Center of Public Finance and Governance at Kyiv School of Economics

KSE Kyiv School of Economics

MOVING FORWARD TOGETHER

Fiscal Digest – Q1 2024

Executive Summary

- **In Q1 2024,** Ukraine received minimal military assistance from its partners, which put an additional burden on the budget through additional domestic spending on military needs. External funding covered only about 10% of the planned needs. This was offset by several factors: shifting year-end expenditures from military salaries to the necessary purchase of weapons at the beginning of the year, introducing a higher tax on the banking system, redirecting personal income tax from military personnel from local budgets to the state budget, and moving the payment of dividends of state-owned companies and part of their net profit from mid-year to early in the year. The NBU also performed better, transferring more funds to the budget than planned.
- **The budget deficit** amounted to \$5.2 bn in Q1 2024, compared to \$6.0 bn in Q1 2023. Despite a significantly lower amount of grants received in Q1 2024 - \$0.9 bn compared to \$3.7 bn in Q1 2023 - the government managed to execute the budget in Q1 2024 with a 13.3 p.p. lower deficit than in Q1 2023.
- **Revenues** (excluding grants) increased sharply in Q1 2024 compared to the same period of the previous year – by \$5.2 bn or 48.5% y-o-y. Tax revenues rose by 54.7% on the back of the economy's adjustment to the war, changes to the tax code, and effects from inflation. The fact that the main taxes (VAT, excise duties, income tax) overshot their targets indicates that economic processes are reviving - most counterparties are paying taxes and increasing their payments compared to last year. However, it is difficult to say that this will continue until the end of the year, given the risks to energy security and pressure on the labor market due to mobilization.
- **Expenditures** soared by 7.6% y-o-y to \$22 bn, with military spending accounting for \$11.1 bn alone. The largest growth is observed in the sectors of public order, security, and judiciary - by 50% (or up to \$3.7 bn) and in the sector of state functions (mainly incl. debt servicing) - by 64.4% (or up to \$1.5 bn). At the same time, a slight decrease occurred in the sectors of social protection and social security - by 7.8% (falling to \$3 bn) and in interbudgetary transfers - by 10.8% (falling to \$0.9 bn).
- **State debt** increased to \$143.1 bn, reflecting a rise of \$32.5 bn, or 29.4%, from the end of Q1 2023. Significant changes occurred in the debt structure. New external debt amounted to \$30.7 bn, or 29.4% more than in Q1 2023, bringing the total external debt to \$101.9 bn. In addition, new domestic debt increased by \$1.7 bn, or 4.4%, reaching a total of \$41.3 bn. **State guaranteed debt** in Q1 2024 compared to Q1 2023 decreased by 14.5% or \$1.4 bn to \$8 bn, including by 10% to \$1.7 bn for domestic and by 15.7% to \$6.2 bn for external.

Budget Revenues

In Q1 2024, the budget[1] received **$15.9 bn in revenues** (excluding grants of $0.9 bn). This represents a substantial increase of **$5.2 bn** or 48.5% vs Q12023. Grants **decreased** by **73.1% compared** to Q1 2023 ($3.7 bn in Q1 2023 to $0.9 bn in Q1 2024).

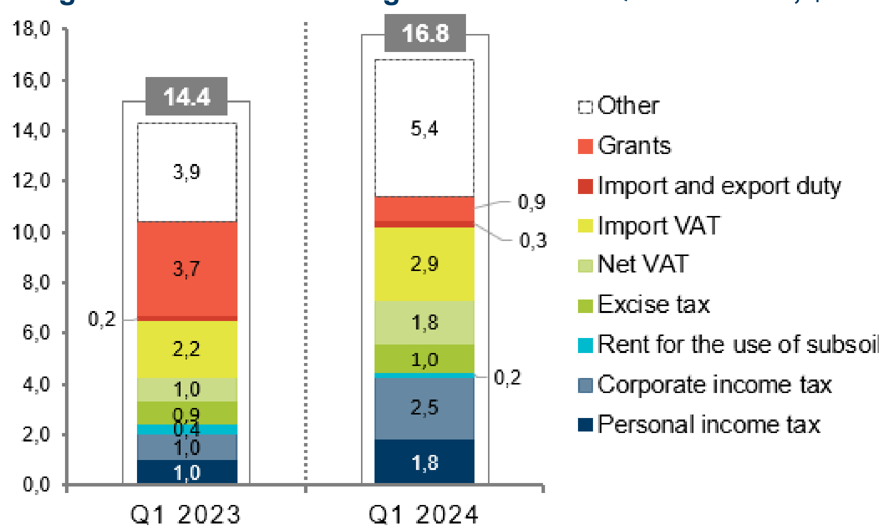
Tax revenues saw a notable uptick in Q1 **2024, rising by 54.7% q-o-q driven by business adaptation and legislative changes.** The key sources of the $10.6 bn in tax revenues in Q1 2024 were:

- Import VAT: $2.9 bn (26.9% of tax revenues)
- Corporate income tax (CIT): $2.5 bn (23.8%)
- Net VAT: $1.8 bn (17%)
- Personal income tax (PIT): $1.8 bn (16.7%)

The most notable growth was observed in CIT, which surged by 166.4%. This was largely due to legislative changes and the introduction of a windfall tax on bank profits. Banks, which enjoyed substantial profits in 2024, were taxed at a special rate of 50%, up from the previous 18%, with no deductions allowed for previous losses. The regular CIT rate was also increased to 25% for future tax periods. Consequently, banks contributed 51.4% of CIT revenues, while enterprises created by foreign investors, state-owned enterprises (SOEs), and other taxpayers accounted for 5.4%, 5.3%, and 37.9%, respectively.

All major tax categories, except for rent from the use of subsoil, saw increases. The rent tax declined by 43.4% due to a drop in natural gas prices, which is a significant tax base. Net VAT revenues increased by 79.5% to $1.8 bn, reflecting growth in consumption, a slow recovery in production, and positive consumption expectations. Import VAT grew by 29.3%, hindered by the temporary blockage of the Polish-Ukrainian border. PIT revenues to the budget rose by 72.3% compared to Q1 2023, mainly due to the reallocation of all PIT from military personnel to the state budget (previously it was divided among state and local budgets), but also because of nominal growth of wages (labor force in the private sector decreased and demand is recovering). Overall, 47.3% of PIT was received from taxation of incomes of military personnel, 31.7% from salaries, and 13.7% from military fees.

Figure1. Structure of budget revenues in Q1 2023-2024, $bn



Source: Ministry of Finance of Ukraine, Openbudget

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

Budget Expenditures

In Q1 2024, budget expenditures soared to over $22 bn, a substantial increase of 7.6% compared to Q1 2023. The primary areas included war-related expenses, social spending, and debt service.

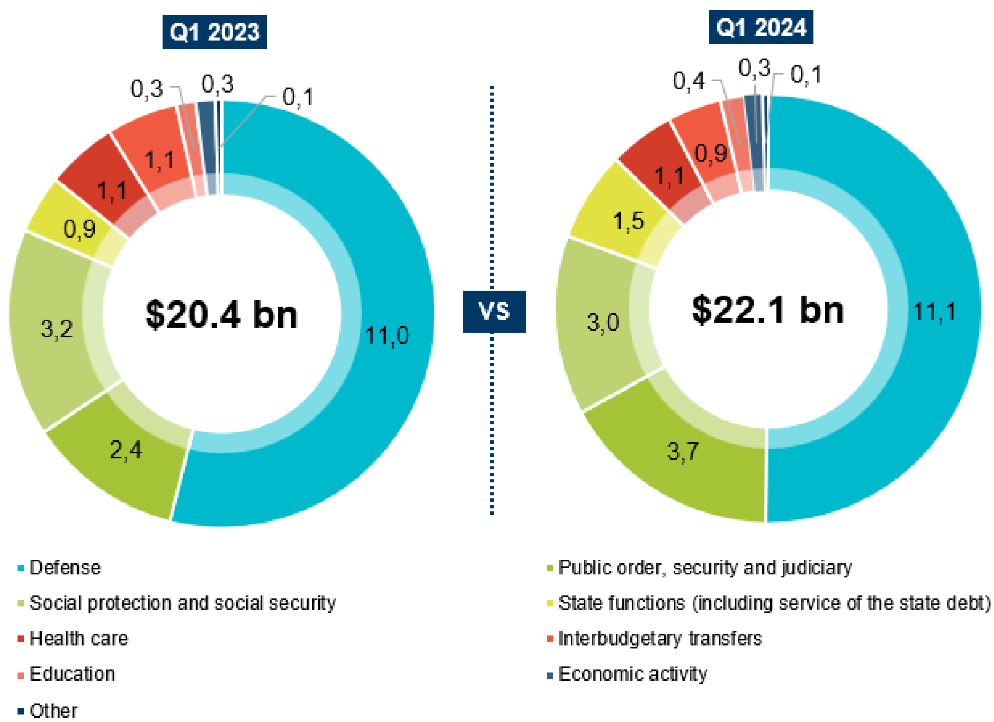
War-related expenditures are estimated to be 67% or $14.8 bn of total expenditures, while 33% or $7.3 bn was directed towards socio-economic development (compared to approximately 65.8% or $13.5 bn, and 43% or $7 bn in Q1 2023, respectively).

Spending by the Ministry of Defense (MOD) amounted to $10.7 bn, representing 48.4% of all expenditures, a slight decrease of 2.1% year-over-year. The decline in the MOD's spending was primarily due to fluctuations in the dollar exchange rate, while actual figures in local currency (UAH) showed growth.

Additionally, war-related spending within the security sector increased significantly, reaching approximately $3.4 bn, a 53% year-over-year increase. This surge was driven by overcoming initial funding challenges in January, which were due to uncertainties about international aid. By the end of the quarter, the security sector's expenditures were up by over 50% compared to Q1 2023 and not only met but exceeded planned targets.

Social expenditures of $3 bn (-7.8% y-o-y) in Q1 2024 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 2023-2024, $bn[2]



Source: Ministry of Finance of Ukraine, Openbudget

[2] *The state functions sector includes the public debt servicing*

In Q1 2024, 23.7% of the annual social protection and social security budget was utilized, totalling $2.96 bn. Within this allocation, expenditures on social payments amounted to $2.95 bn, reflecting an 8% decrease or $0.25 bn less compared to Q1 of 2023.

Actual expenditures on social payments in Q1 2023-2024, $ bn

Indicator	Q1 2023	Q1 2024	Change (%. y-o-y)
Pension Fund funding for pension payments & covering deficit	1.86	1.73	-7,0%
Support for vulnerable citizens	0.71	0.56	-20,2%
Support for low-income families	0.47	0.49	4,2%
Support for children & families	0.16	0.15	-5,8%
Support for persons with disabilities	0.01	0.02	91,6%

Source: Ministry of Finance of Ukraine

In Q1 2024, the reduction in expenditures on social payments by 20.2% or $142.2 mln compared to the corresponding period in 2023 is mainly due to changes in legislation regarding the provision of the subsistence allowance for internally displaced persons. Starting from March 1, 2024, assistance has been automatically extended for 6 months for pensioners with incomes up to $247.4, persons and children with disabilities, and other vulnerable groups. For other categories, assistance is granted based on an application if the family income does not exceed $247.4 per person. At the same time, employable family members must work or be registered with the State Employment Center of Ukraine.

In Q1 2024, funding for the Pension Fund from the budget decreased by 7% or $130.3 mln compared to the same period last year. This is due to the expected increase in the Pension Fund's own revenues from higher receipts from the unified social security contributions (SSC) and a reduction in pension indexation to 7.96% (11.7 percentage points lower than in 2023) due to lower-than-expected inflation in 2023 (5.1%)**.**

Despite the delay in international aid, the Ukrainian government has ensured funding for social assistance payments. However, there have been delays in implementing certain social programs. During times of war, priority social and humanitarian expenditures continue to be funded through grants provided by the United States, EU member states, other countries, and Ukraine's allies (except for expenditures on social insurance, which are financed through contributions to the SSC).

Budget financing

Ukraine reduced its Q1 2024 budget deficit by 13.3% to $5.2 bn, despite receiving significantly fewer grants, through increased external loans and managing debt repayments. Its reliance on external financial assistance remains pronounced, however.

Budget funding sources (revenues and gross financing) in Q1 2023-2024, $bn

Resources	Q1 2023	Q1 2024	Change (%. y-o-y)
Internal budget resources	**14.5**	**18.9**	**30.3%**
Domestic government bonds	3.8	3.0	(21.1%)
Own budget revenues (without grant)	10.7	15.9	48.6%
Share of internal budget resources	56.9%	65.2%	x
External budget resources	**11.0**	**10.1**	(8.2%)
External loans	7.3	9.2	26.0%
Grants	3.7	0.9	(75.7%)
Share of external budget resources	43.1%	34.8%	x

Source: Ministry of Finance of Ukraine, KSE calculations

Ukraine's reliance on external financial assistance remains critical. The country received $9.2 bn in external loans in Q1 2024, up from $7.3 bn in the same period of 2023. A significant portion of this aid, $8.9 bn, was received in March 2024, compared to just $0.3 bn during the first two months of the year. In Q1 2024, $3 bn was raised through the issuance of domestic government bonds, a 21.1% decrease from the $3.8 bn raised in Q1 2023.

Debt repayment in Q1 2024 totalled $3 bn, with $2.3 bn allocated for domestic debt and $0.7 bn for external debt. This compares to $2.6 bn in Q1 2023, which included $2.2 bn for domestic debt and $0.4 bn for external debt. The total net amount for financing the budget deficit in Q12024 amounted to $9.2 bn, which is 8.2% more than in the same period of 2023 ($8.5 bn).

Sources and amounts of external loans to Ukraine in Q1 2024

Foreign loans received in Q1 2024	Mln, €$
EU loan under the implementation of the Bridge Finance mechanism (Ukraine Facility)	€4500
IBRD loan to support development and recovery policies	$1400
Government of Canada Funds	CAD$2000
Loan from the IBRD as part of the project Investing in Social Protection for Improved Coverage, Resilience and Efficiency (INSPIRE)	$297
IBRD loan under the project Strengthening the Health System and Saving Lives	€3
IMF funds	$880
IBRD loan as part of the financing of the Emergency project for providing inclusive support for the restoration of agriculture in Ukraine (ARISE)	$229.4

Source: Ministry of Finance of Ukraine

In Q1 2024, 72.3% of expenditures were covered by budget revenues, excluding foreign grants. An additional 13.6% was financed through the issuance of domestic government bonds, while external loans and grants accounted for 45.9% of all budget expenditures in Q1 2024 (41.8% - loans and 4.1% - grants). Given the one-time nature of some of the Q1 revenues (payment of income tax by banks for the previous year, payment of dividends by SOEs in advance, transfer of funds from the NBU income, etc.), the Ukrainian budget remains vulnerable to any potential shortfalls in external financing. In addition, given that external financing can only be directed to non-defense sectors, any further significant increase in military spending will require stepped-up tax collection and broadening of the tax base (a draft law on this is already being actively developed and may be adopted as early as this summer) or a sharp increase in domestic debt issuance (here, we estimate that potential reserves are smaller).

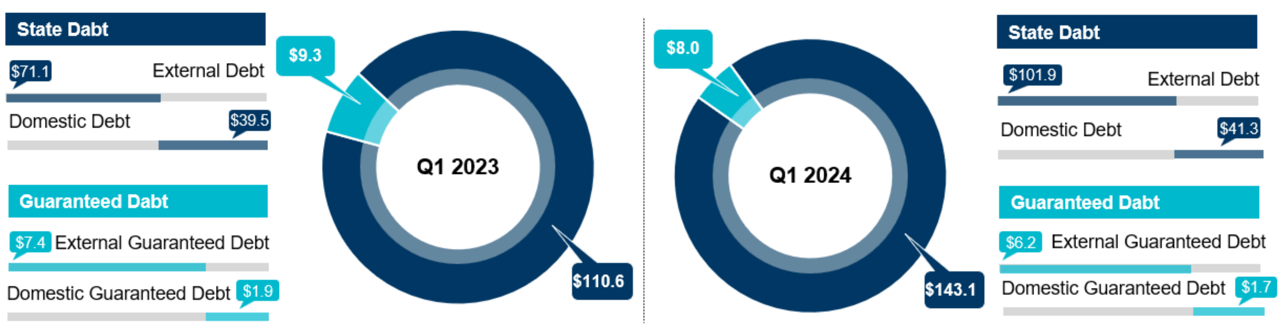
State Debt and State-Guaranteed Debt

At the end of Q1 2024, the total public debt, encompassing both domestic and external obligations, reached $143.1 bn. This represents a $32.5 bn (29.4%) increase from $110.6 bn in Q1 2023. The primary driver of this rise was external public debt, which surged by $30.7 bn (43.2%), growing from $71.1 bn to $101.9 bn over the year. In contrast, domestic public debt saw a modest increase of $1.7 bn, rising from $39.5 bn to $41.3 bn.

The substantial increase in external public debt is attributed to significant international aid received in the form of loans. From the end of Q1 2023 to Q1 2024, the budget received $32.9 billion in international aid.

State-guaranteed debt for the period from the end of Q1 2023 to the end of Q1 2024 decreased by 14.5% from $9.3 bn to $8 bn. In particular, domestic guaranteed debt decreased by 10% from $1.9 to $1.7 bn, while the external guaranteed debt decreased as much as by 15.7% from $7.4 to $6.2 bn.

State Debt and State-Guaranteed Debt in Q1 2023-2024, $bn



Source: Ministry of Finance of Ukraine, KSE calculations

What's Next and Key Risks

At the end of Q1 2024, Ukraine gained clarity on US assistance, with the US Congress passing a law to allocate $61 bn to support Ukraine, including $7.8 bn in loans. Along with the EU's Ukraine Plan, which provides €50 bn over four years (with €16 bn disbursed in 2024), this assistance will help cover Ukraine's critical budget needs for 2024. However, several risks remain:

- **Irregularity in budget support.** The timeliness and sufficiency of budget support from international partners depend on the Ukrainian government's fulfillment of various conditions. These include implementing reforms and updating legislation in certain economic sectors. Failure to meet these conditions could lead to reduced budget support from international partners, significantly impacting macrofinancial stability this year and beyond.
- **Increased defense spending.** The need for additional spending on security and defense may rise significantly. The current budget allocates less for defense expenditures than what was spent last year. If hostilities continue at the current intensity and mobilization increases, the budget may need to be amended to increase defense spending. This will also require raising rates, such as VAT or corporate income tax, and introducing new types of taxation, such as a military fee for small businesses. A draft law addressing these changes is already being developed by the government.
- **Decline in tax revenues.** Lower business activity caused by power outages and further deterioration in the labor market, partly due to increased mobilization, could lead to a decrease in tax revenues. Renewed shelling of energy infrastructure by the enemy could result in power outages for businesses, which, along with labor shortages, may reduce business activity.

Table 1. Ukrainian budget, $bn

Indicators	Q1 2023	Q1 2024	Change (%. y-o-y)
Total revenues	**14.38**	**16.82**	**17.0%**
Grants	3.7	0.9	(75.7%)
Non-tax and other revenues	**7.5**	**6.2**	**(17.5%)**
Tax revenues	**6.87**	**10.63**	**54.7%**
PIT	1.03	1.77	72.3%
Corporate income tax	0.95	2.53	166.4%
Rent for the use of subsoil	0.44	0.25	(43.4%)
Excise tax	0.95	1.03	8.5%
Domestic VAT (net)	1.01	1.81	79.5%
Import VAT	2.21	2.86	29.3%
Import and export duty	0.24	0.32	33.3%
Total Expenditures	**20.5**	**22.0**	**7.6%**
Defense	11.0	11.1	0.6%
Deficit	**6.0**	**5.2**	**(13.3%)**
Deficit (net of grants)	**9.7**	**6.1**	**(37.1%)**
Net borrowings	8.4	9.3	10.7%
Loans	11.0	12.3	11.8%
Repayments	2.6	3.0	15.4%

Source: Ministry of Finance of Ukraine, KSE calculations

Authors:

Yuliya Markuts
Lina Zadorozhnia
Taras Marshalok
Inna Studennikova
Dmytro Andriyenko
Tetiana Lutai

Center of Public Finance and Governance at the Kyiv School of Economics