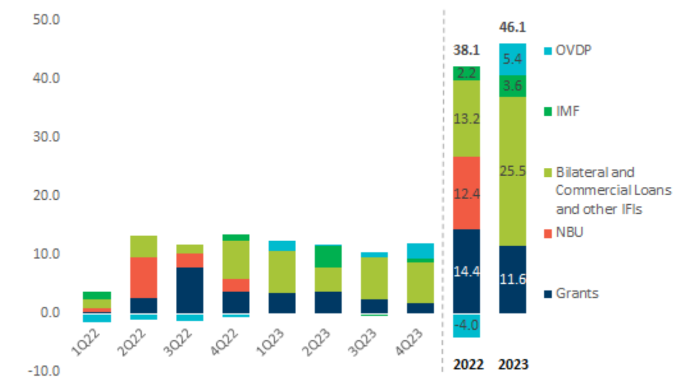


Figure 4. Budget Net Financing, $bn



Source: Ministry of Finance of Ukraine, Openbudget, NBU, KSE

Altogether, only 56% of expenditures were covered by budget revenues (excluding foreign grants). Another 5% were financed internally through the issuance of domestic government bonds, 2% with a change of balances in the State Treasury accounts, while the remaining 37% relied on external loans and grants. This leaves the Ukrainian budget vulnerable to any potential shortages in external funding. Furthermore, given that external funding may be directed exclusively to non-defense sectors, any further significant increase in military expenses would require an intensification of tax collection, extension of the tax base, or a sharper increase in domestic debt.

State Debt and State-Guaranteed Debt

The combined state debt and state-guaranteed debt reached $145.3 bn at end-2023, reflecting an increase of $33.9 bn (or 30.4%) vs. end-2022. This rise is primarily attributed to a significant 49.1% surge in external debt (or $31.2 bn). In contrast, domestic debt saw a modest increase of 10.0%, equivalent to $3.8 bn, while the guaranteed debt decreased by $1.1 bn. Together, this has substantially skewed the debt structure in favor of foreign exchange (FX) debt, which now stands at 73% of the total, up from 67% in 2022. The current debt and guaranteed debt portfolio amounts to an estimated 85% of GDP[2] – a noteworthy increase from 49% in 2021. Around 67% of the debt carries fixed rates, which is close to the number at the end of 2022.

Figure 5. State Debt and State Guaranteed Debt Dynamics, $bn

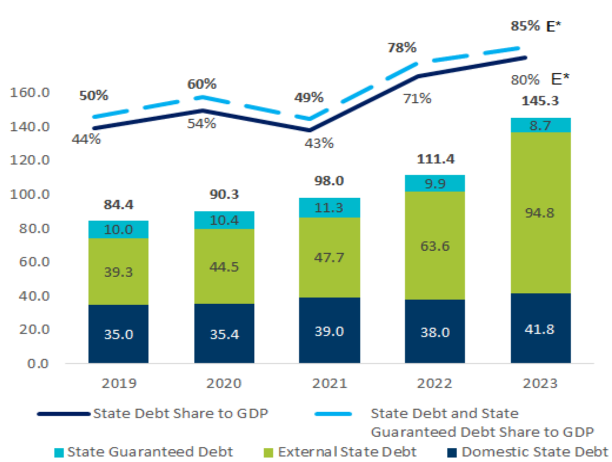
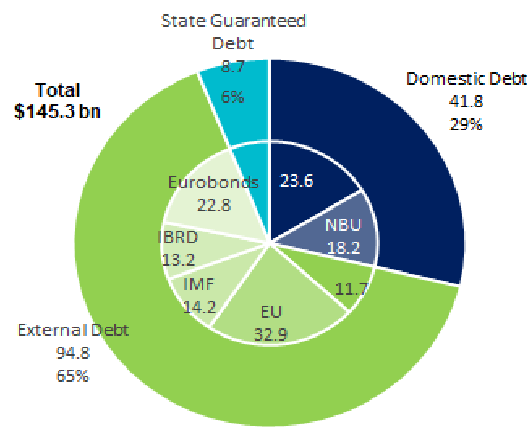


Figure 6. State Debt and State Guaranteed Debt, end of period



Source: Ministry of Finance of Ukraine

Due to the highly concessional nature of newly attracted external debt, the relative service cost of the debt has not changed much since 2022. Ukraine is spending around 11.2% (12.2% in 2022) of state budget revenues (excluding grants) on interest payments for domestic and external debt. The cost of external debt was significantly lower in 2023 than that of domestic debt – 2.2% vs 8.9% of state budget revenues (excluding grants). This is due to elevated interest rates in the domestic market as well as the postponed service of commercial external from 2022 until 2024. In December 2023, Ukraine extended the Memorandum with official creditors from the G7 and Paris Club, which was initially signed in 2022. According to the agreement, debt service is suspended until the end of March 2027, when the current IMF EFF program is also set to conclude. The total debt stock covered by the Memorandum amounts to $3.1 bn. Ukrainian authorities have expressed their commitment to seek a comparable treatment with commercial creditors. Burden sharing is likely to be required by official creditors, given their continued financial backing of critical expenditures during the ongoing war.

[2] E*, based on Ministry of Finance projection of the 2023 GDP used for the State Budget Law 2024

2024 Budget and Key Risks

In 2024, trends in public finance closely mirror those observed in the previous year, with an emphasis on collection of internal tax and non-tax revenues to address mounting military expenditures, and anticipation of substantial international financial assistance to fulfill social commitments. Dynamics are expected to change significantly, however, in terms of total revenues and expenditures: the former are projected to reach $43.5 bn, a decrease of 40% compared to 2023, and the latter are planned at $81.3 bn, down by 26% from 2023.

These changes can be attributed to various factors. First, in 2023, the receipt of grants ($11.6 bn) and other revenues, including those directed to the government's charitable and humanitarian special accounts ($22,2 bn), was unpredictable, leading to cautious budget planning for 2024. While the government anticipates some form of these funds in 2024, they are not extensively budgeted for (pessimistic scenario). Additionally, exchange rate fluctuations play a significant role in the reduced budgetary allocations for 2024 compared to 2023. The 2024 budget is based on an exchange rate of 40.7 UAH/USD, notably higher than the 2023 average exchange rate of 36.57 UAH/USD. Consequently, military spending, which is financed by domestic revenues, is budgeted at a lower level initially but expected to rise throughout the year.

The projected 2024 state budget deficit is $38.6 bn, which the government plans to finance by securing $41 bn in external loans and $12.9 bn through the sale of government bonds. $4.5 bn will be allocated for repaying external debt, while $10.9 bn will be utilized for internal debt payments.

In 2024, the Government anticipates receiving at least $37 bn in direct budgetary assistance. This includes $11.8 bn from the United States, $5.4 bn from the IMF, and funding from the Ukraine Facility.

The primary risks to budget execution encompass the potential escalation of military operations and a deteriorating security situation. These factors may diminish business activity, impede the recovery in specific regions, and contribute to a reduction in tax revenues. Consequently, there may be a heightened need to increase defense expenses. Additionally, logistical challenges, such as border blockades and instability in the grain corridor, could impose further restrictions on the economy's export capabilities, resulting in lower-than-expected tax revenues.

Both of these risks carry the potential to intensify dependence on international financial support. The inadequacy or irregularity of such support could have significant consequences for Ukraine's fiscal stability.

Table 1. Ukrainian budget, $bn

Indicators	2022	2023	Change (%. y-o-y)	2024E
Total revenues	55.3	73.1	32.2	43.5
Grants	14.4	11.6	(19.4)	N/A
Non-tax and other revenues	11.7	28.6	38.4	4.8
Tax revenues	29.4	32.9	12.1	38.7
PIT	4.6	5.7	23.3	7.4
Corporate income tax	3.6	3.9	8.7	4.5
Rent for the use of subsoil	2.5	1.5	(38.8)	1.3
Excise tax	3.2	4.6	44.6	4.8
Domestic VAT (net)	6.6	5.9	(11.3)	7.1
Import VAT	7.8	10.0	28.0	12.3
Import and export duty	0.8	1.1	38.6	1.2
Total Expenditures	83.6	109.8	31.3	81.3
Defence	35.3	57.4	62.3	29.1
Deficit	(28.3)	(36.5)	29.0	(38.6)
Deficit (net of grants)	(42.7)	(48.1)	12.6	(38.7)
Net borrowings	23.8	34.4	44.5	38.5
Loans	37.8	46.4	22.8	53.9
Repayments	(14.0)	(11.9)	(15.0)	(15.4)

Source: Ministry of Finance of Ukraine, KSE

Table 2. Ukraine's Key Macro Indicators

Year	2022	2023	2024E
Real GDP Growth (y-o-y; %)	(28.8)	5.7	3.6
Nominal GDP ($bn)	162.0	176.8	187.8
CPI (y-o-y; %; e-o-p)	26.6	5.1	8.6
GDP deflator (y-o-y; %; avg)	34.9	17.5	12.4
General Gov't Balance* ($ bn)	(26.1)	(36.3)	(27.2)
General Gov't Balance* (% GDP)	(16.1)	(20.4)	(14.6)
State Debt ($bn)	101.6	136.6	177.2
State Debt (% GDP)****	70.9	80.3	97.6
C/A Balance** (% GDP)	4.9	(5.5)	(9.0)
Gross F/X Reserves ($bn)	28.5	40.5	40.4
Key NBU Rate (% p.a., e-o-p)	25.0	15.0	14.7
UAH:USD (official; e-o-p)	36.6	38.0	42.1
UAH:USD (official; avg.)	32.3	36.6	40.7

Notes: *without grants; **without grants and reinvested earnings; ***including grants and IMF financing; ****primarily calculated in national currency (UAH).

Source: National authorities, Law on the State Budget for 2024, KSE

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